



# Combined Project Information Documents / Integrated Safeguards Datasheet (PID/ISDS)

Appraisal Stage | Date Prepared/Updated: 16-May-2017 | Report No: PIDISDSA22204



**BASIC INFORMATION**

**A. Basic Project Data**

Country Mongolia	Project ID P161048	Project Name Strengthening Fiscal and Financial Stability Project	Parent Project ID (if any)
Region EAST ASIA AND PACIFIC	Estimated Appraisal Date 24-Apr-2017	Estimated Board Date 09-Jun-2017	Practice Area (Lead) Governance
Financing Instrument Investment Project Financing	Borrower(s) Mongolia	Implementing Agency Ministry of Finance	

Proposed Development Objective(s)

The Project Development Objective is to contribute to the Government of Mongolia’s efforts to strengthen fiscal and financial stability and improve the quality of expenditure management.

Components

- Component A: Strengthening Macroeconomic and Fiscal Management
- Component B: Improving the efficiency of Public Financial Management
- Component C: Enhancing Financial Sector Stability
- Component D: Strengthening of the Social Protection System
- Component E: Project Management and Monitoring

**Financing (in USD Million)**

Financing Source	Amount
International Development Association (IDA)	12.00
<b>Total Project Cost</b>	<b>12.00</b>

Environmental Assessment Category

C - Not Required

Decision

The review did authorize the preparation to continue



**Note to Task Teams:** End of system generated content, document is editable from here.

Other Decision (as needed)

## B. Introduction and Context

### Country Context

- 1. Mongolia's economy is at a critical juncture. With its vast mineral resources, Mongolia's long-term prospects are promising, but the country will likely face short-term challenges due to fiscal vulnerabilities and external risks.** Mongolia was the world's fastest growing economy in 2011, when an investment and mining boom was under way. However, the economy underwent sharp adjustments in recent years due to the collapse of foreign direct investment and the fall in mineral prices, resulting in a marked deceleration of the country's growth rate (11.6 percent in 2013 to 1 percent in 2016) and a substantial increase in public debt (over 40 percent of the gross domestic product [GDP]). While external factors are beyond Mongolia's control, policy reforms are not and are much needed to address macroeconomic imbalances to avoid higher adjustment costs.
- 2. Mongolia is currently facing significant fiscal challenges due to weak fiscal discipline and public financial management (PFM).** Fiscal policy has been significantly loose, particularly in 2016, thus putting on the policy agenda the need for substantial adjustment in expenditure, greater revenue mobilization, and full integration of off-budget expenditures into the budget. The consolidated overall budget deficit sharply widened from 8 percent of GDP in 2015 to over 19 percent of the GDP in 2016, with total public expenditures increasing by more than a quarter despite declining revenues. Mongolia's expenditure level has grown faster than the average of its peers, reaching 42 percent of the GDP in 2016, while budget revenue fell sharply after the commodity boom in 2011–2012.
- 3. Mongolia also faces important development challenges that require the country to take targeted actions to scale up investment spending to support economic activity and improve the living standard of its citizens.** Even though Mongolia spends more on public investment than other countries, this has not translated into ensuring higher efficiency in public expenditures for better infrastructure financing<sup>1</sup> and service delivery. This situation calls for an improvement of the current public investment management (PIM) system and for an assessment to determine the country's capability to implement effective projects in a macro-economically sustainable manner.
- 4. Although Mongolia has made good progress in reducing poverty, it remains a serious concern because the positive trend shown by the country in past years is likely to be affected by weakening growth and declining household consumption.** Moreover, generous social welfare programs implemented in the past have not been well targeted and therefore have not been as effective in protecting the poor. Thus, policy adjustments to strengthen the social safety nets, particularly targeting

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<sup>1</sup> Infrastructure needs are considerable for a vast, scarcely populated, and sub-arctic climate country, such as Mongolia, with poor transport connectivity and high unit costs of service delivery.



vulnerable groups near or below the poverty line, are needed to help mitigate the social costs of short-term fiscal consolidation.

