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Report No: PAD2269

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROJECT APPRAISAL DOCUMENT

ON

PROPOSED CREDITS

IN THE AMOUNT OF SDR 2.8 MILLION IDA HARD-TERM CREDIT

AND SDR 6 MILLION IDA CREDIT

(US$12 MILLION EQUIVALENT TOTAL)

TO

MONGOLIA

FOR A

STRENGTHENING FISCAL AND FINANCIAL STABILITY PROJECT

May 18, 2017

Governance Global Practice

East Asia And Pacific Region

CURRENCY EQUIVALENTS

Exchange Rate Effective April 30, 2017

Currency Unit =	Mongolian Tugrik (MNT)
MNT 2,415 =	US$1
US$1.36 =	SDR 1

FISCAL YEAR
January 1 – December 31

Regional Vice President:	Victoria Kwakwa
Country Director:	Bert Hofman
Senior Global Practice Director:	Deborah L. Wetzel
Practice Manager:	Robert R. Taliercio
Task Team Leader:	Carolina Luisa Vaira

ABBREVIATIONS AND ACRONYMS

BEPS	Base Erosion and Profit Shifting
BOM	Bank of Mongolia
CMP	Child Money Program
CPS	Country Partnership Strategy
DICOM	Deposit Insurance Corporation of Mongolia
DA	Designated Account
DBM	Development Bank of Mongolia
EMSO	Economic Management Support Development Policy Financing Operation
ERP	Economic Recovery Plan
FM	Financial Management
FRC	Finance Regulatory Commission
FSL	Fiscal Stability Law
FSP	Food Stamp Program
GoM	Government of Mongolia
GFMIS	Government Financial Management Information System
GDP	Gross Domestic Product
HSIGO	Health and Social Insurance General Office
IADI	International Association of Deposit Insurers
IBL	Integrated Budget Law
IMF	International Monetary Fund
IP	Indigenous Peoples
IPPF	Indigenous Peoples Planning Framework
IPSAS	International Public Sector Accounting Standards
MNAO	Mongolian National Audit Office
MTFF	Medium-Term Fiscal Framework
MOF	Ministry of Finance
MLSP	Ministry of Labor and Social Protection
MSTAP	Multi-Sectoral Technical Assistance Project
NBFI	Nonbank Financial Institution
OBI	Open Budget Index
PDO	Project Development Objective
PLR	Performance and Learning Review
PIU	Project Implementation Unit
PSC	Project Steering Committee
PMT	Proxy-Means Test
PFM	Public Financial Management
PFM-PR	Public Financial Management Performance Report
PIM	Public Investment Management
PPP	Public-Private Partnership

BASIC INFORMATION

Is this a regionally tagged project?	Country(ies)	Financing Instrument
No		Investment Project Financing

[ ] Situations of Urgent Need of Assistance or Capacity Constraints

[ ] Financial Intermediaries

[ ] Series of Projects

Approval Date	Closing Date	Environmental Assessment Category
09-Jun-2017	31-Jan-2022	C - Not Required
Bank/IFC Collaboration		
No		

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 Name	Cost (US$, millions)
Component A: Strengthening Macroeconomic and Fiscal Management	2.71
Component B: Improving the efficiency of Public Financial Management	3.80
Component C: Enhancing Financial Sector Stability	2.85
Component D: Strengthening of the Social Protection System	2.00
Component E: Project Management and Monitoring	0.64

Organizations

Borrower : Mongolia

Implementing Agency : Ministry of Finance

PROJECT FINANCING DATA (IN USD MILLION)

[ ] Counterpart Funding	[ ] IBRD	[✔] IDA Credit [ ] Crisis Response Window [ ] Regional Projects Window	[ ] IDA Grant [ ] Crisis Response Window [ ] Regional Projects Window	[ ] Trust Funds	[ ] Parallel Financing

Total Project Cost:	Total Financing:	Financing Gap:
12.00	12.00	0.00
	Of Which Bank Financing (IBRD/IDA):	
	12.00	

Financing (in US$, millions)

Financing Source	Amount
International Development Association (IDA)	12.00
Total	**12.00**

Expected Disbursements (in US$, millions)

Fiscal Year	2017	2018	2019	2020	2021	2022
Annual	0.00	0.67	2.19	3.15	4.26	1.73
Cumulative	0.00	0.67	2.86	6.01	10.27	12.00

INSTITUTIONAL DATA

Practice Area (Lead)

Governance

Contributing Practice Areas

Finance & Markets
Macro Economics & Fiscal Management
Social Protection & Labor

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

Gender Tag

Does the project plan to undertake any of the following?

a. Analysis to identify Project-relevant gaps between males and females, especially in light of country gaps identified through SCD and CPF

No

b. Specific action(s) to address the gender gaps identified in (a) and/or to improve women or men's empowerment

Yes

c. Include Indicators in results framework to monitor outcomes from actions identified in (b)

No

SYSTEMATIC OPERATIONS RISK-RATING TOOL (SORT)

Risk Category	Rating
1. Political and Governance	Substantial
2. Macroeconomic	Substantial
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Low
5. Institutional Capacity for Implementation and Sustainability	Moderate
6. Fiduciary	Moderate
7. Environment and Social	Low

8. Stakeholders	Low
9. Other	Low
10. Overall	Moderate

COMPLIANCE

Policy

Does the project depart from the CPF in content or in other significant respects?

[ ] Yes [✔] No

Does the project require any waivers of Bank policies?

[ ] Yes [✔] No

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

Legal Covenants

Sections and Description

Section 1, A, 1. (a). The recipient shall establish, and thereafter maintain throughout the implementation of the Project, an inter-ministerial Project Steering Committee, chaired by the Deputy Minister of MOF, and comprised of the representatives of the MOF, MLSP, BOM, and FRC, and assigned with such functions, powers, resources and competencies, satisfactory to the Association, as shall be required for the overall policy guidance and general oversight of Project implementation, including inter-ministerial coordination, Project monitoring and evaluation, and the liaison with the Association. The Project Steering Committee shall meet at least once every calendar quarter.

Sections and Description
Section 1, A, 1 (b) The recipient shall establish, and thereafter maintain, throughout the implementation of the Project, the Project Implementation Unit ("PIU"), vested with the responsibility of the overall management and coordination of Project fiduciary obligations, said PIU to be: (i) headed by the State Secretary of MOF as Project Director, assisted by a qualified and experienced Project Manager, procurement officer and financial officer, all of whom shall have experience and qualifications acceptable to the Association and contracted under terms of reference satisfactory to the Association; and (ii) assigned with such functions, powers, resources and competencies, satisfactory to the Association, as shall be required to achieve its purposes, including the fiduciary responsibilities for procurement, financial management, record keeping, disbursement and compliance with monitoring and reporting requirements.

Sections and Description
Section I, A, 1 (c) The recipient shall cause each of MOF, MLSP, BOM, DBM, DICOM and FRC to appoint, and thereafter maintain throughout the implementation of the Project, a coordinator in each of MOF, MLSP, BOM, DBM, DICOM and FRC for the purposes of handling the day-to-day technical aspects of the Project activities (other than the fiduciary responsibilities assigned to the PIU) in each of their respective parts of the Project and technical coordination with the PIU, under terms of reference satisfactory to the Association.

