

SECTOR ASSESSMENT (SUMMARY): PUBLIC SECTOR MANAGEMENT

Sector Road Map

1. Sector Performance, Problems, and Opportunities

1. Gross domestic product (GDP) growth in Mongolia accelerated to 5.1% in 2017 from 1.2% in 2016, mainly as a result of a surge in coal exports and large investments tied to underground development at the Oyu Tolgoi copper and gold mine. The evidence of a recovery from the most recent economic shock is testament to the underlying strengths of the economy and the determination of key stakeholders in government to rebuild economic growth. The Asian Development Bank (ADB) has projected Mongolia's GDP growth to moderate to 3.8% in 2018 before rising again to 4.3% in 2019.

2. Good progress has been made on reducing poverty with reductions at state level from 38.8% in 2010 to 21.6% in 2014. It is anticipated, however, that the 2016 crisis caused by decline of commodity prices combined with government overspending will have a negative effect on the poverty head count, especially with high inflation and decreased job opportunities, although there is an expectation of slow recovery from 2018 onwards because of increasing mineral prices and an anticipated economic recovery.

3. In line with the government's commitments under an agreement with the International Monetary Fund (IMF) Extended Fund Facility, the budget deficit was slashed to the equivalent of 3.9% of GDP in 2017 from 15.3% in 2016. Fiscal consolidation reduced budgetary expenditure by 5.4%, while higher receipts from taxes on external trade and connected activities lifted budget revenue by 35.8%. Even with stronger revenue performance, the authorities withdrew savings from the Fiscal Stability Fund, estimated to equal 2.1% of GDP, to finance normal budgetary operations.

4. Efforts to modernize and improve public finance management systems and arrangements in Mongolia have been consistent in direction, even if at times they have materialized slower than planned. The government, with support from ADB, the World Bank, and other development partners, has made considerable progress in achieving the key objectives of prudent public financial management: maintaining fiscal discipline, strategic allocation of resources, and operational efficiency in the delivery of goods and services. The inherent strength of the system (established practices, consistent direction of change, and skilled officers) has been one factor in the country's rapid economic recovery from the latest crisis.

5. **Public expenditure and financial accountability framework assessment.** A comprehensive diagnosis of the health of Mongolia's public finance management was carried out with support from the World Bank, using its public expenditure and financial accountability framework; the report was published in April 2015.¹ The report notes some areas of good performance as well as areas where further improvements are required.

6. Budget credibility was low, as evidenced by large discrepancies on both the revenue and expenditure side between planned and actual targets. During 2015–2016, actual revenues fell short by 3.3% on average, while actual expenditures fell short by 33.0% on average. Mid-year amendments were required to be made to the budget by the Parliament in each year. The budget's high dependency on volatile revenues from mineral resources provides a challenge to

¹ World Bank. 2015. *Mongolia Public Financial Management Performance Report*. Washington, DC.

revenue forecasting and there has been a tendency to expand budget spending based on overly optimistic forecasts of key macroeconomic parameters.

7. Budget transparency and comprehensiveness has improved, although the off-budget financing, in particular with grant-financed projects, still has a negative impact on the accuracy of budget information and reduced transparency. Similarly, investments financed by loans from the Development Bank of Mongolia were not included in either the medium-term fiscal framework or the annual budget, thereby compromising their credibility.

8. Predictability and control of budget execution was an area characterized by both strengths and weaknesses. Good progress was seen in several areas, including tax administration and tax collections, but weaknesses prevailed in payroll controls and in cash management, which are partly consequences of the lack of budget credibility. Overoptimistic revenue forecasts resulted in an increase in discretionary tax audits to meet revenue targets, hurting the business climate. Weaknesses in tax administration resulted from weak taxpayer registration which, in turn, is a consequence of the lack of integrated information and communication technology (ICT) systems.

9. Accounting, recording, and reporting practices were strong and demonstrated that frontline service delivery units received resources without delay and spent most of their budgets. However, inconsistencies and incomplete systems (the government financial management information systems are not used to prepare reports, which are instead prepared using desktop systems) resulted in task duplication and inefficiencies.

10. External scrutiny and audit is exercised by the National Audit Office, and its procedures for review were firmly established. All central government entities were audited annually, but following submission of audit reports to Parliament, reviews by the relevant parliamentary committee tend to be cursory.

11. Since the last public expenditure and financial accountability exercise, further improvements have materialized. These included changes to control off-budget spending through the Development Bank of Mongolia and resolving the lack of coordination between the Ministry of Finance (MOF), which is in charge of the overall budget plan, and the Ministry of Economic Development, which controls the capital budget. The issue of off-budget expenditures was partly resolved in 2016, although grant-financed operations are still off-budget and while disbursement information on lending operations (ADB, World Bank) is made available, it does not follow the government's budget nomenclature. Responses also included machinery of government changes, which involved the dissolution of the Ministry of Economic Development and the reallocation of some of its responsibilities to the MOF. This significantly reduced the challenges associated with a bifurcated responsibility for budget preparation, e.g., a lack of coordination in the preparation of the capital budget, and weak links between the capital and recurrent sides of the budget.

