

**PROJECT INFORMATION DOCUMENT (PID)  
APPRAISAL STAGE**

Report No.: PIDA3906

<b>Project Name</b>	Mongolia Export Development Project (P147438)
<b>Region</b>	EAST ASIA AND PACIFIC
<b>Country</b>	Mongolia
<b>Sector(s)</b>	SME Finance (30%), General finance sector (20%), Other domestic and international trade (30%), General industry and trade sector (20 %)
<b>Theme(s)</b>	Other Financial Sector Development (20%), Micro, Small and Medium Enterprise support (30%), Other Private Sector Development (20%), Export development and competitiveness (30%)
<b>Lending Instrument</b>	Investment Project Financing
<b>Project ID</b>	P147438
<b>Borrower(s)</b>	Government of Mongolia
<b>Implementing Agency</b>	Ministry of Finance, Agricultural Reinsurance Company
<b>Environmental Category</b>	F-Financial Intermediary Assessment
<b>Date PID Prepared/Updated</b>	18-May-2016
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<b>Appraisal Review Decision (from Decision Note)</b>	

**I. Project Context**

**Country Context**

Mongolia has transformed over the past 25 years into a multi-party democracy and is gradually becoming a more modern economy, with economic activity driven by the mining sector. In 1990, Mongolia turned away from the Soviet-backed one-party state system and the centrally planned economy, and opted for its first free elections and a market-led economic system. In 1991, Mongolia joined the World Bank, the IMF, and the Asian Development Bank (ADB), and the first democratic constitution was approved in 1992. At the beginning of the economic reforms, the country favored mechanisms to support the basis of a market economy, including privatization, price and wage liberalization, currency reform, and integration with international trade.

The strategy of the Government of Mongolia (GOM) is to support sustainable economic growth by investing in infrastructure improvements, guiding the development of mining through better

regulations, promoting investments from domestic and foreign sources, and stimulating production of the agricultural sector and of SMEs. Recognizing the importance of stable investment, the Parliament adopted a new Investment Law in September 2013. The new law provided improved investment climate by bringing greater clarity and stability, simplifying processes, and providing a level playing field for domestic and foreign investors. The Parliament has adopted a new mining development policy and in July 2014, it adopted an amendment to the Mineral Law, which allowed for the lifting of the moratorium of mining licenses.

As a landlocked country of 1.6m sq km of land, Mongolia's history has been very much influenced by its two giant neighbors, Russia and China. The country is rich in minerals, with important oil reserves and deposits of ores such as copper and gold, and has the lowest population density in the world, with about 3.0 million people. Over 60 percent of the population lives in urban areas, approximately 40 percent in the capital city of Ulaanbaatar. The remaining rural population is scattered over wide distances, resulting in significant challenges in transportation, service delivery and communication.

With a GDP of US\$12 billion (2015), Mongolia has a narrowly diversified economy driven by mining, which accounts for 18 percent of GDP, and agriculture, which accounts for about 15 percent of GDP. There are primarily two large mining projects, the Oyu Tolgoi copper and gold mine and the Tavan Tolgoi coal mine. Strong foreign capital inflow for mining investment helped ramp up economic activities in service, transportation and construction industries in recent years, and is now reflected in the growing dominance of mineral exports as their annual share of total exports has been on average 90 percent in the last five years. The dominance of minerals sector has made the Mongolian economy inherently subject to the commodity price swings.

The Mongolian countryside remains a herder-based economy and the majority of its land is dedicated for pasture of cattle, sheep, goats, camels and horses. Agriculture contributes to about 15 percent of the GDP and herding accounts for over 80 percent of agriculture with the livestock population reaching 55 million at the end of 2015. Animals provide sustenance, income, and wealth for nearly half of the residents of Mongolia. However, the agriculture sector has inherent volatility, driven by livestock mortality. Hazards affecting the population of animals (ᠮᠣᠨᠠ dzudsᠮᠣᠨᠠ, e.g. extremely cold winters) can have devastating implications for the rural poor and the overall economy. For example in 2010, 8.8 million livestock were lost to ᠮᠣᠨᠠ dzudᠮᠣᠨᠠ, an equivalent of 4.4 percent of the country's economic output. The GOM, supported by the World Bank (WB), successfully developed and launched in the market an innovative index-based mortality livestock insurance that has helped herders to build their resilience against extreme weather events like ᠮᠣᠨᠠ dzudsᠮᠣᠨᠠ. In 2014, a fully state owned Agricultural Reinsurance Company was established to upgrade the development of agricultural and financial sectors at higher level by delivering reinsurance service.

