



# Report and Recommendation of the President to the Board of Directors

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Project Number: 39229-033  
August 2015

## Proposed Loans for Additional Financing and Administration of Technical Assistance Grant Mongolia: Agriculture and Rural Development Project

This is the version of the document approved by ADB's Board of Directors that excludes information that is subject to exceptions to disclosure set forth in ADB's Public Communications Policy 2011.

Asian Development Bank

## CURRENCY EQUIVALENTS

(as of 24 August 2015)

Currency unit	–	togrog (MNT)
MNT1.00	=	\$0.000502
\$1.00	=	MNT1,992.00

## ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
MOF	–	Ministry of Finance
MOFA	–	Ministry of Food and Agriculture
MOI	–	Ministry of Industry
OCR	–	ordinary capital resources
PAM	–	project administration manual
PMU	–	project management unit
PPB	–	project participating bank
PPE	–	project participating enterprise
SDR	–	special drawing right
SMEs	–	small and medium-sized enterprises
TA	–	technical assistance
VCI	–	value chain investment

## NOTE

In this report, “\$” refers to US dollars.

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## PROJECT AT A GLANCE

<b>1. Basic Data</b>		<b>Project Number: 39229-033</b>	
<b>Project Name</b>	Agriculture and Rural Development Project (Additional Financing)	<b>Department /Division</b>	EARD/EAER
<b>Country</b>	Mongolia	<b>Executing Agency</b>	Ministry of Finance
<b>Borrower</b>	Government of Mongolia		
<b>2. Sector</b>	<b>Subsector(s)</b>	<b>ADB Financing (\$ million)</b>	
✓ <b>Agriculture, natural resources and rural development</b>	Agro-industry, marketing, and trade		32.50
	Livestock		17.50
		<b>Total</b>	<b>50.00</b>
<b>3. Strategic Agenda</b>	<b>Subcomponents</b>	<b>Climate Change Information</b>	
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	Climate Change impact on the Project	Low
Environmentally sustainable growth (ESG)	Eco-efficiency		
<b>4. Drivers of Change</b>	<b>Components</b>	<b>Gender Equity and Mainstreaming</b>	
Governance and capacity development (GCD)	Institutional development	Effective gender mainstreaming (EGM)	✓
Knowledge solutions (KNS)	Knowledge sharing activities		
Partnerships (PAR)	Implementation		
Private sector development (PSD)	Private Sector Promotion of private sector investment Public sector goods and services essential for private sector development		
<b>5. Poverty Targeting</b>		<b>Location Impact</b>	
Project directly targets poverty	No	Rural	High
		Urban	Medium
<b>6. Risk Categorization:</b>	Low		
<b>7. Safeguard Categorization</b>	<b>Environment: B</b>	<b>Involuntary Resettlement: C</b>	<b>Indigenous Peoples: C</b>
<b>8. Financing</b>			
<b>Modality and Sources</b>		<b>Amount (\$ million)</b>	
<b>ADB</b>		<b>50.00</b>	
Sovereign Project loan: Ordinary capital resources		35.00	
Sovereign Project loan: Asian Development Fund		15.00	
<b>Cofinancing</b>		<b>2.00</b>	
Japan Fund for Poverty Reduction		2.00	
<b>Counterpart</b>		<b>11.00</b>	
Government		1.00	
Beneficiaries		10.00	
<b>Total</b>		<b>63.00</b>	
<b>9. Effective Development Cooperation</b>			
Use of country procurement systems		Yes	
Use of country public financial management systems		Yes	

## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on (i) proposed loans to Mongolia for the additional financing of the Agriculture and Rural Development Project, and (ii) the proposed administration of technical assistance (TA) to be provided by the Japan Fund for Poverty Reduction for Supporting Agriculture Value Chain.<sup>1</sup>

2. The additional financing will primarily help Mongolia increase the value addition on its rich yet underutilized livestock and other agricultural resources through (i) value chain investments (VCIs) by agro-enterprises and cooperatives, (ii) capacity strengthening of primary producers and processors, (iii) improvement of marketing and technical capacity of agro-enterprises and cooperatives, and (iv) development of Mongolian product brand(s). As a result, the additional financing is expected to generate employment opportunities and help diversify the Mongolian economy, which has been driven by the mining sector.

## II. THE PROJECT

### A. Rationale

3. The Asian Development Bank (ADB) approved on 29 September 2008 a grant of \$14.72 million from its Asian Development Fund (ADF) for the Agriculture and Rural Development Project (current project).<sup>2</sup> The revised closing date of the current project grant is 31 December 2015. The current project was supported by associated TA of \$2 million from the Japan Special Fund for Agricultural Marketing and Brand Development. The current project aims at a reliable supply of premium-value agricultural products to niche markets by selected enterprises. It comprises two outputs: (i) value chains able to deliver unique, premium-value products to niche markets; and (ii) fully defined process and institutional arrangements for collaborative brand development and management developed and demonstrated.

4. Agriculture sector is the backbone of the Mongolian economy and considered a key for diversifying the economy, which relies too heavily on the mining sector. In 2013, Mongolian agricultural primary products accounted for 20.1% and processed products for about 11.1% of Mongolia's gross domestic product. They are also the second largest export products after mineral products, accounting for 8.2% of total exports by value in 2013.<sup>3</sup> However, the agriculture sector is mostly concentrated on primary production and forgoing significant value addition in agriculture because of limited processing capacity. The bottleneck is lack of long-term financing, which has significantly hindered Mongolian agro-enterprises from making long-term investments to improve their productivity. As a result, Mongolia exports a significant portion of its agricultural products (e.g., wool, cashmere, and animal skins) after primary processing while it imports a substantial volume of processed or final products (e.g., dairy products). It is crucial for Mongolia to capitalize on the rich yet untapped resources of the agriculture sector, which employed 30% of the labor force in 2013. Development of the agro-processing industry will have a substantial impact on employment, in itself and through its backward linkages, in rural areas, where the poor comprised 33.3% of the population in 2012, and consequently contribute to sustainable and equitable development of the nation.

