

## FINANCIAL ANALYSIS

### A. Introduction

1. The project does not have a revenue-generating component, so financial costs and benefits were not analyzed. Instead, the financial position of the government was reviewed and the sustainability of the project was assessed at the fiscal and project levels in accordance with Asian Development Bank (ADB) guidelines.<sup>1</sup>

### B. Financial Position of the Government

2. Annual gross domestic product (GDP) growth in Mongolia has declined sharply from 11.6% in 2013 to 1.0% in 2016. The main factor for the decline in economic growth was a fall in foreign direct investment (FDI) and mineral exports. Limited economic diversification has left Mongolia highly dependent on its mining sector, which relies heavily on inflows of FDI. This renders the economy vulnerable to swings in commodity prices and the economic cycles of its trading partners. FDI fell to \$94.32 million or 0.8% of GDP in 2015 after reaching \$4.5 billion or 36.0% of GDP in 2012. Although inflation declined to 3.2% on average in 2016, it is projected to rise to 5.4% in 2017. The current account deficit grew modestly to about 8.0% of GDP in 2016, but is expected to jump to nearly 17.0% of GDP in 2017 as imports begin to increase following the start of major mining operations.<sup>2</sup>

3. To ease the impact of the fall in GDP growth, Mongolia has pursued a policy to support economic growth by launching the Price Stabilization Program through the Bank of Mongolia in late 2012. Under the program, the Bank of Mongolia provided low-cost funding to businesses whose price-setting behavior mitigated impacts on inflation.<sup>3</sup> At the same time, sovereign bonds (i.e., Chinggis bonds and Development Bank of Mongolia bonds) were issued in the international market to finance domestic infrastructure development and provide short-term foreign exchange liquidity to the banking sector. However, on account of the decline in FDI inflows, bonds issues were increasingly used to fill the balance of payment financing gap.

4. On 24 May 2017, the International Monetary Fund approved a financial arrangement to support the government's economic reform program.<sup>4</sup> Developed in line with the Economic Recovery Plan approved by the parliament on 24 November 2016, the program is expected to stabilize the economy with a large package of external financing, and lay the basis for sustainable, inclusive, and long-term growth. By 2019, growth is projected to pick up to about 8%, as economic and financial conditions improve and key mining projects take off.

5. Table 1 presents selected economic indicators for 2013–2016.

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<sup>1</sup> ADB. 2005. *Financial Management and Analysis of Projects*. Manila; ADB. 2009. *Financial Due Diligence: A Methodology Note*. Manila.

<sup>2</sup> ADB. 2016. *Asian Development Outlook 2016 Update: Meeting the Low-Carbon Growth Challenge*. Manila.

<sup>3</sup> Supported businesses included wholesale distributors of meat, flour, petroleum products, construction, coal, and various agricultural products.

<sup>4</sup> International Monetary Fund. 2017. IMF Executive Board Approves Financial Arrangement for Mongolia. Press Release No. PR17/193. 24 May. <http://www.imf.org/en/News/Articles/2017/05/24/17193-imf-executive-board-approves-financial-arrangement-for-mongolia>.

**Table 1: Economic Indicators, 2013–2016**

Indicator	2013	2014	2015	2016
GDP growth (% per year)	11.6	7.9	2.3	1.0
Inflation (% per year)	10.5	12.8	6.6	3.2
Current account balance (% in GDP)	(25.4)	(11.5)	(4.8)	(8.3)
GDP at current price (MNT billion)	14,350.7	15,482.3	15,837.7	15,996.0
Total government expenditure (MNT billion)	6,164.7	7,144.6	7,136.9	7,954.4
Government expenditure (% of GDP)	32.0	32.0	31.0	29.8
Expenditure on education (MNT million)	936,504.0	1,173,000.8	1,005,228.2	1,203,288.2
Expenditure on education (% of government expenditure)	15.2	16.4	14.1	15.1
Expenditure on education (% of GDP)	6.5	7.6	6.3	7.5

( ) = negative, GDP = gross domestic product.

Sources: National Statistical Office; Ministry of Education, Culture, Science and Sports; Asian Development Bank. 2016. *Asian Development Outlook 2016: Asia's Potential Growth*. Manila.

