

PROJECT INFORMATION DOCUMENT (PID) CONCEPT STAGE

Report No.: PIDC2516

Project Name	MN Export Development Project (P147438)
Region	EAST ASIA AND PACIFIC
Country	Mongolia
Sector(s)	SME Finance (30%), General finance sector (30%), Other domestic and international trade (20%), General industry and trade sector (20 %)
Theme(s)	Other Financial Sector Development (20%), Micro, Small and Medium Enterprise support (15%), Other Private Sector Development (25%), Export development and competitiveness (40%)
Lending Instrument	Investment Project Financing
Project ID	P147438
Borrower(s)	Government of Mongolia
Implementing Agency	Ministry of Economic Development, Development Bank of Mongolia
Environmental Category	F-Financial Intermediary Assessment
Date PID Prepared/ Updated	12-Feb-2014
Date PID Approved/ Disclosed	12-Feb-2014
Estimated Date of Appraisal Completion	07-Mar-2014
Estimated Date of Board Approval	29-May-2014
Concept Review Decision	Track II - The review did authorize the preparation to continue

I. Introduction and Context

Country Context

The Mongolian economy has achieved remarkable progress over the last two years and its medium-term prospect remains promising. It has emerged as one of the fastest growing economies in the world over the last two years and the growing income helped to reduce the poverty rate by 11.3 percentage points during the period. The Mongolian economy is expected to show another double digit growth in 2013 despite the unfavorable external environment.

Meanwhile, the economy became more susceptible to volatile mineral market cycle and more reliant on foreign capital inflows during the recent high growth period. The high growth in 2011 was fueled by a surge in foreign capital inflows and expansionary fiscal policy. The imports increased almost two folds over the year far exceeding the growth of exports even though the exports also grew at

over 65 percent thanks to the robust mineral market. With a decline of total exports amidst the sharp downswing of the global coal market in 2012, current account deficit surged to over 32 percent of GDP. So far in 2013, the Mongolian economy has been facing further challenges from growing external imbalances as the FDI inflow significantly declined and mineral exports remained weak.

Going forward, the Mongolian economy may have to face growing headwinds from unfavorable global economic environment. The global mineral market will also likely remain weak in the near future amidst the abundant supply condition and growing competition among key exporters of major minerals. High product and geographical concentration of Mongolian exports will continue to present a strong economic vulnerability.

Sectoral and Institutional Context

The ongoing process of trade globalization has increasingly led policy-makers in many countries, especially in emerging markets, to focus on export-oriented growth policies – which is also the case with Mongolia. Mongolia has abundance of natural resources and mineral deposits, including one of the largest copper and gold mine and coal mines in the world. Dependency on mineral resources is very high – in 2012, 89.2 percent of the total export consisted of mineral commodities, while agriculture sector (cashmere, textiles, meat and meat products) took up the rest. Almost 92 percent of export in 2012 went to China. Commodity exports contributed almost half of the fiscal revenue. Such high dual dependency on mineral exports makes Mongolia's economy vulnerable to a lack of pricing power (inability to change prices of its exports quickly in response to external circumstances) and external shocks, such as a drop in global metal prices as well as fall in demand from its biggest importer, China.

As of September 2013, Mongolia's total external trade turnover reached approximately US\$7.5 billion, of which exports were US\$2.8 billion. Compared to the same period of the previous year, total external trade turnover decreased by US\$568.7 million (or 7.1 percent). The foreign trade deficit in September 2013 was US\$1.7 billion, down by US\$235.7 million (or 12.4 percent) from the same period in 2012. In Mongolia's total export value, coal was 25.4 percent, copper concentrate 21.6 percent, iron ore 16.0 percent, crude oil 11.1 percent, unrefined and semi-purified gold 7.2 percent, unwashed cashmere 6.3 percent, zinc ore concentrate 3.0 percent, and fluoride ore concentrate 2.1 percent. The remaining 7.3 percent were other export products. See additional data in Annex xx.

The Government of Mongolia has recognized the importance of export diversification early on, and has taken certain steps recently. First, the Government used part of the sovereign bond (the US\$1.5 billion Chinggis bond of 2012) proceeds (i) to direct investments into non-mineral exporting sectors, such as cashmere and agro-business, and (ii) for investments that indirectly support all exports, including the non-mineral ones, as well as the overall trade balance (e.g. investments in transport infrastructure and in import substitution endeavors such as cement and steel production for housing construction purposes).

