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Mongolia: First and Second Reviews Under the Poverty Reduction and Growth Facility, and Requests for Waiver of Performance Criteria, Extension of Arrangement and Rephasing of Purchases—Staff Paper; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Mongolia

In the context of the First and Second Reviews Under the Poverty Reduction and Growth Facility, and Requests for Waiver of Performance Criteria, Extension of Arrangement and Rephasing of Purchases, the following documents have been released and are included in this package:

- the staff report for the First and Second Reviews Under the Poverty Reduction and Growth Facility, and Requests for Waiver of Performance Criteria, Extension of Arrangement and Rephasing of Purchases, prepared by a staff team of the IMF, following discussions that ended on **May 14, 2003**, 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 3, 2003**. 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 11, 2003**, updating information on recent developments.

- a Press Release summarizing the **views of the Executive Board as expressed during its September 12, 2003 discussion** of the staff report that completed the reviews.

- a statement by the Executive Director for Mongolia.

The document(s) listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Mongolia*
Memorandum of Economic and Financial Policies by the authorities of Mongolia*
Technical Memorandum of Understanding*
Poverty Reduction Strategy Paper
Joint Staff Assessment of the Poverty Reduction Strategy Paper

*May also be included in Staff Report

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

MONGOLIA

First and Second Reviews Under the Poverty Reduction and Growth Facility, and Requests for Waiver of Performance Criteria, Extension of Arrangement and Rephasing of Purchases

Prepared by the Asia and Pacific Department
(In consultation with other departments)

Approved by Daniel Citrin and Mark Allen

September 3, 2003

- The discussions for the first and second reviews under the PRGF were held in Ulaanbaatar during December 3–17, 2002 and in Tokyo during May 8–14, 2003. The staff met with Finance Minister Ulaan, Bank of Mongolia Governor Chuluunbat, other officials, and representatives of Parliament and the private sector.
- The staff teams included Messrs. Molho (head), Jang, Marciniak, and Cheng (all APD), Hur (PDR), and Lueth (FAD). Mr. Martin and Ms. Rehm, the Fund's outgoing and incoming Resident Representatives, respectively, assisted the missions. Mr. Callaghan and Ms. Baasankhuu (OED) participated in some of the discussions.
- Mongolia's PRGF arrangement for SDR 28.49 million (56 percent of quota) was approved by the Executive Board on September 28, 2001. The government's I-PRSP, the accompanying JSA (www.imf.org), and the staff report (Country Report No. 01/182) were published.
- In concluding the 2002 Article IV consultation, Directors stressed that enduring fiscal consolidation will be essential to place the public debt on a sustainable path, improve the operation of monetary and exchange rate policies, and facilitate private sector-led growth. Directors noted that a sustainable fiscal position will require a rationalization of public expenditures to make room for essential public investment and basic social services, while reducing over time the high tax burden. In this context, Directors welcomed the authorities' willingness to reconsider their wage and pension policies for 2003.
- Mongolia's macroeconomic data are broadly adequate for surveillance, but some data suffer from serious deficiencies, especially in the real, external, and fiscal sectors.
- A Safeguards Assessment of the Bank of Mongolia (BOM) was completed on March 5, 2002.
- Mongolia has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement and maintains an exchange system that is free from restrictions on payments and transfers for current international transactions.

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EXECUTIVE SUMMARY

Background

- **Performance under the program has been broadly satisfactory to date, despite a breaching of several performance criteria.** Real GDP growth, underpinned by brisk nonagricultural activity, is projected to rise, as programmed, from 3.9 percent in 2002 to 5 percent in 2003. Inflation fell to a lower than programmed 2 percent in 2002, although it picked up to reach 6½ percent (year-on-year) by June 2003.

- **The external finances remained manageable during 2001–02, despite a disappointing export performance.** The stock of post-1991 external debt leveled off at 89 percent of GDP in 2001–02. While negotiations are under way to resolve the large pre-1991 transferable ruble debt to Russia, small arrears on the post-1991 debt, which emerged in early 2002 and early 2003, were cleared in a timely manner.

- **Progress in implementing the government's structural reform agenda has been satisfactory.** While the lack of transparency in the conduct of some fiscal and quasi-fiscal operations emerged as a major source of concern in late 2002 and early 2003, the government is taking steps to address these concerns.

Policy Issues

- **The recently finalized Economic Growth Support and Poverty Reduction Strategy Paper (PRSP) recognizes that fiscal consolidation, supported by reforms to rationalize the civil service and enhance fiscal transparency and accountability, will be key to meeting Mongolia's poverty reduction objectives.** The PRSP also highlights the need for a prudent monetary policy, a flexible exchange rate, and a cautious approach towards new external borrowing.

- **The overall government deficit has been broadly on track, but expenditure pressures pose a continued threat to fiscal sustainability.** To rein in public expenditure in relation to GDP without impinging on pro-poor outlays, the program envisages tighter discipline over civil service wages, improved screening of investment projects, and avoidance of quasi-fiscal activities.

- **Monetary and credit growth significantly exceeded the program's targets in 2001–02, as the effects of continuing reintermediation were compounded by an easing of monetary conditions.** The program envisages decisive steps to bring reserve money growth back on track.

- **Improved economic governance will be essential to put scarce public resources to best use and garner sustained donor support.** As a part of this effort, the safeguards framework for the BOM is being strengthened under the program through the establishment of an independent oversight Board.

I. INTRODUCTION

1. **In September 2001, the Executive Board approved a three-year PRGF arrangement for Mongolia for the period September 2001–September 2004 in an amount of SDR 28.49 million** (Country Report No. 01/182). Mongolia drew SDR 4.07 million (about US$5 million) upon approval of the arrangement, but the first review could not be completed on time. The issues that needed to be addressed to pave the way for the review included concerns about the threat to fiscal sustainability posed by government plans to raise public wages and pensions beyond what would be affordable, as elaborated in the staff report for the 2002 Article IV consultation (Country Report No. 02/252).

2. **Following the adoption of more restrained wage and pension policies in the government's budget for 2003, a mission visited Ulaanbaatar in December 2002 to seek to conclude the discussions for the first and second reviews.** However, concerns about fiscal sustainability resurfaced, as new information became available on large, hitherto unreported quasi-fiscal and extra-budgetary activities by the government and the Bank of Mongolia (BOM). During follow-up discussions held in Tokyo in May 2003, the staff came to an understanding with the authorities on appropriate remedial measures to strengthen economic governance. The authorities have since taken important steps to implement these measures. They have also adopted a Medium-Term Budget Framework (MTBF) and an Economic Growth Support and Poverty Reduction Strategy Paper (PRSP) that provide a sound basis for Fund support under the PRGF, as noted in the Joint Staff Assessment (JSA).

3. **In the attached letter of intent (LOI) to the Managing Director, dated August 29, 2003 (Attachment I) and the accompanying Memorandum of Economic and Financial Policies (MEFP; Attachment II), the authorities set out their economic performance under the PRGF arrangement to date and their planned economic policies for 2003 and the medium term.** The authorities also request waivers for the nonobservance of five quantitative performance criteria (QPCs) and two structural performance criteria (SPCs) for the second and third disbursements, a rephasing of subsequent reviews and disbursements under the PRGF arrangement, and an extension of the arrangement through July 31, 2005.

II. RECENT DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

4. **Macroeconomic performance under the program has been broadly satisfactory to date, notwithstanding the aforementioned breaching of some QPCs and SPCs.** Despite heavy weather-related losses in the herd stock and lackluster exports, output growth was on track in 2001–02, and is projected to rise to 5 percent in 2003, underpinned by brisk nonagricultural activity (Figure 1 and Table 1). Inflation fell to less than 2 percent in 2002, well below the program target, although it picked up to reach 6½ percent (year-on-year) by June 2003, as seasonal upward pressures on food prices appeared to be accommodated by sustained rapid expansion in monetary growth.

5. **The general government's overall deficit narrowed from 7 percent of GDP in 2000 to 5½ to 6 percent of GDP in 2001–02, as a continuing surge in government expenditures was more than offset by significantly stronger than programmed revenue growth** (Table 2 and Figure 2). While the end-June 2002 QPC on net credit to government (NCG) was breached, buoyant revenues have helped bring NCG back on track since late 2002, and the level of NCG fell well below the indicative program target as of end-June 2003. The stock of post-1991 public debt (excluding the large, unresolved pre-1991 debt to Russia) fell sharply from a peak of 100 percent of GDP in 1999 to 92 percent by end-2002, while the net present value (NPV) of the debt declined, as programmed, to 62½ percent of GDP by end-2002.

6. **Despite the favorable recent trends in the public debt dynamics, debt remains high and strong upward pressures on public expenditure pose a continued threat to fiscal sustainability**. The recent pattern of fiscal adjustment based on revenue overperformance will be difficult to extend in the period ahead, as the heavy burden of taxation on Mongolia's private sector leaves no room for any further increases in the already-high ratio of government revenues to GDP. In these circumstances, the government has had to reconsider some of the expenditure-raising elements of the Action Program it adopted before the last parliamentary elections in mid-2000, which, among other things, envisaged a doubling of public wages and pensions during 2000–04. While civil service wages and pensions were raised by 20 percent from October 2002, with the result that the SPC relating to the 2002 budget was breached, the government has since dropped its earlier plans to further raise wages and pensions (by as much as 20 percent in 2003 and 27 percent in 2004) and it is espousing more disciplined expenditure policies under the recently approved MTBF and PRSP. However, political pressures to restore the previously planned wage and pension increases can be expected to mount in the run-up to the next elections in mid-2004, and will need to be carefully managed to protect the achievement of the PRSP's objectives.

7. **The growth of monetary and credit aggregates significantly exceeded the PRGF-supported program's targets during 2001–02** (Table 3 and Figure 3). Broad money growth rose to 28 percent in 2001 or almost double the program target, and it accelerated further to 42 percent in 2002, while the growth of credit to the private sector surged to 142 percent in 2001, before falling to a more moderate but still high 72 ½ percent in 2002. To a large extent, these developments reflect a welcome increase in the public's real demand for domestic-currency assets and the continuing reintermediation in the wake of the sustained implementation of reforms to establish a sound and efficient banking system. However, an easing of monetary conditions also appears to have contributed to the surge in money and credit. While the net domestic assets (NDA) of the BOM and reserve money growth were in line with program targets as of end-2001, a decline in the rate of return on BOM bills, the main outlet for excess bank liquidity, led to a breach of the QPC on the BOM's NDA as of end-June 2002. BOM bill placements and yields continued to fall short of sterilizing the increase in BOM's net international reserves (NIR) thereafter, with the result that reserve money growth surged from 8½ percent in 2001 to 22 percent in 2002. Despite the rapid expansion of money and credit, inflation has so far remained restrained. Nevertheless, to limit any possible threat to macroeconomic stability, the BOM took steps to check the growth of excess bank liquidity in the first half of 2003. As a result, the year-on-year rate of growth of reserve money fell to 11 percent as of end-June 2003.

8. **The overall balance of payments continued to register a large overall surplus in 2001–02, despite a disappointing export performance**. With slackening external demand and weak world copper and cashmere prices, the value of exports stagnated in 2001–02. As import growth remained brisk, the trade deficit widened from about 15 percent of GDP in 2000 to 20 percent of GDP in 2002 (Table 4). However, the overall balance of payments continued to be underpinned by buoyant emigrant's remittances, sustained donor support, and private capital inflows, especially in the mining and banking sectors. As a result, gross international reserves rose to the equivalent of about 17 weeks of next year's imports as of end-2002, well in excess of the program target. The BOM's NIR, which had fallen slightly short of the end-December 2001 QPC, comfortably met the QPC as of end-June 2002, remained largely on track thereafter, and exceeded the indicative program target for end-June 2003 by a wide margin.

9. **Mongolia's external debt has remained high but manageable**. The stock of external public debt (excluding pre-1991 transferable ruble debt to Russia) leveled off at about 89 percent of GDP in 2001–02 (Table 5). Reflecting the high degree of concessionality of a large share of Mongolia's debt, the NPV of external public debt has remained below 60 percent of GDP, while the debt service ratio has been contained to about 5 percent of exports of goods and services. The government has continued to service most of its post-1991 debt in an orderly manner. Delays in the establishment of procedures for in-kind repayments due to Russia led to a temporary breaching of the continuous QPC on the nonaccumulation of external arrears in early 2002 and, again, in early 2003. However, in both instances, the arrears were cleared within 3–4 months.

10. **The BOM pursued a flexible exchange rate policy during 2001–02, but the strength of the balance of payments contributed to the maintenance of a relatively stable exchange rate**. As a result, the real effective exchange rate (REER) came under some upward pressure during 2001 (Figures 1 and 4). While the easing of inflation in 2002 has helped partially reverse this earlier appreciation, the lackluster performance of exports in the face of a sustained deterioration in the terms of trade has raised questions as to the whether external competitiveness is adequate to achieve Mongolia's aim to promote sustainable export-led growth.

11. **Progress in implementing the government's structural reform agenda has been satisfactory**. Important steps have been taken to establish a system for the monitoring and control of budget entities' arrears and, while a slower-than-programmed start in the piloting of a system for the establishment of a Treasury Single Account (TSA) led to a breaching of the respective SPC for end-December 2001, TSA implementation has been expanded and accelerated since July 2002. The rationalization of intergovernmental fiscal relations, another key element of the government's fiscal reform agenda, has been largely on track. In addition, the government made good progress towards meeting unobserved SPCs and benchmarks from the last PRGF-supported program, most notably in the privatization of so-called most-valued companies, which had stalled under the previous Parliament in the late-1990s (Box 1).

Box 1. Mongolia: Structural Conditionality

1. Coverage of Structural Conditionality in the Current Program

Structural conditionality under the program as set out in Tables 4–5 in 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), benchmarks, and prior actions focus on achieving the program's fiscal policy objectives, including through the improvement of fiscal transparency and accountability, and on strengthening the governance of the banking system. The key reforms are based largely on past Fund technical assistance and safeguards recommendations.

2. Status of Structural Conditionality under the Current Program and from Earlier Programs

Most SPCs and benchmarks for the first year of the current program were observed as scheduled and, in the case of the two missed SPCs relating to TSA implementation and the approval of a sound 2002 budget, adequate remedial measures have been taken (MEFP ¶6, 21 and Table 3). More specifically:

- Although initial delays in implementing a pilot TSA led to a breaching of the relevant SPC for end-December 2001, the government began to accelerate and expand its treasury reforms from mid-2002 to cover the bulk of general government operations, and it has begun to account for most transactions through treasury ledger accounts. These achievements have surpassed the original program objectives in this area.
- The end-December 2001 SPC relating to the 2002 budget was missed following the granting of a 20 percent increase in civil service wages and pensions from October 2002 and the emergence of concerns that wage and pension policies for 2003–04 could further threaten fiscal sustainability. However, the government has since decided not to grant any further wage and pension increases in 2003, and has secured Parliamentary approval of a Medium-Term Budget Framework (MTBF) that envisages continued wage restraint.

Significant progress has also been made towards meeting some key unobserved SPCs and benchmarks from the last PRGF-supported program, which had to be excluded from the current program under the new conditionality guidelines. More specifically:

- The Agricultural Bank and the Trade and Development Bank were privatized in October 2002 and March 2003, respectively.
- The Neft Oil Import Concern (NIC), Mongolia state-owned petroleum importer and distributor, was privatized in July 2003.

3. Structural Areas Covered by World Bank Lending and Conditionality

Financial sector: The Bank's FSAC, which was approved in April 2000, envisages the development of an action plan to privatize the Savings Bank and continued steps to improve financial system regulation and supervision and enhance the operation of the government securities market.

Energy sector: The Bank's Board approved a US$30 million energy sector investment loan in March 2001. The structural conditionality under this loan includes the rationalization of the tariff system, the revamping of rural utility systems, and the restructuring of the sector to attract greater private sector participation.

Civil service reform: The Bank is currently helping the authorities to design a comprehensive civil service reform strategy, which is expected to be formulated prior to the approval of the first Poverty Reduction Support Credit in early 2004.

4. Other Structural Measures Not Included in the Current Program

The government is continuing to pursue its program for the privatization of most-valued companies with determination. Aside from the aforementioned already-completed privatizations, steps are under way to place MIAT, Mongolia's national airline, under an external management contract, as a first step towards the company's privatization, and two insurance companies are expected to be brought to the point of sale in the near future. In addition, the Mongolian Telecommunication Company, the Ulaanbaatar Power Distribution Network, and Power plant No. 2 are soon to be restructured and prepared for subsequent privatization.

12. **One remaining area of serious concern is the lack of transparency in the conduct of fiscal and quasi-fiscal operations relating to a few large public investment projects, which were a part of the government's initial Action Program but have nevertheless been inadequately reflected in official budgetary documents and accounts**. The emergence of information about these operations in late 2002 and early 2003 was a principal cause of the continuing delay in the completion of the review discussions. However, the government has since taken some steps to address the staff's concerns in this area and further steps are planned for the period ahead (Box 2).

III. The PRSP and the Medium-Term Framework

13. **The government's poverty reduction strategy as outlined in the PRSP rests on five main pillars**: (i) macroeconomic stability and enhanced public sector effectiveness; (ii) a sound institutional and regulatory environment to enable the private sector to become an engine of growth; (iii) more balanced and environmentally sustainable development; (iv) enhanced human development and equitable distribution of benefits from growth through improved service delivery in education, health, and social welfare; and (v) good governance and gender equality.

14. **The PRSP provides a sound basis for the achievement of the government's main macroeconomic objectives** (MEFP ¶12–14 and JSA ¶16–19). The baseline scenario envisages a growth rate of 5–5½ percent over the medium term, which should be attainable. Even if growth in the nonagricultural sector, which has been particularly buoyant in recent years, slows markedly in the period ahead, a reversion to a more normal pattern of growth in agriculture should suffice to attain these growth rates.

15. **The principal macroeconomic objectives of the medium-term framework underpinning the PRGF-supported program have been aligned with the PRSP's baseline scenario.** The PRSP recognizes the crucial need for continued fiscal consolidation, to be achieved mainly through measures to reduce unproductive expenditure (MEFP ¶15–16). It also highlights the importance of a prudent monetary policy, coupled with a flexible exchange rate policy and a cautious approach towards the contracting of new foreign debt. Although the overall fiscal deficit is targeted to level off at about 6 percent of GDP in 2003–04, the pace of fiscal adjustment would gather pace over the medium term, so that the cumulative reduction in the overall deficit between 2000 and 2006 would be in line with the initial PRGF framework.

16. **While the projected levels of fiscal revenues and expenditures both seem to be somewhat understated in the PRSP, the government's deficit targets remain feasible** (MEFP ¶ 17–19 and JSA ¶20–21). As indicated in the JSA, the government has tended to err on the side of caution in estimating the likely outturns for revenues and expenditures in 2003, and the latest estimates for January-June 2003 corroborate this view. Assuming that tax policies will remain broadly unchanged, the staff's latest projections suggest that government revenues, including grants, would level off at about 38–38½ percent of GDP in 2003–04, exceeding the corresponding PRSP targets by about 1 percentage point. The official projections are also likely to have understated expenditure pressures, especially on goods and

Box 2. Mongolia: Recent Governance Issues and Remedial Measures

In late 2002 and early 2003, the staff became aware that the Bank of Mongolia (BOM) and the government were in the process of conducting large quasi-fiscal and/or extra-budgetary operations. The staff questioned the legality of some of these operations and cautioned that they could threaten debt sustainability, undermine fiscal transparency and accountability, and give rise to misreporting. Since then, the authorities have taken significant steps to address the staff's concerns as summarized below.

1. Recent quasi-fiscal and extra-budgetary operations

In September 2002, the BOM signed a master agreement with a Hong Kong-based holding company, to borrow up to US$2 billion (181 percent of GDP) over the next decade for the financing of infrastructure projects. Under two subsidiary agreements signed subsequently with the same group and its affiliate, the BOM issued a guarantee for a loan of US$130 million (over 10 percent of GDP), of which US$29.4 million was to be used for the construction of the **Durgun Hydropower Project** and the remainder for the development of new gold mines. While the terms of these loans seemed highly concessional, it was difficult to ascertain the *bona fides* of the underlying transactions, which, if carried out in full, would triple Mongolia's current external debt. The agreements also appeared to be of questionable legality, as the Central Bank Law (CBL) allowed the BOM to issue guarantees only within its own capital, which fell far short of the above amounts. In addition, allegations surfaced in the local press that the BOM was improperly pledging its international reserves to open credit lines for third parties.

In late 2002, the government signed two agreements for the construction of large infrastructure projects, which were not explicitly included in the official budget documents but nevertheless could have important implications for fiscal and macroeconomic performance. These included a new concessional loan from the Abu Dhabi Fund, to supplement an earlier loan contracted from the Kuwait Fund, for the construction of the **Taishir Hydropower Project**, at a total cost of US$38 million (3.2 percent of GDP); and an agreement with a joint-venture contractor, whereby the contractor would build a segment of the **Millennium Road** at a cost of US$39 million (3¼ percent of GDP) in exchange for a license for the exploitation of a coal mine.

2. Remedial actions taken to date

To address the staff's concerns and reiterate the government's commitment to improve fiscal transparency and accountability and strengthen BOM's governance, the authorities have taken the following measures:

(i) The BOM has canceled all its previous loan contracts and related agreements with the above-mentioned holding company;

(ii) special audits carried out in line with safeguards recommendations attested to the accuracy of BOM's NIR data as of end-December 2001 and end-June 2002 (the test dates for the first and second PRGF reviews);

(iii) the CBL was amended to clearly bar the BOM from issuing loan guarantees and a framework has been put in place for the establishment of an independent Supervisory Board to oversee the BOM's operations;

(iv) the terms for the financing of the Durgun project were renegotiated, and a more transparent financing arrangement was signed with the contractor, albeit on nonconcessional terms, for a loan of US$26.5 million (2.2 percent of GDP);

(v) the investment outlays for both the Durgun and Taishir projects as well as the associated future debt service payments were explicitly incorporated in the government's Medium-Term Budget Framework (MTBF) in accordance with GFS classification standards; and

(vi) the government has pledged to avoid future recourse to nontransparent quasi-fiscal activities or barter-like financing arrangements for the construction of public investment projects.

3. Remaining measures required to strengthen fiscal governance and central bank safeguards

The authorities will take the following additional measures in the remainder of 2003 under the program's conditionality:

(i) Establish independent oversight Board of the BOM in line with safeguards recommendations;

(ii) continue to carry out biannual special audits of BOM's NIR; and

(iii) develop appropriate business plans for the Durgun and Taishir hydropower projects, in consultation with the World Bank, with a view to minimizing possible future burdens on the budget.

services, where under-budgeting has in the past been a major cause of arrears accumulation. To provide a more realistic base for the program's medium-term budgetary projections, the PRGF framework envisages a more modest, although still ambitious, pace of expenditure reduction than the PRSP, with current expenditure declining steadily from 33½ percent of GDP in 2002 to 31½ percent of GDP by 2006. It is expected that the government will update its own targets at the time of the preparation of the 2004 budget. Since the adjustments on revenues and expenditures are to a large extent mutually offsetting so far, the staff's medium-term framework for the promotion of fiscal sustainability is broadly consistent with the PRSP.

IV. Policy Discussions

17. **The discussions focused on the fiscal, monetary and external sector policies and related governance reforms that were necessary to preserve the recent hard-won gains towards macroeconomic stabilization and consolidate Mongolia's transition to a market-based system**. While overall performance under the program had been broadly satisfactory to date, the staff team recognized that, with the approach of the mid-2004 parliamentary elections, a principal challenge for the government would be to resist the political pressures on it to deliver on the expansionist and/or interventionist planks of its 2000 Action Program. The review discussions accordingly aimed to seek credible commitments from the government that it would stay the course of the program in the key areas of macroeconomic policy, so as to safeguard the achievement of the PRSP's main objectives.