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<sup>1</sup> The design and monitoring framework is in Appendix 1.

<sup>2</sup> ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Asian Development Fund Grant and Technical Assistance Grant to Mongolia for the Agriculture and Rural Development Project*. Manila.

<sup>3</sup> National Statistical Office of Mongolia. 2014. *Mongolian Statistical Yearbook 2013*. Ulaanbaatar.

5. **Performance of the current project.** The current project is considered to be performing well<sup>4</sup> based on the five standards stipulated in the relevant section of the operations manual.<sup>5</sup>

- (i) **Output delivery.** The current project made progress toward the outcome and largely accomplished outputs 1 and 2. Against the outcome, the current project enabled 12 project participating enterprises (PPEs) to start selling some of their products to international and domestic premium-value buyers, but establishment of business partnerships will take longer. Against output 1, the current project financed 12 PPEs to develop their respective value chains to deliver higher-value products.<sup>6</sup> Those PPEs have realized noticeable improvements in product quality and productivity, and significant job creation directly at the enterprises and indirectly at the producers of raw materials.<sup>7</sup> The current project also provided (a) equipment and supplies to livestock testing centers and veterinary service centers of six selected provinces; and (b) machinery, equipment, and agricultural inputs, as well as training to selected agricultural cooperatives to improve the quality and production of raw materials.<sup>8</sup> Against output 2, the current project developed a framework for brand development, applied it to animal fiber and its products, and developed a Mongolian brand certification mark, Mongolian Noble Fiber. The certification mark has been registered at the intellectual property offices of Mongolia and 33 selected countries.
- (ii) **Implementation progress.** Implementation progress is satisfactory: 98.9% of disbursements and 98.9% of contract awards against 94.8% of elapsed time as of 14 August 2015.
- (iii) **Safeguard compliance.** Safeguard requirements have been met satisfactorily. Environmental and social safeguard screening procedures have been well established under the current project and applied to every subproject.
- (iv) **Management of risks.** The report and recommendation of the President for the current project identified (a) inadequate capacity of the enterprises to implement their investment plans, (b) delays in procurement processes, (c) delivery delays by contractors, and (d) misuse of funds by enterprises. Project implementation support provided by the project management unit (PMU) successfully managed most of the risks by assisting the PPEs in ensuring that VCI subloan proposals are feasible and by closely monitoring the PPEs' implementation of the proposals.
- (v) **On-track rating.** The performance of the current project is rated *on track*.

6. **Additional financing eligibility criteria met.** ADB's due diligence confirmed that the additional financing meets the eligibility criteria and standards.<sup>9</sup> The additional financing is in line with the Government of Mongolia's action program for 2012–2016, which places the highest priority on employment generation.<sup>10</sup> The additional financing will fully support ADB's interim country partnership strategy, 2014–2016 for Mongolia, which restores the core sector status of

<sup>4</sup> Summary of Project Performance (accessible from the list of linked documents in Appendix 2).

<sup>5</sup> ADB. 2011. Additional Financing. *Operations Manual*. OM H5/OP. Manila (para. 3).

<sup>6</sup> Against the target of 15, fewer PPEs were assisted because the actual subloan amounts were larger than the subloan amounts estimated during project preparation.

<sup>7</sup> ADB required a VCI proposal as well as financial, environmental, and social due diligence reports for each subloan under the current project, and will continue to do so under the additional financing.

<sup>8</sup> Contract farming between the PPEs and herders for primary livestock-based products (e.g., cashmere, wool, and leather) was found difficult because the PPEs and domestic producers are not able to offer competitive prices to keep herders in contracts, as the middlemen usually offer higher prices in bulk purchases.

<sup>9</sup> ADB. 2011. Additional Financing. *Operations Manual*. OM H5. Manila (para. 4 of BP; para. 3 of OP).

<sup>10</sup> Government of Mongolia. 2012. *Action Program of the Reform Government through the Years 2012–2016*. Ulaanbaatar.

the agriculture, natural resources, and rural development sector; and highlights private sector development for employment generation and diversification of the economy.<sup>11</sup> The additional financing is listed as a firm project for 2015 in ADB's country operations business plan, 2014–2016 for Mongolia.<sup>12</sup> ADB is currently preparing two loan projects for Mongolia: Regional Upgrades of Sanitary and Phytosanitary Measures for Trade Facilitation, which will complement the project by assisting agricultural and food product trade; and Supporting the Credit Guarantee System for Economic Diversification and Employment Project, which will support the financing sector's lending to small and medium-sized enterprises (SMEs).

7. **Additional financing priority met.**<sup>13</sup> The additional financing has a high degree of readiness since implementation capacity is well advanced and safeguard requirements have been met. The PMU's capacity for due diligence, including that for safeguards, built during the current project, adds a distinctive feature. The subproject selection criteria, approval procedure, and monitoring mechanism, established under the current project, will continue to be applied.<sup>14</sup>

8. **Changes in project scope.** The additional financing will assist the government in scaling up and modifying the scope of the current project that is performing well. In response to the government request, the project will (i) include additional subsectors,<sup>15</sup> (ii) adopt a regular onlending modality,<sup>16</sup> and (iii) expand the range of subloans by lowering the minimum amount.<sup>17</sup> The project will focus not only on export-oriented subsectors, but also on subsectors oriented for domestic markets, smaller-scale agro-enterprises, and cooperatives. Consequently, the focus of project impact and outcome was changed from the promotion of partnerships with premium-value buyers to economic diversification through higher value addition to agricultural resources.