5. **These challenges are recognized in and addressed by Mongolia's Economic Recovery Plan (ERP) prepared by the new Government and approved by the Parliament on November 24, 2016.** The new Government—which began its term in July 2016—announced the program, with the following objectives: (a) overcoming the current economic difficulties in the short term, (b) stabilizing the economy at the macro level, (c) reducing debt burden in the medium term, (d) restoring foreign investor sentiment, and (e) diversifying the economy and increasing household income and business profitability in real terms. To support the Government in implementing the reform actions of the economic stabilization program, a three-year Extended Fund Facility program is under preparation by the International Monetary Fund (IMF) for SDR 314.505 million, or US\$425 million. A staff-level agreement was reached with the Government on February 19, 2017, and the program may be approved by the IMF Board as early as May 2017. The World Bank is also currently preparing an Economic Management Support Development Policy Financing Operation (EMSO) to join efforts with the Government in laying the foundation for a stable and sustainable growth path. The Strengthening Fiscal and Financial Stability Project is aligned with both the IMF-led program and EMSO.

## Sectoral and Institutional Context

### **Macro-Fiscal management**

6. **Improvements in in-house macroeconomic modeling capacity and use of latest econometric approaches to produce consistent and realistic economic projections are key conditions to inform budget parameters, as well as to set the basis for a reliable budget preparation process.** In Mongolia, fiscal planning does not necessarily adhere to the deficit or debt ceilings in the Fiscal Stability Law (FSL), and revenue projections tend to be unrealistic. Off-budget expenditures have progressively increased, including un-budgeted government programs and corporate loans of the Development Bank of Mongolia (DBM)—the major source of government guaranteed borrowing. Fiscal policy is also weakened due to the pending implementation of government plans to manage resources through the sovereign wealth fund and improve tax policy to enhance revenue collection and expand the tax base. Finally, the Ministry of Finance (MoF) faces the challenge of strengthening its debt management capacity, diversifying its borrowing sources, and developing debt re-financing options.

### **Public Financial Management**

7. **The Government of Mongolia (GoM) has undertaken reforms to gradually develop a PFM system.** The first phase of reforms between 2003 and 2008 established the basic elements of the system, including strengthening internal controls, cash management, and accounting and reporting. The second phase of reforms included some improvements in fiscal policy, budget planning, and decentralization of roles and resources to subnational governments.



8. **Despite these advances there are still challenges to improve efficiency, effectiveness and transparency of the PFM system and its processes, that could contribute to improve the quality of public expenditures.** A recent assessment completed through the “Public Financial Management Performance Report” (PFM-PR)<sup>2</sup> in 2015 as well as recent analysis done through the World Bank “Mongolia Governance and Public Sector Management Analytic Support Program” identify key challenges and opportunities to improve budget credibility, predictability, comprehensiveness and reporting.

9. **Lack of alignment of expenditures and revenue outputs with the originally approved budget, poor quality of cash flow forecast, and predictability in availability of funds, have weakened budget credibility, which in turn negatively affects service delivery.** Aggregate deviations in expenditures have averaged 11.5% between 2013-2016. This has translated into weak and unpredictable delivery of services in the 20 largest budget heads of the Government, including entities responsible for delivery of education, social welfare, roads, health, and justice services.

10. **Mongolia spends far more on public investment than other comparable countries yet its weak public investment management system has been undermining the efficiency and effectiveness of this growing investment.** The recent Mongolia Public Expenditure Review found that Mongolia’s capital expenditure-to-GDP ratio, reaching almost 10 percent in 2016, far exceeds an average 4.8 percent of lower middle-income countries and a 3 percent average of East Asia and Pacific countries in 2010-14. Most public investment projects have been relying on four funding sources: domestic revenues, foreign grant and loans, DBM funding, and the concessions mostly through build-transfer (BT) projects.