A. Fiscal Policy and Reforms

18. **The fiscal policy discussions were dominated by the need to protect fiscal sustainability while continuing to enhance fiscal transparency and accountability**. The staff team initially advocated the adoption of a more front-loaded pace of fiscal adjustment than envisaged in the PRSP, to provide a margin of safety for the achievement of medium-term sustainability in the event that the economic environment deteriorates down the road. However, the authorities observed that the faster than programmed reduction in the deficit in 2001–02 implied that a slowing pace of fiscal consolidation would not necessarily threaten the achievement of the key program objectives. The PRSP's deficit targets for 2003–06 were still smaller than or equal to the initial program targets, and could be expected to allow for a continuing retirement of the government's high-cost bank restructuring bonds and a steady decline in the public debt ratio. The discussions also had to take into account the need to avoid unrealistic under-budgeting of current expenditures as well as to account for the government's plans to step up its public investment program to achieve its regional development objectives. While some of the already-approved investment projects were initially planned to be funded through quasi-fiscal operations to be carried out by the BOM, the government had accepted the team's recommendation to cancel such operations and had agreed to explicitly include all outlays on new public investment projects in the MTBF and future budgets, in accordance with GFS guidelines, with the exception of the portion of the Millennium Road that was already being funded through nondebt-creating extra-budgetary

operations (MEFP ¶20 and 23). As a result, projected outlays for 2003 and 2004 were now somewhat higher than previously envisaged, making it all the more difficult to opt for faster deficit reduction. Against this background, it was finally agreed that the government's fiscal adjustment program represented a creditable effort which, if faithfully implemented, should suffice to achieve the main program objectives.

19. **On the revenue side, it was agreed that, while the PRSP appropriately emphasized the need for pro-growth reductions in tax rates over the medium term, it would be prudent to put off any significant tax cuts until there is tangible progress towards the containment of expenditure pressures.** Mongolia's two-tiered corporate income tax is particularly onerous for businesses of any significant size, whose income is taxed at the top rate of 40 percent. There was also concern that the relatively low threshold for the top rate (Tog 100 million or about $87,000) tended to spur Mongolian firms to artificially split their activities among a number of smaller-scale but less efficient operations to remain liable to the lower rate of 15 percent rate. Nevertheless, with the bulk of corporate income tax receipts being collected from companies that are subject to the top rate, it was recognized that any major reduction in that rate would be accompanied by large revenue losses. Accordingly, the authorities have postponed until at least 2005 any changes in the top corporate income tax rate, which was to be reduced to 28 percent from 2004 under their earlier plans. The team urged the authorities to also avoid granting any new tax concessions in the context of their ongoing efforts to promote regional development and investment (e.g., through the establishment of free trade zones), as such concessions could greatly complicate the task for the attainment of fiscal sustainability down the road (JSA ¶20).

20. **While the team supports the government's plans to restrain current spending over the medium term, the measures required to achieve its ambitious targets in this area still need to be fleshed out** (JSA ¶21–23 and MEFP ¶18–19). The government's decision not to grant any general increases in wages and pensions in 2003 is a welcome step, as is the decision to limit pension increases during 2004 to no more than the rate of inflation. Over the medium term, however, a credible civil service reform strategy would need to be adopted to achieve the authorities' objectives. The government is expected to develop a comprehensive civil service reform strategy, in collaboration with the World Bank, prior to the approval of a new Poverty Reduction Support Credit (PRSC) in early 2004. As a part of this process, the government is also receiving technical assistance from the World Bank to strengthen its institutional capacity to effectively control the size and cost of the civil service, including through the establishment of a Human Resource Management Information System (HRMIS). The HRMIS is envisaged to begin to be implemented in late 2004. In the meantime, special care needs to be taken to ward off the pressures on the government to grant unaffordable increases in wages and pensions, both to protect fiscal sustainability and to avoid generating wage pressures for the rest of the economy, which could harm Mongolia's growth prospects and external competitiveness. The discussions recognized that it may be difficult to secure any significant reduction in the wage bill in relation to GDP over the medium term even in the context of civil service reform, as wages will need to be decompressed and compensation levels enhanced to attract, retain, and motivate staff in critical positions. Outlays on goods and services may also be difficult to curb, especially in

the social sectors, where the government plans to privatize and contract out selected social services as a way to contain outlays. While the authorities believed that the new expenditure controls under the TSA would serve to prevent overruns on goods and services, the team cautioned that the outsourcing of social services was unlikely to yield net budgetary savings and could jeopardize service delivery to the poor.

21. **The team welcomed the authorities' accelerated efforts to implement treasury reforms**. The extension of the TSA had progressed remarkably quickly in recent months, and the initial program targets relating to the reduction of government arrears had been largely achieved. The next steps in the government's expenditure management reform are to establish clear rules for the allocation and reporting of budgetary entities' excess own-revenues and initiate the establishment of a commitment control system to prevent the future accumulation of arrears (MEFP ¶21–22 and Tables 3–4).

B. Monetary Policy and Banking System Reforms

22. **Important structural changes under way in the banking system complicated the interpretation of recent monetary and credit developments**. The rapid expansion of bank lending to the private sector since late 2000 was, to a large extent, attributable to a return of public confidence in the banking system and the ongoing reintermediation since the banking crises in the late 1990s. The authorities believed that their continuing efforts to improve the legal environment and strengthen bank supervision had made the banking system more resilient and better able to manage credit risks. Nevertheless, following the pickup in the rate of inflation during the early months of 2003, the authorities agreed that they would need to guard against an overly rapid expansion of bank liquidity. To that end, the PRSP envisages the adoption of adequate steps to significantly slow monetary growth. Accordingly, the BOM had recently raised the rates and placement of BOM bills, with the result that reserve money growth had slowed markedly (MEFP ¶25–26).

23. **The team welcomed the government's continuing efforts to establish an efficient and well-governed banking system**. The privatization of the Trade and Development Bank (TDB) and the Agricultural Bank to major foreign investors in 2002–03 were major achievements which, together with the strong interest of foreign banks and NBFIs in acquiring licenses to operate in Mongolia, boded well for a continuing increase in competition within the financial system. However, the ongoing rapid expansion of bank lending in the context of aggressive bidding for customers by new foreign-owned institutions had recently been accompanied by a compression of bank profit margins and a decline in some institutions' loan quality. Against this background, the BOM was committed to taking timely measures to strengthen bank supervision, including by tightening enforcement of prudential controls. In addition, new anti-money laundering legislation will be enacted by end-2003 (MEFP ¶27and JSA ¶27).

C. External Sector Policies and Capacity to Repay the Fund

24. **The program envisages continuation of Mongolia's flexible exchange rate policy in the period ahead, with a view to meeting the authorities' NIR targets while also smoothing excessive exchange rate fluctuations** (MEFP ¶29). The authorities indicated that the recent weakness in export performance was primarily due to an unfavorable external environment, including soft commodity prices. The stability of the togrog in the face of a widening trade deficit had been underpinned by the strength of the overall balance of payments, which reflected in large part the sustained increase in receipts from emigrants' remittances. Nevertheless, the weak quality of the balance of payments statistics on invisible receipts made it difficult to assert with any degree of confidence that the recent pattern of inflows is sustainable. Accordingly, the PRSP recognized that policy vigilance and enhanced exchange rate flexibility were needed to guard against a possible erosion of external competitiveness and protect external sustainability. To improve the operation of the interbank foreign exchange market, the BOM took steps during the first half of 2003 to adjust its midpoint rate on a daily rather than weekly basis, and it widened the buy-sell margin around its midpoint rate from +/-1 togrog to +/-2 togrog in April 2003 and to +/-3 togrog from July 2003. In addition, measures were under consideration to liberalize the marketing of gold exports. With the help of these measures, it was hoped that any sudden reversal in the pattern of private inflows would quickly set in motion appropriate adjustments in the exchange rate, thereby increasing the resilience of Mongolia's external position.

25. **Given Mongolia's debt burden and its vulnerability to external shocks, a prudent external debt management policy will be key to the maintenance of external balance** (MEFP ¶30–31). The authorities recognized that their decision to rule out recourse to nontransparent means of concessional financing that would have required the BOM to incur large contingent liabilities had prodded them to seek more conventional means to finance the construction of the Durgun hydropower project, which was considered key to the achievement of their regional development objectives. However, the terms for this financing (2 percent interest rate and 12½ years maturity) entailed a significant grant element (about 20 percent). Thus, the total amount of debt on account of this project (US$26.5 million) was projected to have a marginal impact on Mongolia's debt service burden (US$3 million a year or less than 0.2 percent of GDP). Moreover, the government was committed to abstaining from new borrowing on nonconcessional terms during the remainder of the program period. The team was also assured that adequate measures had been taken to bar the issuance of new loan guarantees and/or other quasi-fiscal obligations by the BOM. The authorities were hopeful that the ongoing negotiations with Russia on the settlement of pre-1991 transferable ruble debt would soon be concluded on terms that would not place an excessive burden on Mongolia's external finances.

26. **An open trade and investment regime will be central to the success of the government's export-led growth strategy**. The team noted a tension in this area between the interests of protectionist and free-trade policy advocates within Mongolia, which was reflected in the PRSP and other government policy documents (JSA ¶26). Mongolia's formal trade regime is among the least restrictive in Asia, with a low uniform level of import tariffs

(5 percent), a limited number of export taxes, and no significant quantitative restrictions. However, customs regulations are often applied inconsistently, and an excessive number of required licenses, inspections, and certificates may still discourage trade and foreign direct investment. Of particular concern was the impact of the recently formalized policy on quality and sanitation standards for the export of unprocessed raw materials. If these standards are not properly administered, they could become tantamount to nontariff restrictions on exports, and could have highly undesirable effects for growth, external sustainability, and rural poverty.

27. **Mongolia's external position would be sustainable if the authorities pursue policies in line with the PRSP**. The current account deficit (including official transfers) would be contained to 9 percent of GDP in 2003 and would decline to about 6½ percent over the medium term (Tables 4 and 6 and MEFP ¶32). With investor and donor confidence maintained by prudent macroeconomic policies and market-friendly reforms, medium- and long-term official loan disbursements would remain in the range of US$80–100 million a year, while FDI would average US$70–80 million a year. External financing gaps amounting to US$20–30 million a year could be readily filled with disbursements from the World Bank, the AsDB, the Fund, and other donors.

28. **Mongolia should be able to continue to service its obligations to the Fund and other creditors in a timely manner under the program** (Tables 5 and 7). Debt service payments would remain at 4–5 percent of exports of goods and services under the baseline scenario, while the stock of external public debt would peak at about 92½ percent of GDP in 2003 (60½ percent in NPV terms) and decline steadily thereafter. Total Fund credit outstanding would peak at about 80 percent of quota or 5 percent of total external debt in 2004–05, while debt service obligations to the Fund would remain in the range of 0.6 to 0.8 percent of exports of goods and services. Mongolia's debt sustainability shows resilience under the PRSP's low-growth scenario. As is illustrated in Table 6, even if the average annual rate of growth of GDP were to fall to 3½ percent, the external public debt ratio would peak at a level of 94½ percent of GDP in 2004 and it would decline steadily thereafter.[1]

D. Governance, Safeguards, and Data Quality and Reporting Issues

29. **Good governance will be essential to meet the macroeconomic and social objectives of the PRSP** (MEFP ¶20 and 23 and JSA ¶24 and 65). As already noted, the recent efforts to finance some public investment projects through nontransparent quasi-fiscal and extra-budgetary operations had raised serious questions as to whether scarce public resources were being well utilized. The team welcomed the recent steps to integrate most

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[1] A fuller analysis, which was included in the staff report for the 2002 Article IV consultations (Country Report No. 02/252, pp. 48–54), shows that, with sound economic policies, external debt sustainability would be resilient under a wide range of external shocks.

investment projects into the MTBF and urged the authorities to establish strict economic criteria for the evaluation of all public investment proposals. While the authorities thought that it was now too late to reconsider the case for the recently approved hydropower projects, they agreed to develop sound business plans for these projects, in consultation with the World Bank, to minimize possible future burdens on the budget.

30. **To insulate the BOM from pressures to conduct quasi-fiscal activities, a special effort is under way to strengthen the safeguards framework** (MEFP ¶28 and JSA ¶28). As a part of this effort, the authorities have amended the Central Bank Law to establish an independent oversight Board, and semi-annual special audits will be conducted on the BOM's NIR. A monitoring safeguards assessment mission, which is to visit Ulaanbaatar in early September 2003, is expected to confirm the authorities' efforts towards the prompt implementation of priority measures in this important area.

31. **The lack of adequate reporting and statistical coverage of the recent quasi-fiscal and extra-budgetary activities complicated the PRGF review discussions.** To redress these problems, reporting requirements under the program relating to new contracts for the execution of public investment projects are being strengthened (MEFP ¶24). In addition, technical assistance is soon to be provided by a government finance statistics (GFS) mission which, among other things, should help improve the classification and reporting of fiscal and quasi-fiscal transactions. A fiscal ROSC update that is to be carried out in September 2003 should offer recommendations on further measures to improve fiscal transparency and accountability, especially in connection with Mongolia's growing public investment budget.

V. Program Monitoring

32. **The measures to be implemented as prior actions for the completion of the first and second PRGF reviews, as well as the QPCs, SPCs and structural benchmarks for the fourth disbursement, are summarized in the MEFP** (Attachment II, ¶33–34 and Tables 2, 4 and 5).

VI. Staff Appraisal

33. **Mongolia's overall performance under the PRGF-supported program has been broadly satisfactory to date.** The overall government deficit has been significantly reduced, external reserves have been built up to more comfortable levels, and inflation has fallen to the single-digit range. On the structural front, the pace of public expenditure management reforms has been stepped up, the privatization process has been revived, and the banking system continues to be rehabilitated. While the need to deal with serious concerns related to the government's commitment to the pursuit of fiscal sustainability and good governance has led to a lengthy delay in the completion of the first and second PRGF reviews, adequate remedial measures are now being put in place. The recent adoption of a creditable PRSP attests to the authorities' determination to adhere to the spirit of the macroeconomic policies and structural reforms agreed under the program.

34. **Continued fiscal discipline will be central to the achievement of the program's medium-term objectives**. The strong cyclical position of the economy would have probably warranted a more front-loaded pace of deficit reduction than envisaged in the PRSP, to provide a margin of safety for the promotion of fiscal sustainability. Nevertheless, the government's efforts to account more transparently for public investment projects have complicated the task for fiscal adjustment in the short run. Given also that the public debt dynamics appear to be resilient to external shocks in the staff's debt sustainability analysis, the staff can support the fiscal policy stance proposed in the PRSP.

35. **The government's strategy to reduce Mongolia's ratio of public debt to GDP over the medium term is adequate to meet the program's debt sustainability objective and the proposed pattern of fiscal consolidation is basically sound**. Revenue mobilization has accounted for the lion's share of fiscal adjustment in recent years, and the need to establish a favorable environment for private sector-led growth calls for a medium-term effort to progressively reduce Mongolia's relatively high tax burden. However, given the difficult task for expenditure containment in the short run, the staff endorses the government's decision to postpone consideration of any major tax cuts until concrete reforms can be put in place to rein in unproductive spending. The staff commends the government for its decision to refrain from granting any further wage and pension increases during 2003, and urges it to resist political pressures to reopen this issue ahead of the upcoming elections. To curb expenditure pressures over the medium term without impinging on poverty reduction objectives, the authorities are encouraged to develop and adopt as soon as possible a comprehensive reform strategy, in consultation with the World Bank, to establish a more productive and merit-based civil service and rationalize the delivery and effectiveness of priority social services and the targeting of cash transfers.

36. **Continuing reforms to strengthen economic governance will be essential to help put scarce public resources to best use and garner sustained donor support for Mongolia**. The staff welcomes the accelerated implementation of the government's rephased treasury reform program and the progress towards reducing government arrears. To consolidate these gains, the authorities now need to rationalize the rules for the use of budgetary entities' excess own revenues and begin to develop a commitment control system. Although recent steps to finance some of the government's investment projects through quasi-fiscal and extra-budgetary operations have been a serious cause for concern, the government has since integrated most investment projects into its budget. The authorities are urged to apply strict economic criteria for the evaluation of all public investment projects, in consultation with the World Bank, and to continue to strengthen the safeguards framework by taking early steps to establish an independent oversight Board at the BOM.

37. **While the ongoing rapid expansion of credit to the private sector is partly due to a return of public confidence in the banking system, great vigilance is needed to protect price stability and prevent a re-emergence of credit quality problems down the road.** The recent increase in the sales and yields of BOM bills has been an important step in this direction. The authorities will need to make a sustained effort in the period ahead to ensure that the influx of new funds into the banking system from newly licensed and/or privatized

financial institutions will not threaten the achievement of the BOM's monetary program targets for the remainder of 2003. In the area of bank supervision, building on the significant progress made in recent years, the BOM is committed under the program to continue to upgrade its classification and provisioning standards and tighten their enforcement.

38. **Mongolia's flexible exchange rate policy has served it well in recent years.** While the relative stability of the togrog recorded over the last few years does not appear to have been a major factor contributing to the recent weakness of export receipts, steps may need to be taken to guard against an excessive erosion of competitiveness. The staff welcomes the ongoing efforts by the BOM to adopt market-based intervention practices in its dealings with the interbank foreign exchange market, and encourages it to take further steps to liberalize the marketing of gold exports.

39. **To limit the economy's vulnerability to external shocks, the authorities will continue to pursue a prudent external debt management policy and will maintain an open trade and investment regime.** The staff welcomes the recent progress towards the elimination of arrears on post-1991 external debt and looks forward to an early settlement of the large stock of transferable ruble debt to Russia. It will also be important that the authorities strictly adhere to their commitment not to contract any further nonconcessional debt or issue guarantees for private borrowing.

40. **The main risks to the program as highlighted in the JSA would stem from slippages in the key areas where differences of view within government as to the appropriate policy stance may undermine the political will to stay the course of the program.** This is especially of concern in the areas of civil service wage and pension policies and politically-sensitive public investment projects. Failure to address governance concerns in a timely manner would also pose a threat to the objectives of the PRSP, including by discouraging or delaying assistance from donors and IFIs. A worsening external environment could also entail risks for short-term macroeconomic performance. However, as long as policies remain on track and donor support remains strong, adequate concessional assistance should continue to be available, cushioning the effects of external shocks.

41. **Notwithstanding the above-mentioned risks, the government's reform program is worthy of continued Fund support.** With all key indicators of fiscal, monetary and external sector policies having been brought back on track as of end-June 2003, the staff can support the government's request for waivers for the five QPCs that were breached at end-2001, early 2002, end-June 2002 and early 2003. In the case of the missed SPC relating to the TSA, the treasury reforms to date have more than accomplished the objectives of the pilot program, and the staff supports the government's request for a waiver. As regards the missed SPC relating to the 2002 budget, given that the 2003 budget and the recently approved MTBF envisage a prudent wage and pension policy, the staff supports the government's waiver request. The staff also supports the authorities' requests for a rephasing of the fourth and subsequent disbursements and a lengthening of the arrangement. Given the authorities' good track record in maintaining overall macroeconomic stability, and the continuing momentum of structural reform, the staff recommends completion of the first and second reviews under the PRGF arrangement.

Table 1. Mongolia: Selected Economic and Financial Indicators, 1999–2003

Nominal GDP (2002): $1,109 million
Population (2002): 2.45 million
Quota: SDR 51.1 million

	1999	2000	2001		2002		2003	
		Est.	Prog. Country Report No. 01/182	Est.	Prog. Country Report No. 01/182	Est.	Prog. Country Report No. 01/182	Prog.
					(Percent change)			
Real GDP	3.2	1.1	1.4	1.0	4.0	3.9	5.0	5.0
Real GDP (excluding agriculture, percent change)	2.6	12.0	...	11.0	...	9.4	...	5.3
Consumer prices (period average)	7.6	11.6	8.8	6.3	6.0	0.9	5.0	5.0
Consumer prices (end period)	10.0	8.1	8.0	7.9	6.0	1.7	5.0	5.0
					(In percent of GDP)			
General government revenue	27.2	34.5	33.6	38.5	32.7	38.7	32.6	38.2
General government expenditure	39.4	41.5	41.0	43.9	39.8	44.7	39.2	44.2
Current balance	-0.2	3.2	2.7	4.8	3.1	4.4	3.4	4.5
Overall balance	-12.2	-7.0	-7.3	-5.4	-7.1	-6.0	-6.6	-6.0
Net domestic credit to government	0.0	-0.7	-1.5	-1.9	-2.3	-2.2	-1.3	-1.9
Total public debt 1/ 2/	100.1	97.1	94.9	93.6	96.7	91.9	96.2	92.9
NPV of total public debt 1/ 2/	71.8	64.3	63.4	61.1	62.4	62.4	60.8	60.7
					(Percent change)			
Net foreign assets	96.9	33.6	13.0	8.9	16.8	40.1	...	8.9
Net domestic assets	-23.6	-17.9	23.4	96.1	-7.6	45.4	...	55.7
Domestic credit	-11.1	-8.0	0.8	41.6	-4.4	43.2	...	41.6
Credit to enterprises	-39.7	29.5	38.3	141.9	33.9	72.4	...	54.4
Broad money	31.7	17.5	15.3	28.0	11.1	41.9	...	25.0
Reserve money	51.8	19.4	11.1	8.4	10.8	21.7	...	13.9
Broad money velocity (GDP/BM) 3/	4.3	4.0	4.0	3.4	3.9	2.7		2.4
Annual interest rate on central bank bills (percent) 4/	11.4	8.5	...	8.8	...	8.0		14.0
				(In millions of US dollars; unless otherwise indicated)				
Current account balance, excluding official transfers	-127	-153	-170	-169	-159	-178	-155	-180
(In percent of GDP)	-14.1	-16.2	-16.7	-16.6	-14.7	-16.1	-13.4	-15.0
Current account balance, including official transfers	-60.3	-54.4	-74.6	-61.7	-76.5	-105.0	-70.1	-106.9
(In percent of GDP)	-6.7	-5.8	-7.3	-6.1	-7.1	-9.5	-6.1	-8.9
Trade balance	-113	-140	-150	-170	-132	-229	-124	-215
(In percent of GDP)	-12.5	-14.8	-14.7	-16.7	-12.3	-20.6	-10.7	-18.0
Exports, fob	454	536	549	523	601	524	647	596
(Percent change)	-1.8	18.0	2.3	-2.4	9.4	0.1	7.7	13.8
Imports, cif	567	676	699	693	733	753	771	812
(Percent change)	-2.6	19.2	1.7	2.5	4.9	8.6	5.2	7.8
Financial and capital account balance	108	108	112	109	122	158	81	115
(In percent of GDP)	11.9	11.4	11.0	10.7	11.3	14.2	7.0	9.6
Gross official international reserves (end-period) 5/	157	191	209	207	237	268	260	295
(In weeks of next year/projected imports c.i.f.)	12.1	14.3	14.8	14.3	16.0	17.2	16.5	17.9
Public and publicly guaranteed external debt 2/	828	837	912	902	1,009	985	1,089	1,109
(In percent of GDP)	91.4	88.4	89.4	88.8	93.6	88.9	94.2	92.6
NPV of public and publicly guaranteed external debt 2/	571	542	591	587	639	658	679	722
(In percent of GDP)	63.0	57.3	57.9	57.7	59.2	59.4	58.7	60.3
Debt service	31.9	24.2	45.8	33.9	37.4	32.0	40.9	36.1
(In percent of exports of goods & services)	5.7	3.8	7.0	5.3	5.3	4.5	5.4	4.8
Exchange rates								
Togrogs per U.S. dollar (period average) 6/	1,022	1,077	...	1,098	...	1,110	...	1,130
NEER, end-period (1995=100) 6/	59	60	...	61	...	60	...	58
REER, end-period (1995=100) 6/	108	112	...	120	...	114	...	107
NEER, period average (1995=100) 6/	62	60	...	61	...	61	...	59
REER, period average (1995=100) 6/	109	113	...	118	...	114	...	107
Export prices (U.S. dollar, percent change)	-7.0	13.6	-4.3	-11.6	4.7	-4.7	3.1	6.8
Copper prices (U.S. dollar, percent change)	-5.8	18.4	-11.0	-12.2	13.3	-9.9	6.0	5.8
Import prices (U.S. dollar, percent change)	-2.4	2.5	-5.2	-2.3	0.3	2.3	0.5	4.6
Terms of trade (percent change)	-4.8	10.8	0.9	-9.5	4.4	-6.9	2.6	2.1
Nominal GDP (billion togrogs)	925	1,019	1,152	1,116	1,270	1,231	1,401	1,362
Nominal GDP (million U.S. dollars)	906	946	1,020	1,016	1,078	1,109	1,156	1,198

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

1/ Includes IMF loans, guarantees and arrears.
2/ Excludes unresolved claims by the Russian Federation (estimated at TR 10.5 billion) and recent quasi-fiscal operations of the Bank of Mongolia.
3/ Seasonally adjusted figures for broad money velocity from 1997 onwards.
4/ Annualized yield on end-period auction of 14-day bills. For 2003, figures reflect actual data as of end-July.
5/ Beginning December 2000, includes commercial banks' foreign exchange deposits with the Bank of Mongolia.
6/ Figures for 2003 reflect data as of May 2003.

