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Statement by Juan L. Cariaga

**Mongolia - Country Assistance Strategy and
Fiscal Technical Assistance Project**

Overview

We would express our appreciation for this objective assessment of economic and social, as well as political developments in Mongolia in recent years. The Country Assistance Strategy (CAS) presents a comprehensive summary of the most important of these, including treatment of crosscutting issues, and describes how the World Bank Group, in partnership with other organizations, can help accelerate growth and contribute to Mongolia's economic transition.

We are encouraged by the government's impressive commitment to far reaching economic reform without ambiguity in spite of the challenges and social resistance that exists. This attitude will help to create an enabling environment for private sector development, which will be the foundation for sustained growth. Continuing this strategy will be an important factor in support of the Bank's own assistance scenarios.

Although we endorse this CAS and the accompanying Fiscal Technical Assistance Project, we would like to offer some comments and observations that we hope will also be useful:

General Observations

First, the importance and usefulness given to broad consultations with various policymakers and others aimed at identifying and developing better products and outputs struck us most forcefully. We believe it important that the CAS process draws upon a diversity of views, as this one does, including those of the government, politicians, NGOs, private groups and other donors. In particular, we appreciated Box 1 of the CAS, which provides a summary of the key issues discussed and a breakdown of conclusions and recommendations, both overall and by specific groups and organizations. Even though there is unhappiness with some of the pace and effects of the economic reform process, the broad societal agreement about the basic direction seems to be a result of this effort to reach consensus.

Consultation with government and civil society has strengthened ownership and provided a rich feedback, which has been built into the CAS. As a result of those discussions the CAS for Mongolia was able to better address and incorporate the concerns of the different groups consulted, including on the development agenda, the lending and

nonlending programs, and the efficiency of service delivery. Among the concerns expressed by these groups and discussed in the CAS are questions of how to efficiently tackle the problem of poverty reduction, improvement of living standards, employment generation and targeted social assistance.

Such input not only contributes to ownership but we believe it also helps to better inform the preparation of projects and proposals. We congratulate both staff and government authorities for this and we recommend that this approach should be used more often. With this approach we find that the overall assistance strategy and objectives (macroeconomic stabilization, facilitating private sector development, investment in infrastructure and promotion of greater equity in development) is better able to support the government's primary goal of reducing poverty.

The volatility of commodity terms of trade is an issue requiring attention, not only through prudent fiscal management, but also through seeking diversification. Otherwise, this fragility can offset achievements elsewhere in the economy. We are encouraged that the government's 1996-2000 policy agenda largely reflects these challenges.

An area that we suggest needs continuing attention is the financial sector, not only through a better regulatory framework, but also through more competition to bring down interest rates in real terms. Financial intermediation and savings improvement will assist private sector development, especially if the possibility of long term financial resources is improved.

As a transitional economy, Mongolia is challenged by increased poverty, income inequalities and unemployment, some of which is gender specific, even though Mongolian society enjoys relative gender equality. The safety net of health and education services has deteriorated as a result of a reduction in fiscal expenditures. Labor markets are depressed and unemployment is largely caused by a restructuring of enterprises.

In this situation, and as in other transitional economies, there appears to be a growing and vigorous informal sector. As elsewhere, we would urge that consideration be given to seeking tax and other initiatives that will regularize this sector and allow it to contribute to fiscal stability.

Nevertheless, the CAS also highlights certain important problems, including low national savings, which are insufficient to finance the country's investment requirements, and the growth required to diminish the high number of households below the poverty line. We are pleased that the government intends to halve the number of poor households by early next century. Realization of this aim will be a function of sustained growth resulting in job creation and continued support for private sector development.

In view of the great need for infrastructure development in Mongolia, we believe support of such projects is an appropriate method to stimulate growth and private sector development. We also note that there is a deliberate absence of Bank programs in the health and

education sectors and would appreciate a fuller explanation as to the reasons for this.