Sections and Description
Section II, C 1. The Recipient shall carry out the Project in accordance with the Project Implementation Manual.

Sections and Description
Section II, B. The Recipient shall: (a) not later than January 31, 2020 (or such other date as the Association may agree), carry out a mid-term review of the Project and, prepare and furnish to the Association a mid-term report, in such detail as the Association shall reasonably request, documenting progress achieved in the carrying out of the Project during the period preceding the date of such report, taking into account the monitoring and evaluation activities performed pursuant to paragraph 1 of this Section II.A, and setting out the measures recommended to ensure the continued efficient carrying out the Project and the achievement of its objective during the period following such date; and (b) review with the Association, such mid-term report, on or about the date one month after its submission, and thereafter take all measures required to ensure the continued efficient implementation of the Project and the achievement of its objective, based on the conclusions and recommendations of the mid-term report and the Association's views on the matter.

Conditions

Type	Description
Effectiveness	The Project Implementation Unit has been established pursuant to Section I.A.1(b) of Schedule 2 to the Financing Agreement; and the Project Implementation

	Manual has been adopted by the Recipient on terms and conditions satisfactory to the Association.

PROJECT TEAM

Bank Staff

Name	Role	Specialization	Unit
Carolina Luisa Vaira	Team Leader(ADM Responsible)	TTL	GGO14
Jianjun Guo	Procurement Specialist(ADM Responsible)	Procurement	GGO08
Badamchimeg Dondog	Financial Management Specialist	Financial Management	GGO14
Alejandro Alcala Gerez	Counsel	Alternate Country Lawyer	LEGES
Altantsetseg Shiilegmaa	Team Member	Macro	GMF02
Erdene Ochir Badarch	Safeguards Specialist	Social Safeguards	GSU02
Marcelo Buitron	Team Member	Governance	GGO19
Mauricio Monteiro Vieira	Safeguards Specialist	Social Safeguards	GSU02
Miguel Eduardo Ceara Asuad	Team Member	Operations Officer	GGO14
Ning Yang	Environmental Specialist	Environmental Safeguards	GEN2A
Otgonbayar Yadmaa	Team Member		EACMF
Regis Thomas Cunningham	Team Member	Financial Management	GGO20
Ria Nuri Dharmawan	Counsel	Country Lawyer	LEGES
Taehyun Lee	Team Member	Macro	GMF02
Tungalag Chuluun	Team Member	Social Protection	GSP02
Ulle Lohmus	Team Member	Financial Sector	GFM08
Zhuo Yu	Team Member	Finance Officer	WFALN

Extended Team

Name	Title	Organization	Location

MONGOLIA
STRENGTHENING FISCAL AND FINANCIAL STABILITY PROJECT
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I. STRATEGIC CONTEXT

A. 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[1] 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 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

[1] 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.

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.

B. Sectoral and Institutional Context

Macro-Fiscal Management

6. **Fiscal policy was loosened in 2016, requiring adjustments in the coming months to contain the annual budget deficit so that it stays within the Fiscal Sustainability Law's deficit ceiling.** 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 government programs and corporate loans of the Development Bank of Mongolia (DBM)—the major source of government-guaranteed borrowing. To address these challenges, the Ministry of Finance (MOF) needs to strengthen its debt management capacity, diversify its borrowing sources, and develop debt refinancing options.

7. **The Medium-Term Fiscal Framework (MTFF) is not achieving its objective of providing a hard budget constraint.** The challenges faced include: (a) the exclusion of extra-budgetary expenditures from the MTFF; (b) weak forecast of main fiscal aggregates, and (c) weak links between subsequent MTFFs and between the MTFF and the annual budget. In addition, the planning documents produced by several Central Government agencies, are not reconciled with the MTFF, are not formulated within a realistic fiscal envelope, and do not include reasonable costing of investments and recurrent expenditures. All of the above, compromises the effective allocation of resources and the efficiency of government expenditures.

8. **Mongolia's Government debt increased almost five-fold over the last four years and contingent liabilities are not under proper control.** As a result, the debt-to-GDP ratio climbed from 24 percent to 74 percent over the same period. The current debt-to-GDP ratio is among the highest of developing countries, far exceeding the 45.5 percent average for middle-income countries and the 35.6 percent average for low-income countries in 2015. In addition to the explicit debt and guarantees, there are growing fiscal risks from contingent liabilities that are not under proper control and monitoring by the Government.

Public Financial Management

9. **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.

10. **Despite this, there are still challenges related to the efficiency, effectiveness, and transparency of the PFM system that if addressed, could contribute to improving the quality of public expenditures.** A recent assessment completed through the 'Public Financial Management Performance Report' (PFM-PR)[2] in 2015, as well as a recent analysis conducted through the World Bank's "Mongolia Governance and Public Sector Management Analytic Support Program" identify key challenges on budget credibility, predictability, comprehensiveness, and reporting.

11. **The lack of alignment of expenditures and revenue outputs with the originally approved budget, poor quality of cash flow forecast, and unpredictability in availability of funds, have weakened budget credibility, which in turn, negatively affects service delivery.** Between 2013 and 2016, aggregate deviations in expenditures averaged 12 percent of the consolidated budget. This translated into weak and unpredictable delivery of services in the 20 largest budget heads of the Government, including entities responsible for education, social welfare, roads, health, and justice. Revenue outturn deviations have been caused by consistent underestimation of mineral prices during the commodity boom and political pressures for capital expenditures expansion.

12. **The quality of revenue and expenditure forecasts could also be strengthened.** The former is compromised by missing data from certain agencies[3] and the latter because it is based on historical data -approved monthly budget allocations - that is revised based on cash availability and requests from the line ministries. The forecast of capital expenditures is even more difficult because they bear the brunt of the expenditure cuts and therefore, the historical data cannot accurately estimate the cash needs of the spending agencies. This represents a severe constraint for effective and efficient service delivery.

13. **Five or six times each year, the MOF makes changes in monthly allocations for the yearly balance based on updated revenue collection and forecasts.** Decisions regarding the changes, including amounts and uses, are made within the ministry and communicated to the budget executing agencies with two weeks' notice before the start of a month. Procedures for allocation and reallocation are laid out in the Integrated Budget Law (IBL) and its respective regulation. Even if budget allocations have not been changed, the MOF often uses nontransparent cash control mechanisms at the end of the year (such as delaying printing of checks) to address liquidity issues. Also commitments are not recorded in the Government Financial Management Information System (GFMIS) making it difficult to control them.

Table 1. Aggregate Expenditure Outturn Compared to Originally Approved Budget: Consolidated Budget and Central Budget (MNT, billions)

Consolidated Budget							
	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Originally budgeted primary expenditure (1)	2,800	4,046	6,118	7,047	6,831	6,902	7,007
Actual primary expenditure (2)	3,038	4,960	5,892	5,894	6,644	6,407	8,532
Difference: (3) = (1) − (2)	−238	−914	226	1,153	187	495	−1,526
Overall variance: (3) / (1) (%)	**−8.5**	**−22.6**	**3.7**	**16.4**	**2.7**	**7.2**	**−21.8**

[2] Report No. 96546
[3] . General Department of Taxation, the Customs Administration, and the Oil and Petroleum Agency among others.