12. The proposed ADB loan will support the Government of Mongolia to improve the efficiency and transparency of its public expenditure management and tax administration, achieve greater alignment between resource allocation and the pursuit of its main policy goals, and provide improvements in the areas of service delivery and public accountability. Both the public investment information management systems (PIMIS) and tax administration and information system (TAIS) components of the project provide the government the means to address selected

problem areas in public finance management, as identified in various diagnostics supported by ADB, the World Bank, and the IMF.²

13. The component of ADB's project that will be implemented by the General Department of Taxation (GDT) includes the procurement of a series of software packages, developed by the ICT Center for the Ministry of Finance, Tax and Customs (IT SOE), which will support the new tax system. The key objective of the system will be to establish a database that links taxpayer identification numbers to the registration system and all the other main processes of tax administration, including audit and compliance. Implementation of the system, including preparatory work by the GDT, will remedy a fundamental weakness in the tax administration, i.e., the unreliable taxpayer database. The component deliberately aims for incremental improvements, and to avoid problems encountered with earlier, more acute ICT projects in tax administration.

14. The PIMIS component builds on earlier work that has been carried out to strengthen public investment programming, including the use of ICT to improve efficiency and effectiveness. Taken as a whole, the system of public investment management suffers from a lack of integrated information exchange and inefficient business processes. The PIMIS component seeks to integrate and strengthen existing ICT systems, streamline business processes, and improve the capacity of staff.

15. A key aspect of the new platforms is the capacity of the IT SOE to provide continuous support that ensures the security and resilience of the system in the GDT and the MOF. The IT SOE is a relatively young organization, with an early success in the delivery of the "e-Barint system", the value-added tax promotion system. It has strong links with the senior management team in the GDT, which is committed to the ambitious project plans for the TAIS (each member has a copy of the project plan on his or her office wall and each division has officers dedicated to the project). It will be important that the strong role of the IT SOE is matched within the GDT by a role focused on data and information management, both as an intelligent customer of the ICT provider and in terms of developing the data and information strategy for the tax administration, which will be critical to improving compliance over the long term.

2. Government's Sector Strategy

16. The government has for many years been pursuing a development strategy that is anchored in harnessing the revenues from its vast mineral resources to improve the lives of its citizens and abolish poverty. This commitment has also been a driver behind the reform of public finance management, the transparency of government operations, and the promotion of citizens' engagement.

17. It is apparent in engaging with the Mongolian public sector that openness and engagement and respect for the individual are significant traits. Many government initiatives and regulatory measures have been put in place to improve citizens' rights and facilitate their involvement in government, including the ability to monitor government procurement. These initiatives support the goals of fiscal sustainability, strategic allocation of resources, and efficient service delivery, which in turn improve the lives of the citizens.

² A recent technical assistance report by the IMF on public investment spending focused on inefficiencies—which resulted in project delays or cancellations, cost increases, and the deterioration of assets—recommending that greater importance should be given to maintenance spending and that the monitoring of public investment implementation required strengthening. IMF Fiscal Affairs Department. 2018. *Mongolia: Improving the Efficiency of Public Investment Spending*. Washington, DC.

18. Although public financial management reform is highlighted as a priority in several government documents, there is no overall strategy for the pace and direction of these reforms. Officers in the MOF mostly refer to the Budget Law for strategic directions. They noted that the directions in the Budget Law were complemented by the Government's Action Plan, 2016–2020.³ At an aspirational level, these documents are underpinned by Mongolia's Sustainable Development Vision 2030 and the Three Pillars Development Policy, which focuses on good governance, social development, and diversifying the economy. The action Plan lists over 250 specific actions over five broad areas including sustainable economic growth, social policy, and defense.

3. ADB Sector Experience and Assistance Program

19. As mentioned, ADB has supported Mongolia in strengthening its public financial management performance for a number of years and is geared to continue such support in the future. Both the GDT (TAIS) and MOF (PIMIS) components will significantly improve the infrastructure for ICT systems which support Mongolia's public finance management.

20. The PIMIS component focuses on increasing the accuracy, timeliness, and transparency of the budget and other public finance processes. This is likely to provide an opportunity for future alignment and coherence of the organization and processes involved in public finance management. The TAIS component will replace outdated tax ICT systems, ensuring integration of each module, improved tax registration, and linking of processes in the tax cycle through audit and collection. The new infrastructure and database capability should provide a robust platform for future development.