### C. Financial Sustainability

6. From 2013 to 2016, total education expenditures increased from MNT936,504.0 million to MNT1,203,288.2 million, or by about 29%. Total education expenditures as a percentage of total government expenditures averaged close to 15% over the same period. Total education expenditures as a percentage of GDP remained around 7.0 on average from 2013 to 2016.

7. The Ministry of Education, Culture, Science and Sports (MECSS) executes the education budget. Education expenditures account for the largest share of total MECSS expenditures—97% in 2013 and an estimated 92% in 2016. Education expenditures declined substantially (15.4%) from 2014 to 2015. For 2016, preliminary figures estimated an increase of 12.8%. A breakdown of MECSS expenditures for 2013–2016 is in Table 2.

**Table 2: Total Expenditure of the Ministry of Education, Culture, Science and Sports 2013–2016 (MNT million)**

Item	2013	%	2014	%	2015	%	2016 <sup>a</sup>	%
<b>MECSS Total</b>								
<b>Expenditures</b>	1,037,534.1		1,307,416.2		1,100,890.9		1,218,348.5	
Total recurrent costs	921,013.4	88.8	1,038,271.4	79.4	972,985.4	88.4	1,039,042.6	85.3
Total capital costs	116,520.7	12.7	269,144.8	25.9	127,905.5	13.1	179,305.9	17.3
<b>Education</b>								
Total expenditures	1,002,027.4		1,169,105.4		989,179.5		1,115,881.8	
Total recurrent costs	893,416.8	89.2	949,534.8	81.2	890,739.5	90.0	954,045.4	85.5
Total capital costs	108,610.6	12.2	219,570.6	23.1	98,440.1	11.1	161,836.4	17.0

MECSS = Ministry of Education, Culture, Science and Sports.

<sup>a</sup> Estimates.

Source: MECSS.

8. An upward trend in the education budget is also projected within the medium-term budget framework for 2016–2019 (Table 3). However, in April 2017, a revised government budget, including the budget for MECSS, was approved by the parliament, in accordance with the agreement reached with the International Monetary Fund. Given a restriction on government spending, the MECSS budgets are expected to be substantially lower from 2017 to 2019.

**Table 3: Projected Budgets for the Ministry of Education, Culture, Science and Sports  
2016–2019 (MNT million)**

Item	2016	2017	2018	2019
Basic and secondary education budget	831,905	866,913	1,013,362	1,125,297
Pre-primary	268,296	276,365	285,757	314,450
Primary and secondary	563,609	590,547	727,605	810,847

Source: Ministry of Education, Culture, Science and Sports.

9. On account of this situation, the share of the project costs (\$50.69 million) borne by the government will be kept at about 1.4% or \$690,000. The government will provide the counterpart funding through tax exemptions on goods procured under the project. Thus, negative impacts on the budget are considered minimal.

10. As shown in Table 4, the annual incremental recurrent costs, including operation and maintenance of the schools and kindergartens supported under the project, have been estimated to be MNT396 million in 2018, MNT983 million in 2019, MNT8,008 million in 2020, and MNT3,740 million in 2021. The costs represent about 0.04% in 2018, 0.09% in 2019, 0.62% in 2020, and 0.26% in 2021 of the basic and secondary education budget. Therefore, the impact of the annual incremental recurrent costs of the project facilities on the basic and secondary education budget is deemed affordable for the sustainability of project benefits.

**Table 4: Projected Incremental Recurrent Costs and Operation and Maintenance  
Expenditures for the Facilities under the Project, 2018–2021 (MNT million)**

Item	2018	2019	2020	2021
Basic and secondary education budget <sup>a</sup>	1,013,362	1,125,297	1,282,838	1,462,436
Recurrent costs including O&M of project schools and kindergartens	396	983	8,008	3,740
Recurrent costs including O&M as % of basic and secondary education budget	0.04	0.09	0.62	0.26

MECSS = Ministry of Education, Culture, Science and Sports; O&M = operation and maintenance.

<sup>a</sup> Estimates.

Source: Asian Development Bank and MECSS estimates.