9. Lessons from the current project were incorporated in the project design. First, it became clear that PPEs do not have sufficient technical and marketing capacity to establish business relationships with buyers of high-value products, particularly international ones. In response, two broad outputs under the current project were articulated into four outputs to factor in capacity improvement of agro-enterprises and primary producers in the project design. Second, the current project was implemented with three separate PMUs, according to project component, and experienced high costs of operation and difficult coordination between the components. To address such issues, the PMUs will be integrated into a single PMU with three subunits: a VCI subloan processing subunit for output 1 and two technical advisory subunits, one responsible for output 2 and the other for outputs 3 and 4.<sup>18</sup>

<sup>11</sup> ADB. 2014. *Interim Country Partnership Strategy: Mongolia, 2014–2016*. Manila.

<sup>12</sup> ADB. 2014. *Country Operations Business Plan: Mongolia, 2014–2016*. Manila.

<sup>13</sup> ADB. 2011. *Additional Financing. Operations Manual*. OM H5/BP. Manila (para. 11).

<sup>14</sup> Project Administration Manual (accessible from the list of linked documents in Appendix 2).

<sup>15</sup> The project will continue to support the wool and cashmere, leather, meat, and dairy subsectors; and add apparel, sea buckthorn, and bee farming subsectors. During project implementation, more subsectors and business types relating to agro-processing and agriculture may be added.

<sup>16</sup> Under the current project, the government provides a project participating bank (PPB) with an actual credit transfer equivalent to 50% of the subloan amount free of charge as a guarantee. This guarantee mechanism was designed to support the PPBs' lending to the agro-processing industry and served the purpose under the current project financed by a grant. With additional financing from loans, the government will relend loan proceeds to the PPBs for subsequent onlending to the PPEs.

<sup>17</sup> The additional financing will set the minimum amount at \$150,000, instead of \$600,000 under the current project.

<sup>18</sup> Under the current project, three PMUs had been set up in different offices for the (i) value chain development component, (ii) rural infrastructure and services development component, and (iii) associated TA.

## B. Impacts and Outcome

10. The impacts of the overall project will be (i) competitiveness of the agriculture processing industry enhanced, (ii) private sector-led employment generated, and (iii) SMEs developed. The outcome of the overall project will be value addition on Mongolian agricultural resources increased by PPEs. The project is expected to increase primarily the agro-processing capacity and secondarily primary agricultural production in Mongolia, and hence increase value addition to agricultural resources. The increased capacity will lead to employment generation, and indirectly benefit herders, farmers, and primary processors through the PPEs' increased demand for raw materials (footnote 8).

## C. Outputs

11. The overall project will have the following outputs: (i) VCIs financed, (ii) production capacity of herders and farmers improved, (iii) enterprises' marketing and technical capacity improved, and (iv) Mongolian product brand(s) developed. To ensure relevance and sustainability, capacity development will be conducted in cooperation with technical agencies, universities, and business associations in Mongolia.

12. **Output 1: Value chain investments financed.** Output 1 comprises (i) preparation of the VCI proposals; (ii) due diligence of the VCI subprojects; (iii) provision of subloans to the PPEs<sup>19</sup> to improve their value chains and/or enhance their production and productivity; and (iv) capacity development of the PPEs and project participating banks (PPBs) on financial management, value chain development, and social and environmental safeguards. The consolidated PMU will assist the PPEs in preparing the VCI proposals for subloan application, particularly in identifying areas for business improvement such as marketing, product development, and quality control. The identified needs will be reflected in the VCI proposals and used to tailor activities under outputs 2 and 3. The VCI financing is described in para. 18.

13. **Output 2: Production capacity of herders and farmers improved.** Output 2 comprises (i) capacity development for herders, farmers, and primary processors of agricultural products; (ii) provision of veterinary medical supplies, equipment, machinery, material, and inputs for herders, farmers, and primary processors of agricultural products; and (iii) construction of a livestock primary processing facility. The project will help herders, farmers, and primary processors, including potential suppliers of raw materials and primary processed products to the PPEs, to improve their production capacity and quality control.

14. **Output 3: Enterprises' marketing and technical capacity improved.** Output 3 comprises (i) marketing and technical capacity development to enable the PPEs to produce and deliver high-value and/or quality products to domestic and international markets; and (ii) provision of equipment and capacity development to technical and research institutes dealing with food and agriculture products. This output is based on an observation from the current project—that a substantial gap exists between the capacity of the PPEs and the quality standards that international markets require. In tandem with financial support to the PPEs (output 1), strengthening enterprises' marketing and technical capacity is crucial to realizing higher value addition. The capacity development training will be given not only to the PPEs, but also to other agro-enterprises of interest for a wider impact. The training will help strengthen the

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<sup>19</sup> PPEs under the current project comprise public limited or limited liability companies. Under the additional financing, PPEs will also include cooperatives registered under the Law on Cooperatives.



quality-testing capacity of technical institutes, which will help improve and assure the quality of Mongolian products in the medium term.

15. **Output 4: Mongolian product brand(s) developed.** Output 4 comprises (i) brand development for export-oriented products (e.g., animal fiber and its processed products); and (ii) promotion and management of brand(s) developed and/or to be developed. Regarding brand management, the project will continue to help the government register the Mongolian Noble Fiber certification mark with national intellectual property offices of selected countries that are current and potential buyers of the Mongolian animal fiber products. Regarding brand promotion and management, the project will assist Mongolian agro-enterprises in getting their products tested and certified for the certification mark.

#### D. Investment and Financing Plans

16. The additional financing is estimated to cost \$61.0 million (Table 1). Detailed cost estimates by expenditure category and by financier are in the project administration manual (PAM) (footnote 14).