The Bank Group program envisages Mongolia remaining in IDA-only status and includes lending, various non-lending services and demand-driven IDA guarantees. It foresees an increase in lending to around \$35 million per year, on average, depending on improved macroeconomic management, structural reforms and portfolio performance. We endorse the base case strategy outlined for eight lending operations, which assumes continued strong government commitment to reform and political stability, as well as the alternative scenarios outlined in the event of slippage or external shocks.

We would also support the IDA initiative to hold an Investor's Conference on agroindustry and tourism, jointly with FIAS, IFC and MIGA. This type of meeting can help the authorities to more efficiently promote economic sectors in order to attract and mobilize FDI, needed for the development of specific export oriented projects.

We also strongly support Bank's coordination and close collaboration with other donor countries and international organizations. Establishment of a Resident Mission in 1998 will facilitate this task, and also improve program implementation and monitoring. We welcome this and understand the Mission is to be opened officially in June.

Economic Considerations and CAS Risks

The privatization process of remaining state-owned industries should continue. Perhaps the engagement of IFC could accelerate this strategy and ensure transfer of remaining state assets to the private sector. Steps in the right direction are the rationalization of food prices and the adjustment of energy prices, reducing the need for subsidies. New central bank and commercial banking laws as well as the introduction of new corporate taxes, a value added tax (VAT) and mining law will hopefully mean that domestic financing of a budget deficit will not be necessary, allowing domestic credit to the private sector to expand.

We were pleased to see that growth resumed in 1994, after some years of decline. These achievements were possible due to improvement in macroeconomic management and a strong commitment from authorities to deepening and implementing structural reforms. Nevertheless, in spite of this, it is also apparent that much remains to be done in many areas, especially as regards the high level of poverty.

In order to ensure sustained economic growth it is important that Mongolia diversify its exports, reach new markets and attract higher levels of FDI. In view of this, we believe it appropriate that there be more involvement by IFC in the promotion of private sector development, as was also asked by private sector representatives consulted in the preparation of the CAS.

Mongolia is endowed with vast natural resources, especially minerals. This has helped to attract investments and to expand exports. However, this situation has also meant a dependency on world markets and world market prices. The prospects for growth will be

determined by the external environment, its ability to diversity exports and to integration into international markets and attract higher levels of FDI. Trade data shows an improvement in this regard, but it poses a difficult challenge for the management of external influences. More integration into the world economy should help to bring improvement in the terms of trade.

As mentioned in the CAS, one of the main risks remains the unsustainable debt level associated with a disputed TR10.5 billion transferable ruble debt to Russia. Can staff comment on which is the most realistic scenario that may be expected for resolution of this question.

The impact of East Asian crisis has been limited for Mongolia, but we would appreciate an update on this as well as any additional staff views on envisioned future impact if the crisis is not resolved. Specifically, how would this affect exports and flow of FDI to the country?

Fiscal Technical Assistance Project

The proposed fiscal technical assistance project addresses the need for improving the government's financial management system as well as establishing a more effective, non-distorting system of value-added tax (VAT) collection for goods and services. This project is part of a broader effort to support the Mongolian government's Public Administration Reform. There are a number of possible controversial aspects to this program, including questions as to whether it enjoys broad support from pertinent agencies as well as other stakeholders. The opposition political party has sought more time for evaluation. We have seen that this has caused problems when implementing public sector reform in other countries. Another risk that is identified is that a significant part of government banking services are expected to be handled by a limited number of viable banks, creating possibilities for conflicts of interest.

Nevertheless, we also note that there is strong political commitment from the highest levels of the government, which has undertaken an extensive effort to develop public support and that a great deal of startup activity has already occurred. In view of this, as well as the evident need for improvement in the government's financial management system, we believe that this project merits our endorsement.

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Finally, we would like to wish the Government of Mongolia and its people every success in the implementation of this Country Assistance Strategy and express our hopes that it will soon bring important economic growth and developmental benefits to all the people of Mongolia.