Central Budget						
	2011	2012	2013	2014	2015	2016
Originally budgeted primary expenditure (1)	2,745	4,674	5,578	5,187	4,986	5,049
Actual primary expenditure (2)	3,584	4,272	4,422	4,791	4,335	6,440
Difference: (3) = (1) − (2)	−840	402	1,156	396	651	−1,391
Overall variance: (3) / (1) (%)	**−30.6**	**8.6**	**20.7**	**7.6**	**13.1**	**−27.5**

Source: World Bank staff estimations based on MOF data.

14. **Government financial reporting faces challenges because of the incomplete implementation of Mongolia's accounting framework, the accrual-based International Public Sector Accounting Standards (IPSAS)**. A 2015 Global Survey [4] indicates that Mongolia is on the right path but additional reforms still need to take place. The survey shows that 52 percent of countries follow the accrual or modified accrual basis and 71 percent, of the 120 governments surveyed, say that they will apply accrual accounting in five years. The survey states that accrual accounting increases the quality and reliability of financial statements and helps restore confidence in the ability to manage fiscal balances. The latter is critical to Mongolia, given its recent fiscal imbalances. The Government is still in the process of implementing the standards and has prepared a preliminary 'gap' analysis to inform the work remaining to be done. In this context, the project will provide the Government with technical assistance and training needed to implement the new and revised standards.

15. **The Mongolian GFMIS needs to be upgraded to strengthen government financial management (FM), control, accountability, and transparency.** The Government acquired the FreeBalance software, an international, mid-size, enterprise resource planning package through a competitive procurement process and installed it during 2003–2005. The system was designed using the cash basis of accounting, with the objectives of controlling cash and budget expenditures. While the system met those limited objectives, it did not adapt to the evolving FM requirements that included the implementation of accrual basis financial reporting. Instead, the Government installed other non-integrated, stand-alone, fixed asset accounting, procurement, budget entity, and consolidated financial reporting systems that create reliability, efficiency, and control issues. This situation is not uncommon and is shared by one out of three countries responding to the PwC 2015 Global Survey.

16. **The Government is currently using FreeBalance Version 6.5 and has recently contracted the latest web-based version of the software, FreeBalance 7.** The new version has been significantly enhanced and could help the Government overcome most of the challenges described in the previous paragraph. The new contract covers upgrades to the technical platform, implementation of the Version 7 software, and migration of 2016 closing balances as well as 2017 transactions. International experience suggests that a strong GFMIS is a key tool to comply with IPSAS. Implementation of modern information technology solutions also leads to more efficient processes, better data quality, and enhanced analytical capabilities, enabling public managers to make informed decisions that can have a positive impact on the use of public resources.

17. **The Government's internal audit shows improvements but is still at an early stage of development.** The 2015 PFM-PR review confirmed that solid progress has been made in establishing internal audit capacity within the Government. However, as the internal audit function was only

[4] PwC Global Survey on Accounting and Reporting by Central Governments. 2015. *Towards a New Era in Government Accounting and Reporting*. 2nd edition.

established in 2012, the function is still at a relatively low level on the internal audit maturity curve and much work remains to be done. A Government priority, in this regard, is strengthening internal audit in: (a) risk assessment capabilities and (b) the ability to advise management on mitigating controls, related to the budget, including areas such as public-private partnership (PPP) arrangements and contingent liabilities that could significantly impact the budget.

18. **External audit of budget entities is carried out not only by Mongolian National Audit Office (MNAO), the Supreme Audit Institution, but also by a large number of private audit firms.** Supervision and inspection of audit firms, to ensure the quality of these audits, is limited. The 2016 Law on Auditing transferred significant audit oversight responsibility to the MOF, which is just beginning to develop capacity in this area. Strengthening government audit oversight and inspection capability over audit firms is key to providing assurance to the reliability of both government financial reporting and Mongolian companies. The audit assurance allows investors to trust the financial reporting and is therefore, a key ingredient to the proper functioning of the Mongolian capital markets.

19. **Mongolia's PIM faces various challenges that undermine the efficiency and effectiveness of the country's growing investment**. The Government used the newly established DBM as an off-budget investment vehicle by injecting the proceeds of sovereign and sovereign-guaranteed borrowing into the development arm until 2015, when public investment projects funded through the DBM were included in the general government budget. According to the public investment output index[5], recently developed by the IMF, Mongolia scored lower than its peer countries with comparable per capita capital stock. The study also found that volatile annual aggregate spending on public investment makes it difficult to plan over the project cycle of ongoing investment projects, resulting in large inefficiencies caused by project delays and cancellations.

20. **The main challenges faced by PIM functions are** [6]

(a) Weaknesses in the implementation of the current legal framework;

(b) Lack of quality in the planning and designing phases of investment projects that inhibits the effective screening of projects for strategic relevance;

(c) Weak project appraisals that seem to be the consequence of a lack of standard PIM guidelines;

(d) Weak linkage of capital budgeting and PIM planning/appraisal and lack of an ex post evaluation scheme that would otherwise allow better understanding of the efficiency and effectiveness of completed investments;

(e) DBM spending not being effectively supervised or managed from the wider perspective of the country's fiscal sustainability; and

[5] IMF (International Monetary Fund). Forthcoming. *Mongolia-Public Investment Management Assessment (PIMA)*.
[6] World Bank. 2015. *Mongolia: Public Financial Management Performance Report*; World Bank. 2012. *Mongolia: Improving Public Investments to Meet the Challenge of Scaling Up Infrastructure*; World Bank. 2016. *Options for Immediate Fiscal Adjustment.*

(f) PPPs being managed outside the regular PIM system; and the Concession Law (2010) for PPPs legislating the tendering process for concession of projects but not including broader regulations for the right institutional framework for PPPs, particularly covering both the upstream decision processes for PPP project preparation, appraisal, and selection, and the downstream implementation and fiscal management.

21. **Emerging evidence indicates that countries that have undertaken 'budget transparency' efforts, as part of their overall PFM reforms, are more likely to respond to people's needs in ways that will improve their lives.**[7] Among its main benefits, budget transparency—when paired with citizen engagement efforts—can lead to greater fiscal credibility and performance, and improved allocations of resources. This can translate into better provision of public services, in particular in social sectors (health, education, social protection, and others) while limiting corruption and wasteful spending, which will have a positive impact on overall good governance outcomes.[8]

22. **Mongolia has made significant progress in the involvement of citizens in policy decision making. With this purpose, it has recently adopted four pieces of legislation that reinforce the national legal environment to consult citizens on public matters,** including (a) the Law on Development Policy and Planning, (b) the Law on Public Hearings, (c) the General Law on Governance, and (d) the Law on Legislation. However, in practice the implementation of these laws and the quality of the consultative process vary significantly across agencies, and the required process is often bypassed when strong interests are involved.

23. **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 (a) ensuring the efficient and proper use of state and local government funds and assets, (b) improving the transparency of decisions and actions concerning budget management, and (c) strengthening citizens' oversight through an information system. The Accounts Law was approved by the Parliament in July 2014 and entered into force on January 1, 2015.