11. **With regard to fiscal transparency, an important initiative has been the adoption of the Law of Mongolia on Glass Accounts (“Accounts Law”)** which aims at (i) ensuring the efficient and proper use of state and local government funds and assets, (ii) improving the transparency of decisions and actions concerning budget management, and (iii) strengthening citizens’ oversight through an information system. The Accounts Law was approved by the Parliament on July 2014 and entered into force on January 1, 2015.

### **Financial Sector**

12. **The Mongolian financial system is dominated by the banking sector.** Banks account for about 95 percent of total financial system assets. They are highly concentrated and competition remains limited, with the top 5 banks accounting for 67 percent of total financial system assets and more than 80 percent of total assets.

13. **The vulnerability of the banking system has markedly increased in recent years, with asset quality steadily deteriorating.** Mongolia’s credit growth had rapidly accelerated in 2013-14, reaching 54 percent at the end of 2013, fueled by a substantial monetary easing by the Central Bank through a series of quasi-fiscal policy lending programs. Fresh liquidity injected by the Central Bank reached MNT 3.5 trillion—18 percent of GDP—at its peak at the end of 2013. As the Bank of Mongolia (BOM) began to gradually withdraw the monetary easing program and the economy gradually slowed from mid-2014, credit conditions have substantially tightened, with bank loan growth (year-on-year) dropping from 43 percent in June 2014 to less than 2 percent at the end of 2015. With tighter credit conditions and continued slowdown of the economy, the asset quality of banks has been rapidly deteriorating. Formally

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<sup>2</sup> Report No. 96546.



reported Non-Performing Loans (NPL) reached 9.1 percent of total outstanding loans in November 2016, a substantial increase from 5 percent at the end of 2014. Loans that are past due (over 3 months) also increased to 7.6 percent of the total outstanding loans, from 2.2 percent over the same period.

14. **Efforts to deepen capital markets in Mongolia are still in progress and far from completed, hampered by weaknesses in the regulatory framework as well as institutional capacity.** Capital markets remain in early stages of development; the insurance market is small, with a penetration rate of about 0.64 percent of GDP. Progress in the development of non-bank financial institutions (NBFIs) is slow, and continuous effort is needed to build appropriate institutions, policies and oversight arrangements. The Financial Regulatory Commission (FRC), a supervisor of both NBFIs and capital markets, faces significant challenges to fill the gaps in the legal framework and strengthen the regulatory, supervisory, governance, internal control, and accounting and auditing frameworks.

15. **The interconnectedness of the financial sector has significantly increased and the Development Bank of Mongolia (DBM) has become a systemically important financial institution.** However, there is a lack of transparency and accountability around DBM's activities, as DBM has operated without adequate corporate governance processes and policies.

16. **The legal framework for financial system stability and development remains weak.** The Mongolia Multi-Sectoral Technical Assistance Loan Project (P119825) or MSTAP, has strengthened the institutional capacity of the BOM and MOF to improve the legal and regulatory framework for the financial sector in line with international good practices. However, while the BOM is moving to a more risk-based supervisory approach, further capacity building is required in this area, as well as on risk monitoring and economic analysis. Also, regulatory forbearance is still widespread. For MOF, the remaining challenges include capacity for financial policy making and management, financial sector infrastructure development, and effective management of state-owned financial institutions, including DBM.

### **Social Protection**

17. **Largely due to its legacy as a former socialist country, Mongolia has a relatively well established social protection system with an extensive set of benefits in both social welfare and social insurance.** Different social protection benefits and entitlements have emerged at different times which, coupled with population growth, has made the social protection system relatively complex and expensive over time. Overall fiscal pressures, especially in the area of social insurance, have also been increasing and are projected to accelerate in the future. This has raised questions about both the design and sustainability of the social welfare and social insurance systems as well as the equity and efficiency in fulfilling their objectives.