**Table 1: Project Investment Plan**  
(\$ million)

Item	Current Amount <sup>a</sup>	Additional Financing <sup>b</sup>	Total
<b>A. Base Cost<sup>c</sup></b>			
1. Value chain investments financed	39.55	52.02	91.57
2. Production capacity of herders and farmers improved <sup>d</sup>	2.22	2.22	4.44
3. Enterprises' marketing and technical capacity improved	0.00	1.22	1.22
4. Mongolian product brand(s) developed	0.00	0.56	0.56
Project management <sup>e</sup>	2.40	1.51	3.91
<b>Subtotal (A)</b>	<b>44.17</b>	<b>57.54</b>	<b>101.71</b>
<b>B. Contingencies<sup>f</sup></b>	<b>3.33</b>	<b>0.67</b>	<b>4.00</b>
<b>C. Financing Charges During Implementation<sup>g</sup></b>	<b>0.00</b>	<b>2.79</b>	<b>2.79</b>
<b>Total (A+B+C)</b>	<b>47.50</b>	<b>61.00</b>	<b>108.50</b>

Note: Numbers may not sum precisely because of rounding.

<sup>a</sup> Refers to the original amount. Includes taxes and duties of \$0.67 million to be financed by the government.

<sup>b</sup> Includes taxes and duties of \$0.54 million to be financed from the government and Asian Development Bank (ADB) loan resources. ADB financing of taxes and duties is deemed acceptable as the (i) amount is within the reasonable threshold identified during preparation of the country partnership strategy, (ii) amount does not represent an excessive share of the project investment plan, (iii) taxes and duties apply only to ADB-financed expenditures, and (iv) financing of taxes and duties is material and relevant to the success of the project.

<sup>c</sup> In mid-2015 prices as at 16 March 2015.

<sup>d</sup> This output corresponds with the rural infrastructure and services development component of the current project.

<sup>e</sup> Comprises (i) project management support, and (ii) capacity development of the project steering committee and project management unit to ensure effective project management and implementation.

<sup>f</sup> Physical contingencies computed at 5% for all expenditure categories except value chain investments and consulting services. Price contingencies computed for all expenditure categories except value chain investments at 1.5% for 2016, 1.4% for 2017, and 1.5% for the years 2018–2020 on foreign exchange costs; and 9.0% for 2016, 8.5% for 2017, and 8.0% for the years 2018–2020 on local currency costs; includes provision for potential exchange rate fluctuation under the assumption of a purchasing power parity exchange rate.

<sup>g</sup> Includes interest and commitment charges. Interests during construction have been computed for (i) ADB's Asian Development Fund loan at 2.0% per annum during the implementation period, and (ii) ADB's ordinary capital resources loan at the 5-year US dollar fixed swap rate plus an effective contractual spread of 0.5% and maturity premium of 0.1%. Commitment charges for an ordinary capital resources loan are 0.15% per year to be charged on the undisbursed loan amount.

Source: Asian Development Bank estimates.

17. The government has requested a loan of \$35 million from ADB's ordinary capital resources (OCR) to help finance the project. The OCR loan will have a 25-year term, including a grace period of 5 years, following the straight-line method, an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility, a commitment charge of 0.15% per year (the interest and other charges during construction to be capitalized in the loan), and such other terms and conditions set forth in the draft loan agreement.<sup>20</sup> The average maturity is 15.25 years, and the maturity premium payable to ADB is 0.1% per annum. The government has also requested a loan in various currencies equivalent to SDR10.719 million from ADB's Special Funds resources (ADF) to help finance the project. The ADF loan will have a 25-year term, including a grace period of 5 years, an interest rate of 2% per annum during the grace period and thereafter, and such other terms and conditions set forth in the draft loan agreement.<sup>21</sup>

18. **Financing for value chain investment subloans.** For output 1 (item i), the government will relend an estimated \$41.25 million from the loan proceeds to the PPBs under onlending agreements to be entered into between the Ministry of Finance (MOF) and the PPBs on terms and conditions satisfactory to ADB. The government's relending to the PPBs will carry interest that reflects the cost of funds plus a minimum spread to cover transaction costs and risks such as the foreign exchange risks. The PPBs will then provide subloans to the PPEs under subloan agreements to be entered into between the PPBs and the PPEs on terms and conditions satisfactory to ADB and the government. The subloans to the PPEs (VCI subloans) will carry interest that reflects at least the cost of funds plus a minimum spread to cover transaction costs and risks, but not less than the interest rate under which ADB provides loans from its OCR.<sup>22</sup> Each VCI subloan will be in an amount between \$0.15 million and \$3.0 million. The VCI subloans will be selected based on the selection criteria and through the selection process in the PAM. No subloan will finance any activities in ADB's prohibited investment activities list as set forth in Appendix 5 of ADB's Safeguard Policy Statement (SPS, 2009). Loan guarantees will be provided from ADB loans or existing guarantee schemes outside the project mainly to help SMEs and cooperatives with limited financial capacity overcome lack of collaterals.<sup>23</sup> Loan proceeds for VCI subloans repaid by the initial batch of PPEs as well as the current grant proceeds repaid by 12 PPEs will be further revolved for wider impacts on agriculture value chain development.<sup>24</sup> The financing plan is in Table 2.

<sup>20</sup> Loan Agreement: Ordinary Capital Resources (accessible from the list of linked documents in Appendix 2).

<sup>21</sup> Loan Agreement: Asian Development Fund (accessible from the list of linked documents in Appendix 2).

<sup>22</sup> Relending terms for financial intermediaries and onlending terms for final borrowers will be decided in reference to those offered for similar financial intermediation loans of other development partners in Mongolia.

<sup>23</sup> The PPEs may also avail of guarantees from an ADB loan for Mongolia's Supporting the Credit Guarantee System for Economic Diversification and Employment Project, the processing of which will start shortly.