Over the last decade, per capita income grew four-fold thanks to rapid economic growth driven by activity in the mining sector and, as a result, Mongolia is now an upper-middle income country. An average unemployment in Mongolia was about 7.5 percent in 2015. Poverty has been on a declining trend over the past decade, and poverty rates declined from 39 percent in 2010 to 21.6 percent in 2014. However, about a tenth of the population are still highly vulnerable and small negative shocks can push them back below the poverty line. Under these circumstances, the government

focus on economic diversification is indispensable as a way to create alternative sources of employment and increase the economic resilience to shocks.

### **Sectoral and institutional Context**

In 2015, Mongolia's total exports were US\$4 billion, of which 87 percent consisted of mineral commodities, while cashmere products represented 5 percent of total exports. In addition to the concentration of exports in mineral products, Mongolia's main export market is China, which absorbs about 95 percent of total Mongolian exports per year.

The current export structure indicates significant concentration risks in external trade from (i) heavy dependency on mineral products and (ii) heavy dependency on China. The dual dependency - on mineral exports and on one destination market - makes Mongolia's economy vulnerable to external shocks. It leads to the lack of pricing power (inability to change prices of its exports quickly in response to external circumstances) and the economy becomes susceptible to external shocks, such as a drop in global metal prices as well as fall in demand from its biggest importer, China.

In an economy where exports are heavily dominated by mining commodities, export diversification is expected to boost productivity, overall entrepreneurship and encourage new entrants to the market. Minerals, metals and stones account for about 87 percent of total exports while textiles and related articles are the second largest exports representing 6 percent of total exports. Although the mining sector has a high labor productivity, it employs only 4 percent of the workforce; agriculture, on the other hand, employs close to 30 percent of the workforce but has a low productivity. Therefore, economic diversification to agricultural related product is expected to have an important impact in terms of employment and productivity in the country.

The main non-mining exports in Mongolia mostly comprise agricultural related products such as cashmere, combed goat hair, sheep wool, and leather, all of which --except for goat hair-- have increased their export volumes over the past decade. Government targeting of SMEs of current and potential exporters in agricultural related products will directly contribute to growth and employment. Increases in productivity, paid wages, taxes, and foreign revenues will lead to new investment and consumption in the country. These factors will directly and positively impact incomes of the lower strata of the population. A stronger SME sector can play a pivotal role in supporting a more inclusive economic development by reducing poverty and increasing shared prosperity in Mongolia.

In Mongolia, SMEs represent about 95 percent of total business entities, of which about half are in the wholesale, retail, and household good sectors. SMEs employ roughly half of the country's workforce and account for about 40 percent of GDP but contributes with less than 2 percent to the state budget in taxes. According to the Law on SMEs from 2007, in Mongolia SMEs are defined by sectors. In general, various assessments of the SME sector point out to similar challenges faced by SMEs in their struggle for development and long term sustainability, which include: access to finance, high taxes and high costs of doing business, poor market conditions, cumbersome procedures, and lack of capacity.

Mongolia became a member of the WTO in 1997 and trade liberalization and integration with international trade has been one of the main focus of the economic policies since the early reforms of the Mongolian economy in the 90s. Mongolia has consistently encouraged a multilateral trading

system, and has in the past pursued a liberal trade policy by eliminating trade barriers, however the benefits of this has not been fully realized as Mongolia's trading partners maintain high tariffs and tough non-tariff measures.