24. **Despite enacting relevant legislation regarding fiscal transparency and citizen engagement, challenges remain.** The 2015 Open Budget Index (OBI) report indicates that Mongolia did not make progress in two main areas: (a) it has not produced a mid-year review and (b) it does not publish the full version of the Executive's budget proposal. Moreover, the country ranks low and is far behind the global average score regarding 'Opening Opportunities for Citizen Participation' (19 out of 100).

25. **Both the PFM-RM[9] report and the OBI Survey place special emphasis on the need for Mongolia to place transparency and participation at the core of the reform process.** The former highlights the need to publish financial information (data and econometric basis models) and ensure accessibility for public scrutiny and feedback, which will help provide greater transparency in the budget process. The latter indicates that Mongolia should prioritize establishing credible and effective mechanisms to make financial information available and create two-way communication with the public during the budget cycle. Moreover, the OBI Survey stresses the importance of holding legislative public hearings.

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[7] Folscher, Alta. 2011. *Budget Transparency: New Frontiers in Transparency and Accountability*. http://www.transparency-initiative.org/reports/new-frontiers-in-transparency-and-accountability.
[8] de Renzio, Paolo and Wehner, Joachim. 2015. *The Impact of Fiscal Openness a Review of Evidence.* http://www.internationalbudget.org/publications/the-impacts-of-fiscal-openness-a-review-of-the-evidence)
[9] World Bank. 2015. *Mongolia Public Financial Management Performance Report.*

Financial Sector

26. **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 five banks accounting for 67 percent of the total financial system assets. The banking sector is small, with total assets at 90 percent of GDP and loans at 50 percent of GDP.

27. **The vulnerability of the banking system has markedly increased in recent years, with the asset quality steadily deteriorating.** Mongolia's credit growth had rapidly accelerated in 2013–2014, reaching 54 percent at the end of 2013, fueled by 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 reported nonperforming loans 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 three months) also increased to 7.6 percent of the total outstanding loans, from 2.2 percent over the same period. While the reported capital adequacy ratio of the banking system remains above international thresholds, many banks are reporting losses and are under-provisioned, putting pressure on the capital adequacy. The banking system remains vulnerable to the continuation of economic downturn, with a substantial amount of loans concentrated in the riskier sectors—such as construction, mining, and real estate. These weaknesses were also reflected in the downgrading of Mongolia sovereign and bank ratings in 2015. In addition, based on the Standard & Poor's Banking Industry Country Risk Assessment (November 2015 update) Mongolia is the only East Asian country in the highest risk category of 10.

28. **Efforts to deepen capital markets in Mongolia are still in progress and are hampered by weaknesses in the regulatory framework and the institutional capacity.** Capital markets remain in the early stages of development and the insurance market is small, with a penetration rate of about 0.64 percent of GDP. Progress in the development of Nonbank Financial Institutions (NBFIs) is slow, and continuous efforts are needed to build appropriate institutions, policies, and oversight arrangements. The Finance 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. Thus, it is critical to strengthen the non-bank financial sector by providing support to the FRC and to the government policy makers to improve the risk-based supervisory framework and enhance its enforcement capacities.

29. **The legal framework for financial system stability and development remains weak.** The Mongolia Multi-Sectoral Technical Assistance Project (MSTAP, P119825), 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 the 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 the DBM.

30. **The interconnectedness of the financial sector has significantly increased and the DBM has become a systemically important financial institution.** However, there is a lack of transparency and accountability in the DBM's activities. The DBM has operated without adequate corporate governance processes and policies. It is the only state-owned financial institution where the exercise of ownership rights has been delegated directly to the Government, opening the door for direct political interference in its management and day-to-day operations. The capability of the DBM to measure, manage, and mitigate risks is limited with little evidence of any risk analysis or measures taken to mitigate its risk exposures. It is important to improve the mandate and governance and operations of the DBM to bring them in line with best practices.

31. **The capacity of the Deposit Insurance Corporation of Mongolia (DICOM), as the key financial safety net for possible banking sector distress, remains weak.** Strengthening the financial safety nets, especially the capacity of DICOM, remains a critical task in light of the deteriorating banking sector's financial soundness. The World Bank's recent assessment on the DICOM's structure and operation, based on the International Association of Deposit Insurers (IADI) Core Principles for Effective Deposit Insurance Systems, found that DICOM is compliant with only 5 out of 15 eligible principles.

Social Protection

32. **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 the years. 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.

33. **Mongolia has a relatively large number of small but fragmented targeted cash-based benefits.** Overall, spending on social welfare programs is broadly similar in comparison to middle- and high-income countries[10] but multiple issues affect equity and operational and allocative efficiency. The majority of social welfare programs are categorically targeted to different population groups (for example, children, the disabled, the elderly, and single mothers) that are traditionally seen as vulnerable. Some of these programs are needs-oriented, while others are merit-oriented. The latter are often most generous and politically difficult to remove and/or amend. A recent World Bank study[11] suggests that the poorest 20 percent of households receive 34 percent of total social welfare transfers, a level lower than comparable peer countries.[12] The current support to poor households in terms of post-transfer consumption is also very low by international standards.[13]

[10] Honorati, Maddalena, Ugo Gentilini, and G. Ruslan Yemtsov. 2015. *The State of Social Safety Nets 2015*. Washington, DC: World Bank Group.
[11] Onishi, Junko and Tungalag Chuluun. 2015. *Review of Program Design and Beneficiary Profiles of Social Welfare Programs in Mongolia*. Washington, DC: World Bank Group.
[12] This includes the CMP. In European and Central Asian as well as Latin American countries (for example, Croatia, Poland,

34. **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. So far, the coverage and benefit size of the program have 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 years. 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.[14] As a result, the 2017 budget targeted the CMP to 60 percent of all children belonging, approximately, to the poorest 50 percent of households.

35. **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 World Bank-funded MSTAP, 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.[15] The PMT-based Integrated Household Database has been established and the Government has made the database inter-sectoral, so that it could 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 (a) the absence of concrete actions for consolidation of fragmented social welfare programs, (b) the need for improvements to verification and validation measures of the PMT methodology, and (c) shortcomings in the area of monitoring and evaluation. As the Government increasingly emphasizes the need for a more comprehensive set of monetary and nonmonetary support, including social work services,[16] capacity building of the relevant institutions and frontline service workers are also needed.

36. **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 the Parliament in December 2015 to "create a 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

Argentina, and Uruguay), the share of total benefits going to the poorest 20 percent reaches over 40 percent.

[13] World Bank. 2016. *Options for Immediate Fiscal Adjustment - Just-in-Time Public Expenditure Review.* Washington, DC: World Bank Group.

[14] World Bank. 2016. *Mongolia: Progress in Reducing Poverty and Shared Prosperity?* Washington, DC: World Bank Group.

[15] The PMT survey methodology was first approved by a joint decree of Ministry Social Welfare and Labor (then) and National Statistic Office in 2010 and revised in 2013.

[16] 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.

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 percent of GDP in the 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.