Second, in September 2013 the Government adopted Export Promotion Program (EPP) which will lead to 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.

Key Issues Facing the Export Sector

Mongolian export sector is facing numerous challenges. Mongolia is a landlocked country, which presents logistical issues for its export products (primarily heavy commodities) to reach final buyers. Road and railway network in Mongolia is severely 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. Composition of Mongolian exports does not allow easy and quick re-direction of product flows in case the terms of trade with existing buyers worsen. Value added is also very low, as majority of exports are unprocessed products, severely limiting pricing power. Economic diplomacy is nascent. Finally, institutional set-up is relatively new and largely untested in strong and broad public policies for export support (as, e.g., attested by deliberations on the placement of the Chinggis bond proceeds in early 2013). A number of these challenges are being addressed to some scale, yet this is just the beginning of a long process.

Relationship to CAS

The World Bank's Country Partnership Strategy for Mongolia identifies three areas which the Bank will support between FY13 and FY17: (i) enhancing Mongolia's capacity to manage its mining economy, (ii) building a diversified basis for economic growth and employment, and (iii) addressing vulnerabilities through improved access to services, safety net provision, and disaster risk management. Export diversification falls into the realm of the second area of interventions. The CPS notes that the World Bank Group will support the Government's efforts to diversify the economy and generate employment by (i) enhancing its overall competitiveness and (ii) strengthening the competitiveness of the agricultural sector. Indeed, agricultural sector with all its products and value-added derivatives, from meat and dairy to skins and cashmere, stands to benefit the most from specific efforts to promote export diversification.

Furthermore, under the second CPS pillar, one of the targeted outcomes is improved access to credit for the MSME sector. Developing a line of export finance products and services would significantly benefit the MSMEs which, differently from the group of large mineral exporters, have limited and expensive access to specialized trade/export finance products.

II. Proposed Development Objective(s)

Proposed Development Objective(s) (From PCN)

The development objective of the project is to strengthen support to Mongolian exporters towards diversification and expansion of their exports by (i) improving access of Mongolian exporters to export finance products and services, and (ii) capacity building of exporters and quality improvements in export products.

Key Results (From PCN)

The ultimate Project beneficiaries will be existing and would-be exporters in Mongolia. The main expected outcome will be stronger competitiveness of Mongolian exporters in global markets, which would lead to appearance of new export products, new export destinations, and increasing share of non-mineral exports. Project outcomes and performance indicators will be:

- (i) The number of new export finance products established
- (ii) The number and volume of export finance products provided to the Mongolian exporters during the life-time of the Project
- (iii) Stronger acumen and deeper knowledge of Mongolian exporters on foreign trade (entering and expanding in foreign markets) based on received training and customized advise, measured through exporter surveys and factual increase in incremental exports

(iv) Expanded access to foreign markets of Mongolian exports based on ISO and other internationally recognized product/process quality certificates received by exporters as a result of the matching grant scheme, measured through exporter surveys and factual increase in incremental exports.

It should be noted that due to a relatively short proposed lifespan of the Project (3 years) the important long-term results such as stronger competitiveness of Mongolian exports, improved capabilities (foreign trade skills) of exporters, incremental exports, and increasing share of non-mineral exports will mostly be observed in the years following the completion of the Project. Realism of the indicated key results will be further assessed before appraisal.

The project will also measure the reach of its outputs to women entrepreneurs and specialist staff (exporting companies' owners, managers, and staff receiving training). The team will further consult with the regional gender team and country focal points for advice during preparation.

III. Preliminary Description

Concept Description

The proposed operation would support the Government's efforts in providing public sector assistance to exporters, with a particular focus on non-mineral exporters. The Project will largely build on the recently adopted EPP and will cover financial and non-financial support activities of the Government. The objective of the EPP and the Project is to strengthen the fundamental structure of support and available resources to the Mongolian entrepreneurs who wish to start, maintain, or expand exports of their products. International competitiveness of Mongolian exports would thus be strengthened, leading to export expansion and diversification.