18. **Mongolia has a relatively large number of small but fragmented targeted cash-based benefits.** In the aggregate, spending on social welfare programs is broadly similar in comparison to middle- and high-income countries<sup>3</sup> but multiple issues affect equity and operational and allocative efficiency. The majority of social welfare programs are categorically targeted to different population groups (e.g., children, disabled, elderly, and single mothers etc.) traditionally seen as vulnerable. Some of these programs are needs-oriented while others are merit-oriented; the latter are often most generous and

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<sup>3</sup> Honorati, Maddalena; Gentilini, Ugo; Yemtsov, Ruslan G., 2015. *The state of social safety nets 2015*: World Bank Group.



politically difficult to remove and/or amend. A recent World Bank study<sup>4</sup> suggests that the poorest 20 percent of households receive 34 percent of total social welfare transfers, a level lower than comparable peer countries.<sup>5</sup> The current support to poor households in terms of post-transfer consumption is also very low by international standards.<sup>6</sup>

19. **The government has made some attempts over the last two years to improve the equity and allocative efficiency of social welfare spending in light of the budget situation, and the recent “Program for Economic Stabilization” reinforces these efforts with support from development partners.** The Food Stamp Program (FSP) and the Child Money Program (CMP) are two important social welfare programs that have recently been reformed or will be reformed as part of the “Program for Economic Stabilization” and can serve complementary functions in terms of protecting the poor and boosting shared prosperity. The FSP provides nutrition assistance to the poorest households. The coverage and benefit size of the program have so far been inadequate, but are expected to increase in 2018. In recent years, the CMP has amounted to about half of all social welfare spending, providing benefits to all households with children under 18. While the near-universal CMP provided some income support to the poor, it also contributed to the large share of social welfare spending going to non-poor households and proved fiscally unsustainable in the economic downturn.<sup>7</sup> As a result, the 2017 budget targeted the CMP to the children in the poorest 50 percent of households of which 60% are children.

20. **The steps to improve equity and allocative efficiency on the policy side need to be complemented by appropriate improvements of implementation systems on the ground.** With assistance from development partners, including the WB-funded MSTAP project, the government has taken important steps, including establishing the enabling infrastructure for targeting the social welfare benefits. An online Welfare Administration Information System has been newly developed and a poverty targeting methodology - Proxy-Means Test (PMT) - has also been introduced.<sup>8</sup> The PMT-based Integrated Household Database has been established and the government has made the database inter-sectoral to be used not only for social welfare but also for other government support and subsidies provided to the poor. While the basic arrangements for implementing cash-based social welfare benefits are in place, a number of challenges limit the social welfare system’s equity and efficiency. These include (i) the absence of concrete actions for consolidation of fragmented social welfare programs; (ii) the need for improvements to verification and validation measures of the PMT methodology; and (iii) shortcomings in the area of monitoring and evaluation. As the government puts an increasing emphasis on the need for a more comprehensive set of monetary and non-monetary support including social work services,<sup>9</sup> capacity building of the relevant institutions and front line service workers are also needed.

21. **In the area of social insurance, the Pension Insurance Scheme poses a sharply growing fiscal burden as a result of the rapidly aging population and several measures introduced in recent years to the scheme which increased benefits and/or reduced eligibility requirements.** In this context, the State Policy on Pension Reform (2015-2030) was approved by Parliament in December 2015 to “create a

<sup>4</sup> Onishi, Junko; Chuluun, Tungalag. 2015. *Review of program design and beneficiary profiles of social welfare programs in Mongolia*. Washington, D.C.: World Bank Group.

<sup>5</sup> This includes the Child Money Program. In European and Central Asian as well as Latin American countries (for example, Croatia, Poland, Argentina and Uruguay) the share of total benefits going to the poorest 20 percent reaches over 40 percent.

<sup>6</sup> World Bank. 2016. *Options for Immediate Fiscal Adjustment – Just-in-Time Public Expenditure Review*. Washington, D.C.: World Bank Group.

<sup>7</sup> World Bank. 2016. *Mongolia: Progress in Reducing Poverty and Shared Prosperity?*. Washington, DC. World Bank Group.

<sup>8</sup> The PMT survey methodology was first approved by a joint decree of MSWL (then) and NSO in 2010 and revised in 2013.