37. **Additional technical support will be needed as the authorities translate the general policy directions of the state policy into specific amendments to the Social Insurance Law, the establishment of special provisions for herders, and the establishment of a private supplementary pension insurance law.** In addition, political commitment is needed for institutional reforms, including establishing stronger governance and FM of social insurance accounts and funds. There are also other objectives of the State Policy on Pension Reform, including measures to create stronger incentives for coverage of herders, informal workers, and the self-employed, and establishment of a regulatory framework for private supplementary occupational and personal pension savings arrangements. There are also a number of challenges to strengthen the institutional arrangements for the Social Insurance Scheme and the Pension Insurance Scheme that are managed by the Health and Social Insurance General Office (HSIGO). They include the need to address weaknesses in the governance, accountability, and transparency of social insurance funds, including oversight of financial control, audit, and financial accountability controls through the HSIGO. The framework for investment management of any reserves set aside for future benefits is extremely limited.

C. Higher Level Objectives to which the Project Contributes

38. **The proposed operation is closely aligned with the multiple pillars and relevant outcomes of the World Bank Country Partnership Strategy (CPS) for Mongolia for FY2013–2017 (Report No. 106796-MN) discussed by the World Bank Board of Executive Directors on April 19, 2012**:

(a) Under Pillar 1 (Enhance Mongolia's Capacity to Manage the Mining Economy Sustainably and Transparently), the proposed project would support Outcome 1.2: Supporting a more robust, equitable, and transparent management of public revenues and expenditures.

(b) Under Pillar 2 (Build a Sustained and Diversified Basis for Economic Growth and Employment in Urban and Rural Areas), the proposed project would support Outcome 2.1: Enhancing the investment climate and financial intermediation.

(c) Under Pillar 3 (Address Vulnerabilities through Improved Access to Services and Better Service Delivery, Safety Net Provision and Improved Disaster Risk Management), the proposed project would support Outcome 3.1: Working with the Government on the design, adaptation, and implementation of a comprehensive social welfare information system and (PMT) database for targeting the poor.

39. **A Performance and Learning Review (PLR) of the CPS, concluded in December 2016,** noted that, since the formulation of the CPS, considerable progress had been achieved on these outcomes through the support provided by the ongoing MSTAP. On the basis of the review of the country program, the PLR identified the Strengthening Fiscal and Financial Stability Project as one of the IDA17 pipeline projects agreed with the Government to continue supporting multi-sectoral technical assistance.

40. **The proposed operation is structured to support the GoM to address current challenges and is aligned with the EMSO under preparation**. Components A, B, and C of the project will contribute to the policy actions under Pillar 1 of the EMSO, including (a) phasing out quasi-fiscal expenditure, (b) strengthening revenue mobilization, and (c) improving the management of fiscal risks and public investment portfolio. Component D of the project will support policy actions under Pillar 2 that aim to improve the financial sustainability of the pension system.

II. PROJECT DEVELOPMENT OBJECTIVES

A. PDO

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

B. Project Beneficiaries

42. **The beneficiaries of the project will be the MOF, Ministry of Labor and Social Protection (MLSP), BOM, FRC, and other related agencies whose human resources and institutional capacity will be enhanced through implementation of the project.** Components under the project are related to macro-fiscal management, financial sector, and social protection and are designed to support activities aimed at improving public sector capacities to deliver sound policies and analysis. Improved capacities and tools for financial and investment management and for better targeting of social programs will improve expenditure allocative efficiency and potentially expenditure productivity efficiency. All these will then translate into strong improvements in service delivery, expenditure efficiency, and risks control, thus ultimately benefiting the people of Mongolia, particularly the poor.

C. PDO-Level Results Indicators

(a) Aggregate deviation of expenditures is reduced by 15 percent or less and commitment controls are in place.

(b) Financial sector stability improved by decreasing percentage of nonperforming loans.

(c) Aggregate poverty-targeted social welfare support going to the poorest 20 percent is increased.

III. PROJECT DESCRIPTION

A. Project Components

Component A: Strengthening Macroeconomic and Fiscal Management (US$2.71 million)

43. The overall objective of this component is to strengthen fiscal responsibility and support the implementation of relevant policy measures toward (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

the MOF to strengthen their capacity. Specifically, technical assistance will be provided in the following areas:

Subcomponent A.1. Improving macroeconomic policy tools and enhancing research capacity

44. It is necessary to improve the MOF's capacity to better estimate and forecast macroeconomic indicators, growth and development policy plans by (a) using innovative and latest econometric tools and (b) establishing and operationalizing a well-functioning policy research think-tank with a track record that is able to conduct independent economic and fiscal policy analysis. The following activities, under this subcomponent, are designed to achieve the abovementioned objectives and are proposed in order of priority from highest to lowest:

- Upgrade existing macroeconomic models.
- Strengthen macroeconomic forecasting capacity and data analysis skills for macroeconomic planning of related stakeholders through short- and long-term training.
- Establish an independent Fiscal Council to monitor and scrutinize the fiscal planning of the Government against the fiscal rules.
- Establish a forum led by the Fiscal Council to promote civil society organizations' participation in the discussions of the fiscal planning and forecasting activities.
- Conduct detailed economic research and econometric analysis of the current socioeconomic context.

Subcomponent A.2. Strengthening fiscal policy and planning

45. Since approval of the FSL and IBL, Mongolian economic conditions have evolved rapidly and the fiscal environment has changed. Unreported budget relations, that are currently not included in the fiscal laws, have been raised. Therefore, there is a need to improve the existing legal framework by reviewing the related fiscal laws and including the new fiscal relations. As part of the IMF-led program and upcoming EMSO (P162402) agreed actions, the Government (MOF) is working to implement the second stage of tax reform by increasing seven types of taxes and introducing the latest international taxation rules and regulations. The MOF is planning to revise the major tax laws and regulations, address the inconsistencies in tax laws, introduce international best practices in the tax laws such as transfer pricing and base erosion and profit shifting (BEPS), and build comprehensive revenue forecasting and financial models for economic analysis of large-scale mega projects. The following activities under this subcomponent are designed to achieve the abovementioned objectives in order of priority from highest to lowest:

- Develop amendments to the IBL to expand the budget coverage by including unreported fiscal relations, such as PPPs, contingent liabilities, off-budget spending, government liabilities, and future pension funds.
- Strengthen the IBL in relation to budget reporting, medium-term planning, and risk control.
- Provide support to formulate tax policy including tax burden assessment, redrafting of revised version of tax laws, and regulations on international taxation matters.

- Provide technical assistance on transfer pricing, integrated tax file number, BEPS, and improving existing value added tax refund system.
- Support building of a comprehensive revenue forecasting model with additional inputs such as commodity prices and economic indicators by technical configuration of existing models and pilot the model for mega projects (short term).
- Conduct extensive media coverage and public consultations on proposed changes to fiscal legislation (FSL and IBL), tax policy issues, and proposed tax increases.