<sup>24</sup> The Japan International Cooperation Agency has demonstrated success in revolving financial intermediary loans through Mongolian commercial banks.

**Table 2: Financing Plan**

Source	Current <sup>a</sup>		Additional Financing		Total	
	Amount (\$ million)	Share of Total (%)	Amount (\$ million)	Share of Total (%)	Amount (\$ million)	Share of Total (%)
ADB ADF Grant	14.72	31.0	0.00	0.0	14.72	13.6
ADB ADF Loan	0.00	0.0	15.00	24.6	15.00	13.8
ADB OCR Loan	0.00	0.0	35.00	57.4	35.00	32.3
Government	1.41	3.0	1.00	1.6	2.41	2.2
PPBs	11.00	23.2	0.00	0.0	11.00	10.1
PPEs	20.37	42.9	10.00	16.4	30.37	28.0
<b>Total</b>	<b>47.50</b>	<b>100.0</b>	<b>61.00</b>	<b>100.0</b>	<b>108.50</b>	<b>100.0</b>

ADB = Asian Development Bank, ADF = Asian Development Fund, OCR = ordinary capital resources, PPB = project participating bank, PPE = project participating enterprise.

Note: Percentages may not total 100% because of rounding.

<sup>a</sup> Refers to the original amount.

Source: Asian Development Bank estimates.

## E. Implementation Arrangements

19. MOF will continue to be the executing agency. The Ministry of Food and Agriculture (MOFA) and Ministry of Industry (MOI) will be the implementing agencies. The project steering committee will continue to oversee project implementation. It will comprise representatives from MOF, which chairs the committee; MOFA; MOI; the Ministry of Environment, Green Development and Tourism; and the Bank of Mongolia. The project director of the PMU will continue to be the secretary of the project steering committee and also be responsible for overall project management. The implementation arrangements are summarized in Table 3 and described in detail in the PAM (footnote 14).

**Table 3: Implementation Arrangements**

Aspects	Arrangements		
Implementation period	January 2016–December 2020		
Estimated completion date and loan closing date	31 December 2020 and 30 June 2021		
Management			
(i) Oversight body	Project steering committee		
(ii) Executing agency	Ministry of Finance		
(iii) Implementing agencies	Ministry of Food and Agriculture and Ministry of Industry		
Procurement	National competitive bidding	18 contracts	\$2,797,878
	Shopping	3 contracts	\$72,920
Consulting services	Individual consultant selection	382 person-months <sup>a</sup>	\$843,000
Disbursement	The Asian Development Fund and ordinary capital resources loan proceeds will be disbursed in accordance with the Asian Development Bank's <i>Loan Disbursement Handbook</i> (2015, as amended from time to time), and the detailed arrangements agreed upon between the government and the Asian Development Bank.		

<sup>a</sup> Contracts of six of the seven consultants engaged under the current project will be extended while an additional consultant will be recruited for the additional financing.

Source: Asian Development Bank estimates.

## III. TECHNICAL ASSISTANCE

20. The TA is estimated to cost \$2.33 million, of which \$2.00 million will be financed on a grant basis by the Japan Fund for Poverty Reduction. The government will provide counterpart support in the form of office accommodation and other in-kind contributions. MOFA will be the executing agency for output 2 and MOI for outputs 3 and 4. The TA is expected to be implemented from April 2016 to March 2019. The TA will finance consulting services to improve

the capacity of primary producers and processors, improve the marketing and technical capacity of agro-enterprises and cooperatives, and develop the Mongolian product brand(s). The TA will be an integral part of the project since the additional financing needs to cover more and diverse subsectors and business types and, expectedly, smaller agro-enterprises and cooperatives that have limited capacity.<sup>25</sup>

#### IV. DUE DILIGENCE

##### A. Technical

21. The project design was modified to include output 3 to reduce the gaps between PPEs' technical capacity and the quality standards that markets demand, which were observed under the current project. The PMU will be equipped with agribusiness, marketing, and sector experts to assist selected PPEs in designing their VCI proposals according to the requirements of target markets and in overcoming technical deficiencies through the implementation of the VCIs.

##### B. Economic and Financial

22. The economic and financial analyses examined model VCI subprojects from seven subsectors and an animal skin primary processing subproject (footnote 15). As enterprises and farms will be selected during implementation, necessary information was collected from relevant enterprises and farms. The analysis confirmed the financial and economic viability of all the subprojects.<sup>26</sup> The sensitivity analysis confirmed that they are, by and large, robust against different adverse scenarios. During project implementation, the PPBs will conduct financial due diligence for each subproject. The PMU will continue its own financial due diligence for cross-checking and conduct economic due diligence on selected subprojects.<sup>27</sup> The financial due diligence reports of the four PPBs prepared for the current project were updated.<sup>28</sup> Those reports confirmed that all the PPBs are qualified to continue to participate in the project.<sup>29</sup>

##### C. Governance

23. A financial management assessment of MOF and procurement capacity assessments of MOFA and MOI confirmed that all three ministries, with the support of the PMU, have adequate capacity for financial management and procurement under the project. The PMU members for the current project, who are familiar with the government's and ADB requirements on disbursement, procurement, and social and environmental safeguards, will continue project implementation. ADB's Anticorruption Policy (1998, as amended to date) was explained and discussed with the government and the executing and implementing agencies. The specific policy requirements and supplementary measures are described in the PAM (footnote 14).

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<sup>25</sup> While the TA will finance consultants, training for capacity development for agro-enterprises, primary producers, and processors under outputs 2 and 3 will be separately financed by the ADF loan due to TA budget constraints.

<sup>26</sup> Economic Analysis and Financial Analysis (accessible from the list of linked documents in Appendix 2).