<sup>9</sup> In 2016, the government approved a national program to support development and protection of target (poor) families but it has not yet been implemented at scale.



*framework for the government, employers and individuals to be jointly responsible for addressing the ever increasing pension costs due to the changes in demographic structure and life expectancy and provide a decent pension benefit that is adequate for living for elders".* The State Policy envisioned addressing the fiscal burden through parametric reforms which better align contributions and benefits and limit the state subsidy to the social insurance fund to no greater than 2% of GDP in a long term. The policy, however, is not legally binding and therefore needs to be followed-up with amendments to the Social Insurance Law to achieve the policy objectives envisioned. In-country technical capacity for evidence-based pension policy making and implementation is limited.

### **C. Proposed Development Objective(s)**

Development Objective(s) (From PAD)

The Project Development Objective is to contribute to the Government of Mongolia's efforts to strengthen fiscal and financial stability and improve the quality of expenditure management.

#### Key Results

1. Aggregate deviation of expenditures is reduced by 15 percent or less and commitment controls are in place.
2. Financial Sector Stability improved by decreasing percentage of non-performing loans.
3. Level of targeted social welfare support going to the poorest 20 percent is increased.

### **D. Project Description**

**Component A: Strengthening Macroeconomic and Fiscal Management:** The overall objective of this component is to strengthen fiscal responsibility and support the implementation of relevant policy measures towards: a) improving the quality of expenditure management, b) strengthening macroeconomic and budget policy making capacity, and c) improving regulatory processes. Various technical assistance activities will be provided to relevant departments of MoF in support of their capacity.

**Component B: Improving the Efficiency Public Financial Management:** The overall objective of this component is to improve fiscal discipline by strengthening the country's Public Financial Management (PFM) and to enhance the quality of expenditures by revamping Public Investment Management (PIM) and fostering activities aimed at increasing transparency and accountability. Technical assistance activities will be provided to relevant departments of MoF to support building its capacity.

**Component C: Enhancing Financial Sector Stability:** The objective of this component is to support the MOF, the BoM, the FRC, the DBM and the Deposit Insurance Corporation of Mongolia (DICOM) to strengthen the resiliency of the Banking system by: a) enhancing financial stability in Mongolia; b) mitigating risks in the financial sector; and c)



promoting insurance sector and capital markets development. Various technical assistance activities will be provided to relevant departments including MoF, BoM, FRC, DBM and DICOM in support of their capacity.

**Component D: Strengthening of the Social Protection System:** The objective of this component is to support government efforts to improve public expenditure quality in social protection through: a) strengthening the design, targeting, operations, and performance of social welfare programs to protect the poor and vulnerable; b) strengthening social insurance by supporting the implementation of measures set forth in the state policy on pension reforms (2015-2030) and other reforms to strengthen social insurance programs; and, c) strengthening the governance and financial management aspects of social welfare and social insurance programs.

**Component E: Project Management and Monitoring:** This component will support the strengthening of MOF's capacity for Project implementation, monitoring and evaluation, including audit arrangements, reporting requirements, procurement, disbursement and financial management activities.

## E. Implementation

### Institutional and Implementation Arrangements

**The MOF will be the implementing agency for the Project and will be responsible for its overall management and implementation.** The existing Project Implementing Unit (PIU) responsible for the ongoing Multi Sectoral Technical Assistance Project (MSTAP) and another recently-effective Bank-financed Export Development Project will continue providing its services to this new project by effectively carrying out its implementation and overall project administrative work. The PIU will ensure compliance with procurement, disbursement and financial management policies and procedures given its many years of experience in implementing Bank-financed projects under the management of MOF, even prior to the MSTAP. The PIU will report to a Project Director to be appointed by MOF.

**To effectively oversee the implementation of the Project, a Project Steering Committee (PSC) will be created, headed by the MOF and comprising other beneficiary agencies for the Project,** i.e. the Ministry of Labor and Social Protection (MLSP), the Bank of Mongolia (BoM), and the Financial Regulatory Commission (FRC). The PSC shall meet regularly and be responsible for the key functions of project implementation such as ensuring efficient inter-departmental and inter-agency interactions, exercising monitoring and evaluation of project progress and propose recommendations for improvement, and interacting with the Bank.