Table 2. Mongolia: Summary Operations of the General Government, 1999–2008

	1999	2000	2001		2002			2003			2004	2005	2006	2007	2008
	Actual		Prog.	Actual	Program	amend.	Actual	Program	Budget	Proj.	Rev. Prog.	Proj	Proj	Proj	Proj
			Country Report No. 01/182		Country Report No. 01/182	Budget		Country Report No. 01/182							
	(In billions of togrogs)														
Total revenue and grants	251.7	351.4	387.3	429.5	414.8	443.1	477.0	456.1	494.9	519.8	575.5	626.1	693.5	768.2	851.2
Total expenditure and net lending	364.6	422.6	472.0	489.7	505.6	525.9	550.5	548.6	579.8	601.7	664.8	718.2	777.4	850.5	930.6
Financing	117.3	71.0	84.7	67.1	90.8	82.8	70.9	92.5	84.9	81.9	89.3	92.1	83.9	82.3	79.4
Foreign financing (net)	105.8	66.6	56.1	72.8	86.5	70.2	81.8	86.1	70.8	73.4	80.1	82.4	72.8	74.3	75.0
Other	11.5	4.4	3.1	-5.7	-19.8	-9.0	-10.9	-5.7	-15.0	-14.1					
Privatization receipts	11.7	7.2	10.2	5.6	9.7	20.1	16.8	12.6	15.4	11.1	12.1	13.4	11.1	7.2	3.4
Domestic bank financing (net)	-0.2	-7.0	-16.8	-18.8	-29.6	-29.1	-27.7	-18.3	-30.4	-25.2	-14.5	-9.6	0.1	0.9	1.0
Domestic non-bank financing (net)	0.0	0.0	0.0	-2.4	0.0	0.0	0.0	0.0	0.0	0.0					
Other (settlement of claims with the BOM)	0.0	4.2	9.8	9.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	...	...	25.4	...	24.2	21.6	0.0	12.1	29.2	22.6	11.6	5.9	0.0	0.0	0.0
	(In percent of GDP)														
Total revenue and grants	27.2	34.5	33.6	38.5	32.7	36.0	38.7	32.6	36.3	38.2	38.2	37.5	37.5	37.5	37.5
Current revenue	26.5	34.0	33.1	37.7	32.0	35.3	38.1	32.0	35.7	37.5	37.5	36.9	36.9	36.9	36.9
Tax revenue and social security contributions	19.7	25.6	25.7	29.4	24.9	27.6	29.2	24.9	27.4	29.6	29.7	29.1	29.1	29.1	29.1
Income taxes	4.2	6.2	5.7	5.8	5.8	5.5	5.9	6.0	5.0	5.8	5.8	5.1	5.0	5.0	4.9
Social security contributions	3.3	3.9	3.3	4.8	3.3	3.4	4.4	3.3	4.1	4.7	4.7	4.7	4.7	4.7	4.7
Sales tax and VAT 1/	6.5	7.5	8.0	9.3	7.9	9.3	9.6	7.9	8.9	9.5	9.5	9.5	9.6	9.6	9.6
Excise taxes	2.9	4.0	4.0	4.8	4.0	4.4	4.2	3.9	4.3	4.2	4.2	4.2	4.2	4.2	4.3
Customs duties and export taxes	1.0	2.2	2.7	2.4	2.0	1.9	2.0	2.0	2.0	2.1	2.1	2.1	2.1	2.1	2.1
Other taxes 1/	1.8	1.9	2.0	2.3	2.0	3.0	3.1	2.0	3.0	3.4	3.4	3.4	3.4	3.4	3.5
Nontax revenue	6.8	8.4	7.4	8.2	7.2	7.7	9.0	7.1	8.3	7.9	7.8	7.8	7.8	7.8	7.8
Capital revenue and grants	0.7	0.5	0.5	0.8	0.6	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Total expenditure and net lending	39.4	41.5	41.0	43.9	39.8	42.7	44.7	39.2	42.6	44.2	44.1	43.0	42.0	41.5	41.0
Current expenditure	26.7	30.8	30.5	32.9	29.0	32.4	33.7	28.6	31.9	33.1	32.6	32.2	31.6	31.1	30.7
Wages and salaries	6.9	8.5	7.5	8.3	7.1	8.4	8.5	6.9	8.6	8.6	8.6	8.6	8.4	8.2	8.1
Purchase of goods and services	10.9	12.2	12.6	14.6	11.6	13.2	14.7	11.5	12.2	13.2	13.2	13.0	12.8	12.8	12.6
Of which: clearance of budget entities' arrears	...	...	0.4	0.7	0.3	0.3	0.2	0.3	0.2	0.2	0.2	0.0	0.0	0.0	0.0
Subsidies to public enterprises 2/	0.1	0.0	0.0	0.5	0.0	0.8	0.7	0.0	0.7	0.7	0.6	0.6	0.4	0.3	0.2
Transfers	7.0	8.3	7.9	8.0	7.6	8.1	8.2	7.6	8.5	8.6	8.4	8.2	8.2	8.0	7.9
Interest payments	1.9	1.8	1.7	1.5	1.7	1.7	1.6	1.5	1.5	1.5	1.4	1.1	1.0	0.9	0.9
Contingency allocation	...	...	0.7	...	1.0	0.3	...	1.0	0.5	0.5	0.5	0.7	0.8	0.9	1.0
Capital expenditure and net lending	12.7	10.6	10.5	11.0	10.8	10.3	11.0	10.6	10.6	11.1	11.5	10.8	10.4	10.4	10.3
Capital expenditure	4.0	5.1	4.5	5.3	4.0	4.5	5.5	4.1	4.8	4.8	5.3	4.8	5.3	5.7	5.8
Domestically-financed	3.1	4.3	3.4	4.4	2.9	3.5	4.2	3.4	3.9	3.9	4.6	4.1	4.6	5.0	5.2
Foreign-financed	0.9	0.8	1.1	0.9	1.1	1.0	1.3	0.7	0.9	0.9	0.7	0.7	0.7	0.7	0.7
Net lending	8.7	5.5	6.0	5.7	6.8	5.8	5.4	6.4	5.9	6.3	6.2	6.0	5.1	4.8	4.5
On-lent foreign project loans (net)	8.3	5.3	5.8	5.3	6.5	5.7	5.4	6.1	5.8	6.2	6.0	5.8	5.0	4.7	4.4
Domestic lending minus repayments	0.4	0.2	0.2	0.5	0.3	0.1	0.1	0.3	0.1	0.1	0.2	0.2	0.1	0.1	0.1
Current balance (excl. privatization receipts)	-0.2	3.2	2.7	4.8	3.1	...	4.4	3.4	3.8	4.5	4.9	4.7	5.3	5.8	6.2
Overall balance (incl. grants)	-12.2	-7.0	-7.3	-5.4	-7.1	-6.7	-6.0	-6.6	-6.2	-6.0	-5.9	-5.5	-4.5	-4.0	-3.5
Discrepancy between deficit from above and below the line	0.5	0.0	0.0	0.6	0.0	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing	12.7	7.0	7.3	6.0	7.1	6.7	5.8	6.6	6.2	6.0	5.9	5.5	4.5	4.0	3.5
Foreign Financing (net)	11.4	6.5	4.9	6.5	6.8	5.7	6.6	6.1	5.2	5.4	5.3	4.9	3.9	3.7	3.4
Project loans	9.4	6.2	7.1	6.2	7.8	6.7	6.6	7.2	6.7	7.1	6.7	6.4	5.7	5.4	5.2
Program loans	1.8	1.3	0.0	2.1	0.0	0.0	1.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Buligaar 3/	1.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	1.1	1.0	2.2	1.8	1.0	1.0	1.2	1.0	1.5	1.7	1.4	1.6	1.8	1.8	1.8
Privatization receipts	1.3	0.7	0.9	0.5	0.8	1.6	1.4	0.9	1.1	0.8	0.8	0.8	0.6	0.4	0.2
Settlement of claims with the BOM	0.0	0.4	0.9	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic Bank Financing (net)	0.0	-0.7	-1.5	-1.7	-2.3	-2.4	-2.2	-1.3	-2.2	-1.9	-1.0	-0.5	0.0	0.0	0.0
Domestic Non-Bank Financing (net)	0.0	0.0	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap (identified)	...	...	2.2	0.0	1.9	1.8	...	0.9	2.1	1.7	0.8	0.4	0.0	0.0	0.0
Memorandum items :															
Social expenditure	19.1	22.1	...	23.2	...	22.3		...			...	...	...	...	
Defense expenditure	2.0	2.6	...	2.3	...	2.2		...			...	...	...	...	
Domestic debt/GDP	8.7	8.7	5.5	4.8	3.1	2.5	3.1	...	...	0.3	0.0	0.0	0.0	0.0	0.0
Public sector payables 4/	1.8	2.3	1.1	0.8	0.7	0.5	0.5	...	...	0.3	0.0	0.0	0.0	0.0	0.0
Other	6.9	6.4	4.4	4.0	2.4	2.0	2.5	...	...	0.0	0.0	0.0	0.0	0.0	0.0
Nominal GDP	925	1,019	1,152	1,116	1,270	1,231	1,231	1,401	1,362	1,362	1,508	1,670	1,849	2,049	2,270

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

1/ In 2002 the VAT on gold was replaced by a revenue-neutral increase in the royalty on gold mining, which is included under other taxes.

2/ From 2001 onward this item includes subsidies to SOE for quasi-fiscal activities which previously had been recorded under purchases of goods and services.

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

4/ Public sector arrears comprise arrears accumulated by budget entities and the MOFE treasury; they do not include arrears accrued by extrabudgetary funds.

Table 3. Mongolia: Monetary Aggregates, 1999–March 2004 1/

	1999	2000	2001		2002	2003					2004
	Dec Act.	Dec Act.	Dec Prog. Country Report No. 01/182	Dec. Act. 2/	Dec Act 2/	Mar Act 2/	June Prog.	June Act 2/	Sep. Prog.	Dec Prog.	Mar Prog.
	(In billions of togrogs; end of period)										
Monetary survey											
Broad Money	220.4	258.8	298.4	331.4	470.1	504.3	551.6	557.9	570.0	587.7	605.1
Currency	87.3	100.9	112.6	109.2	120.8	115.0	153.7	141.1	153.2	151.0	138.0
Deposits	133.1	157.9	185.8	222.2	349.3	389.3	397.9	416.9	416.8	436.7	467.1
Net foreign assets	151.2	202.1	228.4	220.1	308.3	307.3	316.5	321.9	330.0	335.7	335.7
Net international reserves	153.6	206.5	232.8	227.0	321.5	320.1	329.7	335.8	343.3	348.9	348.9
Bank of Mongolia	113.0	154.3	176.2	176.3	253.9	242.7	262.1	267.7	275.6	281.3	281.3
Commercial banks	40.7	52.2	56.6	50.7	67.6	77.4	67.6	68.1	67.6	67.6	67.6
Other foreign assets, net	-2.4	-4.4	-4.4	-7.0	-13.2	-12.7	-13.2	-13.9	-13.2	-13.2	-13.2
Net domestic assets	69.1	56.8	70.0	111.3	161.8	196.9	235.1	236.0	240.0	252.0	269.5
Domestic credit	130.6	120.1	121.1	170.1	243.5	289.6	327.7	329.4	332.6	344.6	362.1
Net credit to government 3/	47.7	51.3	33.1	31.5	7.4	3.6	22.4	-3.7	2.4	-13.4	-8.4
Claims on nonbanks 4/	82.8	68.8	88.0	138.6	236.1	286.0	305.4	333.1	330.2	358.1	370.5
Of which:											
Claims on public enterprises	8.6	6.3	7.9	10.4	12.2	11.2	15.8	12.6	17.1	15.5	19.1
Claims on the private sector	31.4	45.5	63.7	114.8	203.7	239.3	264.5	282.8	285.9	317.8	326.7
Nonperforming loans	42.1	15.9	15.3	10.9	16.6	30.3	20.4	33.3	22.2	20.1	20.1
Other items, net	-61.4	-63.4	-51.1	-58.7	-81.6	-92.6	-92.6	-93.4	-92.6	-92.6	-92.6
Monetary authorities											
Reserve money	111.3	132.9	147.6	144.1	175.3	181.0	197.0	195.3	207.0	199.7	204.9
Net foreign assets	119.3	154.6	176.6	176.5	254.1	242.8	262.3	268.0	275.8	281.4	281.4
Net international reserves	113.0	154.3	176.2	176.3	253.9	242.7	262.1	267.7	275.6	281.3	281.3
Other assets, net	6.3	0.4	0.4	0.2	0.2	0.1	0.2	0.3	0.2	0.2	0.2
Net domestic assets	-8.0	-21.7	-28.9	-32.5	-78.8	-61.7	-65.3	-72.7	-68.8	-81.7	-76.5
Net credit to government	32.6	34.1	22.9	35.0	6.3	-3.0	2.8	-15.7	-5.2	-7.5	-3.0
Claims on deposit money banks	6.7	4.8	4.8	7.3	8.0	8.4	10.9	9.9	11.9	14.9	15.6
Claims on nonbanks	4.6	0.9	0.9	1.0	1.0	0.9	1.0	0.7	1.0	1.0	1.0
Minus: Central bank bills (net)	21.2	21.1	28.3	50.0	61.0	43.0	57.0	48.6	62.6	57.0	57.0
Other items, net	-30.6	-40.4	-29.2	-25.8	-33.1	-25.0	-23.0	-19.1	-13.9	-33.1	-33.1
Of which: precious metals	5.5	7.8	7.8	12.6	7.0	5.1	14.8	17.0	17.7	7.0	
Memorandum items:											
Annual broad money growth	31.7	17.5	15.3	28.0	41.9	45.8	37.6	39.1	30.3	25.0	20.0
Net foreign assets 5/	44.5	23.1		6.9	26.6					5.8	
Net credit to government 5/	-0.1	1.6		-7.7	-7.3					-4.4	
Claims on nonbanks 5/	-9.6	-6.4		27.0	29.4					25.9	
Annual growth of credit to nonbanks 6/	-39.7	29.5	38.3	141.9	72.4	81.4	59.2	67.8	66.6	54.4	38.1
Annual growth of credit to nonbanks 7/	-16.3	15.6	27.9	101.5	70.4	84.4	56.0	70.2	63.5	51.7	29.6
Credit to nonbanks in percent of GDP	8.9	6.8	7.6	12.4	19.2	21.0	22.4	24.5	24.2	26.3	24.6
Annual reserve money growth	51.8	19.4	11.1	8.4	21.7	26.7	11.9	11.0	9.1	13.9	13.2
Velocity, seasonally adjusted	4.3	4.0	4.0	3.4	2.7	2.6	2.5	2.3	2.4	2.4	
Broad money/reserve money	2.0	1.9	2.0	2.3	2.7	2.8	2.8	2.9	2.8	2.9	3.0
Currency/broad money	39.6	39.0	37.7	32.9	25.7	22.8	27.9	25.3	26.9	25.7	22.8
Foreign currency deposits/broad money	27.4	26.7		26.4	28.8	29.4		27.9			
Foreign currency loans/total loans	38.8	40.3		36.4	37.0	36.0		36.2			
Nonperforming loans/total loans	50.8	23.1		7.8	7.0	10.6		10.0			
Total loans/deposits	62.2	43.6	47.4	62.4	67.6	73.5	76.7	79.9	79.2	82.0	79.3
NIR of the BOM (million, U.S. dollar) 8/	105.4	140.6	160.6	160.0	225.7	212.9	233.0	235.0	245.0	250.0	250.0
Of which:											
Monetary gold (million, U.S. dollar)	0.4	22.5		51.1	49.8	30.4		41.2			
GDP (billions of togrogs)	925.3	1,018.9	1,152.4	1,115.6	1,231.3	1,362.2	1,362.2	1,362.2	1,362.2	1,362.2	1,508.0
Exchange rate (togrogs per U.S. dollar)	1,072.4	1,097.0	1,097.0	1,102.0	1,125.0	1,140.0	1,125.0	1,139.0	1,125.0	1,125.0	1,125.0

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

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

2/ Valued at actual exchange rates and gold price.

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

4/ 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.

5/ Contribution to growth of broad money (in percent of beginning-of-period broad money).

6/ Excludes nonperforming loans.

7/ Includes nonperforming loans.

8/ 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.

Table 4. Mongolia: Balance of Payments, 2001–08

(In millions of US dollars, unless indicated otherwise)

	2001	2001	2002	2002	2003	2003	2004	2005	2006	2007	2008
	Prog. Country Report No. 01/182	Actual	Prog. Country Report No. 01/182	Est.	Country Report No. 01/182	Prog.	Prog.	Prog. -----------	Proj.	----------	----------
Trade balance	-149.7	-169.9	-132.2	-228.7	-123.6	-215.4	-198.8	-195.6	-210.1	-222.7	-227.5
Exports, f.o.b.	549.2	523.2	601.0	524.0	584.8	596.2	654.3	711.2	763.1	823.1	896.3
Copper	151.2	147.9	176.5	140.2	193.6	158.7	181.8	202.4	216.8	232.2	248.7
Imports, c.i.f. 1/	-698.9	-693.1	-733.2	-752.7	-841.5	-811.6	-853.1	-906.8	-973.1	-1,045.8	-1,123.8
Services, net	-13.2	-22.2	-15.7	-9.4	-17.5	-16.3	-19.1	-21.1	-22.3	-24.5	-26.8
Receipts	102.9	113.5	106.0	184.5	110.3	155.3	182.1	190.7	201.1	211.1	221.7
Payments	-116.0	-135.7	-121.7	-193.9	-127.8	-171.6	-201.2	-211.8	-223.3	-235.6	-248.6
Income, net	-16.2	-2.0	-19.6	-4.5	-23.0	-13.2	-14.6	-17.7	-19.2	-20.9	-22.7
Private unrequited transfers	9.0	25.0	9.0	64.4	9.0	65.0	67.0	70.0	77.0	82.0	87.0
Current account balance, excluding official transfers	-170.1	-169.1	-158.5	-178.2	-155.1	-179.9	-165.6	-164.4	-174.5	-186.1	-190.0
Public unrequited transfers, net	95.5	107.4	82.0	73.2	85.0	73.0	73.0	73.0	73.0	73.0	73.0
Official grants	85.3	92.1	75.0	53.0	80.0	53.0	53.0	53.0	53.0	53.0	53.0
Other official transfers, net	10.2	15.3	7.0	20.2	5.0	20.0	20.0	20.0	20.0	20.0	20.0
Financial and capital account	72.0	109.1	81.2	157.5	80.6	115.1	117.6	122.8	130.8	137.7	138.7
Direct investment	45.3	43.0	44.4	77.8	73.0	73.0	73.0	75.0	79.0	83.0	85.0
Loans	79.1	77.6	97.3	102.4	95.2	62.1	64.6	67.8	71.8	74.7	73.7
Medium- and long-term, net	70.1	68.6	90.3	102.4	88.2	62.1	64.6	67.8	71.8	74.7	73.7
Disbursements	153.6	167.1	165.8	185.1	165.8	165.4	169.6	177.1	182.9	188.4	191.7
Public sector	72.6	84.2	83.8	86.9	85.3	85.3	87.0	90.7	86.6	89.6	92.2
Private sector	81.0	82.9	82.0	98.2	80.1	80.1	82.6	86.4	96.3	98.8	99.5
Amortization	-83.5	-98.5	-75.6	-82.7	-103.3	-103.3	-105.0	-109.2	-111.0	-113.8	-118.0
Public sector	-21.4	-18.0	-16.1	-13.2	-19.2	-19.3	-18.0	-21.9	-26.9	-29.5	-32.3
Private sector	-62.2	-80.5	-59.5	-69.5	-84.1	-84.0	-87.0	-87.3	-84.1	-84.3	-85.7
Short-term, net	9.0	9.0	7.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits, net	-3.5	3.8	-10.0	-8.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial banks, net	-4.0	3.8	-10.0	-8.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Trade credits, net	-9.0	-15.3	-10.0	-14.0	-20.0	-20.0	-20.0	-20.0	-20.0	-20.0	-20.0
Errors and omissions	0.0	-32.6	0.0	14.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-2.6	14.7	4.7	66.5	10.6	8.2	25.0	31.4	29.3	24.6	21.7
Financing	2.6	-14.7	-4.7	-66.5	-10.6	-8.2	-25.0	-31.4	-29.3	-24.6	-21.7
Increase in net official reserves (-)	-25.3	-19.5	-35.8	-65.8	-24.1	-24.1	-35.0	-36.4	-29.3	-24.6	-21.7
Use of IMF credit (+) (excluding disbursments from 2003 onwards)	-6.9	-1.7	-7.9	-7.7	-8.4	-8.5	-6.8	-5.6	-5.7	-4.9	-3.3
Increase in gross official reserves (-)	-18.3	-17.8	-27.9	-58.1	-32.4	-27.1	-39.6	-42.2	-23.6	-19.7	-18.4
Accumulation of new arrears (+)	0.0	4.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayment of outstanding arrears(-)	0.0	0.0	0.0	-0.7	0.0	-4.1	0.0	0.0	0.0	0.0	0.0
Exceptional financing / rescheduling	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap 1/	27.8	0.0	31.1	0.0	36.7	31.5	21.4	16.4	0.0	0.0	0.0
of which : new disbursments under the PRGF	...	...	...	...	...	11.5	11.4	11.4	...	...	...
Memorandum items :											
Current account balance, excluding official transfers (in percent of GDP)	-16.7	-16.6	-14.7	-16.1	-12.9	-15.0	-12.8	-11.7	-11.4	-11.2	-10.6
Current account balance, including official transfers (in percent of GDP)	-7.3	-6.1	-7.1	-9.5	-5.8	-8.9	-7.1	-6.5	-6.7	-6.8	-6.5
Exports, f.o.b. (annual growth)	2.3	-2.4	9.4	0.1	11.6	13.8	9.7	8.7	7.3	7.9	8.9
Imports, c.i.f. (annual growth) 2/	1.7	2.5	4.9	8.6	11.8	11.9	5.1	6.3	7.3	7.5	7.5
Export volume growth	6.9	10.5	4.5	5.1	4.5	6.5	6.5	6.5	7.0	7.5	7.5
Import volume growth 2/	7.2	5.0	4.5	6.2	4.6	7.0	7.0	6.5	6.0	6.0	6.0
Export price index change	-4.3	-11.6	4.7	-4.7	6.8	6.8	3.0	2.1	0.3	0.3	1.3
Import price index change	-5.2	-2.3	0.3	2.3	6.8	4.6	-1.8	-0.2	1.2	1.4	1.4
Trade balance (in percent GDP)	-14.7	-16.7	-12.3	-20.6	-10.7	-18.0	-15.3	-13.9	-13.8	-13.5	-12.7
Net official reserves (end-period) 4/	160.6	160.1	196.4	225.9	250.0	250.0	285.0	321.4	350.7	375.3	397.0
Gross official reserves (end-period)	209.2	206.8	237.1	268.2	300.6	295.3	334.9	377.1	400.7	420.5	438.8
(In weeks of next year/ projected imports of goods)	14.8	14.3	16.0	17.2	18.3	18.0	19.2	20.2	19.9	19.5	19.0
(In weeks of next year/ projected imports of goods & services))		11.4		14.1	15.3	15.1	16.3	17.1	16.9	16.6	16.4
Outstanding arrears (end-period)	0.0	4.8	0.0	4.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt service (in percent of exports of goods and services)	7.0	5.3	5.3	4.5	4.4	4.8	4.6	4.7	5.0	4.8	4.6
Public and publicly guaranteed external debt stock 3/	912	902	1,009	985	1,081	1,109	1,191	1,265	1,319	1,371	1,426
NPV of public and publicly guaranteed external debt 5/	591	587	639	658	658	722	780	834	871	908	947
Public and publicly guaranteed external debt stock (in percent of GDP) 3/	89	88.8	93.6	88.9	90.3	92.6	91.8	90.0	86.6	82.8	79.4
NPV of public and publicly guaranteed external debt (in percent of GDP) 4/	57.9	57.7	59.2	59.4	55.0	60.3	60.1	59.3	57.1	54.9	52.7
GDP (in millions of U.S. dollars)	1,020	1,016	1,078	1,109	1,198	1,198	1,298	1,406	1,524	1,655	1,797

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

1/ The financing gap is to be bridged by disbursements from the World Bank, AsDB, and the Fund.