The Government of Mongolia believes that trade liberalization is very important in improving the living standards of the population, and in this context the government is working towards the success of the implementation of the Doha Development Agenda. However, the further development of the export sector in Mongolia is facing a series of constraints:

- Because Mongolia is a landlocked country, it presents logistical issues for its export products (primarily heavy commodities) to reach final buyers. Road and railway network is underdeveloped. Most export-bound products have to travel through Russia or, more commonly, through China to reach buyers in those countries or ports for onward journey, and therefore Mongolia's two neighbors have traditionally been its main trading partners;
- Despite the fact that the Government has persistently promoted an export-led growth policy, raw and low value added products continue to dominate most exports. The majority of mineral exports (coal, copper and iron ores) are exported without being processed;
- Exporters and potential exporters lack access to export-specific financing. Current trade finance options are limited for non-mining export enterprises in Mongolia, and the options available are not fully utilized as there seems to be a lack of knowledge about the export financing products offered and their applicability. Although, Mongolia's largest banks have been offering financing tools for importers, mostly through letters of credit and guarantees for post-shipment, financing needs of exporters have been largely neglected. Therefore, exporters continue to restrict their activities to the traditional way of obtaining finance through commercial or personal loans for their exporting activities

Based on the SME Survey, conducted in September 2015 by the SME Policy Implementation and Coordination Department of the Ministry of Industry, Mongolian SMEs lack the skills to engage in export and access to export financing remains one of the challenges for them. The commercial banks are not so willing to extend export credit to SMEs who are seen as high-risk business. At the same time, the risks associated with exporting include the following for the Mongolian SMEs: country political risk; currency risk, transfer risk, credit risk (relating to credit and financing); non-performance risk; transport risk; legal risk; risk of fraud and risks related to social, and geographical issues.

Export credit insurance can serve as an alternative tool to advance cash payment, letters of credit, documentary collection and others in securing export revenues. This provides a strategic tool for the exporter to sell in an open account. The competition in the export market, as also noted by SMEs in the Survey, makes foreign buyers to often press exporters for open account terms. Exporters who are reluctant to extend credit could lose sales to competitors who are willing to offer better payment terms. Credit insurance is therefore considered to be a critical component in a country's export-led growth strategy. In recognizing these barriers and benefits, governments around the world in various ways have come out with different schemes (in a form of export credit agencies or export credit insurance companies) to help exporters, especially SMEs, to have access to trade credit insurance services. This is usually done through collaboration among government, businesses, and

financial sector partners.

Recognizing the vulnerability of the economy to minerals market cycle and the large external imbalance, Mongolian authorities understand the importance of strengthening its export performance by diversifying markets and products; by maximizing the benefits it draws from its mining sector but also stimulating non-mineral sectors, thus supporting economic diversification and employment. In this context, Mongolian Government is trying to develop opportunities to increase exports of higher value added products, and the Government has been exploring ways to promote exports through addressing various constraints:

➤(¢ First, the Government provided around MNT270 billion of the proceeds from the Sovereign bond issuance to promote export-related industries including non-mineral exports such as cashmere, textile and dairy products in 2013. A part of the Chinggis bond proceeds was also used for investments that indirectly supported all exports (e.g., investments in transport infrastructure and in import substitution endeavors such as cement and steel production for housing construction purposes). Also a portion of the Samurai bond proceeds was used to promote industries for export or import substitution in 2014.

➤(¢ Second, in September 2013 the Government adopted an Export Promotion Program (EPP) which supports the expansion of Government-supported export finance and non-financial services to exporters, e.g., export credit, insurance, guarantees, foreign market research, compliance with technical standard requirements, and economic diplomacy and product promotion.

➤(¢ Third, the Government is entering into bilateral free trade agreements. In February 2015, a free trade agreement was signed with Japan, which will most likely come into effect in the spring of 2016. Similarly, the Government expressed in early 2015 its interest in establishing a similar free trade agreement with Korea and hopes to start negotiations soon. This will open new doors for the Mongolian exports to important and populous markets in the region.