Subcomponent A.3. Strengthening capacity for debt management and external development financing operations

46. The MOF has strong demand to implement the Debt Management Law, which was passed in 2015 and requires the Government to improve the legal framework for more comprehensive and transparent debt and contingent liability management; prepare the Medium-Term Debt Management Strategy for proper monitoring and control of risks; strengthen fiscal risk analysis and monitoring capacity; support the establishment of integrated debt and contingent liability reporting system; develop legal framework and policies on managing the domestic bond, external loans, and grants; and improve the portfolio management of the externally funded investments. Specific activities under this subcomponent include the following, in order of priority from highest to lowest:

- Improve the regulatory framework for issuing and trading of international and domestic government bonds and for government on-lending procedures (2017).
- Support the preparation of the Government Medium-Term Debt Management Strategy and develop an implementation action plan and periodic implementation reports for the Debt Management Strategy (2017).
- Create an information database and platform to establish direct contact with the investors and enhance relationships.
- Promote public outreach activities to inform about government debt and debt-related legislation and improve debt management capacity of the MOF by various training programs (2017).
- Strengthen the legal framework for better planning and execution of development financing projects and the MOF's capacity to assess the effectiveness of development financing and create an Oracle Database Application database for better portfolio management**.**

Component B: Improving the Efficiency of Public Financial Management (US$3.8 million)

47. The overall objective of this component is to improve fiscal discipline by strengthening the country's PFM and enhance the quality of expenditures by revamping PIM and fostering activities aimed at increasing transparency and accountability. Technical assistance activities will be provided to relevant departments of the MOF to strengthen their capacity. Specifically, technical assistance will be provided in the following areas:

Subcomponent B.1. Improving budget credibility, predictability, and execution for better delivery of services

- Strengthen the MTFF preparation process, management and compliance, including better regulatory framework, coverage, forecasting of fiscal aggregates, and alignment of the budget to ensure that the MTFF provides a hard budget constraint.
- Enhance budget preparation and planning functions, including budget preparation rules, processes and supporting information sources and systems, revenue forecasting methodologies and processes, spending efficiency analysis, and government financial statistics.
- Improve budget preparation, including regulations and processes to ensure sector preparation of realistic expenditure plans, and to support adequate implementation of the Medium-Term Expenditure Framework.
- Improve budget execution processes, including, among others, the budget manual and regulations and strategies to strengthen commitment controls. This will include technical assistance to the MOF and spending agencies and line ministries.
- Enhance budget control, internal audit, and risk management functions.

Subcomponent B.2. Increasing budget comprehensiveness and transparency through better control, reporting, and expansion of the recipient's Integrated Financial Management Information System capabilities

- Strengthen government accounting and financial reporting and audit oversight capabilities in the MOF.
- Strengthen management and operation of the GFMIS, cash management, and Single Treasury Account operations, by updating and operationalizing a more up-to-date version of the current Integrated Financial Management Information System to advance the implementation of IPSAS.

Subcomponent B.3. Strengthening the public financial management institutional capacity

- Strengthen the MOF's organization by carrying out targeted functional reviews on priority areas for the ministry (that is, asset management).
- Enhance the MOF's operations through a process reengineering program informed by the functional reviews.
- Strengthen the institutional capacity of the MOF as well as the relevant stakeholders through capacity building and training programs on, among others, PFM, information and communication technology and leadership, and fiscal transparency and citizen engagement.

Subcomponent B.4. Strengthening Public Investment Management

- Develop PIM operational guidelines with regulated procedures and responsibilities for the implementation of investment project strategy/planning, appraisal, selection/prioritization, and budgeting processes. Include project selection/prioritization criteria for investment projects consistent with planning guidelines issued by the MOF and/or the National Development Agency.

- Support developing the Public Investment Program Rationalization Guideline, including rationalization methodology, criteria, and procedures to identify and restructure the underperforming projects.
- Provide a guidance note for driving public investment budget submission to include adequate allocation for maintenance funding.
- Provide special PIM training programs to planning and investment offices, in those entities, with the highest expenditure levels.

Component C: Enhancing Financial Sector Stability (US$2.85 million)

48. The objective of this component is to support the MOF, BOM, FRC, DBM, and 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 of the MOF, BOM, FRC, DBM, and DICOM to strengthen their capacity. Specifically, technical assistance will be provided in the following areas, in order of priority:

Subcomponent C.1. Developing and implementing a financial sector development strategy to strengthen financial sector stability

- Develop a Financial Sector Medium-term Development Strategy: 2017–2025 (the Strategy) aimed at strengthening financial sector stability, efficiency, and inclusiveness.
- Prepare a detailed medium-term action plan for 'the Strategy'.
- Improve the capacity of selected civil servants in the financial sector regulating agencies to implement and monitor 'the Strategy'.
- Develop a crisis management strategy and program development model in line with the international best practices.
- Strengthen capacity to determine and calculate economic composite leading indicators, acquire knowledge in the field of financial risk evaluation, and prompt action approaches to mitigate financial sector risks.
- Strengthen capacity to develop sustainable housing mortgage programs.
- Improve the legislation related to foreign exchange.
- Improve regulations on saving and credit cooperatives.

Subcomponent C.2. Providing support to the effective management the Development Bank of Mongolia (DBM)

- Review and amend the Development Bank Law and relevant legislation to align it with the international comprehensive audit recommendations.

- Improve the structure, operations, including risk management, and corporate governance of the DBM.
- Develop capacity to prepare feasibility studies for large infrastructure projects.

Subcomponent C.3. Strengthening financial safety nets

- Improve knowledge and framework on financial safety net and crisis preparedness and management issues (contingency tools) and preparation of internal guidelines and documents.
- Support the cohesive and effective cooperation among the financial sector safety net institutions in Mongolia.
- Improve the process through which the new legislations on the safety net and crisis preparedness framework are prepared, processed, discussed, approved, and adopted.

Subcomponent C.4. Strengthening the institutional capacity of the Financial Regulatory Commission

- Design and launch a midterm program for capacity building of the FRC's inspections officers.
- Support drafting a regulatory package law for the nonbank financial market.
- Prepare the review on the current legal environment for the nonbank financial sector, such as for securities, insurance, and microfinance markets.

Subcomponent C.5. Improving the capacity of the Bank of Mongolia to enhance financial stability

- Enhance the quality of countercyclical policy formulation and the BOM's decision-making process.
- Design and implement the macro-prudential operational framework.
- Strengthen the capacity and infrastructure of the Financial Stability Council.
- Improve and upgrade the credit information software.
- Increase awareness by building capacity and training to fight against money laundering and financing of terrorism.
- Improve knowledge and research capabilities on theoretical and empirical issues in microeconomics with extensive application, including access to professional software.

Component D: Strengthening of the Social Protection System (US$2.0 million)

49. The objective of this component is to support the Government's 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 FM aspects of social welfare and social insurance programs.

Subcomponent D.1: Strengthening social welfare design, targeting, operations, and performance

50. The subcomponent will support an increase in the social welfare system's equity and efficiency by fostering a plan for consolidation of fragmented social welfare programs and its implementation, supporting improvements to verification and validation measures of the PMT methodology and strengthening monitoring and evaluation. Moreover, the subcomponent will provide a more comprehensive and coordinated set of monetary and nonmonetary support through capacity building of the relevant institutions and frontline service workers. Specific activities under this subcomponent include, but are not limited to, the following:

- Design, plan, and implement a comprehensive reform of the social welfare system by consolidating existing programs and developing social welfare/social care services to be achieved through (a) strengthening the design and operations of social welfare programs by conducting relevant reviews and analysis, identifying gaps, and formulating and beginning to implement a plan for consolidation of the existing social welfare programs and (b) supporting the process of gradually developing social welfare services and non-cash support to the poor and vulnerable that are to complement the existing cash benefits.
- Improve the implementation and quality of the existing PMT poverty-targeting system to be achieved through (a) improving the performance of the PMT poverty-targeting methodology through gradual introduction of verification and validation measures; (b) supporting regular update, maintenance, and expansion of inter-sectoral use of the PMT-based Integrated Household Database; and (c) formulating and executing an internal and external (public) awareness campaign to improve public understanding of the needs, rationale behind, mechanics, and importance of targeting, in an effort to gradually build a social consensus on targeted support to the poor.
- Strengthen the existing delivery mechanism of the social welfare programs, including capacity building, monitoring, and evaluation, and the management information system to be achieved through (a) supporting capacity building of the relevant institutions and personnel, including establishment of in-house training capacity to ensure systematic and continuous learning and capacity building in the context of high turnover of the personnel; (b) enhancing the monitoring and evaluation of social welfare programs to improve the equity and efficiency of the public expenditure and support evidence-based policy making; and (c) supporting further refinements of the newly developed Welfare Administration Information System and maximizing the practical application of the specific modules for administrative reporting and monitoring and evaluation purposes.