2/ While total imports include aircraft leases valued at US$ 27.5 million in 2002, volume calculation excludes leases.

3/ Excludes unresolved claims by Russia estimated at TR 10.5 billion.

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

5/ Discount rate for SDR decreased from 5.16 percent in 2001 to 4.82 percent in 2002.

Table 5. Mongolia: External Debt and Debt Service, 2001–08 1/

	2001	2002	2003	2004	2005	2006	2007	2008
			Projections					
				(In millions of US dollars)				
Nominal Debt Stock	902	985	1,109	1,191	1,265	1,319	1,371	1,426
Total Debt Service	33.9	32.0	36.1	38.2	42.4	47.8	50.0	51.9
Amortization	24.8	20.9	23.7	24.8	27.6	32.6	34.3	35.6
Interest	9.0	11.1	12.4	13.4	14.8	15.2	15.7	16.3
Debt Service on Existing Debt								
Amortization	24.8	20.9	23.7	24.8	27.6	29.9	31.7	32.9
Medium and long term	24.8	20.9	23.7	24.8	27.6	29.9	31.7	32.9
Multilateral	6.8	9.0	10.2	10.4	10.7	11.8	13.6	13.5
Asian Development Bank	0.0	0.6	0.9	2.1	3.3	3.9	5.9	7.1
World Bank	0.0	0.7	0.7	1.4	1.8	2.2	2.8	3.1
IMF	6.8	7.7	8.5	6.8	5.6	5.7	4.9	3.3
IFAD	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1
Official Bilateral	18.0	11.9	12.1	13.0	15.4	16.7	16.6	18.0
Paris Club	17.6	8.4	10.2	11.1	13.6	14.5	13.9	14.6
Japan	2.1	2.9	3.8	4.5	7.4	12.0	12.1	12.1
Russia	14.8	4.4	4.9	4.9	4.9	1.0	0.2	0.0
Germany	0.8	1.0	1.6	1.7	1.0	1.1	1.1	2.1
Other	0.0	0.0	0.0	0.1	0.2	0.4	0.4	0.4
Non - Paris Club	0.4	3.5	1.8	1.9	1.9	2.1	2.7	3.3
China	0.0	0.0	0.0	0.0	0.0	0.0	0.6	1.3
Korea	0.2	0.4	0.6	0.6	0.6	1.6	1.7	1.7
Other	0.1	3.1	1.3	1.3	1.3	0.5	0.5	0.3
Commercial	0.0	0.0	1.4	1.4	1.4	1.4	1.4	1.4
Interest	9.0	11.1	11.1	10.9	11.2	10.8	10.3	9.9
Medium and long term	9.0	11.1	11.1	10.9	11.2	10.8	10.3	9.9
Multilateral	3.9	4.9	4.9	5.1	5.1	5.0	4.9	4.8
Asian Development Bank	2.7	3.6	3.5	3.8	3.8	3.7	3.7	3.6
World Bank	1.0	1.2	1.3	1.3	1.3	1.3	1.3	1.2
IMF	0.2	0.1	0.1	0.022	0.007	0.001	0.000	0.0
IFAD	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Official Bilateral	5.1	6.2	5.7	5.4	5.9	5.6	5.4	5.1
Paris Club	4.7	5.9	5.3	5.1	5.1	4.9	4.7	4.4
Japan	3.3	3.6	4.2	4.2	4.2	4.2	4.0	3.7
Russia	0.8	1.7	0.4	0.2	0.1	0.0	0.0	0.0
Germany	0.4	0.4	0.6	0.5	0.6	0.6	0.6	0.6
Other	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Non-Paris Club	0.4	0.3	0.4	0.3	0.8	0.7	0.7	0.6
China	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Korea	0.3	0.2	0.3	0.2	0.7	0.6	0.6	0.6
Other	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Commercial	0.0	0.0	0.4	0.4	0.3	0.2	0.1	0.1
Debt Service on New Borrowing	0.0	0.0	1.3	2.5	3.6	7.0	8.0	9.0
Amortization	0.0	0.0	0.0	0.0	0.0	2.7	2.7	2.7
Interest	0.0	0.0	1.3	2.5	3.6	4.4	5.3	6.3
Memorandum items :								
GDP	1,016.4	1,109.0	1,197.8	1,297.8	1,405.6	1,524.3	1,655.2	1,796.9
Exports of goods and services	636.7	708.5	751.5	836.4	901.9	964.1	1,034.2	1,118.0
General government revenue								
In millions of US dollars	391.3	429.7	452.2	490.3	522.1	565.8	614.8	666.7
In percent of GDP	38.5	38.7	37.8	37.8	37.1	37.1	37.1	37.1
Total debt service								
In percent of exports of goods and services	5.3	4.5	4.8	4.6	4.7	5.0	4.8	4.6
In percent of GDP	3.3	2.9	3.0	2.9	3.0	3.1	3.0	2.9
Total debt stock	902.4	985.5	1,109.1	1,190.9	1,265.5	1,319.5	1,371.2	1,425.9
In percent of exports of goods and services	141.7	139.1	147.6	142.4	140.3	136.9	132.6	127.5
In percent of GDP	88.8	88.9	92.6	91.8	90.0	86.6	82.8	79.4
Net present value of debt 2/	586.6	658.4	722.3	779.7	834.1	870.7	908.3	947.1
In percent of exports of goods and services	92.1	92.9	96.1	93.2	92.5	90.3	87.8	84.7
In percent of GDP	57.7	59.4	60.3	60.1	59.3	57.1	54.9	52.7
Average Interest Rate (In percent)	1.1	1.2	1.3	1.2	1.2	1.2	1.2	1.2

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

1/ Debt service excludes outstanding transferable rouble claims and disputed debts.

2/ Discount rate for SDR decreased from 5.16 percent in 2001 to 4.82 percent in 2002.

Table 6. Mongolia: Medium-Term Macroeconomic Framework, 1999–2008

(In percent of GDP; unless otherwise indicated)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
				Est.		Prog.			Proj.	
Real sector										
Real GDP (percent change)	3.2	1.1	1.0	3.9	5.0	5.3	5.5	5.5	5.5	5.5
GDP deflator (percent change)	9.7	8.9	8.5	6.2	5.4	5.1	5.0	5.0	5.0	5.0
Consumer prices (period average, percent change)	7.6	11.6	6.3	0.9	5.0	5.0	5.0	5.0	5.0	5.0
Per capita GDP (in U.S. dollars)	383.9	398.7	421.9	453.5	482.6	515.7	550.2	586.4	624.2	664.2
Saving and investment 1/										
Gross domestic investment	37.0	36.2	35.8	29.0	27.3	27.4	27.7	28.4	28.6	28.7
Government	14.7	12.4	16.8	10.9	10.9	11.3	10.5	10.4	10.4	10.0
Private	22.4	23.8	19.0	18.1	16.4	16.1	17.2	18.0	18.2	18.7
Gross domestic saving	14.6	10.4	5.7	4.1	7.9	10.7	12.3	13.1	13.5	14.4
Government	10.2	16.8	19.6	20.6	21.0	21.1	20.7	21.2	21.3	21.2
Private	4.4	-6.4	-13.9	-16.5	-13.1	-10.5	-8.4	-8.1	-7.8	-6.8
Gross national saving	30.3	30.4	29.7	19.6	18.3	20.3	21.2	21.7	21.7	22.1
Investment-national saving balance	-6.7	-5.8	-6.1	-9.5	-8.9	-7.1	-6.5	-6.7	-6.9	-6.6
Fiscal accounts										
Total revenue and grants	27.2	34.5	38.5	38.7	38.2	38.2	37.5	37.5	37.5	37.5
Domestic revenue	26.5	34.0	37.7	38.1	37.5	37.5	36.9	36.9	36.9	36.9
Grants	0.7	0.5	0.8	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Total expenditure and net lending	39.4	41.5	43.9	44.7	44.2	44.1	43.0	42.0	41.5	41.0
Current expenditure	26.7	30.8	32.9	33.7	33.1	32.6	32.2	31.6	31.1	30.7
Wages and salaries	6.9	8.5	8.3	8.5	8.6	8.6	8.6	8.4	8.2	8.1
Goods and services	10.9	12.2	14.6	14.7	13.2	13.2	13.0	12.8	12.8	12.6
Interest payments	1.9	1.8	1.5	1.6	1.5	1.4	1.1	1.0	0.9	0.9
Other	7.1	8.4	8.6	8.9	9.8	9.5	9.5	9.4	9.2	9.1
Capital expenditure and net lending	12.7	10.6	11.0	11.0	11.1	11.5	10.8	10.4	10.4	10.3
Current balance	-0.2	3.2	4.8	4.4	4.5	4.9	4.7	5.3	5.8	6.2
Primary balance	-10.3	-5.2	-3.9	-4.4	-4.5	-4.6	-4.4	-3.5	-3.1	-2.5
Overall balance (including grants)	-12.2	-7.0	-5.4	-6.0	-6.0	-5.9	-5.5	-4.5	-4.0	-3.5
Foreign financing	11.4	6.5	6.5	6.6	7.0	6.1	5.2	3.9	3.7	3.4
Monetary sector										
Broad money (percent change)	31.7	17.5	28.0	41.9	25.0	15.0	12.5	12.0	11.8	11.8
Velocity (GDP/M2)	4.3	4.0	3.4	2.7	2.4	2.4	2.4	2.4	2.4	2.4
Balance of payments										
Exports (percent change)	-1.8	18.0	-2.4	0.1	13.8	9.7	8.7	7.3	7.9	8.9
Imports (percent change)	-2.6	19.2	2.5	8.6	7.8	5.1	6.3	7.3	7.5	7.5
Current account balance (excluding official transfers)	-14.1	-16.2	-16.6	-16.1	-15.0	-12.7	-11.7	-11.5	-11.3	-10.7
Current account balance (including official transfers)	-6.7	-5.8	-6.1	-9.5	-8.9	-7.1	-6.5	-6.7	-6.9	-6.6
Capital and financial account balance	11.9	11.4	10.7	14.2	9.6	9.0	8.7	8.6	8.4	7.8
Overall balance	1.6	3.6	1.4	6.0	0.7	1.9	2.2	1.9	1.5	1.2
Financing gap (in millions of U.S. dollars)	0.0	0.0	0.0	0.0	20.0	10.0	5.0	0.0	0.0	0.0
Gross official reserves										
(in millions of U.S. dollars)	157	191	207	268	295	335	377	401	420	439
(in weeks of imports of goods)	12.1	14.3	14.3	17.2	18.0	19.2	20.2	19.9	19.5	19.0
Debt indicators										
Total public debt	100.1	97.1	93.6	91.9	92.9	91.7	90.0	86.7	83.4	80.3
of which: external debt	91.4	88.4	88.8	88.9	92.6	91.7	90.0	86.7	83.4	80.3
(in millions of U.S. dollars)	827.8	837.0	902.4	985.5	1,109.1	1,190.9	1,265.5	1,319.5	1,371.2	1,425.9
NPV of total public debt	71.8	64.3	61.1	62.4	60.7	60.1	59.1	57.1	55.1	53.2
of which: external debt	63.0	57.3	57.7	59.4	60.3	60.0	59.3	57.2	55.2	53.3
(in millions of U.S. dollars)	570.5	542.1	586.6	658.4	722.3	779.7	834.1	870.7	908.3	947.1
External public debt service 2/	5.7	3.8	5.3	4.5	4.8	4.6	4.7	5.0	4.8	4.8
Sensitivity analysis										
(real GDP growth rate: 3.5 percent a year in 2003-07)										
Total public debt	100.1	97.1	93.6	91.9	94.3	94.6	94.6	93.0	91.2	89.5
NPV of total public debt	71.8	64.3	61.1	62.4	61.6	62.1	62.2	61.2	60.2	59.3

Sources: Mongolian authorities; and staff estimates and projections.

1/ Authorities' estimates up to 2002. GDP estimates from the expenditure side for 2002 are 8.8 percent higher than those from the production side.

2/ In percent of exports of goods and services.

Table 7. Mongolia : Fund Position and Indicators of Fund Credit, 2000–08 1/

	2000	2001	2002	2003	2004	2005	2006	2007	2008
	(In millions of SDRs; unless otherwise indicated)								
Outstanding use of Fund credit (end of period)	38.6	37.3	31.3	33.4	36.6	40.8	36.7	32.4	29.2
Enhanced Structural Adjustment Facility	38.6	37.3	31.3	33.4	36.6	40.8	36.7	32.4	29.2
Poverty Reduction and Growth Facility	0.0	4.1	4.1	12.2	20.4	28.5	28.5	27.7	26.9
IMF obligations (during the period)									
Total purchases and disbursements	5.9	4.1	0.0	8.1	8.1	8.1	0.0	0.0	0.0
Total repurchases and repayments	4.8	5.4	5.9	6.1	4.9	4.0	4.0	4.3	3.2
Total charges	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.0
Enhanced Structural Adjustment Facility									
Purchases	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repurchases	4.8	5.4	5.9	6.1	4.9	4.0	4.0	3.5	2.4
Charges	0.2	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Poverty Reduction and Growth Facility									
Purchases	5.9	4.1	0.0	8.1	8.1	8.1	0.0	0.0	0.0
Repurchases	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.8	0.8
Charges	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.0
Outstanding use of Fund credit (end of period)	(In percent)								
Exports of goods and services	8.0	7.5	5.7	6.2	6.2	6.3	5.3	4.4	3.7
Total external public debt	6.0	5.2	4.3	4.2	4.3	4.5	3.9	3.3	2.9
Gross official reserves	26.3	24.5	22.3	24.6	27.0	29.9	26.9	23.7	21.4
GDP	5.4	4.7	3.7	3.9	4.0	4.1	3.4	2.7	2.3
Quota	75.5	72.9	61.3	65.3	71.7	79.8	71.9	63.5	57.2
Debt service obligations to IMF	(In percent)								
Exports of goods and services	1.0	1.1	1.1	1.1	0.8	0.6	0.6	0.6	0.4
Total external public debt	0.8	0.8	0.8	0.8	0.6	0.4	0.4	0.4	0.3
Gross official reserves	3.4	3.7	4.3	4.5	3.6	2.9	3.0	3.1	2.3
GDP	0.7	0.7	0.7	0.7	0.5	0.4	0.4	0.4	0.2
Quota	9.8	10.9	12.0	12.3	9.7	8.0	8.1	8.5	6.3
Memorandum item:									
Quota (million SDR)	51.1								

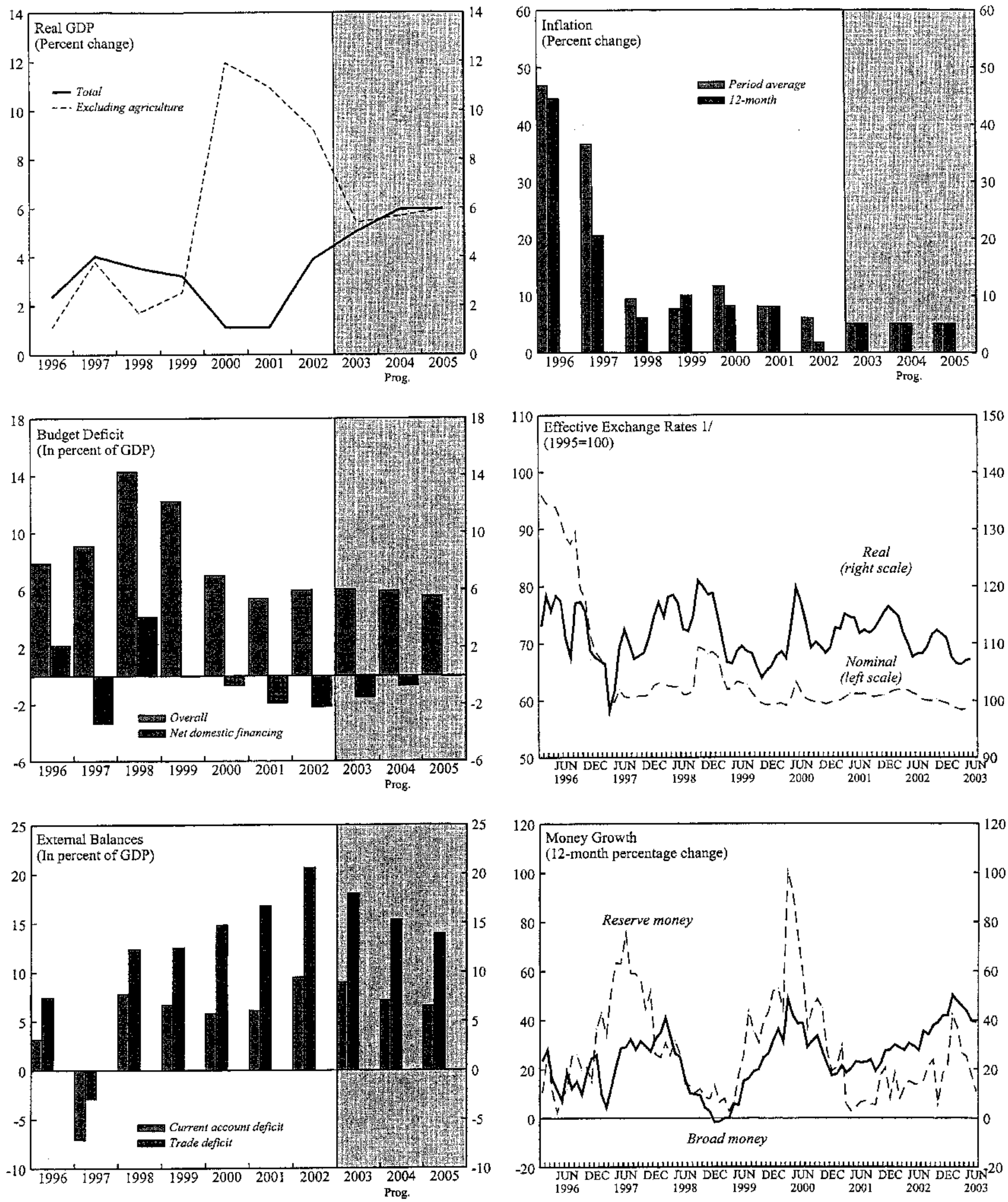
Sources: International Monetary Fund, Finance Department; and staff projections.
1/ Assumes purchases and debt service under the existing PRGF arrangement.

Table 8. Mongolia: Proposed Schedule of Disbursements Under the PRGF Arrangement, 2001–05

Amount (In millions of SDRs)	Available Date	Conditions for Disbursement
4.07	September 28, 2001	Board approval of the three-year arrangement
8.14	September 2003	Observance of end-December 2001 and end-June 2002 quantitative and structural performance criteria and completion of first and second reviews
4.07	January 2004	Observance of end-September 2003 performance criteria and completion of third review
4.07	July 2004	Observance of end-March 2004 performance criteria and completion of fourth review
4.07	January 2005 1/	Observance of end-September 2004 performance criteria and completion of fifth review
4.07	July 2005 1/	Observance of end-March 2005 performance criteria and completion of sixth review

1/ An extension of the PRGF commitment period through July 31, 2005 will be needed to allow for the disbursement.

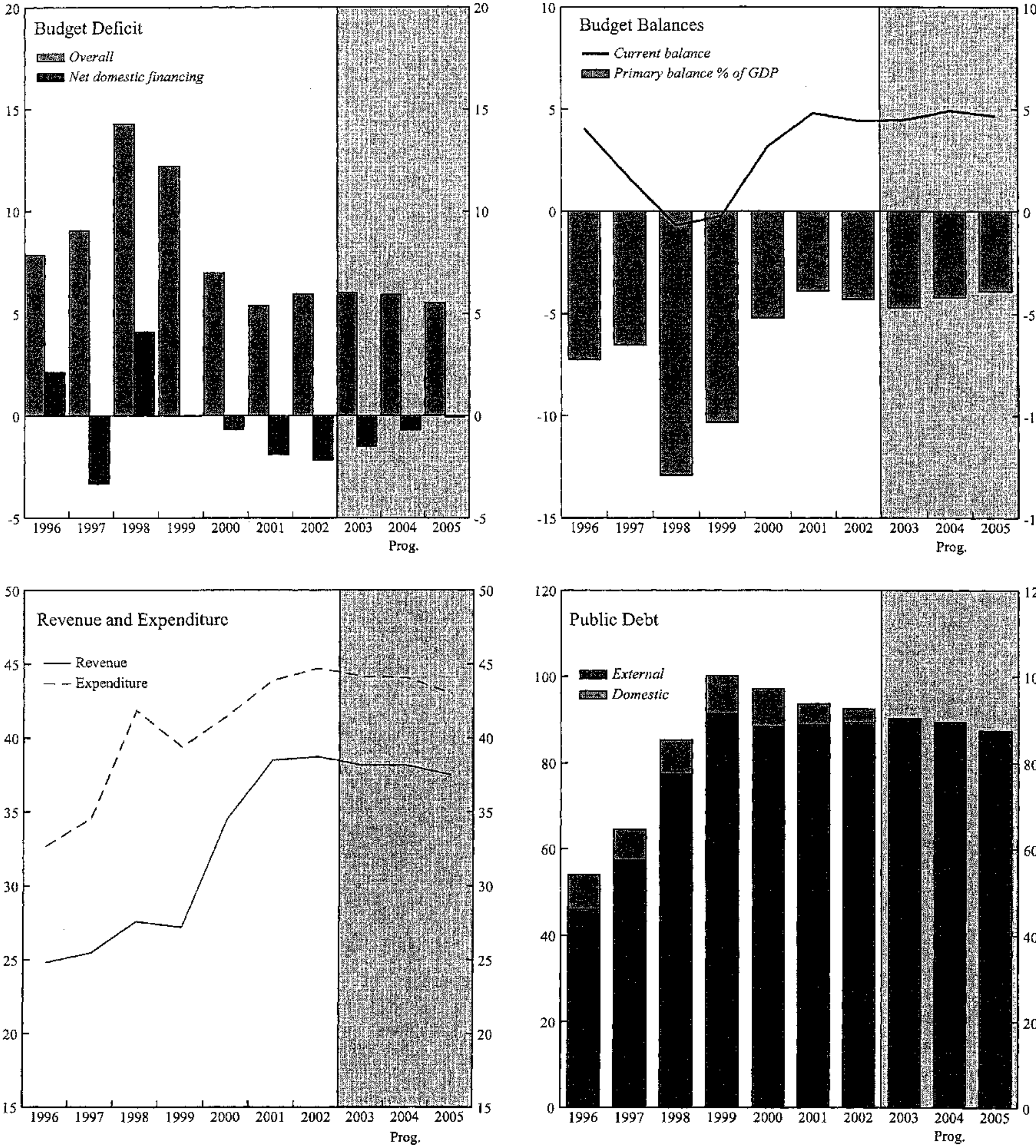
Figure 1. Mongolia: Economic Developments, 1996-2005



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

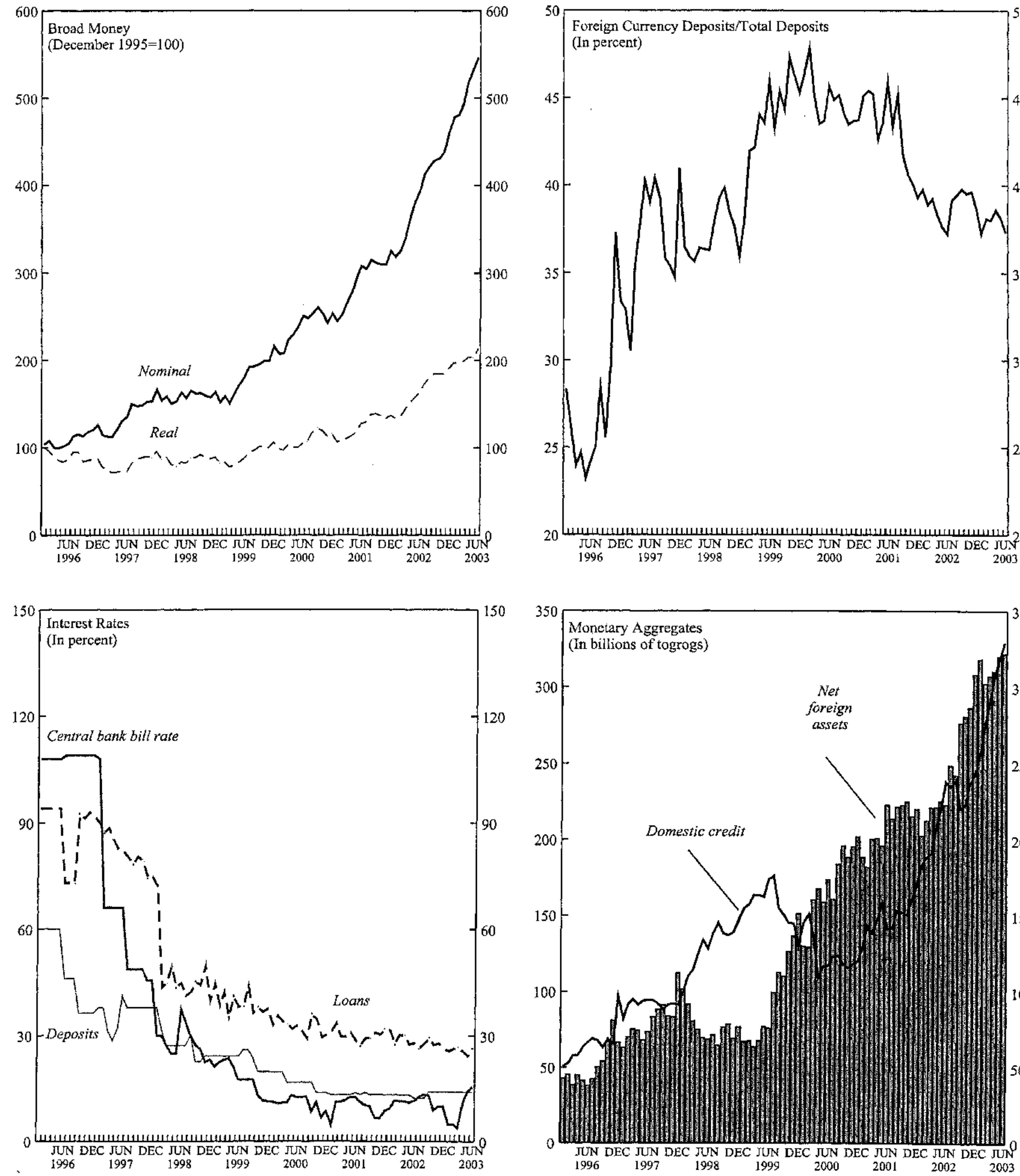
1/ An increase indicates appreciation.