<sup>27</sup> As the number of subprojects will be large, economic analysis will focus on the examination of economic viability through a cost-benefit analysis and on selected subprojects in each subsector and business type.

<sup>28</sup> Khan, Xac, Trade and Development, and Golomt banks, PPBs under the current project, will continue to serve for the project since they (i) substantially meet the Bank of Mongolia's prudential requirements and (ii) have adequate staff for financial management of the project.

<sup>29</sup> Due Diligence Reports of Project Participating Banks (not available to the public as per ADB's Public Communications Policy 2011). Other banks and nonbank financial institutions may be considered for participation in the project if they pass the financial due diligence.

## D. Poverty and Social

24. The overall project (under output 1) will generate 1,800 new jobs, 40% of which will be for women, at the PPEs and their respective supply chains. The project will also have an indirect impact on employment generation by primary product producers and processors in rural areas because demand will increase as the processing capacity increases. Poor and socially marginalized households will potentially benefit from these job opportunities, particularly at the PPEs. The overall project will also assist 120 agricultural cooperatives under output 2. Outputs 2 and 3 will include programs to build primary producers' capacity and provide training to PPEs' employees to ensure production efficiency, product quality, and safety. The project is classified as effective gender mainstreaming. A gender action plan was prepared.

## E. Safeguards

25. **Environment.** The project continues to be classified as category B. The current project confirmed mainly positive environmental benefits. For the additional financing, an environmental assessment and review framework<sup>30</sup> was prepared in compliance with Mongolia's environmental regulations and SPS to guide the executing agency and the PPBs in the preparation of the environmental assessments of subprojects. The screening procedures in the environmental assessment and review framework, which were established under the current project, and complemented with a brief climate risk assessment, will be applied to screen every subproject and exclude all category A subprojects. Based on the proposed activities, no significant adverse environmental impacts are expected, and climate risk is considered low.<sup>31</sup> The impacts will be mitigated through the implementation and monitoring of the environmental management plans.

26. **Involuntary resettlement and indigenous peoples.** The project continues to be classified as category C for involuntary resettlement and indigenous peoples. Screening procedures for those social safeguards established under the current project will be applied under the additional financing. For involuntary resettlement, the PMU will also assess the socioeconomic impacts of each subproject and take measures to avoid displacement. Construction activities will take place on enterprise-owned land. Additional land, if needed by the PPEs, will be acquired commercially under willing buyer–willing seller agreements. Land acquisition that would cause involuntary economic and physical displacement will not be permitted. For indigenous peoples, the project is expected to have only positive impacts, if any, as subprojects will provide capacity development and agricultural machinery, equipment, materials, and inputs for project beneficiaries; and provide job opportunities at the PPEs. Given the uncertainty, an ethnic minorities planning framework was prepared.<sup>32</sup> If indigenous peoples groups, as defined by SPS, Safeguard Requirement 3, be identified as project beneficiaries or impacted, an ethnic minorities development plan will be prepared for the subproject.

## F. Risks and Mitigating Measures

27. Major risks and mitigating measures are summarized in Table 4 and described in detail in the risk assessment and risk management plan.<sup>33</sup> The overall risk rating of the project is moderate. The integrated benefits and impacts are expected to outweigh the costs.

<sup>30</sup> Environmental Assessment and Review Framework (accessible from the list of linked documents in Appendix 2).

<sup>31</sup> Most project activities are indoors, except sea buckthorn plantation and bee farming, which are not particularly sensitive to climate change impacts.

<sup>32</sup> Indigenous Peoples Planning Framework: Ethnic Minority Planning Framework (accessible from the list of linked documents in Appendix 2).

<sup>33</sup> Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

**Table 4: Summary of Risks and Mitigating Measures**

<b>Risks</b>	<b>Mitigating Measures</b>
Fluctuations in international market prices and the foreign exchange rate adversely affect the sales and exports of project participating enterprises.	The project will provide the project participating enterprises with advisory services and training on marketing so that they can mitigate the impact from such fluctuations on their businesses.

Source: Asian Development Bank.

## **V. ASSURANCES AND CONDITIONS**

28. The government, MOF, MOFA, and MOI have assured ADB that implementation of the project shall conform to all applicable ADB policies including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the PAM (footnote 14) and loan documents.

29. The government has agreed with ADB that no withdrawals or transfers shall be made from the loan accounts to the special account of a PPB until (i) MOF and such PPB shall have duly entered into an onlending agreement, and (ii) the onlending agreement shall have become legally binding upon the government and such PPB in accordance with its terms.

## **VI. RECOMMENDATION**

30. I am satisfied that the proposed loans would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve

- (i) the loan of \$35,000,000 to Mongolia for the additional financing of the Agriculture and Rural Development Project, from ADB's ordinary capital resources, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 25 years, including a grace period of 5 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board;
- (ii) the loan in various currencies equivalent to SDR10,719,000 to Mongolia for the additional financing of the Agriculture and Rural Development Project, from ADB's Special Funds resources, with an interest charge at the rate of 2% per annum during the grace period and thereafter; for a term of 25 years, including a grace period of 5 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board; and
- (iii) the administration by ADB of technical assistance not exceeding the equivalent of \$2,000,000 to the Government of Mongolia for Supporting Agriculture Value Chain to be provided by the Japan Fund for Poverty Reduction on a grant basis.