Subcomponent D.2: Strengthening social insurance design, governance, and financial management

51. The subcomponent will provide technical support to translate the State Policy on Pension Reforms into specific legal provisions. In addition, it will support institutional reforms, including strengthening the institutional arrangements for the Social Insurance Scheme and the Pension Insurance Scheme managed by the HSIGO. These will address weaknesses in social insurance governance, accountability, and transparency, including oversight of financial control, audit, and financial accountability controls through the HSIGO. The framework for investment management of any reserves set aside will also be enhanced. Specific activities under this subcomponent include but are not limited to the following:

- Strengthen in-country technical capacity for implementation of the State Policy on Pension Reform (2015–2030) through technical assistance to develop a program of parametric reforms that limit the state subsidy to 2 percent of GDP by 2030.
- Support reform actions to strengthen the social insurance system, including pension scheme adequacy and sustainability.
- Support formulation of programs or other mechanisms to improve social insurance coverage among informal workers, herders, and the self-employed.
- Design the legal and regulatory framework and supervisory system for private voluntary occupational and individual pension arrangements.
- Strengthen the non-pension elements of the Social Insurance Scheme, including support for adjusting technical parameters to improve financial sustainability, work and contributory incentives, and adequacy of benefits. This includes analyzing and reconciling contributory and noncontributory social welfare benefits for short- and long-term disability, survivorship, work-injury, maternity and child family benefits, and funeral benefits.
- Support the process of strengthening the governance, accountability, and transparency framework for social insurance. This will include developing modules of institutional strengthening, including (a) FM, control, and internal and external audit; (b) governance, including constitution and responsibilities of the Governing Board and subcommittees; (c) strengthening of the benefits processing function, including training as necessary; (d) strengthening of the aggregated and individual disclosure of benefit entitlements; (e) establishment of a strategy to record and recognize entitlements before 1995; and (f) validation of accounts and beneficiaries to eliminate duplication and potential ghost workers and retirees.
- Raise public awareness for gradually building social consensus on the pension reform needs and principals.
- Build in-house actuarial capacity and technical capacity for evidence-based policy making.

Component E: Project Management and Monitoring (US$0.64 million)

52. This component provides support for project implementation, coordination, monitoring and evaluation, including, among others, audit arrangements, reporting requirements, procurement, and FM activities.

B. Project Financing

53. The lending instrument is Investment Project Financing. The total cost of the project is US$12 million equivalent for a period of four years. This will be financed by an IDA credit to the GoM of SDR 6.0 million (US$8.2 million equivalent) and an IDA hard-term credit of SDR 2.8 million (US$3.8 million equivalent). The credits have a final maturity of 25 years, including a grace period of five years.

Project Cost and Financing

Project Components	Project Cost (US$)	IBRD or IDA Financing (US$)	Trust Funds	Counterpart Funding
Component A	2,710,000	2,710,000	0	0
Component B	3,800,000	3,800,000	0	0
Component C	2,850,000	2,850,000	0	0
Component D	2,000,000	2,000,000	0	0
Component E	640,000	640,000	0	0
Total Costs US$12,000,000				
Total project costs	12,000,000	12,000,000	-	-
Front end fees	0	0	-	-
Total Financing Required	12,000,000	(US$8,200,000 IDA Credit and US$3,800,000 IDA hard-term credit)		

C. Lessons Learned and Reflected in the Project Design

54. **The design of this new lending operation draws on and benefits from the lessons learned during the implementation of MSTAP,**[17] **previous interventions, such as the Mongolia Development Policy Credit Operation in 2008–2009, as well as from the analysis and lessons emerging from the PLR of the current CPS,**[18] in particular:

(a) **The need for an effective combination of technical assistance, analytical work, and capacity-building efforts** to enhance reform implementation in a low-capacity policy environment to ensure the sustainability of the project. These lessons were drawn from MSTAP and the Mongolia Development Policy Credit Operation in 2008–2009.

(b) **Efforts to bring fiscal consolidation and strengthen public sector management in Mongolia in the past have only partly succeeded because of changes in the political context and structural weaknesses in PFM policies and processes.** Building on the lessons learned, the new project will continue to support the GoM in the implementation of targeted technical measures aimed at reducing its structural deficit, while also working to address selected overarching governance challenges, such as limited fiscal transparency and public scrutiny. The objective is to work toward fiscal consolidation with a growth and equity perspective such that it is both realistic and pragmatic.

(c) **While the underpinnings of social welfare programs are in place, the country continues to face challenges related to fragmentation, duplication, and proliferation of low-benefit programs for the poor**. Findings from MSTAP and the 2015 'Review of Program Design and Beneficiary Profiles of Social Welfare Programs in Mongolia' informed the design of the social welfare component in this project, which will help make the social welfare system, overall, more efficient, including through a more conscious use of poverty targeting;

[17] As collected in the latest Implementation Status and Result Report from December 2016.
[18] World Bank. 2016. *Performance and Learning Review of the Country Partnership Strategy for Mongolia for the Period FY 2013-2017*.

supporting the effective implementation of basic infrastructure; and fostering efforts to gradually build a social consensus on targeted support to the poor.

(d) **The need to focus on high-quality analytical work as a foundation for the dialogue with the GoM to address some existing challenges and support the envisioned reforms.** In the past years, the World Bank Group has supported the GoM through its policy dialogue notes, economic reports, and other analytical work to help the country address its fiscal deficit and strengthen its public investment systems. The preparation of this project heavily relied on key analytical work such as the Public Financial Management Progress Report 2015 and the ongoing Public Expenditure Review whose emerging findings helped inform the proposed intervention and discuss priority activities with the Government. Moreover, a Political Economy Analysis on the Budget Process (under preparation) will help understand the driving forces around the preparation, enactment, and execution of the national budget and provide evidence to support more targeted interventions during project implementation.

(e) **Government ownership and commitment is critical for multi-sectoral projects.** Cognizant of this, the proposed project prioritized the GoM's commitment and ownership as a key to move ahead with the project's readiness. The task team engaged in constant dialogue with the Government, including presenting the project to the Parliament and specialized commissions.

(f) **Senior-level leadership and strong management support is needed for the successful implementation of the project.** Professional capability and dedication of the implementing unit and beneficiaries (over 20 different departments and divisions) and an experienced Project Implementation Unit (PIU) management team, as the one currently responsible for MSTAP, will be one of the core success factors of the project.