The Project will be inclusive: in spite of export diversification as the ultimate long term aspiration supported by the Project, all products, services and public goods envisioned to be provided by the Project will be available to all exporters, including those exporting core commodities. Any targeted support by the Government to specific exporting industries and/or product groups can of course still be part of the government policy and will complement the Project's expected results.

The project will aim to achieve the proposed development objective through two dimensions that will lead to export diversification, quality improvements, and export volume increase. First, availability of financial products and services targeted directly to exporters will be expanded from the current limited selection. Trade finance is generally offered by Mongolian banks, yet it largely consists of instruments more suitable for importers rather than exporters. The Project objective is to enable an exporter to access a menu of affordable export-finance instruments – such as pre-shipment credit, supplier's credit, buyer's credit, finance for export of projects and consultancy services, capital equipment finance, export project cash-flow, and export insurance and guarantee products.

Second, non-financial support to existing and potential exporters will be expanded through better availability of foreign trade training programs and professional consultations as well as matching grants directed towards an increase in quality of exportable products and competitiveness of exporters in foreign markets. The latter will focus on increasing the number of ISO certificates among the exporters and raising the general foreign trade acumen of Mongolian entrepreneurs.

The project will have four components:

Component 1: Development of a new line of export finance products (\$10 million). This component will provide financial, technical, and institutional development support to the Development Bank of Mongolia (DBM) in building a new line of export finance products. It would enable the DBM to develop and start provision of a full range of export credit, insurance, and guarantee products to Mongolian firms. As an additional outcome from this component, a center of excellence on trade/export finance would be established in the DBM to provide consulting services to other financial institutions and exporting companies. This component will have two parts

Sub-component 1.1: Knowledge and expertise transfer and other TA for the Development Bank of Mongolia (\$1 million). This sub-component will see, for the duration of the Project, key DBM staff going on short (1- 6 months) fact-finding missions to solid foreign partner/s (Exim or development bank/s to be determined jointly by DBM and WB) for on-site learning related to export finance development. The sub-component will also allow partner bank management and staff to visit DBM for knowledge sharing sessions. It will allow the DBM to draw on the expertise and experience of the relevant partners in developing and launching a full range of export credit, insurance, and guarantee products to Mongolian entrepreneurs engaged in export activities.

Sub-component 1.2: Seed capital for DBM's new export insurance subsidiary (\$9 million). This sub-component will provide investment needed for the initial phase of setting up the export insurance subsidiary and making it operational, thus providing a stage for development and launch of export insurance products and services.

Component 2: Increasing export know-how of Mongolian exporters (\$3 million). This component will provide training on foreign trade to Mongolian firms. It will augment existing public and private sector-provided training programs to Mongolian entrepreneurs interested in starting or increasing exports. Furthermore, it will systematize such training, expand its modules, sectoral depth, geographical coverage, and virtual outreach. In addition to exporters, the component will provide training to trainers, public sector officials and Mongolian diplomatic corps responsible for economic representation of Mongolia abroad. A foreign trade research center of excellence would be set up within the structure laid out in the EPP ("Mongolian Exports SOE") and provide market research to exporting companies.

Component 3: Matching grants for stronger competitiveness (\$5.8 million). This component will provide matching grants to Mongolian exporters towards acquisition of ISO and other internationally recognized quality certificates and customized consulting services to Mongolian exports/exporters. It will pay part (e.g., half) of the cost towards acquiring ISO or other certificates by Mongolian exporters and thereby improve international competitiveness of their products and services.

Component 4: Project Implementation Support (\$1.2 million). Under this component, a Project Implementation Unit (PIU) will be established in the MOED. The PIU will be dissolved at Project closing. Technical skills of the PIU staff developed during the Project will be crucial for long-term sustainability of export promotion work, and will remain with the MOED (and DBM) after Project closing.

IV. Safeguard Policies that might apply

Safeguard Policies Triggered by the Project	Yes	No	TBD
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	

V. Financing (in USD Million)

Total Project Cost:	20.00	Total Bank Financing:	20.00
Financing Gap:	0.00		
Financing Source			Amount
BORROWER/RECIPIENT			0.00
International Development Association (IDA)			20.00
Total			20.00

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