Takehiko Nakao  
President

25 August 2015

## REVISED DESIGN AND MONITORING FRAMEWORK

<p><b>Impacts the project is aligned with:</b></p> <p><b>Current project</b> Premium value differentiation for Mongolian products sustained</p> <p><b>Overall project</b> Competitiveness of agriculture processing industry enhanced Private sector-led employment generated Small and medium-sized enterprises developed (MDG–based Comprehensive National Development Strategy of Mongolia, 2008)<sup>a</sup></p>
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Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
<p><b>Outcome</b></p> <p><b>Current project</b> Fifteen Mongolian enterprises have improved quality, premium-value Mongolian agricultural products available in select niche markets, and replicable process developed for brand development and management</p> <p><b>Overall project</b> Value addition on Mongolian agricultural resources increased by PPEs</p>	<p><b>Current project</b> Deliveries of the 15 funded enterprises in partnership with premium-value buyers</p> <p><b>Overall project</b> By Q4 2020, compared with the level before VCI implementation: a. PPEs increase their shares of processed products in total sales by at least 10% (added) b. Export-oriented PPEs increase their export share in total sales by 20% on average (added) c. PPEs generate 1,800 new jobs, of which at least 40% are to be filled by women (added; 2015 baseline: 1,150)</p>	<p>PPEs' VCI implementation and monitoring reports, contracts with raw material producers, and audited and unaudited financial statements through quarterly project progress reports from PMU</p>	<p>Fluctuations in international market prices and the foreign exchange rate adversely affect the sales and exports of PPEs.</p>

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
<p><b>Outputs</b></p> <p><b>Output 1</b>  <b>Current project</b>  Value chains able to deliver unique premium-value products to niche markets</p> <p><b>Overall project</b>  VCIs financed</p>	<p><b>Current project</b>  Supply chains of 15 enterprises supported by the project are capable of meeting quality and reliability standards that allow them to deliver products to identified premium-value niche markets by December 2012</p> <p><b>Overall project</b>  1a. About 80 VCIs are financed by Q4 2020 (changed; 2015 baseline: 12)  1b. Due diligence of about 80 VCI subprojects is completed by Q3 2020 (added; 2015 baseline: 16)  1c. 800 person-times of PPE staff and 120 person-times of PPB staff are trained on finance, safeguards, gender, and monitoring by Q2 2020, of which at least 40% are women (added; 2015 baseline: 300 and 32)</p>	<p>1a. Signed subloan agreements from PMU</p> <p>1b. Due diligence documents of the VCI subprojects from PMU</p> <p>1c. Quarterly project progress reports from PMU</p>	<p>1a.–1b. Economic slump will suppress the PPEs' borrowing capacity and interest in the VCI opportunities.</p>
<p><b>Output 2</b>  <b>Overall project</b>  Production capacity of herders and farmers improved (new; defined as a separate output from output 1 of the current project)</p>	<p><b>Overall project</b>  2a. 120 herder and farmer cooperatives supported by the project increase their outputs by at least 20% by Q4 2020 (added; 2015 baseline: 104)  2b. 5,500 person-times of herders, farmers, primary processors, and relevant technical staff of local governments, of which 40% are women, trained by Q4 2019 (added; 2015 baseline: 4,320)</p>	<p>2a. Cooperative survey</p> <p>2b. Quarterly project progress reports from PMU</p>	<p>2a. Severe weather hampers production of the cooperatives.</p>
<p><b>Output 3</b>  <b>Overall project</b>  Enterprises' marketing and technical capacity improved (new; defined as a separate output from output 2 of the current project)</p>	<p><b>Overall project</b>  3a. 800 person-times of PPE staff, of which at least 40% are female, are trained on marketing and technical skills by Q4 2020 (added; 2015 baseline: 350)  3b. Technical guidelines for enterprises of animal fiber and leather subsectors are developed by Q4 2019 (added)</p>	<p>3a. Quarterly project progress reports</p> <p>3b. Quarterly project progress reports</p>	



Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	3c. Target market analysis for leather subsector is completed by Q4 2019 (added)	3c. Target market analysis report for leather subsector	
<p><b>Output 4</b>  <b>Current project</b>  Fully defined process and institutional arrangements for collaborative brand development and management developed and demonstrated (output 2 of the current project)</p> <p><b>Overall project</b>  Mongolian product brand(s) developed (redefined output 2 of the current project)</p>	<p>4a.  <b>Current project</b>  Framework for brand development is ready by June 2012</p> <p><b>Overall project</b>  Framework for brand development is ready by Q3 2013 (completed)</p> <p>4b.  <b>Overall project</b>  Mongolian animal fiber certification mark is registered with the Mongolian Intellectual Property Office by Q2 2013 (completed)</p> <p>4c.  <b>Overall project</b>  Procedures and standards for the Mongolian animal fiber certification mark are developed by Q4 2015 (added)</p> <p>4d.  <b>Overall project</b>  Mongolian animal fiber certification mark is registered with intellectual property offices of selected 31 countries by Q4 2015 (completed)</p> <p>4e.  <b>Current project</b>  Brand partnership agreements between at least three Mongolian enterprises and international brands by June 2012</p> <p><b>Overall project</b>  Brand partnership agreements between at least three Mongolian enterprises and international brands by Q4 2020 (changed; 2015 baseline: 0)</p>	<p>4a.–4e. Quarterly project progress reports from PMU</p>	

## Key Activities with Milestones

### 1. VCIs financed

- 1.1 Establish the PMU for the VCI component (Q3 2009) (completed).
- 1.2 Finalize the VCI proposals for all enterprises (Q3 2012) (completed).
- 1.3 Complete assessments by the PPBs, finalize lending terms, and set up individual credit lines (Q4 2012) (completed).
- 1.4 Finalize the contractual and procurement arrangements (Q4 2014) (completed).
- 1.5 Complete all VCIs (Q4 2010–Q4 2014) (completed).
- 1.6 Provide the PPEs and the PPBs with advisory services and training on proposal preparation, finance, safeguards, gender, and monitoring (Q1 2016–Q2 2020) (added).
- 1.7 Assist about additional 80 PPEs in preparing the VCI proposals and conduct due diligence for the VCIs (Q2 2016–Q3 2020) (added).
- 1.8 Facilitate conclusion of the VCI subloan agreements between the additional PPEs and PPBs (Q3 2016–Q4 2020) (added).