This project ties well with and is complementary to the groundwork that the Government has done in recent years to bolster SME development. Back in 2012 the government of Mongolia partnered with the EU and the EBRD and launched a five-year development program to support the SME sector. The goal of this program was twofold, one: to enhance the country's institutional framework for SME development, and two: to facilitate businesses access to external advice in order to improve their competitiveness. More recently, in 2015, the Parliament endorsed a series of reforms to foster domestic production of export-oriented competitive goods. These reforms include: the law on Free Trade Zone (amended and restated), the law on Promotion of Industrial Manufacturing, the law on Corporate Income Tax, and the law on Promotion of Economic Transparency. Moreover, the government is currently designing an SME development program that could extend until 2020 focusing on i) improving the SME regulatory framework, ii) fostering innovation, iii) facilitating access to finance, and iv) promoting access to markets. In this context, the proposed project is very complementary to a series of efforts the government has been carrying out to expand and diversify its export sector.

## II. Proposed Development Objectives

The development objective of the project is to support Mongolian small and medium size firms in the non-minerals sectors to strengthen their export capabilities and expand access to export markets.

### III. Project Description

#### Component Name

Component 1: Development of a new line of export finance products

#### Comments (optional)

This component will provide financial, technical, and institutional development support to the Agricultural Reinsurance Joint Stock Company (AgRe) in building a new line of export finance products.

#### Component Name

Component 2: Export competitiveness enhancement.

#### Comments (optional)

This component will provide funding for (i) export-related training programs and (ii) matching grants which would support various expenditures by exporters directed at enhancing competitiveness of individual companies in global markets.

#### Component Name

Component 3: Project Implementation Support

#### Comments (optional)

The existing Project Implementation Unit (PIU) responsible for the Multi-Sectoral Technical Assistance Project (MSTAP) will provide its services for this Export Development Project.

### IV. Financing (in USD Million)

Total Project Cost:	20.78	Total Bank Financing:	20.00
Financing Gap:	0.00		
<b>For Loans/Credits/Others</b>			<b>Amount</b>
BORROWER/RECIPIENT			0.78
International Development Association (IDA)			20.00
Total			20.78

### V. Implementation

The MOF will be responsible for the implementation of the project, including overall coordination, results monitoring and communicating with the World Bank on all fiduciary aspects and a Project Steering Committee (PSC) will be established at MOF for this purpose. AgRe and its subsidiary to be established specializing especially in export credit insurance but also in other trade finance instruments will carry day-to-day implementation of Component 1 of EDP: the knowledge transfer and export finance programs with strong collaboration of the PIU. AgRe will establish a new Export Insurance Department with 10 people for implementation of sub-component 1.1. This Department will be transferred to the EIS after its establishment. The PIU at the MOF will carry out implementation of Component 2 on export-related training & research and the matching grants program.

The PIU, in close collaboration with the AgRe for sub-component 1.1, will handle technical specifications and terms of reference for project expenditures, participate in evaluating bids and proposals for the project's activities, and assume responsibility for day-to-day supervision of suppliers and consultants. Accordingly, the AgRe will only allocate funds allocated to Sub-component 1.2 to EIS for provision of export credit insurance.

The proposed structure is a two-level implementation arrangement, with a high-level Steering Committee led by the representative of Ministry of Finance. A PSC will be headed by the representative of MOF and will include representatives from the MOF, AgRe, Ministry of Food and Agriculture; it will also include representatives from the private sector, including e.g. the National Chamber of Commerce and Industry (NCCI), Mongolian Banking Association and Mongolian Business Council. The PSC will provide strategic guidance to the project and will hold meetings annually, more meetings shall be held if required to facilitate coordination among agencies, provide overall policy guidance, and review progress reports. Further, a Steering Committee meeting (actual or virtual) can be called at any time to resolve any emerging issue. The decision to call for an actual or virtual meeting shall be made by the State Secretary of Finance, Project Director. The PSC will be responsible for ensuring synergies among the Project and other public and private sector initiatives on export development. In particular, the PSC will ensure consistency between project implementation and implementation of the Government's Export Promotion Program and other export development initiatives.