Figure 2. Mongolia: Fiscal Indicators, 1996-2005
(In percent of GDP)



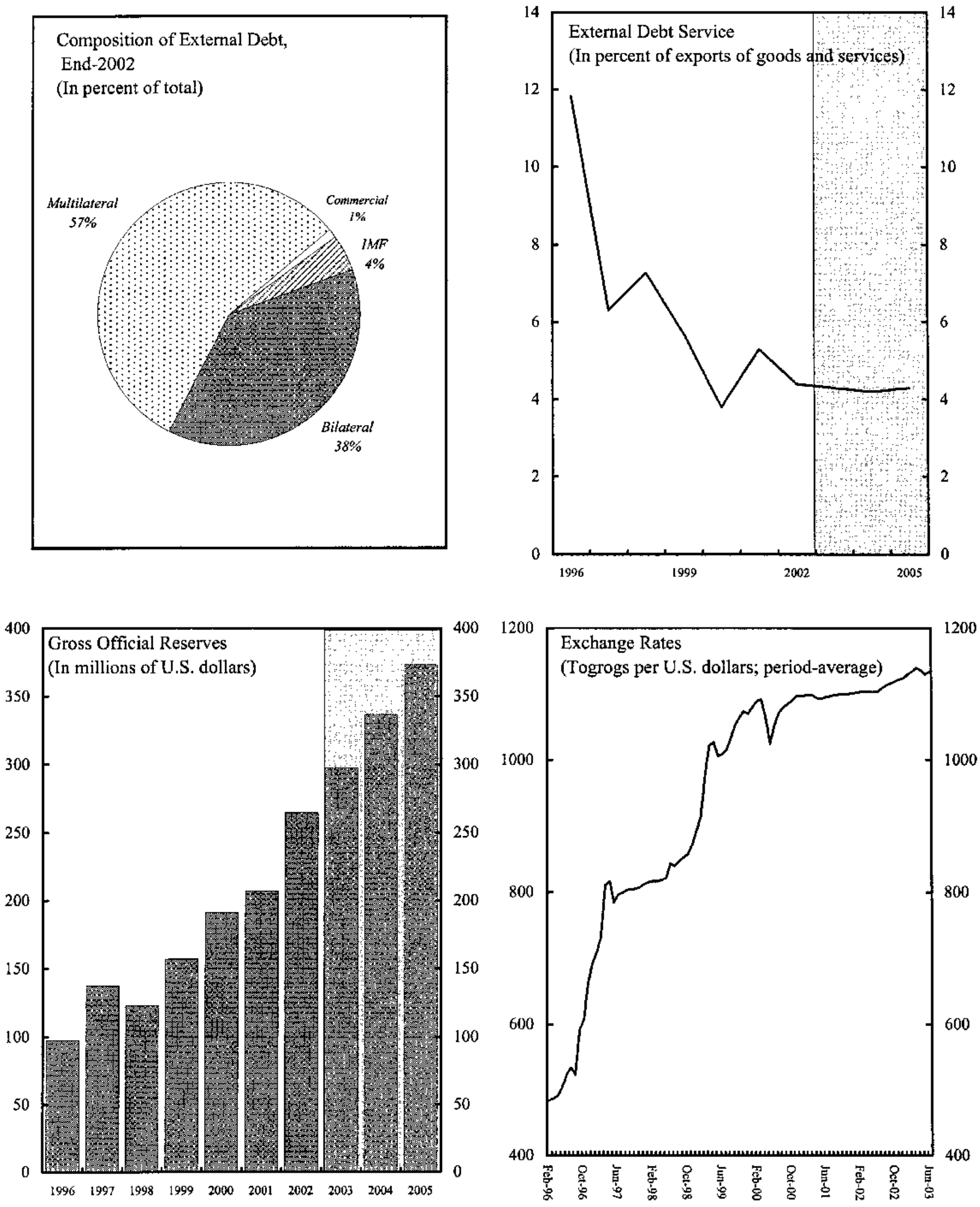
Sources: Mongolian authorities; and Fund staff estimates and projections.

Figure 3. Mongolia: Monetary Developments, 1996-2002



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—POVERTY PROFILE

According to the *2002 World Development Indicators*, the per capita PPP Gross National Income (GNI) in Mongolia was around US$1,760 in 2000 and was ranked 161st among 207 nations. In light of an average per-capita PPP GNI of US$1,980 in all low-income countries, Mongolia has one of the lowest living standards in the world.

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 Program (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 55 percent of extremely poor[2] urban households were large households (defined as households with

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

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

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, in particular, school enrollment and maternal and infant mortality rates, have demonstrated a marked improvement since 1999**.

Mongolia—Social and Demographic Indicators

Indicator	Unit of Measure	Latest Single Available Year			Same Region/Income Group	
		1980–89	1990–95	1996–2001	East Asia & Pacific	Low-income
Poverty						
National headcount index	Percent of population	...	36.3	35.6	...	...
Urban headcount index	Percent of population	...	38.5	39.4	...	...
Rural headcount index	Percent of population	...	33.1	32.6	...	...
Income						
GDP per capita	Constant 1995 US$	511	392	428	1,252	466
PPP GNI per capita	PPP international dollars	1,750	1,540	1,760	4,130	1,980
Gini coefficient		...	0.31	0.35	...	...
Health						
Mortality						
Infant mortality	Per 1,000 live births	...	44.4	30.0	35.5	76.1
Maternal mortality	Per 100,000 live births	...	101.0	82.0	...	...
Immunization rate						
Measles	Percent under 12-months	86.0	85.0	93.0	85.4	56.6
DPT	Percent under 12-months	84.0	88.0	94.0	85.2	56.6
Child malnutrition	Weight for age, percent under five years	...	12.3	8.6	10.0	...
Life expectancy at birth						
Total	Years	61	65	67	69	59
Male	Years	60	64	65	67	58
Female	Years	63	66	69	71	60
Access to water supply	Percent of population	...	67.5	51.9	74.8	75.7
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	Percent of age group	...	93.4	102.1	119.4	96.6
Male	Percent of age group	...	93.6	101.5	120.9	102.5
Female	Percent of age group	...	93.1	102.6	120.9	85.5
Secondary	Percent of age group	...	65.6	68.2	68.9	45.7
Pupil-teacher ratio: primary	Pupils per teacher	30.9	24.8	30.9	23.0	42.0
Adult illiteracy						
Total	Percent of population aged 15+	48.2	41.7	38.6	14.2	37.6
Male	Percent of males aged 15+	35.6	30.5	28.1	7.9	28.4
Female	Percent of females aged 15+	60.5	52.7	49.0	20.7	47.0
Human Resources						
Population						
Total	Millions, mid-year	2.1	2.3	2.4	1,855.2	2,459.8
Urban	Percent of population	56.2	52.3	57.6	35.2	31.9
Population growth rate						
Total	Annual Percent	2.4	1.5	1.3	1.1	1.9
Urban	Annual Percent	6.0	-1.7	-1.0	...	3.4
Labor force (aged 15-64)						
Total	Millions	...	0.81	0.85	1,051.70	1,115.07
Female	Percent of labor force	...	47.3	48.7	44.4	37.8
Age dependency ratio	Dep. to working-age pop.	0.84	0.74	0.63	0.50	0.71
Fertility rate	Births per woman	4.8	3.6	2.5	2.1	3.6
Natural Resources						
Land area	Thousand, sq. km	1,566.5	1,566.5	1566.5	15,968.9	32,535.7
Population Density	Persons per sq. km	1.32	1.45	1.53	116.17	75.60
Arable land	Percent of land area	0.88	0.84	0.84	11.85	13.17
Irrigrated land	Percent of crop land	5.6	6.4	6.4	38.7	26.4

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—STATISTICAL ISSUES

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 has been participating in the General Data Dissemination System (*GDDS*) since August 2000. A ROSC mission in May 2000 assessed Mongolia's data dissemination practices in relation to the IMF's *GDDS*. Mongolia's ROSC data module was published on the IMF website in May 2001. The NSO publishes monthly and annual *Statistical Bulletins* in English and Mongolian.

National accounts. The authorities revised the annual GDP estimates for 1995–99 to incorporate new data and rebase to 1995 prices, in conjunction with a February 2000 STA mission. STA has posted a long-term resident advisor on real sector statistics at the NSO since August 2001. The quality of GDP estimates needs to be improved further, particularly with respect to the deflation methods for constant price estimates, the coverage of the informal sector and small-scale activity, especially in the services sector. The NSO has revised the methodology for estimating catastrophic animal losses due to adverse weather conditions. As a result, the GDP estimates for 2000–2002 have been adjusted. The compilation of estimates of GDP by types of expenditure remains deficient and quarterly estimates of GDP are still lacking.

Prices, wages and labor market. The methodology for compiling the CPI was revamped in January 2001, based on the results of the 1999 Household Income and Expenditure Survey (HIES). The expenditure weights were updated again in March 2002 based on the 2000 HIES results and the CPI was rebased from December 1995 to December 2000. NSO provides a monthly CPI for Ulaanbaatar with a one-week lag. The NSO produced the first national CPI in 2002, with urban and rural components; however, the data have not been published. A seasonally adjusted time series from 1996 has been produced. Development of a producer price index has been hampered by resource and capacity constraints. Data on wages, earnings, and the labor market are deficient in the absence of quarterly surveys. Efforts are underway to establish a reliable database on civil service employment and wages under the World Bank-supported HRMIS.

Government finance statistics. The authorities provide, for monitoring purposes, monthly fiscal data with a one-month lag. Despite improvements in the coverage of the subsectors of general government, reconciliation of fiscal and monetary data remains inadequate. The planned implementation of a government-wide chart of accounts is expected to help improve the quality of fiscal data while ongoing treasury reforms should significantly upgrade accounting and reporting practices.

Monetary statistics. The Bank of Mongolia (BOM) provides weekly data on the monetary authorities with a one-week lag and monthly data on deposit money banks with a two-week lag. A STA mission in May 2001 assisted the authorities in upgrading the framework for compiling monetary statistics.

External sector statistics. The BOM is responsible for compiling balance of payments statistics. The accuracy and timeliness of BOP statistics has been enhanced substantially in the aftermath of the assignment of a long-term resident advisor. Further improvement, however, is needed, especially with respect to data on workers' remittances, foreign direct investment, enterprise survey, and international transactions of commercial banks.

Mongolia—Core Statistical Indicators
(As of August 15, 2003)

	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	June 30, 2003	Aug , 8 2003	Aug. 8, 2003	Aug. 8, 2003	Jun. 30, 2003	Jun. 30, 2003	July 2003	May 2003	Q4 2002	Jun. 2003	2002	2002
Date Received	Jul. 3, 2003	Aug. 14, 2003	Aug. 14, 2003	Aug. 14, 2003	Jul. 16, 2003	Jul. 3, 2003	Aug. 7, 2003	Apr. 12, 2003	Apr. 27, 2003	Jul. 12, 2003	Apr. 10, 2003	Apr. 8, 2003
Frequency of Data	Daily	Weekly	Weekly	Weekly	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	NSO	BOM	MOFE	NSO	MOFE
Mode of Reporting	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Fax	Fax	Electronic
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—Fund Relations[1]
(As of June 30, 2003)

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

		SDR Million	Percent Quota
II.	**General Resources Account**:	**SDR Million**	**Percent Quota**
	Quota	51.10	100.0
	Fund Holdings of Currency	51.01	99.82
	Reserve Position in Fund	0.10	0.19
III.	**SDR Department**:	**SDR Million**	**Percent Allocation**
	Holdings	0.03	N/A
IV.	**Outstanding Purchases and Loans**:	**SDR Million**	**Percent Quota**
	ESAF/PRGF Arrangements	27.81	54.43

V. **Financial Arrangements**:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	09/28/2001	09/27/2004	28.49	4.07
ESAF/PRGF	07/30/1997	07/29/2000	33.39	17.44
ESAF	06/25/1993	06/24/1996	40.81	29.68

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

	Forthcoming				
	2003	**2004**	**2005**	**2006**	**2007**
Principal	2.60	4.86	4.01	4.04	4.30
Charges/interest	0.06	0.12	0.09	0.07	0.05
Total	2.66	4.98	4.10	4.11	4.35

VII. **Safeguards Assessments**:

Under the Fund's safeguards assessment policy, the Bank of Mongolia (BOM) was subject to a full safeguards assessment with respect to the PRGF arrangement that was approved by the Executive Board on September 28, 2001. An on-site safeguards assessment of the BOM was completed on March 5, 2002. Staff recommended that the BOM implement measures to strengthen its external audit mechanism and financial reporting framework. The BOM has so far implemented several of the recommendations. Staff continues to monitor the BOM's efforts to: (i) commit to the full adoption of International Accounting Standards (IAS) and to

[1] Prepared by the staff of the IMF. Contact person: Mr. Jong Kyu Lee, Senior Economist, Division 6, Asia and Pacific Department, phone (202) 623-6206.

disclose its guarantees and pledges in its financial statements; (ii) disclose the fair value of derivatives in its net international reserve position and financial statements; and (iii) amend the central bank law to introduce independent oversight of BOM operations through an expanded Board that includes non-executive members. At the conclusion of the December 2002 PRGF discussions, the BOM agreed to implement special semi-annual audits of NIR to provide further assurance on the NIR position and to identify any related pledges or guarantees. Staff has reviewed the results of the initial audits through June 30, 2002 and will analyze progress on subsequent special audits during the safeguards assessment monitoring mission being conducted in early September 2003.

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. However, the BOM has, at times, made active use of its intervention practices to maintain a stable nominal exchange rate vis-à-vis the U.S. dollar over extended periods of time. The official exchange rate is now set daily on the basis of transactions in the interbank market. At end-June 2003, the official midpoint rate was Tog 1,139 per U.S. dollar. The official exchange rate is applied to the public sector's transactions in imports and services, including debt-service payments, and to trade and service transactions conducted under bilateral payments arrangements. Mongolia accepted the obligations of Article VIII, Sections 2, 3, and 4 on February 1, 1996, and maintains an exchange system that is free from restrictions on payments and transfers for current international transactions.

IX. **Article IV Consultation**:

The 2002 Article IV consultation (Country Report No. 02/252) was concluded by the Executive Board on October 25, 2002. Mongolia will be on the 24–month cycle, subject to the provisions of the decision on consultation cycles approved on July 15, 2002.

X. **ROSC Assessments**:

- ROSC, Data Module, May 4, 2001 (www.imf.org)
- ROSC, Fiscal Transparency Module, November 8, 2001 (Country Report No. 01/218)

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. The second annual arrangement in an amount of SDR 11.13 million (21.8 percent of quota) was approved on November 23, 1994. The ESAF arrangement lapsed on June 24, 1996.

A three-year arrangement under the ESAF/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. The ESAF/PRGF arrangement lapsed on July 29, 2000.

A new three-year arrangement under the PRGF in an amount equivalent to SDR 28.49 million (55.8 percent of quota), with the first year of the arrangement in an amount of SDR 12.21 million (23.9 percent of quota), was approved by the Executive Board on September 28, 2001.

XII. **Technical Assistance**:

Missions:

- Banking supervision and accounting (MAE), November 2002.
- Revenue administration (FAD), September 2002
- Banking supervision and accounting (MAE), May 2002
- 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, payments 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–September 2003
- Treasury reform (FAD), June 1999–November 2003
- Balance of payments (STA), March 1999–May 2001

Technical assistance for the period May 1995–October 1999 is reported in Annex II of the Staff Report for the 1999 Article IV Consultation, First Review Under the Second Annual Arrangement Under the Poverty Reduction and Growth Facility, and Request for Waiver and Modification of Performance Criteria.

XIII. **Resident Representative**:

Ms. Rehm succeeded Mr. Martin as the Fund's resident representative in Mongolia at end-December 2002.

MONGOLIA—RELATIONS WITH THE WORLD BANK GROUP[1]

Mongolia became a member of the World Bank, IDA and IFC in February 1991. The World Bank now has a wide-ranging policy dialogue covering structural reforms, economic growth and poverty reduction, including public administration/civil service reform, financial reforms, private sector development, education, health, urban and rural development, social reforms, infrastructure and judicial reforms. This annex focuses on Bank activities in areas of relevance to the Fund's programs.

Mongolia vision for development and poverty reduction is laid out in the Economic Growth Support and Poverty Reduction Strategy (EGSPRS)—the first full poverty reduction strategy paper prepared by the government. The EGSPRS builds on the strategy articulated in the interim report (I-PRSP) presented to the IDA and IMF Boards in September 2001. It is based on five main pillars: which are: (i) ensuring macroeconomic stability and enhancing public sector effectiveness; (ii) establishing a sound institutional and regulatory environment to complete Mongolia's transition to a market economy and enabling the private sector to become an engine of growth; (iii) enhancing balanced and environmentally sustainable development; (iv) fostering sustainable human development and equitable distribution of the benefits from growth through improved service delivery in education, health, and social welfare; and (v) promoting good governance and gender equality. It provides an adequate framework for implementing the government's development agenda. The Bank and the Fund have jointly provided assistance to the Government in the formulation and preparation of the EGSPRS and provide their assessment of the strategy in a Joint Staff Assessment (JSA). They will continue to advise the Government in the implementation of the strategy and monitor progress through PRSP progress reports. The Bank assists the Government in building capacity and creating mechanisms for institutionalizing the participatory process in the EGSPRS implementation.

World Bank Policy Dialogue in Mongolia

Country Assistance Strategy. A Country Assistance Strategy (CAS) was discussed by the Board in April 1998. The primary goals of the CAS were to support Mongolia's transition to a market-led economy, improve living standards, and reduce poverty. The current Country Assistance Strategy (CAS) is under preparation and will be finalized in December 2003. It will support the Government's development objectives laid out in the EGSPRS of Mongolia, completed in July 2003.

Aid coordination. The World Bank plays a strong role in aid coordination. The second Mongolia Consultative Group meeting, co-chaired by the World Bank and the Government, was held in Ulaanbaatar in July 2002. There have been several follow-up thematic donor meetings such as on rural development, the urban sector, and information technology, and regular meetings are held in Mongolia. More recently, a CAS retreat was organized with the Government cabinet members, Bank staffs and other donors in June 2003. The Ulaanbaatar

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[1] Questions may be addressed to Ms. Genevieve Boyreau-Debray at 473-8541.

Donor Conference, sponsored jointly by the Municipality of Ulaanbaatar and the Bank, was also held in June 2003.

Public Sector and Fiscal framework. Mongolia's vision for public management is laid out in the Public Sector Management and Finance Law (PSMFL). The Bank is assisting the Government to strengthen the management of public expenditure and civil service administration. The first PRSC for Mongolia is expected to focus on public sector management issues with a view to enhancing fiscal discipline, effectiveness of government programs and transparency and accountability. The Fund provides advice on fiscal policy, treasury reform (with the Bank) and how to strengthen fiscal governance.

Public expenditure management. The Bank and the Fund support the Government in the establishment of its medium term fiscal framework. The Bank is assisting the Government to strengthen budget planning, execution, reporting and accountability and improve public administration. This includes technical assistance to support institutional reform and policy development; training and capacity building; and a major upgrading of core systems for public financial management. The objective is to help the Government put in place an effective, integrated Government Financial Management Information System (GFMIS), and a Human Resource Management and Information System (HRMIS), based on a new, integrated account code structure. This will enable accurate and timely consolidated budget reporting and cash accounting. It will form a platform for introduction of commitment accounting and other elements of accruals accounting; and combined with the new inter-bank payments system (supported by the World Bank Financial Sector Development Project Technical Assistance—FSDP-TA), will support the introduction of a Treasury Single Account.

Civil service reform. There are two main issues constraining civil service performance and affecting its ability to deliver public services effectively and efficiently. First, the quality of civil service needs to be upgraded. Second, there is pressure to grant large wage increases which would either increase the deficit or crowd out public investment. Hence, to deliver quality services more efficiently, and ensure that the benefits of renewed growth reach the poor, the Government is trying to control personnel expenditures by adjusting the civil service size, cost and skills mix to socio-economic needs and fiscal realities. The Bank is providing advice and capacity-building support to strengthen: (i) medium term human resource policy and expenditure formulation by enabling more realistic estimates of projected civil service remuneration costs, including sustainable employment and wage levels, and incorporating civil service cost projections into the medium term expenditure framework (MTEF) in light of the PRSP; (ii) human resource expenditure execution by improving payroll management through greater control of personnel expenditures.

Financial sector. Despite the government's initiatives to strengthen and liberalize the financial system in the 1990s, the banking sector suffered recurring crises and failures in 1994, 1996 and 1998/99. While the sector appeared to recover substantially after each crisis, the recoveries turned out to be transitory. Since 2000, the Government has adopted a number of actions to stabilize the financial system with the assistance of the international community. As a result, public confidence in the system is gradually recovering, and bank loan portfolio has expanded rapidly. However, fundamental weaknesses remain, especially in the areas of prudential regulation and supervision, accounting practices, corporate governance and internal control, and risk management. Financial intermediation is low with total banking system assets accounting for only 40 percent of GDP. Interest rate spread remains high, indicating high actual Non-Performing Loans (NPLs) and operating expenses. Because of these structural weaknesses, there is risk in the short to medium term that the continuous rapid expansion of commercial banks' loan portfolio may bring stress to the system.