## F. Project location and Salient physical characteristics relevant to the safeguard analysis (if known)

This is a country level technical assistance project. As such, the project area is the whole nation.

## G. Environmental and Social Safeguards Specialists on the Team

Erdene Ochir Badarch, Ning Yang, Mauricio Monteiro Vieira



**SAFEGUARD POLICIES THAT MIGHT APPLY**

Safeguard Policies	Triggered?	Explanation (Optional)
Environmental Assessment OP/BP 4.01	No	The proposed project will support technical assistance and institutional strengthening activities in the areas of macroeconomic, fiscal and financial sector in the country. The proposed project activities focus on improving management of the revenue and budget, the strengthening of capital market, financial sector and social welfare system. There are no civil works or construction activities included in the project. Based on environmental screening per OP4.01, the project will have indirect social benefits, while it is not anticipated to have any environmental safeguard issues. Therefore it is proposed to assign Category C to the project. No environmental assessment instrument needs to be prepared.
Natural Habitats OP/BP 4.04	No	The project is not anticipated to involve any natural habitats. The policy is not triggered.
Forests OP/BP 4.36	No	The project is not anticipated to involve any forest. The policy is not triggered.
Pest Management OP 4.09	No	The project is not anticipated to involve the use or procurement of pesticide. The project is not triggered.
Physical Cultural Resources OP/BP 4.11	No	The project is not anticipated to affect physical cultural resources. The policy is not triggered.
Indigenous Peoples OP/BP 4.10	No	The project is not anticipated to affect Indigenous People. This policy is not triggered.
Involuntary Resettlement OP/BP 4.12	No	The project is not anticipated to involve resettlement of population. The policy is not triggered.
Safety of Dams OP/BP 4.37	No	The project is not anticipated to involve any dams. The policy is not triggered.
Projects on International Waterways OP/BP 7.50	No	The project does not involve any international waterways. The policy is not triggered.
Projects in Disputed Areas OP/BP 7.60	No	The project does not involve any disputed areas. The policy is not triggered.



## KEY SAFEGUARD POLICY ISSUES AND THEIR MANAGEMENT

### A. Summary of Key Safeguard Issues

1. Describe any safeguard issues and impacts associated with the proposed project. Identify and describe any potential large scale, significant and/or irreversible impacts:

None.

2. Describe any potential indirect and/or long term impacts due to anticipated future activities in the project area:

None

3. Describe any project alternatives (if relevant) considered to help avoid or minimize adverse impacts.

None

4. Describe measures taken by the borrower to address safeguard policy issues. Provide an assessment of borrower capacity to plan and implement the measures described.

This is a category C technical assistance project, hence no safeguards will be triggered.

5. Identify the key stakeholders and describe the mechanisms for consultation and disclosure on safeguard policies, with an emphasis on potentially affected people.

Not applicable

### B. Disclosure Requirements

### C. Compliance Monitoring Indicators at the Corporate Level (to be filled in when the ISDS is finalized by the project decision meeting)

#### The World Bank Policy on Disclosure of Information

Have relevant safeguard policies documents been sent to the World Bank's Infoshop?

NA

Have relevant documents been disclosed in-country in a public place in a form and language that are understandable and accessible to project-affected groups and local NGOs?

NA



### All Safeguard Policies

Have satisfactory calendar, budget and clear institutional responsibilities been prepared for the implementation of measures related to safeguard policies?

NA

Have costs related to safeguard policy measures been included in the project cost?

NA

Does the Monitoring and Evaluation system of the project include the monitoring of safeguard impacts and measures related to safeguard policies?

NA

Have satisfactory implementation arrangements been agreed with the borrower and the same been adequately reflected in the project legal documents?

Yes

### CONTACT POINT

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**APPROVAL**

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