### 2. Production capacity of herders and farmers improved

- 2.1 Establish the PMU for the rural infrastructure and service development component (Q3 2009) (completed).
- 2.2 Recruit consultants (Q1 2010) (completed).
- 2.3 Complete all consultative decision processes (Q2 2010) (completed).
- 2.4 Finalize the contractual and procurement arrangements (Q1 2012) (completed).
- 2.5 Complete all rural infrastructure and service development investments (Q3 2012) (completed).
- 2.6 Complete the needs analysis and assessments (Q3 2016–Q1 2017) (added).
- 2.7 Select the cooperatives for capacity development and other assistance (Q4 2016–Q2 2017) (added).
- 2.8 Implement capacity development and other assistance (Q4 2016–Q4 2019) (added).

### 3. Enterprises' marketing and technical capacity improved

- 3.1 Develop the technical guidelines for enterprises, particularly of animal fiber and leather subsectors (Q3 2012–Q4 2019) (added).
- 3.2 Update technology and techniques for wool and cashmere, leather, and garment technical institutes (Q4 2013–Q4 2019) (added).
- 3.3 Undertake a needs assessment on PPEs' marketing and technical capacity for each project subsector and identify trainee agro-enterprises and cooperatives with value addition opportunities (Q3 2016–Q2 2017) (added).
- 3.4 Develop and implement a marketing and technical training program for selected agro-enterprises and cooperatives of each project subsector (Q1 2017–Q4 2020) (added).
- 3.5 Conduct a target market analysis for the leather subsector (Q1 2018–Q4 2019) (added).

### 4. Mongolian product brand(s) developed

- 4.1 Establish the PMU for the Technical Assistance for Agricultural Marketing and Brand Development (Q3 2011) (completed).
- 4.2 Develop the Mongolian animal fiber certification mark (hypothetical brand case), (Q1 2012–Q1 2013) (completed).
- 4.3 Register the Mongolian animal fiber certification mark with the Mongolian Intellectual Property Office (Q4 2012–Q3 2013) (completed).
- 4.4 Develop a business plan for brand management agency (Q4 2012–Q1 2013) (completed).
- 4.5 Complete the internal and external surveys (Q3 2013) (completed).
- 4.6 Register the Mongolian animal fiber certification mark with intellectual property offices of selected countries (Q4 2012–Q4 2015) (added).
- 4.7 Develop procedures and standards for the Mongolian animal fiber certification mark (Q1 2013–Q4 2015) (added).
- 4.8 Facilitate the matchmaking between the PPEs and international brands (Q1 2012–Q4 2020) (added).
- 4.9 Support at least three enterprises for partnership using the Mongolian animal fiber certification mark (Q1 2013–Q4 2020) (changed).

**Project Management Activities**

Prepare quarterly project progress reports (Q3 2009–Q4 2020) (added).  
 Monitor the implementation of output 1 (Q3 2009–Q4 2020) (added).  
 Recruit key consultants for outputs 2, 3, and 4 (Q4 2015–Q2 2016) (changed).  
 Establish an integrated PMU (Q2 2016) (added).  
 Make procurement arrangements for outputs 2 and 3 (Q3 2009–Q4 2019) (changed).  
 Conduct capacity development of the project steering committee and the PMU on project management (Q1 2012–Q2 2020) (added).  
 Submit audited annual financial statements (Q1 2011–Q4 2020) (added).  
 Submit annual gender action plan and environment monitoring reports (Q1 2012–Q4 2020) (added).

**Inputs**

<b>Asian Development Bank</b>	
<b>Loan</b>	<b>Grant</b>
\$0 (current)	\$14.72 million (ADF, current)
\$35.00 million (OCR, additional)	\$0 (additional)
\$15.00 million (ADF, additional)	
\$50.00 million (overall)	\$14.72 million (overall)

<b>Cofinancier</b>
<b>Technical Assistance Grant</b>
\$2.00 million (JSF, current)
\$2.00 million (JFPR, additional)
\$4.00 million (overall)

<b>Government</b>
\$1.41 million (current)
\$1.00 million (additional)
\$2.41 million (overall)

**Assumptions for Partner Financing**

Not applicable.

ADF = Asian Development Fund, JFPR = Japan Fund for Poverty Reduction, JSF = Japan Special Fund, MDG = Millennium Development Goal, OCR = ordinary capital resources, PMU = project management unit, PPB = project participating bank, PPE = project participating enterprise, Q = quarter, VCI = value chain investment.

<sup>a</sup> Government of Mongolia. 2008. *MDGs-Based Comprehensive National Development Strategy of Mongolia*. Ulaanbaatar.

Source: Asian Development Bank.

### **LIST OF LINKED DOCUMENTS**

<http://adb.org/Documents/RRPs/?id=39229-033-3>

1. Loan Agreement: Asian Development Fund
2. Loan Agreement: Ordinary Capital Resources
3. Sector Assessment (Summary): Agriculture, Natural Resources, and Rural Development
4. Project Administration Manual
5. Summary of Project Performance
6. Contribution to the ADB Results Framework
7. Development Coordination
8. Attached Technical Assistance
9. Financial Analysis
10. Economic Analysis
11. Country Economic Indicators
12. Summary Poverty Reduction and Social Strategy
13. Gender Action Plan
14. Environmental Assessment and Review Framework
15. Indigenous Peoples Planning Framework: Ethnic Minority Planning Framework
16. Risk Assessment and Risk Management Plan

### **Supplementary Documents**

17. Financial Management Capacity Assessment
18. Project Procurement Classification
19. Procurement Capacity Assessment
20. Due Diligence Reports of Project Participating Banks