Bank involvement. The Bank has increased its involvement in Mongolia's financial sector since late 1999 through a financial sector review and the Financial Sector Adjustment Credit (FSAC) program. The objectives of the FSAC are to support the government's medium-term strategy for financial sector reform and development, focusing on strengthening of prudential regulation and supervision, bank restructuring and privatization, resumption of Government payments services in the rural areas, and timely servicing of Government debt. FSAC became effective in September 2001 when the first tranche was released. Two more tranches are yet to be released. While the Government has met the conditions for the floating tranche release, the Bank is yet to disburse the funds, so as to coordinate with the timing of the Fund's second PRGF program. The FSAC program has been extended once, and the current closing date is June 30, 2004.
The Bank is also working with the Government and selected commercial banks to strengthen the banking system's capacity in credit risk management, automated payments system and Savings Bank resolution under the Financial Capacity Development Project (FCDP). The Private Sector Development Credit (PSDC) provides technical assistance in developing term-lending capacity in selected Mongolian banks, and enhancing central bank supervision capacity, in addition to financing private sector capital investment. The Bank will undertake a mid-term review together with ADB of Mongolia's financial sector within FY04, and will update its assistance program for the next three to four years based on the result.
The Bank Group's IFC is considering minority investment in two recently privatized Mongolian banks, to help enhance corporate governance and introduce international best banking practices. IFC has also provided funding support to a start-up microfinance bank to support its operations and liquidity. It will continue to focus on financial sector in the next three to four years.

Private sector support. Mongolia's private sector started to emerge when the country embarked on a peaceful transition to democracy in the early 1990s. Since then, the private sector share of GDP is expanding at a rate that is consistently higher than the overall GDP growth rate. However, most private enterprises are small-, medium- or micro-sized. The oversimplified two level income tax system is a main disincentive for private enterprises to grow in size and scale. The complex body of laws and regulations leads to inconsistency and confusion, and adds to business cost. Corruption is becoming more deeply rooted in society, particularly in customs, court, land management office, police, banks, and public prosecutor. Corporate governance of private enterprises is weak, and modern business management expertise is a scarce resource. There is also paucity of basic market institutions to support a more robust private sector development by providing services in accounting and financial reporting, marketing, credit rating, and logistics management. Lack of access to formal finance is another obstacle. However, weakness in enforcing International Accounting

Standards, corporate governance, and credit culture means lending to private enterprises in Mongolia is high risk for commercial banks. Perhaps the biggest obstacle is inconsistency in Government policy and the lack of a coherent strategy for promoting private sector development, although the Government has reiterated its commitment to private sector led growth in its EGSPRSP.

Bank involvement. The Bank Group started its assistance program for private sector development through operations which supported state-owned enterprise reforms and legal and regulatory changes in the early and mid-1990s. Since late 1990s, the Bank has focused on alleviating the access to finance problem through the above mentioned PSDC project. In addition, the Bank has been promoting private sector participation in service delivery through lending and non-lending operations that aim at enhancing the regulatory framework and business environment. More recently, the Bank has initiated an Investment Climate Assessment. Other studies to be undertaken include those on supply chains, trade facilitation and SME finance. These studies are to help both the Government and the Bank to better understand the main macro and institutional constraints to private sector development, so that a coherent private sector development strategy based on Mongolia's competitive advantages in the regional and international markets can be developed and adopted. The second PRSC is expected to focus on improving the business environment for private sector development. New lending operations encouraging private sector participation in infrastructure sector are being considered for the next three to four years.
The Bank Group's IFC has a long history of involvement in Mongolia. Its activities range from advisory services on foreign direct investment and technical assistance to SMEs to a couple of loans to private sector borrowers. IFC also plans new operations to support private sector development in the leasing industry and telecommunication sector in the next three to four years.

Social sector and Poverty. The Bank provides assistance to the Government to redesign and implement its household income and expenditure surveys. The Bank plans to assist the Government conduct the subsequent poverty analysis in order to obtain an updated poverty profile. The Bank will also undertake a Poverty Assessment in FY05. Also, the Bank works with the Government to improve financial and budget management of the social sector and will provide technical assistance through the upcoming ECTAC[2] operation (where education and social welfare will be pilot ministries). In terms of sectoral policies in *health*, the Bank has been working with the Government on hospital rationalization, and will work on broader health financing issues in the coming years. In *social security*, the Bank assisted in analyzing the sustainability of the pension scheme, and a study will be initiated to assess the targeting efficiency of the social assistance schemes using household survey data. Together with the updated poverty assessment, the study will form the analytical basis for the redesign of the cash transfer programs. The Bank is working with the Fund and ADB to ensure policy consistency and coordination particularly regarding the budgetary impact of social policies and the need to protect social expenditures and pro-poor investment.

[2] Economic Capacity-building Technical Assistance Credit.

Rural and Urban development. The Bank provides its support to the government in developing its rural and urban development strategies. In the rural sector area, the Bank assists in promoting secure and sustainable livelihoods through pastoral risk management, micro-finance services, basic infrastructure investment and project management. In the urban area, the Bank is assisting the Government in its city development strategy. The Bank also supports the improvement of services delivery, particularly on improvement of water supply and ger area upgrading.[3] Finally, the Bank also helps the Government in assessing urban poverty. The Bank and the Fund collaborate and coordinate their assistance in the domain of municipal finance and intergovernmental fiscal relations.

Infrastructure. The Bank provides assistance for shaping sectoral strategies and for financing an energy and a transport program. The Bank and Fund have interests in common in monitoring inter-enterprise arrears, in road sector financing and the efficient management and cost-effective use of those funds and the social impact assessment of energy prices. Areas of mutual concern also include transparency in investment decisions and financing arrangements, especially relating to the Millennium Road.

Corruption, justice and legal environment. Corruption is perceived to be an emerging problem though its nature and extent varies across departments and functions. Enactment of a new Procurement Law and the implementation of the Public Sector Management and Finance Law (PSFML) are positive steps, but much will depend on the quality of the implementing rules and regulations, some of which are still being drafted. Media publicity is significant and could act as a deterrent against corruption. However, key systemic constraints remain: Decision making is still perceived to be non-transparent, and patronage and lack of accountability remain major problems. The Bank and the Fund assist the Government in strengthening the rule of law. While the Fund focuses on the Central Bank and Anti-Money Laundering laws, the Bank assists in enhancing public confidence in the legal system with a focus on the judiciary system. Challenges remain in enhancing access to justice, especially for the poor; disseminating new laws to the public; and enforcing existing laws.

B- Bank–Fund Collaboration

The following table categorizes the major areas where the Bank and the Fund collaborates and complement each other:

[3] A ger is the traditional dwelling tent of Mongolian people.

Table 1. Bank-Fund Collaboration on Mongolia (ongoing or planned)

Area	Specialized Advice from Fund	Specialized Advice from Bank	Key Instrument/Conditionality
Macroeconomic Framework	Medium-term fiscal framework, monetary and exchange rate policies, external debt management, economic statistics, PRSP support	Sources of growth, medium-term expenditure framework, PRSP support, FSAC (macroeconomic indicators, action plan on external shock mitigation)	*Fund*: PRGF performance criteria and benchmarks *Bank*: Public Expenditure Review, AAA (Mining and cashmere sectors, regional development) *Jointly*: Joint Staff Assessment, PRSP progress report
Fiscal Management and Public Sector Reform	Fiscal policy, treasury reform, and fiscal governance	Strengthening the budgetary process, implementing a medium term expenditure framework, civil service reform, administrative streamlining, establishment of Human Resource Management Information System (HRMIS) and Government Financial Management Information System (GFMIS)	*Fund*: PRGF performance criteria and benchmarks and technical assistance on reforms to improve fiscal transparency and accountability *Bank*: PRSC, ECTAC, Fiscal Technical Assistance Project, IDF Grants (for Strengthening Expenditure Management, Strengthening Audit Capacity, etc) *Jointly*: Joint Staff Assessment, PRSP progress report
Financial Sector	Banking supervision, auditing, accounting, and safeguards for Bank of Mongolia operations	Bank prudential regulatory framework, banking privatization and restructuring, corporate governance, commercial bank risk management and national payments system development	*Fund*: PRGF performance criteria and benchmarks and technical assistance on prudential controls on the banking system, internal and external auditing, and accounting *Bank*: Financial Capacity Development Project, Financial Sector Adjustment Credit (FSAC) *Jointly*: Joint Staff Assessment, PRSP progress report

Table 2. Bank-Fund Collaboration on Mongolia (continued)

Social/Poverty	Budgetary policies consistent with the need to protect social expenditures and pro-poor investment	Household Survey and Poverty analysis Health reforms Pension reforms Education reforms	*Bank*: Poverty assessment (2001 PLSA) and update planned; Trust Fund for Statistical Capacity Building. Technical assistance in the Health sector (hospital restructuring and health account management), Technical assistance in the Education sector (PHRD), Pension management and audit (PHRD), Capacity building in financial management (ECTAC), Policy notes *Jointly*: Joint Staff Assessment and PRSP progress report
Private Sector	Tax regime	Private sector environment, financing of SME capital investment	*Bank*: Private Sector Development Credit, Investment Climate Assessment, Supply Chains Study *Jointly*: Joint Staff Assessment and PRSP progress report
Infrastructure		Energy sector strategy and reform Road sector financing	*Bank*: Energy project, Infrastructure Services Project, Social impact assessment of energy prices. AAA on improving heating stoves study, policy notes on energy sector strategy, transport Project, update of Transport sector strategy
Rural Development		Rural Development Strategy, Pastoral risk management, rural microfinance services	*Bank*: Sustainable livelihoods project, rural strategy policy notes

Urban Development	Intergovernmental fiscal relations	City Development Strategy, Urban services delivery, urban poverty	*Fund*: Technical assistance on rationalization of intergovernmental fiscal relations *Bank*: urban poverty assessment, UB services improvement project (I and II), Municipal Finance study, policy notes on City Development Strategy.
Legal framework	Amendments to Central Bank Law and Anti-Money Laundering Legislation	Legal and Judicial Reform	*Fund*: PRGF performance criteria and benchmarks and technical assistance on the drafting and implementation of new banking system legislation *Bank*: Learning and Innovation Lending (LIL)

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. However, the COS also provides that support for road sector investment would be considered if the contribution of the sector to reducing poverty and promoting human development can be established. Accordingly, ADB currently focuses its operations on the six core sectors, namely, finance, public sector, social sector, agriculture, urban development and road. ADB plans to develop a new strategy (now called the Country Strategy and Program) for Mongolia in 2004.

In March 2002, ADB and the Government conducted the second joint annual review of the implementation of PPA. The PPA annual review confirmed that Mongolia is on a right track towards achieving the Millennium Development Goals. Good progress has been made in addressing the non-income poverty and achieving the goals of human development, particularly in terms of reducing infant and under-five mortality, improving health care and school enrollment. The bottleneck for poverty reduction lies with staggering economic growth unable to create sufficient employment or ensure a steady improvement of income, particularly the income of the poor. Therefore, greater emphasis on accelerating economic growth has been recommended.

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 selected banks to supplement ADB's public sector interventions in the financial sector.

By early July 2003, the ADB had approved 32 loans from the Asian Development Fund (ADF) totaling $553.2 million. In addition, by that date, the ADB had approved 116 technical assistance (TA) grants amounting to $53.9 million. ADB has taken a lead role in several key sectors (e.g., policy and institutional reforms in the agriculture sector, public administration

[1] Prepared by Asian Development Bank staff.

reforms, education, health, finance, roads, telecommunications, power, air navigation, and housing). A Second Health Sector Development Project, of $14 million was approved in 2003 and a Second Governance reform program of approximately $15.5 million is under preparation and is expected to be presented to the ADB Board in the second half of 2003. The Program will, in particular, help the Government implement public sector reforms in the social sectors. The grant technical assistance program in 2003 will total approximately $2 million, mainly for project preparation.

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. Mongolia has performed satisfactorily measured against these benchmarks. The planned lending level of $29.5 million in 2003 reflects resource constraints facing the Asian Development Fund.

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 Ninth Assistance Group Meeting held in Ulaanbaatar in July 2002, 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 : (i) achieving greater efficiency in the delivery of social services; (ii) the promotion of good governance in formulating effective policies and establishing efficient institutions; (iii) public sector management and finance which will lay a foundation for effective macroeconomic management; and (iv) the financial sector, to provide affordable financing services badly needed for increased private sector investment and production efficiency. The ADB will also continue to assist the Government in strengthening its capacity in aid coordination, and planning and management of public investments. ADB's effectiveness in delivering its program of assistance to Mongolia has been strengthened with the official opening and full operation of a Resident Mission in August 2001.

In March 2002, Mongolia was accepted as a full member of the ADB supported sub-regional cooperation for the Central Asian Republics and People's Republic of China (PRC). This sub-regional cooperation will provide Mongolia with a new dimension to participate in regional cooperation on a wider geographic basis. Started with a moderate program in 2000, ADB has assisted Mongolia and PRC to establish a very effective institutional framework to promote and coordinate between the two countries. Cooperation in transportation, trade and investment and environmental management has been identified as a common priority.

August 29, 2003

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Köhler

1. On September 28, 2001, the IMF's Executive Board approved a three-year arrangement for Mongolia under the Poverty Reduction and Growth Facility (PRGF) for SDR 28.49 million (56 percent of quota). The purpose of this letter and the attached Memorandum of Economic and Financial Policies (MEFP) is to: (i) advise on progress to date under the PRGF-supported program; (ii) update the government's macroeconomic policy framework for 2003 and the medium term; and (iii) request waivers for nonobservance of five quantitative and two structural performance criteria pertaining to the second and third disbursements under the arrangement.

2. Macroeconomic performance so far under the PRGF-supported program has been satisfactory. Real GDP growth was largely on track in 2001–02, while inflation fell to under 2 percent in 2002, well below the program target. The general government's overall deficit has been restrained as programmed, with revenue overperformance offsetting overruns in outlays, and the overall balance of payments has recorded large surpluses, allowing for a significantly larger than programmed build-up of net international reserves.

3. The government is taking continuing steps to meet the program's key macroeconomic and poverty reduction objectives. The 2003 budget provides for restraint on civil service wages and pensions, consistent with the need to protect fiscal sustainability, and a prudent medium-term fiscal framework was approved by Parliament in June 2003. Governance and fiscal transparency are being upgraded, including through the implementation of the Treasury Single Account (TSA) and compliance with the IMF's safeguards recommendations, and a comprehensive and sound Economic Growth Support and Poverty Reduction Strategy Paper (PRSP) was recently finalized in close consultation with the IMF and World Bank staffs.

4. In view of the generally favorable macroeconomic performance during the first and second years of the PRGF-supported program and the government's continuing efforts to meet its key objectives, we would like to request waivers for the nonobservance of the following quantitative and structural performance criteria: (i) the floor on net international reserves of the BOM as of end-December 2001; (ii) the ceiling on net credit to government of the BOM as of end-June 2002; (iii) the ceiling on net domestic assets of the BOM as of end-June 2002; (iv) the continuous performance criterion on the nonaccumulation of external arrears as of early 2002 and early 2003; (v) the structural performance criterion on the 2002 budget; and (vi) the structural performance criterion relating to the implementation of the TSA. Given the delays in completing the first and second reviews, the government also

requests that the subsequent reviews and disbursements be appropriately rephased and the commitment period for the arrangement extended through July 31, 2005.

5. The government believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of its program, but it will take any further measures that may become appropriate for this purpose. Mongolia will consult with the Fund on the adoption of such measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such consultations.

6. In continuing with our policy of transparency, we consent to the publication, including on the IMF's website, of the attached MEFP and the accompanying Executive Board documents prepared by the IMF staff.

Sincerely yours,

/s/

Ch. Ulaan
Minister of Finance
and Economy

/s/

O. Chuluunbat
Governor
Bank of Mongolia

MONGOLIA—MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

I. INTRODUCTION

1. This memorandum reviews program implementation to date under Mongolia's three-year PRGF arrangement (September 2001–September 2004) and sets out the government's policies for the remainder of 2003. It also updates the medium-term macroeconomic framework covering the period 2003-2006 consistent with the Mongolian government's Economic Growth Support and Poverty Reduction Strategy Paper (PRSP), dated July 3, 2003.

2. Mongolia has made great progress toward its transition to a market-based system since the early 1990s, including with the help of three successive PRGF-supported arrangements. However, major challenges remain to promote sustained economic growth and reduce poverty as needed to meet the objectives set under the PRSP. To help meet these objectives, the current PRGF-supported program aims to consolidate the recent progress towards the establishment of macroeconomic stability and, in particular, fiscal sustainability, while also continuing to strengthen fiscal governance and improve the efficiency and pro-poor orientation of public expenditure policies.

II. DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM DURING 2001–02

3. Overall macroeconomic performance was broadly on track during 2001–02. Although performance with respect to several quantitative and structural performance criteria and benchmarks was mixed, adequate measures have been taken to bring all the key policies back on track (Tables 1, 2 and 3). On that basis, the government requests waivers for the nonobservance of five quantitative performance criteria (QPCs) and two structural performance criteria (SPCs) as of end-December 2001, early 2002,end-June 2002, and early 2003, as detailed below.

4. Output and inflation performance in 2001–02 have been in line with program targets. Real GDP growth, which was depressed to 1 percent in 2001 by extraordinarily large weather-related losses in the herd stock, recovered to 3.9 percent in 2002, close to the program target of 4 percent. Despite the recurrence of drought conditions through much of the country during the summer of 2002, which resulted in renewed heavy losses in the agricultural sector, growth was sustained by robust performance in the industrial and service sectors together with buoyant domestic demand. The year-on-year rate of inflation, after having been restrained to 8 percent as of end-2001, fell to under 2 percent in 2002, well below the program target, with the help of stable import prices and a leveling off of domestic food prices.

5. The general government's overall deficit was broadly on track in 2001–02, although strong upward pressure on public expenditure has continued to pose a challenge for fiscal management. While the end-June 2002 QPC on net credit to government (NCG) was breached, the overall deficit (including grants) narrowed from 7 percent of GDP in 2000 to 5½–6 percent of GDP in 2001–02, as a significant overperformance on revenues more than

offset a continuing surge in government expenditures in relation to GDP. The ratio of public debt to GDP remained on a downward trend, broadly in line with program targets. However, these trends may be difficult to sustain in the period ahead, as Mongolia has no more room to raise the burden of taxation on its private sector, which is evidenced by its already-high ratio of revenues to GDP. In these circumstances, a key challenge for government policies will be to continue to restore the purchasing power of wages and pensions, which suffered a sharp decline during the first half of the 1990s, without undermining medium-term fiscal sustainability. Although the SPC relating to the policy content of the 2002 budget could not be observed following a 20 percent increase in civil service wages and pensions from October 2002, a more disciplined wage and pension policy was adopted under the 2003 budget, which was approved by the Parliament in late 2002.

6. Significant progress has been made over the last two years towards implementing the government's program to strengthen fiscal transparency and accountability. In line with the recommendation of a fiscal ROSC completed in 2001, an effective system was established for the monitoring and control of budget entities' arrears and important steps were taken to improve the quality and frequency of fiscal reporting. In the key area of treasury reforms, a slower-than-programmed start in the piloting of a system for the establishment of a Treasury Single Account (TSA) led to a breaching of the respective SPC for end-December 2001. However, the government took decisive measures to expand and accelerate TSA implementation beginning in July 2002, leading to the establishment of local treasury offices in all provinces and the transfer of most budget entities' accounts from commercial banks to the TSA.

7. The rationalization of intergovernmental fiscal relations, another key element of the government's fiscal reform program, has been largely on track. Beginning in January 2002, taxes were assigned to tiers of government by type of tax rather than tax subject, and a VAT-sharing arrangement was introduced to help eliminate regional disparities in local governments' finances, broadly in line with the program. In addition, efforts have been stepped up to strengthen local tax administration. Following the adoption of the far-reaching Public Sector Financing and Management Law (PSFML) in mid-2002, spending authority equivalent to about 10 percent of GDP has been shifted from local governments to line ministries, with the proceeds from the personal income tax (PIT), the VAT, excises, and royalties reassigned to the central budget. As most transfers from the central budget to local governments have been related to specific outputs, the implementation of a formula-based transfer equalization scheme has no longer been pursued.

8. The growth of monetary and credit aggregates significantly exceeded the PRGF-supported program's targets during 2001–02. To a large extent, these developments are a welcome sign of the improved public confidence in the banking system and the continuing reintermediation in the wake of the sustained implementation of reforms to establish a sound and efficient banking system. However, an easing of monetary conditions also appears to have contributed to the surge in money and credit, as evidenced by a breaching of the end-June 2002 QPC on the net domestic assets (NDA) of the BOM. Despite the rapid expansion of money and credit, inflation has so far remained restrained. Nevertheless, to limit any

possible threat to macroeconomic stability, the BOM has recently taken steps to slow the growth of reserve money, as discussed below.

9. Mongolia's overall balance of payments was largely on track during 2001–02. As demand in major export markets slackened and world copper and cashmere prices declined, export performance was lackluster throughout 2001–02. With import growth remaining buoyant, the trade deficit widened significantly, but the balance of payments continued to be underpinned by buoyant emigrant's remittances, increasing foreign direct investment (including in connection with the privatization of the Trade and Development Bank (TDB)), and other private inflows. Gross international reserves rose to the equivalent of about 17 weeks of imports as of end-2002, well in excess of the program target. The BOM's NIR, which had fallen slightly short of the end-December 2001 QPC, comfortably met the QPC as of end-June 2002 and remained largely on track thereafter.

10. Mongolia's external debt situation has remained on track. The stock of external public debt (excluding the large amount of pre-1991 transferable ruble debt to the Russian Federation) leveled off at about 89 percent of GDP in 2001–02. Reflecting the high degree of concessionality of a large share of Mongolia's debt, the net present value (NPV) of external public debt has remained below 60 percent of GDP, in line with program targets. The government has continued to service most of its post-1991 debt in an orderly manner. Delays in the establishment of procedures for in-kind repayments due to the Russian Federation led to a temporary breaching of the continuous QPC on the nonaccumulation of external arrears in early 2002 and, again, in early 2003. However, in both instances, the arrears were cleared within 3–4 months.

11. The BOM pursued a flexible exchange rate policy during 2001–02, although the strength of the balance of payments contributed to the maintenance of a relatively stable exchange rate. The togrog depreciated by a cumulative 3.1 percent vis-à-vis the U.S. dollar in 2001–02. The real effective exchange rate (REER) appreciated by 5 percent in 2001, but this appreciation was largely reversed as inflation eased in 2002.

III. Objectives and Policies for 2003 and the Medium Term

A. Short-Term Outlook and Macroeconomic Framework

12. The macroeconomic outlook for 2003 is expected to be affected by the continuing uncertainties in the global environment, which have been exacerbated by the outbreak of SARS in neighboring countries. Mongolia's prompt measures to prevent any local transmission of SARS appear to have been effective so far. Even so, the economic fallout of the spread of SARS elsewhere in the region could have significant repercussions. Mongolia's proximity to some of the most affected provinces of China has had a dampening effect on tourism, and this could have unfavorable effects on both economic growth and the balance of payments. The disruption of travel to and from China has also given rise to shortages of some imported food items in Mongolia. Reflecting also a large seasonal increase in meat prices, the twelve-month rate of inflation rose to 6½ percent as of June 2003. In the face of the risks posed by these developments, the government will redouble its efforts to implement policies

and reforms conducive to macroeconomic stability and private sector-led investment and growth.

13. Under the government's macroeconomic baseline scenario, which is presented in greater detail in the PRSP, the annual rate of growth of GDP is projected to rise steadily from about 5 percent in 2003 to 5½ percent by 2005–06. A marked improvement in conditions in the agricultural sector, together with continuation of buoyant activity in manufacturing, should help more than offset the effects of the SARS-related decline in tourism during 2003. The manufacturing, mining and service sectors are projected to continue to underpin growth over the medium term as the government's market-friendly reforms help promote faster private sector development. The average annual rate of inflation is targeted to be restrained to 5 percent during 2003 and over the medium term. Gross official reserves are targeted to increase to about $300 million or 18½ weeks of imports by end-2003, and they would rise to about $400 million or 20 weeks of imports by 2006.