The Project Director will provide strategic direction to overall project execution issues, and shall address any implementing issues that may arise. Project Director (State Secretary of Ministry of Finance) shall be supported by a full-time Project Implementation Unit (PIU) headed by a Project Manager. Regular project implementing issues (such as coordinating different component agencies) may be delegated to the PIU manager. However, the Project Director will sign-off on all requests for the Bank's no objection.

The Leads of Implementing Agencies, as identified in respective subcomponents, will be responsible for implementing respective subcomponents. This implies that implementing agency heads will be responsible for: (i) preparing terms of references for assignments/study tours etc; (ii) effective intra-agency coordination; (iii) establishing and monitoring evaluation committees to select consultants/firms; (iv) ensuring component objectives are achieved; and (v) reporting progress with component implementation to the PIU, MOF and Project Steering Committee, as needed.

The Project Implementation Unit will be responsible for project implementation, including overall project management, financial management, monitoring, evaluation, and reporting (current PIU responsible for Multi-Sectoral Technical Assistance Project). The PIU will be headed by a PIU manager and will report to the Project Director (State Secretary of MOF), MOF and the PSC, will run day-to-day project implementation activities. The PIU will liaise with beneficiary agencies to develop all technical inputs such as the preparation of terms of references, technical specifications and other component related implementation plans. Once terms of references have been prepared by component implementing agencies, and respective clearance from the Project Director and Bank obtained, the PIU shall take care of all contracting, procurement arrangements, and financial management obligations.

The PIU may hire additional staff under TORs satisfactory to the World Bank, to accommodate all the responsibilities under the Project. The existing PIU responsible for MSTAP shall include: a Project Manager (responsible for the day-to-day management of the Project); a financial management specialist, a procurement specialist, M&E specialist and other support staff (IT specialist, Financial Management assistant), and 4-5 people team to lead implementation of Component 2.

As and when needed, specific technical working groups will be set up by the PIU, MOF with membership drawn from export development stakeholders such as other ministries, the AgRe, beneficiary enterprises, private sector chambers and associations, agencies and consultants. These technical working groups will be given specific tasks related either to the development of TORs/ technical specifications or elicitation and verification of user requirements related to the development of exporter training and research modules. Also, given that a significant part of the project is knowledge transfer and capacity building, the PIU will ensure that various stakeholders, such as public agencies, beneficiaries, sector associations, and NGOs can record and catalogue their learning and share it among them during the implementation process.

The AgRe will implement Component 1 of the Project through its Export Insurance Department (EID) with the strong collaboration of PIU. The EID will be responsible for preparing the AGRE's export credit insurance and other trade finance products. To this end, it will perform legal and market analysis and assessment in these areas; arrange for the AgRe EID staff to acquire relevant knowledge/expertise from appropriate foreign partners; and oversee enactment of the required internal policies, regulations, and action plans for development of the new products. AgRe will also be responsible for establishing and operationalizing its Export Insurance Subsidiary (EIS) which will issue the new products - export insurance cover to Mongolian exporters. The paid in capital will be provided as a sub-loan from the Government to AgRe and from AgRe as an equity injection to EIS only after its disbursement conditionalities are met.

The MOF and the AGRE will responsible for implementing the ESMF. AgRe would have to invest in arrangements with local environmental and social experts either through training of their own staff or engaging consultants in order to successfully implement the ESMF.

## VI. Safeguard Policies (including public consultation)

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01	x	
Natural Habitats OP/BP 4.04	x	
Forests OP/BP 4.36	x	
Pest Management OP 4.09		x
Physical Cultural Resources OP/BP 4.11		x
Indigenous Peoples OP/BP 4.10	x	
Involuntary Resettlement OP/BP 4.12	x	
Safety of Dams OP/BP 4.37		x
Projects on International Waterways OP/BP 7.50		x
Projects in Disputed Areas OP/BP 7.60		x

**Comments (optional)**

## VII. Contact point

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