21. In addition to the TAIS and PIMIS projects, ADB is supporting both tax policy reform and improvements to tax administration through the ADB technical assistance.⁴

22. The ADB country partnership strategy, 2017–2020 for Mongolia supports “investments, policy reforms, capacity building, and knowledge sharing to sustain inclusive growth in a period of economic difficulty. To achieve this, ADB will base its operations in three strategic areas (i) promoting economic and social stability, (ii) developing infrastructure for economic diversification, and (iii) strengthening environmental sustainability.”⁵

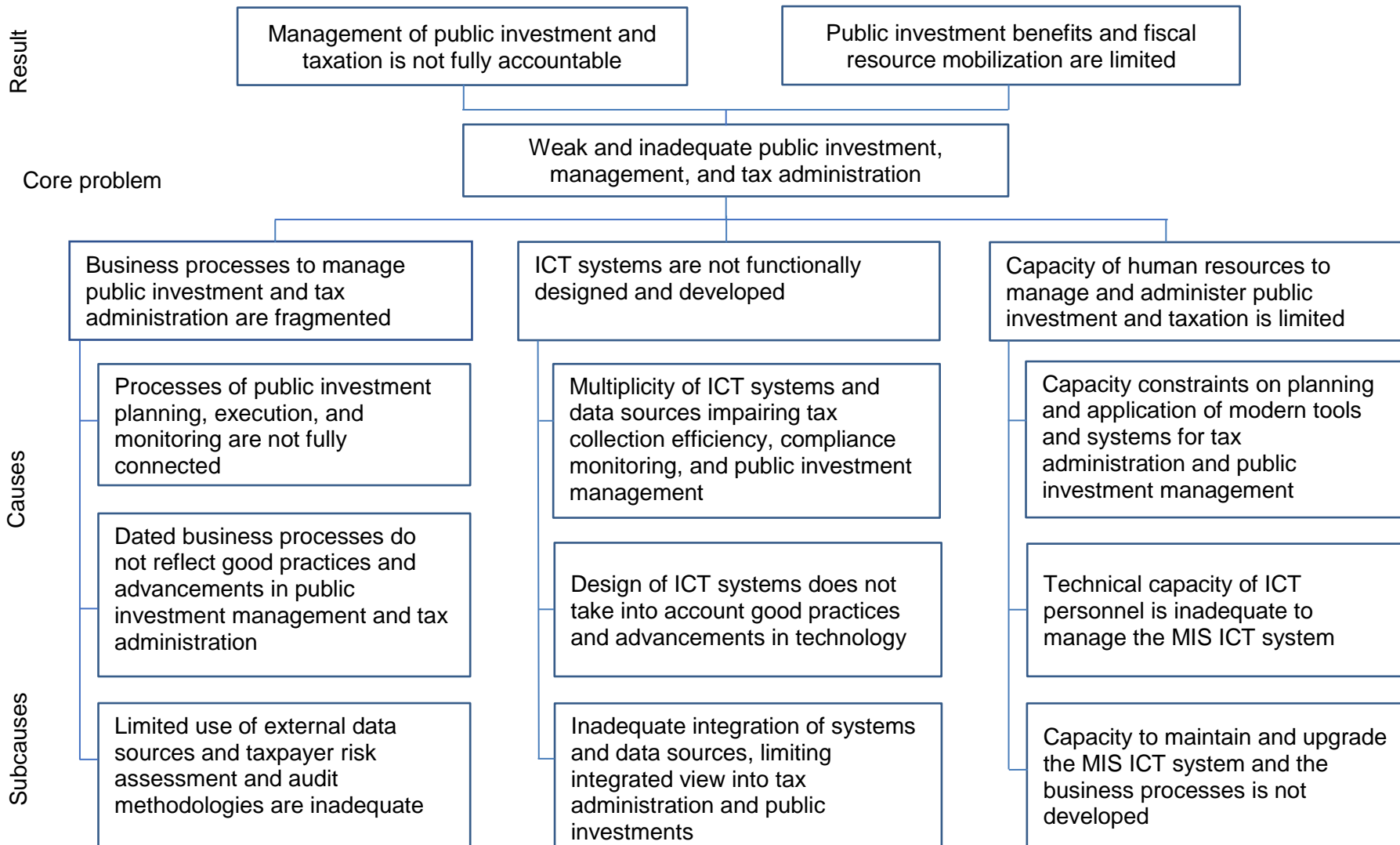
23. The work of ADB in support of public finance management in Mongolia is well-coordinated with support from other development partners, such as the IMF and the Korea International Cooperation Agency. There are still challenges, though. Grant-financed projects are not included in the budget and therefore no information on disbursements of these projects is available to the government. Disbursement information from loan-financed projects from the largest donors (World Bank and ADB) is made available within 2 months of the end of the quarter, but does not follow the budget classification system and is therefore not included in the budget reports.

³ Government of Mongolia. 2016. *Government Action Plan, 2016–2020*. Ulaanbaatar.

⁴ ADB. Mongolia: *Strengthening Information and Communication Technology Systems for Efficient and Transparent Public Investment and Tax Administration Project*. <https://www.adb.org/projects/documents/mon-51084-001-cp>.

⁵ ADB. 2017. *Country Partnership Strategy: Mongolia, 2017–2020*.

Problem Tree for Public Sector Management



ICT = information and communication technology, MIS = management information system
 Source: Asian Development Bank