14. To meet these objectives while also promoting the achievement of medium-term sustainability, the government will be steadfast in its pursuit of prudent fiscal and monetary policies. The overall fiscal deficit (including grants) will be restrained to 6 percent of GDP in 2003, a level somewhat lower than the initial program target. With NCG remaining on a declining trend, it is expected that the entire stock of the government's high-cost domestic debt to the banking system will have been virtually retired by the end of 2003. While broad money growth is projected to moderate in 2003, the decline in NCG would make room for a continued healthy rate of expansion of credit to the private sector. Although the stock of external public debt (excluding pre-1991 transferable ruble debt) is projected to edge up to 92½ percent of GDP in 2003 reflecting the valuation effects of the recent weakening of the U.S. dollar, the external debt ratio would be placed on a steadily declining path thereafter.

B. Budgetary Policy and Reforms to Strengthen Fiscal Governance

15. A strong and transparent fiscal position will be crucial for maintaining a stable macroeconomic environment, achieving debt sustainability, and meeting the government's growth and poverty reduction goals as spelled out in the PRSP (¶ 3.25–3.42). The centerpiece of the government's medium-term fiscal adjustment strategy will be to gradually reduce unproductive current expenditure in relation to GDP, so as to make room down the road for a reduction in Mongolia's high tax burden without impinging on public investment and social sector outlays. Achieving these goals will require improving budget execution and formulation, implementing a comprehensive civil service reform to contain the cost of government and improve public service delivery, and continuing to adopt measures to strengthen fiscal transparency and accountability.

16. The government's medium-term budget framework (MTBF), which was approved by Parliament in June 2003, bodes well for the achievement of the PRSP's objectives. To fully incorporate in the budget the costs associated with the government's regional development strategy, some of which were previously intended to be financed off-budget, public investment outlays are somewhat higher under the MTBF than envisaged in the initial budget for 2003. Even so, with the help of tighter controls on current expenditures, the overall

budget deficit is projected to be restrained to about 6 percent of GDP in 2004 and 5½ percent of GDP in 2005, in line with the initial program targets. Completion of some lumpy projects should pave the way for somewhat faster deficit reduction thereafter. The post-1991 stock of public debt is projected to decline steadily in relation to GDP under the MTBF. With the deficit continuing to be more than financed with external loans and privatization receipts, NCG was well within the indicative program ceiling as of end-June 2003. Based on these developments and prospects, the government requests a waiver for the nonobservance of the end-June 2002 QPC on NCG.

17. On the revenue side, the PRSP recognizes that, while Mongolia's relatively high tax burden needs to be reduced over the medium term to encourage private sector-led investment and growth, the need to protect sustainability leaves little room for any significant tax reductions in the short run (¶3.13–3.15). Earlier plans to reduce corporate income tax rates have accordingly been suspended at least until 2005, and will then be implemented only if accompanied by reforms to generate offsetting reductions in current expenditures. On that basis, the PRSP projects that government revenues would level off at about 37–37½ percent of GDP in 2003–04, and would decline to about 36½ percent of GDP thereafter. While revenue performance so far in 2003 has been stronger than envisaged in the MTBF and the PRSP, suggesting that the MTBF's revenue targets probably err on the conservative side, the government is not prepared to amend its fiscal framework at this point, as the MTBF was only recently approved by Parliament. However, the fiscal projections will be updated in the fall of 2003 at the time of the preparation of the 2004 budget.

18. The PRSP relies primarily on a sustained effort to rein in current expenditure to meet the government's fiscal adjustment objectives. To contain the pressure emanating from wage and pension outlays, the granting of any civil service wage or pension increases is ruled out during the remainder of 2003, and pension increases during 2004 are to be limited to no more than the rate of inflation (¶3.28 and 3.215). The government is committed to implementing a broad-based civil service reform program over the medium term. As a first step, a preliminary data verification exercise among a wide range of government entities conducted jointly by the Civil Service Council (CSC) and the Ministry of Finance and Economy (MOFE) was completed in April 2003. A comprehensive civil service census is to be conducted following the establishment of a Human Resource Management Information System (HRMIS). At that point, the government will develop and adopt a credible civil service reform program, and a reliable system for the monitoring and control of the wage bill, in consultation with the World Bank. The government will consider the possibility of granting future increases in civil service wages only in the context of the civil service reform process, and will grant no such increases until a credible mechanism for the containment of the wage bill is in place.

19. With the help of these policies, the PRSP aims to bring current spending down from nearly 34 percent of GDP in 2002 to 32 percent of GDP in 2003–04, and to about 30½ percent of GDP by 2006. The government recognizes that these expenditure reduction targets are highly ambitious and can be achieved within the timetable envisaged in the MTBF only if prompt action is taken to introduce far-reaching expenditure-saving reforms. The targeted pace of expenditure reduction will be revisited at the time of the preparation of the

2004 budget in the fall of 2003. Even if the expenditure targets have to be revised upwards at that point, the government will make every effort to adhere to the PRSP's overall deficit targets, which should still be feasible in light of the expected overperformance on revenues. Based on these prospects and undertakings, the government requests a waiver for the nonobservance of the end-December 2001 SPC relating to the 2002 budget.

20. To create an enabling environment for private investment, the PRSP envisages a sustained increase in public investment on energy, road construction, and other basic infrastructure, especially in some of Mongolia's less developed regions (¶4.29–4.92). Given the lumpiness of some high-priority projects launched under the government's regional development strategy, the ratio of public investment to GDP is projected to edge up in 2003–04, before tapering off and declining thereafter. With the exception of the Durgun hydropower station, which is being financed with nonconcessional suppliers' credits on the order of US$26.5 million (2.2 percent of GDP), all other debt-financed projects will continue to be funded with foreign concessional assistance. To reassure investors and donors that scarce public funds will be put to the most effective use, the government, in consultation with the World Bank, will establish strict economic criteria for the evaluation and tendering of projects to be considered for inclusion in its Public Investment Program. For the major new hydropower projects already under way, the government will develop sound and realistic business plans on both the generation and distribution sides before end-2003, in consultation with the World Bank, with a view to ensuring that the new plants will be economically viable and will not place any new future burdens on the budget.

21. As indicated in the PRSP, the centralization of all government funds in a TSA is key to the government's efforts to strengthen expenditure and cash management and improve fiscal transparency and accountability (¶3.71–3.87). After initial delays in implementing the pilot TSA, the momentum of treasury reform has accelerated since mid-2002. The government has been extending the TSA arrangement to cover the bulk of general government operations by closing remaining individual bank accounts of budget entities, including social insurance funds, and it has begun to account for all revenue and expenditure transactions through treasury ledger accounts. To complete this process expeditiously, steps are under way to identify and close any remaining budgetary accounts in commercial banks and the government is seeking foreign donors' consent to transfer grant and loan accounts to the TSA. As a result of these ongoing efforts, the share of government bank balances held in the TSA at the BOM is projected to have increased to no less than 75 percent by end-August 2003. To further improve expenditure management in the period ahead, a ministerial resolution will be issued to set clear rules for the allocation of budgetary entities' excess own-revenues, and semi-annual and annual fiscal reports will be required to indicate any adjustments to spending plans associated with such revenues. On the basis of these measures and undertakings, which have now more than accomplished the objectives set for 2001–02 under the program's structural conditionality, the government requests a waiver for the nonobservance of the end-December 2001 SPC relating to the TSA.

22. An important objective of the government's treasury reform program is to guard against a re-emergence of public sector arrears. All domestic debt service arrears have been eliminated since late 2000 and interest on government bonds continues to be paid on a timely

basis. In addition, a time-bound plan for the reduction of arrears accumulated by budget entities was established in mid-2002 and was broadly adhered to subsequently. The establishment of the TSA has also enabled the Treasury to begin to cross-check payments against budget appropriations. Building on these efforts, the government will adopt a ministerial regulation by end-October 2003 to require budget managers to make commitments strictly in accordance to their monthly apportionments of budget appropriations and report monthly to the Treasury on commitments entered. On that basis, the Treasury will develop cash plans to ensure prompt settlement of due payables.

23. To further strengthen fiscal governance, the government is committed to preventing the emergence of quasi fiscal obligations. The BOM has accordingly cancelled all loan agreements and other contracts previously signed with foreign parties, which would have required it to issue large amounts of loan guarantees to support borrowing by private or joint-venture companies. In addition, the General Budget Law was amended in June 2003 to rule out future recourse to quasi-fiscal operations, except to the extent that they are identified in the MTBF or future government budgets. While a portion of the government's Millennium Road project is to be implemented during 2003-04 through extra-budgetary operations equivalent to US$39 million (3¼ percent of GDP), which were not included in the official accounts, the underlying transactions have been in full conformity with the applicable laws and regulations. More specifically, in accordance with the provisions of the Law on Minerals, a license has been granted to a Mongolian-Chinese joint-venture company to exploit the Ulaan Ovoo coal mine and, in return, that company has undertaken to use its own resources to construct 350 kilometers of road along the route of the Millennium Road. To improve fiscal transparency, the government has indicated in the PRSP that contracts for public works will henceforth avoid barter-like financing arrangements (¶3.36).

24. To enhance program monitoring, the MOFE and the BOM will provide updated information to the Fund on a fortnightly basis with regard to any new contracts for the execution of public investment projects which have been signed or are under negotiation with foreign or domestic nongovernmental entities as elaborated in Section VII.C of the attached Technical Memorandum of Understanding (Attachment III). In addition, the Fund's resident representative will receive fortnightly briefings from the MOFE on any recent or pending cabinet decisions that carry potential implications for Mongolia's public finances, its external debt position, or other issues relating to the implementation of the PRGF-supported program.

C. Monetary Policy, Banking System Reforms, and Safeguards

25. To meet the government's inflation and external reserve objectives, the PRSP envisages a moderation of the rate of growth of monetary and credit aggregates (¶3.132–3.137). The annual growth rate of broad money has been targeted to be reduced from about 42 percent in 2002 to 25 percent in 2003. With the rate of growth of credit to enterprises projected to moderate somewhat in 2003, domestic credit growth would level off in 2003. The slower pace of credit expansion should facilitate the achievement of a gross reserve buildup of about US$33 million during 2003.

26. Consistent with the above targets, the BOM will take adequate steps to keep reserve money growth within a prudent range, while leaving the required reserve ratio unchanged. Although reserve money growth remained on an upward trend during the early months of 2003, the BOM is committed to meeting its end-year monetary program targets. The placement of BOM bills was already stepped up beginning in May 2003. As a result, the BOM's NDA have been on a declining trend, and reserve money growth stayed within the indicative program ceiling for end-June 2003. Based on this performance, the government requests a waiver for the nonobservance of the end-June 2002 QPC on the BOM's NDA.

27. Noticeable progress has been achieved in recent years in strengthening the domestic banking system, as evidenced by the steady increase in bank deposits and workers' remittances. The BOM has continued to upgrade its supervisory and prudential framework, and efforts are underway to implement the recommendations set forth in a recently completed assessment against the Basle Core Principles. To address concerns stemming from recent indications of a deterioration in banks' asset quality, the BOM will require banks to submit internal audit reports following a new supervisor's manual by end-October 2003, and provisioning requirements on substandard and doubtful loans will be increased during the first quarter of 2004. In addition, new anti-money laundering recommendations to banks in line with Financial Action Task Force (FATF) guidelines were issued in late 2002, and legislation requiring banks to file reports on suspicious accounts and empowering the authorities to freeze such accounts will be enacted by end-2003.

28. A special effort is under way to strengthen BOM's governance. The Central Bank Law was amended by Parliament in June 2003 to provide for a clear prohibition of quasi-fiscal activities that are not akin to central banking operations and to set up a legal framework for the establishment of an independent Supervisory Board. The draft terms of reference (TOR) for the operation of this Board are being developed in line with the Fund's safeguards recommendations and will be approved by Parliament before end-October 2003. In accordance with these TOR, the Supervisory Board will, among its other functions, ensure that the BOM's financial accounting and reporting framework is fully in line with International Accounting Standards. In addition, it will exercise oversight over the external auditing process, including the appointment of the auditing firm, and will ascertain that external audits are conducted in accordance with International Auditing Standards. The government and the BOM will take all necessary steps in a timely fashion to ensure that the new Supervisory Board will assume its full duties from November 2003. Special external audits of BOM's NIR data as of end-December 2001 and end-June 2002 (the test dates for the second and third PRGF disbursements), which have already been completed, attest to the accuracy and reliability of the BOM's NIR data. The BOM will continue to conduct special audits of its NIR on a semi-annual basis during the remainder of the program period.

D. External Sector Policies

29. The BOM will continue to pursue a market-based exchange rate policy in the period ahead, with a view to meeting the program's NIR targets while also smoothing excessive exchange rate fluctuations. To reinforce the responsiveness of the exchange rate to market forces, the BOM began to change its mid-point rate on a daily rather than weekly basis in

January 2003. In addition, the buy-sell margin around BOM's mid-point rate was widened from +/- 1 togrog to +/- 2 togrog from April 2003, and to +/- 3 togrog from June 2003. To expand the growth of the interbank foreign exchange market, the government will also take steps to liberalize gold trading, including by removing any remaining laws or regulations that may be discouraging private sector activity in the marketing of gold exports. The NIR of the BOM increased by about US$9 million during the first six months of 2003 and, given the official aid inflows assumed under the program, they are on track to meet the government's end-2003 target. On this basis, the government requests a waiver for the nonobservance of the end-December 2001 QPC on the BOM's NIR.

30. The PRSP reaffirms the government's commitment to the pursuit of a prudent debt management policy and orderly relations with all creditors (¶3.110–3.131). In April 2003, the government cleared its arrears (US$4.1 million) on Mongolia's post-1991 debt to the Russian Federation and came to an agreement on the terms for the payment of debt service due during 2003. Progress was also made in the negotiations on the settlement of pre-1991 transferable ruble (TR) held during the visit of Mongolia's Prime Minister to Moscow in early-July 2003, and there are good prospects for a final agreement on this matter on terms that would not jeopardize external sustainability. Negotiations are also underway to resolve other outstanding claims by foreign creditors (about US$30–40 million), which arose from past issuance of guarantees on nonconcessional external loans to public and private enterprises. During the period of the PRGF-supported program, the Government will continue to service its external obligations on a timely basis and will refrain from contracting or guaranteeing any new nonconcessional debt as defined in Attachment III, other than the obligations already undertaken in connection with the Durgun hydropower project. Based on these developments and undertakings, the government requests waivers for the nonobservance of the continuous performance criterion on the nonaccumulation of external arrears as of early 2002 and early 2003.

31. An open trade and investment regime will remain a linchpin of Mongolia's strategy to promote private-sector led growth and poverty reduction. Although Mongolia's tariff regime is already among the least restrictive in Asia, remaining impediments to trade facilitation and foreign direct investment will be removed during the program period. Accordingly, the government will take further steps during 2003 to simplify and streamline customs controls, licensing, and regulations, especially in connection with quality certification for the import and export of raw materials and minerals. The government will not introduce any new trade-related taxes, quantitative restrictions, voluntary restraints, or any other measures to limit exports or imports during the program period.

IV. External Financing Requirements

32. The policies set out in this memorandum are key for reducing Mongolia's external vulnerability in line with the objectives set out in the PRSP (¶3.88–3.109). The current account deficit (including official transfers) is projected to be restrained to about $100 million or about 6½ percent of GDP over the medium term. Assuming that medium- and long-term loan disbursement would average US$88 million annually, additional financial assistance of about US$23 million annually would be required during 2003–05 to cover the

financing gaps. These gaps are expected to be filled through program loans from the World Bank, the AsDB and the Fund.

V. Program Monitoring

33. The quarterly benchmarks and semi-annual QPCs established under the program for the period September 2003-March 2004 include: (i) a ceiling on net banking system credit to government; (ii) a ceiling on net domestic assets of the BOM; (iii) a floor on net international reserves (NIR) of the BOM; (iv) a ceiling on government and government-guaranteed external debt; (v) the nonaccumulation of external arrears; and (vi) the nonaccumulation of domestic interest arrears. In addition, indicative ceilings have been specified for reserve money and the net domestic assets of the consolidated banking system. Table 2 and Attachment III provide more details on the settings and definitions of variables to be monitored under the PRGF arrangement. The proposed structural benchmarks and performance criteria for 2003–04 are presented in Table 4.

34. To reiterate its commitment to implement the PRGF-supported program, the government has taken and/or will take the following actions prior to the Executive Board's consideration of the first and second PRGF reviews: (i) Secure Parliamentary approval of a Medium-Term Budget Framework in line with the understandings reached with the staff as elaborated in paragraphs 16–22 above; and (ii) amend the Central Bank Law to strengthen safeguards by establishing an independent Supervisory Board and prohibiting the conduct of quasi-fiscal activities, and prepare draft terms of reference for the Bank of Mongolia's new Supervisory Board for consideration by the fall session of Parliament, in line with the understandings reached with the staff (Table 5).

35. Given the delays in completing the first and second reviews, the government requests the rephasing of the subsequent reviews and disbursements under the PRGF arrangement, with each disbursement, review and test date to be postponed by nine months. Accordingly, the third review under the program is expected to be completed by end-January 2004 with performance to be assessed based on the observance of QPCs as of end-September 2003 and the structural benchmarks and performance criteria as of end-October and end-November 2003. The third review will focus primarily on the implementation of the 2003 budget, the approval of a budget for 2004 in line with the principles adopted in the MTBF, and the implementation of the new safeguards arrangements for the Bank of Mongolia. At the time of the third review, the QPCs and structural benchmarks and performance criteria for end-March 2004 will be revised and those for end-September 2004 will be established.

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

	2001			2002									
	End-Dec.			End-March			End-June			End-Dec.			
	Performance Criteria Country Report No. 01/182	Adjusted Targets	Actual	Indicative Targets 15/ Country Report No. 01/182	Adjusted Targets	Actual	Performance Criteria 15/ Country Report No. 01/182	Adjusted Targets	Actual	Indicative Targets 15/ Country Report No. 01/182	Indicative Targets Dec. 02	Adjusted Targets	Actual
Quantitative Performance Criteria													
	(In billions of togrogs)												
1. Net bank credit to government (ceiling) 2/ 3/ 4/ 5/	-16.8	-16.2	-18.7	1.5	-0.9	4.3	1.8	1.0	9.3	-29.6	-23.8	-26.5	-27.7
2. Net domestic assets of the Bank of Mongolia (stock, ceiling) 4/ 6/ 7/ 8/	-28.9	-27.3	-30.4	-28.9	-31.1	-32.6	-29.4	-27.7	-10.1	-40.4	-43.5	-62.0	-67.0
3. Domestic interest arrears (stock, ceiling) 9/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	(In millions of U.S. dollars, unless otherwise indicated)												
4. Net international reserves of the Bank of Mongolia (stock, floor) 7/ 10/	160.6	159.7	158.9	161.0	163.0	159.7	170.0	166.8	169.3	185.6	196.0	188.5	219.4
5. New nonconcessional external debt contracted or guaranteed by the government or the BOM (ceiling)													
Maturities of less than 1 year 3/ 11/ 12/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Maturities of 1–12 years 3/ 11/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
6. External payments arrears (stock, ceiling) 9/ 13/	0.0	0.0	4.8	0.0	0.0	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)	70.0	71.7	113.2	82.7	80.5	127.6	89.2	93.2	178.3	64.7	160.8	169.5	172.3
Memorandum items :													
BOM's monetary gold pledged as collateral for external loans to domestic private companies	0.0		0.0	0.0		0.0	0.0		0.0	0.0	0.0		0.0
Balance of payments support 3/ Excluding disbursements from the IMF	22.5		21.6	0.0		2.0	5.2		2.0	20.5	21.6		14.1
External budgetary assistance (program loans) 3/ (In billions of togrogs)	25.4		23.8	0.0		2.2	6.1		2.2	24.2	24.4		15.7
Privatization receipts 3/ (In billions of togrogs)	10.2		5.6	0.0		0.2	0.0		1.6	9.7	19.5		16.8
Transfer from the BOM to government 3/ (In billions of togrogs)	11.3		12.3	0.0		0.0	0.0		3.1	1.7	5.0		16.4
Reserve money (In billions of togrogs)	147.6	147.6	144.1	148.1	148.1	142.8	157.4	158.0	176.0	163.6	172.7	179.5	175.0
Togrogs per U.S. dollar	1097		1097	1097		1097	1097		1097	1097	1102		1102
U.S. dollars per SDR	1.25		1.25	1.25		1.25	1.25		1.25	1.25	1.29		1.29
Monetary gold prices (U.S. dollars per ounce)	270.6		270.6	270.6		270.6	270.6		270.6	270.6	290.0		290.0

1/ The technical memorandum of understanding (TMU) attached to EBS/01/166 sets out the definitions for the above targets under which Mongolia's performance under the program was to 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 above-mentioned 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 and end-December 2002 and the performance criteria for end-June 2002 were to be revised at the time of the first PRGF review.

Table 2. Mongolia: Quantitative Performance Criteria and Indicative Targets Under the PRGF Arrangement, 2002–March 2004 1/

	2002			2003								2004
	End-Dec.			End-March			End-June			End-Sept.	End-Dec.	End-March
	Indicative Targets Rev. Prog.	Adjusted Targets	Actual	Indicative Targets	Adjusted Targets	Actual	Indicative Targets	Adjusted Targets	Actual	Performance Criteria	Indicative Targets	Performance Criteria 15/
Quantitative Performance Criteria												
	(In billions of togrogs)											
1. Net bank credit to government (ceiling) 2/ 3/ 4/ 5/	-23.8	-26.5	-27.8	10.0	10.9	-4.5	15.0	39.1	-13.0	-5.0	-20.8	5.0
2. Net domestic assets of the Bank of Mongolia (stock, ceiling) 4/ 6/ 7/ 8/	-43.5	-62.0	-74.8	-65.9	-57.4	-58.6	-65.3	-61.8	-68.3	-68.8	-81.7	-76.5
3. Domestic interest arrears (stock, ceiling) 9/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
4. Net international reserves of the Bank of Mongolia (stock, floor) 7/ 10/	196.0	188.5	222.2	222.0	214.5	212.7	233.0	215.7	233.9	245.0	250.0	250.0
5. New nonconcessional external debt contracted or guaranteed by the government or the BOM (ceiling)												
Maturities of less than 1 year 3/ 11/ 12/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Maturities of 1–12 years 3/ 11/ 16/	0.0	0.0	0.0	0.0	0.0	0.0	26.5	26.5	26.5	26.5	26.5	26.5
6. External payments arrears (stock, ceiling) 9/ 13/	0.0	0.0	0.0	4.1	4.1	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)	160.8	169.5	165.8	189.7	198.2	199.2	235.1	254.6	239.4	240.0	252.0	269.5
Memorandum items :												
BOM's monetary gold pledged as collateral for external loans to domestic private companies	0.0		0.0	0.0		0.0	0.0		0.0	0.0	0.0	0.0
Balance of payments support 3/ Excluding disbursements from the IMF	21.6		14.1	7.5		0.0	17.3		0.0	17.3	20.0	5.0
External budgetary assistance (program loans) 3/ (In billions of togrogs)	24.4		15.7	8.5		0.0	19.5		0.0	19.5	22.6	5.7
Privatization receipts 3/ (In billions of togrogs)	19.5		16.8	0.5		8.1	8.2		8.6	8.5	11.1	0.5
Transfer from the BOM to government 3/ (In billions of togrogs)	5.0		16.4	0.0		0.0	5.0		0.0	5.0	5.0	0.0
Reserve money (In billions of togrogs)	172.7	179.5	175.3	184.0	184.0	180.8	197.0	201.0	195.1	207.0	199.7	204.9
Togrogs per U.S. dollar	1102		1,125	1,125		1,125	1,125		1,125	1,125	1,125	1,125
U.S. dollars per SDR	1.29		1.362	1.362		1.362	1.362		1.362	1.362	1.362	1.362
Monetary gold prices (U.S. dollars per ounce)	290.0		325.38	325.38		325.38	325.38		325.38	325.38	325.38	325.38

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 above-mentioned 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 performance criteria for end-March will be revised at the time of the third PRGF review.

16/ Figures after end-June 2003 reflect nonconcessional suppliers' credits for Durgun hydropower station.

Table 3. Mongolia: Structural Benchmarks and Performance Criteria Under the PRGF Arrangement, 2001–02

	Policy Action	Timing	Status
A.	Structural Performance Criteria		
1.	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	Observed.
2.	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	Observed.
3.	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	Largely observed, albeit with delay; while some accounts of the social insurance funds, a pilot entity, and donor-controlled project implementation accounts have not yet been transferred to the TSA at the BOM, this is due primarily to technical factors that are outside the government's control.
4.	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	Not observed. An amended budget for 2002 approved by Parliament on August 30, 2002 was more in line with staff recommendations than the initially approved budget, but wages and pensions were raised by 20 percent with effect from October 2002 against the staff's advice and current expenditure continued to exceed program targets.
5.	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	Observed.

Table 3. Mongolia: Structural Benchmarks and Performance Criteria
Under the PRGF Arrangement, 2001–02 (concluded)

	Policy Action	Timing	Status
B.	Structural Benchmarks		
6.	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, with the first semi-annual report to cover data for January–June 2001.	End-September 2001	Partly completed. Given the MOFE's limited technical capacity, the semi-annual reports contained many mistakes. Comprehensive data on public employment are available, but not on a semi-annual basis.
7.	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	Observed. Taxes were reassigned. The reassignment of spending authority from local governments to line ministries, as envisaged in the PSFML, has eliminated the need for the recommended transfer model.
8.	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	Completed in June 2002.
9.	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	Observed.
10.	Implement arrears reduction plan and meet arrears reduction targets set for each debtor agency under the Treasury/SFSA joint action program.	End-June 2002	Not observed. In light of the delay in completing item 8, the implementation of the arrears reduction plan was assessed as of end-December 2002. The target was missed by a small margin (0.02 percent of GDP).
11.	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	Not observed. Rephased, more ambitious TSA reforms are under implementation. While some central government accounts remain outside the BOM as indicated under item 3, the TSA has now been extended to local governments; as a result, 75 percent of total general

Table 3. Mongolia: Structural Benchmarks and Performance Criteria
Under the PRGF Arrangement, 2001–02 (concluded)

	Policy Action	Timing	Status
			government deposits are projected to be consolidated within the TSA at the BOM as of end-August 2003.
12.	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	Ongoing.

Table 4. Mongolia: Structural Benchmarks and Performance Criteria for 2003–04

Structural Benchmarks

1. Issue a ministerial resolution stipulating clear rules for the allocation of excess own-revenues and indicate in semi-annual and annual fiscal reports the adjustments to spending plans due to excess own-revenues by economic classification (end-October 2003).

2. Adopt ministerial regulation that obliges budget managers to make commitments strictly according to their monthly apportionments of budget appropriations and report monthly to the Treasury on commitments entered, and develop Treasury cash plans to prevent the accumulation of arrears (end-October 2003).

3. Tighten enforcement of prudential controls on the banking system by requiring banks to submit internal audit reports to the BOM in accordance with the new supervisor's manual issued in December 2002 (end-October 2003).

4. Fully adopt IAS, including IAS 39, in 2003 and all future BOM financial statements (end-March 2004).

Structural Performance Criteria

5. Secure Parliamentary approval of terms of reference (TOR) for BOM's Supervisory Board in line with the understandings reached with the staff (end-October 2003).

6. Establish Supervisory Board empowered to carry out independent oversight of BOM operations along the lines indicated in the above-mentioned TOR and begin to enforce the amendments to the Central Bank Law approved in June 2003 (end-November 2003).

7. Complete special audits of the BOM's NIR as of end-June and end-September 2003, with a view to ensuring appropriate valuation of gold-related and derivatives transactions and contingent liabilities, including any impairment, guarantees or commitments against gold deposits or other reserve assets (end-November 2003).

8. Increase BOM's provisioning requirements on commercial banks from 25 percent to 50 percent for substandard loans and from 50 percent to 75 percent for doubtful loans (end-March 2004).

Table 5. Mongolia: Prior Actions for the Completion of the First and Second PRGF Reviews
(to be completed by end-August 2003)

1. Secure Parliamentary approval of Medium-Term Budget Framework in line with understandings reached with Fund staff.

2. Secure Parliamentary approval of amendment to the Central Bank Law to prohibit the conduct of quasi-fiscal operations and establish oversight of the Bank's operations by an independent Supervisory Board, and prepare draft terms of reference for the Supervisory Board, in consultation with Fund staff, for consideration by the fall session of Parliament.

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 end-September 2003 and end-March 2004 and indicative targets for June 2003 and December 2003 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 June 30, 2003 and December 31, 2003 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 incorporated in Mongolia 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 1,125 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$1.362. Monetary gold will be valued at US$325.38 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.

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 incurred to restructure, refinance, or prepay existing debts, to the extent that such debt is incurred on more favorable terms than the existing debt; (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 2002, the CIRRs published by the OECD in January 2002 will be used. For example, based on January 2002 CIRR rates, a U.S. dollar-denominated debt with a 12–year maturity and 5 years of grace would be considered concessional if the interest rate did not exceed 0.99 percent. Loans provided by a private entity will not be considered concessional unless accompanied by a grant or grant element provided by a foreign official entity equal to at least 35 percent of the combined loan.

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 of 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 Payments Arrears

38. A continuous performance criterion applies to the nonaccumulation of external payments 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 payments 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 or in hard copy 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.

- 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.

C. External Sector Data (BOM and MOFE)

- Complete list of new contracts for the execution of public investment projects, which have been signed or are under negotiation with foreign or domestic entities, including details on the amounts, terms, and conditions of current or future debt or nondebt obligations arising from these contracts.

- 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).

- 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. Culture and Art Fund
4. Employment Promotion Fund
5. Privatization Fund

Central Government Units with Individual Budgets

6. Environment Fund
7. Fund for Development of Small and Medium-Sized Enterprises
8. Health Insurance Fund
9. Industrial Accidents and Occupational Disease Insurance Fund
10. Pension Insurance Fund
11. Poverty Alleviation Fund
12. Road Fund
13. Social Benefits Insurance Fund
14. Unemployment Insurance Fund

Local Government

15. City and 9 districts of Ulaanbaatar
16. 21 provinces
17. 331 districts and municipalities

Data Coverage

Data in central government tables cover operations of units 1–4, 8–10, and 12–14. Units 6–7 and 11–12 comprise central government extrabudgetary funds; units 8–10 and 13–14 comprise central government social security funds

Data in local government tables cover operations of units 15–17.

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

First and Second Reviews Under the Poverty Reduction and Growth Facility, and Requests for Waiver of Performance Criteria, Extension of Arrangement and Rephasing of Purchases
Supplementary Information

Prepared by Asia and Pacific Department

(In consultation with other departments)

Approved by Daniel Citrin and Anthony Boote

September 11, 2003

1. This supplement summarizes information on recent developments that has become available since the circulation of the staff report, especially as regards the status of prior actions and economic performance relative to the key program objectives. The new information does not change the staff appraisal contained in the staff report.

Prior Actions

2. **Both prior actions under the MEFP for the first and second PRGF reviews have now been fully completed.**

3. **The first prior action relating to the Medium-Term Budget Framework (MTBF) was completed in June 2003, when Parliament approved the government's first MTBF.** In line with the understandings reached with the staff, the MTBF: (i) envisages an adequate reduction of the budget deficit during 2004-06 to meet the program's debt sustainability objective; (ii) postpones any reduction in corporate income tax rates until at least 2005; (iii) transparently accounts for projected outlays on most public investment projects and debt service obligations, in accordance with GFS guidelines; (iv) rules out the granting of any civil service wage increases during the remainder of 2003, and links future salary increases to the implementation of public sector reforms to be developed in consultation with the World Bank; and (v) stipulates that the government will avoid future recourse to extra-budgetary or quasi-fiscal operations.

4. **The second prior action was fully completed on September 4, 2003, when draft terms of reference (TOR) for the new Supervisory Board of the Bank of Mongolia**

(BOM) were submitted for consideration to the Economic Standing Committee of the Parliament.[1] A safeguards assessment monitoring mission carried out at the BOM during September 1–10, 2003 has verified that the draft TOR is in line with the understandings reached with the staff. The safeguards mission has also ascertained that the BOM is taking steps to progressively implement the majority of other priority measures proposed by the previous safeguards assessment in March 2002. In particular, comprehensive and timely external audits of annual financial statements are now being conducted in accordance with International Standards on Auditing; the 2002 audited financial statements reflect nearly complete compliance with International Accounting Standards (IAS), and were provided to Parliament and published in accordance with the CBL; and controls over the management of international reserves are gradually being strengthened. The updated safeguards assessment is expected to be completed by end-October. The staff will assess the implementation of the main safeguards recommendations, including the related conditionality that is already incorporated in the program, in the context of the third PRGF review.[2]

Recent Economic Developments

5. **Economic performance remains on track to achieve the program's main inflation and external targets**. Inflation, after having peaked at 6½ percent (year-on-year) in June–July 2003, declined to 4½ percent in August, and it is on track to be limited, as programmed, to 5 percent in 2003, provided that adequate measures are taken to rein in the growth of money and credit (as discussed below). In the external accounts, preliminary data for January-August 2003 point to a continuing sluggishness in export performance, which can now be expected to give rise to a somewhat larger than programmed increase in the trade deficit over the full year. However, the wider trade deficit is being largely offset by the sustained strength of invisible receipts and private capital inflows. Thus, the BOM's net international reserves (NIR) rose to US$242 million as of end-August, and are set to comfortably meet the program's end-September 2003 target.

6. **Preliminary data for January-August 2003 suggest that fiscal performance also remains largely on track**. Total revenues increased by 17½ percent during January–August 2003 with respect to the same period of the previous year, thus pointing to a likelihood of somewhat stronger than programmed over-performance relative to the budget over the full

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[1] This prior action had been partly completed in June 2003 when Parliament amended the Central Bank Law (CBL) to prohibit the conduct of quasi-fiscal operations and establish oversight of the BOM's operations by an independent supervisory Board.

[2] Parliamentary approval of the TOR for the Supervisory Board and enforcement of the already-approved amendments to the CBL are structural performance criteria for the third PRGF review.

year. The brisk growth in revenues appears to be underpinned by buoyant receipts from the VAT on imports, customs duties, income taxes and social security contributions. On the expenditure side, outlays on wages and salaries and goods and services have remained largely on track. While capital expenditures have recorded a faster than expected rise as the implementation of recently launched large projects appears to have gathered pace, the continuing over-performance on revenues should still enable the authorities to contain the annual overall government deficit to 6 percent of GDP.

7. **Data for January–July 2003 point to continuing rapid growth in money and credit, which calls for a reinforcement of BOM's efforts to meet its monetary program targets in the period ahead**. Broad money growth has declined at a slower than programmed rate, falling from 42 percent at end-2002 (year-on-year) to 38 percent as of end-July 2003. While the over-performance on fiscal revenues has helped to keep net credit to government (NCG) comfortably below the program targets, the rate of growth of credit to the private sector has remained well over 70 percent or 5-10 percentage points in excess of the corresponding program targets. Thus, on current trends, there is a risk that the net domestic assets of the banking system will exceed the program's indicative target for end-September 2003. Despite a sustained increase in BOM bill rates over the last few months, the expansionary effects of rising NIR have more than offset the impact of a modest decline in the BOM's net domestic assets (NDA), with the result that reserve money growth accelerated to 13½ percent (year-on-year) as of the first week of September 2003. In such circumstances, the authorities agree that they will need to step up the placement of BOM bills over the next few weeks to ensure that the target for the NDA of the BOM and the indicative program target on reserve money for end-September 2003 will be achieved.

Press Release No. 03/157
FOR IMMEDIATE RELEASE
September 12, 2003

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes First and Second Reviews of Mongolia's PRGF Program and Approves US$11 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the first and second reviews of Mongolia's arrangement under the Poverty Reduction and Growth Facility (PRGF)—(see Press Release No. 01/42). The Board also determined that Mongolia's Economic Growth Support and Poverty Reduction Strategy (EGSPRS) provides a sound basis for Fund concessional financial assistance. This enables the immediate release of a further SDR 8.14 million (about US$11 million) from the arrangement, which would bring total disbursements under the IMF-supported program to SDR 12.21 million (about US$17 million).

The Board also approved the extension of Mongolia's program period by about ten months to July 31, 2005 to allow the rephasing of the subsequent disbursements.

The PRGF is the IMF's concessional facility for low-income countries. It is 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. 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.

After the Executive Board's discussion on Mongolia, Anne Krueger, First Deputy Managing Director and Acting Chair, made the following statement:

"Mongolia has performed commendably in its on-going transition to a market-based economy, achieving positive performance under the PRGF-supported program, and engaging in a constructive policy dialogue with the Fund, notwithstanding some difficult issues that led to a delay in the first and second PRGF reviews. Prudent macroeconomic policies have contributed to a pickup in growth, containment of inflation, and a reduction in external vulnerability. While large quasi-fiscal activities, which emerged in late-2002, appeared to threaten fiscal sustainability, the authorities have taken strong measures to improve the fiscal position, limit a recurrence of such activities, and enhance fiscal transparency.

"Consistent with the recently-approved PRSP, which provides a basis for multilateral concessional assistance, the program aims to promote fiscal sustainability by restraining public expenditures, supported by reforms to streamline the civil service, while enhancing the quality and efficiency of pro-poor spending. The authorities have also exerted restraint in wage and pension increases so far in 2003.

"The program envisages a continued effort to improve economic governance. The authorities achieved considerable progress in implementing a Treasury Single Account to strengthen expenditure controls and reduce budgetary arrears, and intend to incorporate all new investment projects into the budget. Along with legal and institutional reforms to improve fiscal transparency, the authorities are also taking important steps to strengthen the safeguards framework for the Bank of Mongolia (BOM), including through the upcoming establishment of an independent oversight board. Privatization is continuing.

"The authorities are committed under the program to pursue a prudent monetary policy, coupled with a flexible exchange rate policy. The BOM has in recent months increased the placement of BOM bills to contain excess bank liquidity, but may need to step up these efforts in the period ahead to keep money and credit growth within a prudent range. The program also envisages a cautious approach in the management of external debt, including through the maintenance of orderly relations with all creditors and avoidance of new borrowing on nonconcessional terms or the guaranteeing of private borrowing," Ms. Krueger said.

Statement by Michael J. Callaghan, Executive Director for Mongolia
and Damba Baasankhuu, Advisor to Executive Director
September 12, 2003

Key points

- There is a constructive policy dialogue between the Mongolian authorities and the Fund which has contributed to a significant improvement in the policy framework.
- Economic performance under the program has been significant. Growth is accelerating, inflation is under control, the fiscal position has improved, reserves have increased and debt is at manageable levels.
- The authorities recognize, as outlined in the recently completed PRSP, that fiscal consolidation is central to meeting the objectives of the program. In particular expenditure control is necessary to provide room for reducing the high tax burden and ensuring that essential infrastructure projects are advanced while public sector debt levels are kept under control.
- A medium term policy orientation has been established.
- Substantial progress with the authorities structural reform agenda has been achieved, including the privatization of some key banking institutions.

A constructive policy dialogue with the Fund

While there has been a delay in bringing the First and Second Reviews under the PRGF to the Board for completion, this should not be seen as indicating any stalling in Mongolia's progress in establishing macroeconomic stability and advancing a structural reform agenda that will promote sustained economic growth and a reduction in poverty.

A great deal has been achieved since the PRGF program was approved in September 2001, notwithstanding the delays in the program reviews. This progress has built upon the remarkable achievements that have been made over the past decade in Mongolia's transition to a market based economy.

The Fund, along with the Multilateral Development Banks, have made an important contribution to Mongolia's reform achievements and our authorities would particularly like to extend their appreciation to the support that they have received from the staff and management of the Fund. As is evident from the staff report, there is a very constructive policy dialogue between Mongolia and the Fund. Importantly, the authorities have been very responsive to the advice they have received.

Issues have arisen over the course of the program which have delayed the competition of the reviews, such as the disclosure of quasi-fiscal and extra budgetary activities undertaken by the Government and the Bank of Mongolia (BOM). The authorities action in this area did not represent a move away from the objectives of the PRGF, but rather the result of capacity limitations and shortcomings in institutional arrangements. However when the staff's concerns were raised, the Government moved decisively to implement a range of significant policy measures to address the situation.

Economic developments are encouraging.

The overall economic performance under the program has been relatively strong, despite unfavorable weather and external conditions, including the impact of SARS. The economy grew by 3.9 per cent in 2002, with contributions from the processing industry and service sectors, compared with 1 per cent growth in 2001, when growth was significantly affected by heavy-weather related herd loses. Inflation fell to 1.6 per cent in 2002,although has risen in the first half of 2003 due to seasonal factors and the impact of SARS. Notwithstanding weak international prices for a number of Mongolia's main exports, large capital inflows resulted in an overall surplus in the balance of payments and a rise in the international reserves position to about 17 weeks imports. The exchange rate has remained relatively stable.

A medium term policy framework has been adopted

A number of key policy documents have recently been completed and adopted, including the Economic Growth and Poverty Reduction Strategy Paper (PRSP), which establish the medium term policy objectives of the Government. The PRSP is the main policy document which outlines the medium-term task towards achieving sustained economic growth and there are two alternative growth scenarios. As noted in the staff report, the main macroeconomic objectives of the medium-term framework underpinning the PRGF have been aligned with the PRSP's baseline scenario.

Importantly, the authorities also adopted a medium-term budget framework in June 2003 which is consistent with the pursuit of the PRGF's objectives. The adoption of the Public Sector Management and Financing Law by Parliament and its enforcement this year is seen by the Government as an important step towards improving budget accountability.

Fiscal consolidation is the key to macroeconomic stability and sound debt dynamics.

The authorities are committed to prudent fiscal policy, and this is a central element of the PRSP. The general Government's overall deficit narrowed from 12.5 per cent of GDP in 1999 to 5.9 per cent in 2001-02, reflecting a surge in revenue, and was well below the initial program target. The budget deficit is projected to rise slightly in 2003 due to the incorporation into the budget of new large investment projects.

The fiscal deficit was around 12-13 percent of GDP in 1998-1999, with the current balance also in deficit. The significant improvement over the past few years, which has seen a reversal in the downward trend in the current fiscal balance, reflects in particular the implementation of measures towards improving public expenditure management.

The exceptionally strong revenue performance over the past year reflects the impact of tax enhancing measures coupled with a strengthening of tax and customs administration. As the staff report notes, however, the tax level in Mongolia is very high, with tax revenue and social security contributions projected at nearly 30 per cent of GDP in 2003. The authorities strongly feel that the corporate tax burden has to be reduced in order to provide greater incentive to private sector development. However, they fully recognize that action can not be taken on this front which would undo the hard-won gains to date in the battle to achieve fiscal sustainability. It is with this in mind that the plan to reduce the corporate income tax rate in 2003 was postponed until 2005.

Given the need to reduce the tax burden combined with the task of further lowering the fiscal deficit in order to improve Mongolia's debt dynamics, this means that the priority must be placed on lowering public sector expenditure. However there is also the need to improve the country's infrastructure. Some of the public sector investment projects that are planned will facilitate private sector development in the rural areas where unemployment, poverty and migration are high. In addition, there is considerable pressure to increase public sector wages and pensions, which was one of the Government's election promises . The only way these various tensions can be reconciled is through improving the efficiency of public sector expenditure and reducing unproductive outlays.

The authorities have established a high level task force with the objective of reducing public sector expenditure. Some of the proposals that were considered included the privatization of components of social sector budget entities along with civil service retrenchments. As noted previously, the Government has been very receptive to Fund advice and after consultations with the Fund and the World Bank it was agreed that many of the proposed expenditure reduction plans were short-term and a more sustainable approach was required.

The task force is continuing its work in identifying areas for a sustainable reduction in expenditure. This has proved to be a challenging task given data deficiencies and they have planned a number of functional reviews of major ministries. The focus is on the reform of the civil service and with the assistance of the World Bank, a comprehensive overhaul of the civil service should be completed by 2004.

The staff have noted that revenue and expenditure projections are traditionally cautious/understated. The authorities believe that it is prudent to take a cautious approach to revenue estimation and that this has served them well. Nevertheless they fully endorse the need for all budget projections to be as realistic as possible and a considerable effort has been directed towards improving budget planning and expenditure control. In particular the reforms relating to the treasury system, and the introduction of the Treasury Single Account has already significantly improved the monitoring and control of Government expenditures, along with improving the quality and reliability of the fiscal reports. Timely budget allocations have increased the confidence of budget entities and ensured timely expenditure payments. Arrears from budget entities have been substantially eliminated and the bank restructuring bonds have been retired ahead of schedule and borrowing through T-bills reduced. These latter steps have lowered high-cost domestic sources of budget financing.

Increased confidence in the banking sector and prudent monetary policy settings

Major structural changes have helped improve public confidence in the banking system. To quote the headline in a recent Oxford Analytica article on Mongolia ; 'Banks are better after a decade of reform'. This progress is a critical element in Mongolia's transition to a market economy and the authorities recognize that a strong and efficient financial sector is a pre-condition to sustained economic growth and poverty alleviation. The changes that are underway in the financial sector do, however, complicate the interpretation of monetary and credit developments. In recent years money and credit growth has expanded at unprecedented rates although this has not translated into appreciably higher inflation. During the program period bank deposits nearly doubled from Tog 222.2 billion at end 2002 to Tog 436.8 . There was a similar increase in credit growth to the private sector. As noted, this increase should primarily be viewed as an indication of the improved confidence in the banking sector and, despite the high growth in money and credit supply, NPLs were reduced. Underpinning this improvement in confidence is greater competition in the sector and improvements in the legal environment and central bank supervision. Importantly, there have been recent moves to amend the central banking law in order to strengthen the governance procedures for the central bank (BOM) with the establishment of an independent supervisory body. As outlined in the staff report, there have also been decisive moves to prohibit the BOM from undertaking any quasi-fiscal activities.

With the rise in inflation in the early months of 2003, the BOM has increased the rate on central bank bills in order to slow monetary growth. Inflation is currently trending down.

Structural reforms continue to be advanced

The Government is decisively pursuing policies to deepen structural reforms. An important achievement was the privatization of two commercial banks to strategically important investors. In addition, in July 2003 an international management team took control of the Mongolian airline, MIAT. This is a significant step towards the privatization of the company, which is the Government's objective.

The privatization of NIC, one of the largest oil importing companies was also successfully completed. The biggest local insurance company has been offered for sale and seven bids have been received. The tender is expected to be completed in late September, 2003. A new tender for the sale of the Government's 70 per cent share in Gobi, the cashmere company, will be announced in the latter half of 2003.

Foreign investment has risen in recent years. This reflects steps by the Government to promote foreign investor interest in Mongolia and, in particular, improvements in political and economic developments along with enhancements in the legal framework. The Government sees this development as an important factor in maintaining sustainable economic growth.

The Government has adopted a sustainable energy sector development strategy to cover the period 2002-2010. As part of this strategy, a restructuring of the energy sector is currently underway which includes the establishment of an independent energy regulatory authority.

Energy generation, distribution and transmission companies are being restructured and some are being prepared for privatization, with a power generation station and two distribution companies to be privatized this year. In 2002 an energy construction company was privatized and at the start of v2003 two local power stations were privatized.

Risks to the program are manageable

The staff report notes that there are risks to the implementation of the ambitious reform program which underpins this program, particularly in the lead-up to the parliamentary elections in 2004. In many respects this is a fact of life in any democracy and the risks to policy settings associated with the political cycle are not unique to Mongolia. However the authorities are committed to maintaining and building on the significant gains that have been made in Mongolia's transition to a market economy. That will not give up the progress that has been made on fiscal consolidation and the reform of the banking and financial sectors. With the continued strong support of the donor community, along with the assistance provided by the Fund and other international agencies, the authorities are confident that progress will be maintained and they believe that they are well placed to meet the many challenges that lie ahead.