IV. IMPLEMENTATION

A. Institutional and Implementation Arrangements

55. **The MOF will be the implementing agency for the project and will be responsible for its overall management and implementation.** The existing PIU that is responsible for the ongoing MSTAP and the Export Development Project will continue providing its services to this project. Given its vast experience with World Bank projects, the PIU will ensure compliance with the procurement, disbursement, and FM policies and procedures. The PIU will report to a project director who will be appointed by the MOF.

56. **To effectively oversee the implementation of the project, a Project Steering Committee (PSC) will be created, headed by the MOF and comprising other beneficiaries of the project, for example, the MLSP, BOM, and FRC.** The PSC shall meet regularly and be responsible for the key functions of project implementation, such as: (a) ensuring efficient interdepartmental and beneficiaries interactions, (b) supervising the monitoring and evaluation, (c) proposing recommendations to strengthen implementation, and (d) interacting with the World Bank.

57. **While the MOF will be the implementing agency for the project, the beneficiaries will be responsible for the technical supervision** The MOF will be responsible for the technical supervision of the activities under Component A: Strengthening Macroeconomic and Fiscal Management; Component B: Improving the Efficiency of Public Financial Management; and Component E: Project Management and Monitoring. The BOM, FRC, DBM, and DICOM will be responsible for the technical supervision of Component C: Enhancing Financial Sector Stability. The MLSP will be responsible for the technical supervision of Component D: Strengthening of the Social Protection System. The beneficiaries already possess relevant experience and knowledge, given their previous experience of implementing MSTAP. The existing Project Implementation Manual for MSTAP —which currently sets the rules and framework followed by the PIU at the MOF—will be revised, as necessary, to adapt it to this project.

B. Results Monitoring and Evaluation

58. **Each ministry/agency will track the desired outcomes of the project in accordance with the Results Framework specified in section VII and will report to the PSC on an annual basis**. The PSC will meet at least once a year and will monitor implementation through quarterly FM reports, annual audits, and other reports on a semiannual basis. A joint midterm review will be carried out by the Government and the World Bank approximately two years after the project becomes effective. This will provide an in-depth assessment of progress toward the desired project outcomes and the way forward. Two months before the project's closing date, the PSC team will prepare and provide to IDA a report on the execution of the project, its costs, and the current and future benefits to be derived from it. This report will be attached to IDA's Implementation Completion and Results Report in accordance with IDA guidelines. A set of indicators, defined in section VII, will be used to develop a monitoring baseline and for regular project monitoring.

C. Sustainability

59. **The GoM continues to show commitment to reform.** Before the implementation of MSTAP (2009), the GoM undertook policy actions that required bipartisan support and demonstrated a strong political ownership of the reforms needed to address the impact of the 2009 financial crisis, promote the recovery, and establish an improved policy framework for the medium term. As stated, the design of this operation has benefited from the lessons learned from the implementation of MSTAP and from continued dialogue with government officials after the 2016 legislative election. The new government continues to be committed to reforms that improve the budget process and contribute to the efficiency and resilience of the economic system in Mongolia, as evidenced by the willingness to continue and expand the reforms under MSTAP and the ownership shown by several government agencies, particularly the MOF.

60. **Technical assistance activities will contribute to the sustainability of the reforms.** Institutional capacity building and training to be provided, as part of this project, will also improve its sustainability by further deepening the institutional commitment to implement the reform agenda. Finally, this technical assistance project does not create any additional burden on government finances. On the contrary, the key actions in each of the components are targeted to generating cost savings and efficiencies.

D. Role of Partners

61. **Coordination with local partners.** As was the case with MSTAP, IDA's platform continues to play a critical role in the overall support program for the Government's policy reform agenda (balance of payments support, budget support, and technical assistance) by Mongolia's development partners. To ensure coordination, improve synergies, and minimize overlapping, the team consulted with several development partners, such as: the Asian Development Bank, the European Union, the German Agency for International Cooperation (*Deutsche Gesellschaft für Internationale Zusammenarbeit*), and, the Swiss Economic Cooperation and Development Cooperation. In addition, the team consulted with other relevant Mongolian non-state actors.

62. **Partner financing of supporting analytical work.** Donors were fundamental to inform the preparation of the project, which included funding from Korea's Single Donor Trust Fund for Governance and Public Financial Management to finance the implementation of two key studies, (a) a Functional Review of the Treasury, Debt, and Asset Management Functions in the MOF and (b) a Political Economy Analysis of the Budget Process in Mongolia. In addition, the team will continue to hold discussions with Korea's Single Donor Trust Fund to leverage support for a possible Governance and Public Financial Management II operation aimed at providing the GoM with strategic technical assistance to help shape and inform reform processes around civil service reforms, transparency, and accountability measures aimed to support fiscal discipline and, reduce state capture and corruption, among others that will help support the implementation of the proposed operation.

V. KEY RISKS

A. Overall Risk Rating and Explanation of Key Risks

63. **The overall risk rating for this project is Moderate**. As this project builds on the activities initiated under MSTAP, and given the satisfactory implementation of the abovementioned activities, there are no major risks associated with this operation. However, substantial macroeconomic risks will pose a significant challenge during implementation.

(a) **Political and governance risks are Substantial.** Mongolia's track record in implementing institutional reforms and the complex and, at times, volatile political and institutional environment might affect the concerted implementation of project components necessary to maximize the project's development impact. A presidential election will take place in June 2017. AS Mongolia is a parliamentary democracy (elections to the Parliament were held last year), there will be no major changes in the Government, and the impact to the proposed operation should be minimal. Mitigation measures include close alignment with the EMSO and other World Bank operations and implementation support during supervision. Moreover, the Government's commitment to the operation is high and the prior intervention was implemented satisfactorily. The latter will also aid in risk mitigation.

(b) **Macroeconomic risks are Substantial.** Fiscal policy management poses significant challenges because unreliable fiscal parameters can affect an adequate budget preparation process. However, the current fiscal crisis represents a good opportunity to launch the reforms required to strengthen the budget preparation process, as the pressing fiscal conditions will set the right incentives for all parties involved to conduct budget discussions under more realistic and reliable parameters.

(c) **There is a Moderate risk of adverse impact on the PDO stemming from sector strategies and policies.** Policies and strategies in relevant sectors are generally adequate for the purpose of this operation.

(d) **The risks associated with technical design of the project, its environmental and social aspects, and stakeholders are Low.** The likelihood that factors related to the technical design of the project may adversely affect the achievement of the PDO are low. As this project builds on activities initiated by a prior project, stakeholder commitment to implementation is High. Similarly, as this is a Category C project, the environmental and social risks are Low.

(e) **There is a moderate likelihood that institutional capacity for implementing and sustaining the operation may adversely affect the PDO.** The implementation arrangements will remain the same as for MSTAP. The implementing agency and the beneficiaries are well-coordinated and monitoring and evaluation arrangements are largely adequate. Operational rules and processes are comprehensive and generally enforced. It must be noted that as highlighted in the PLR of the CPS, high attrition and turnover affects the civil service, so the team will pay close attention to the capacity-building efforts of the project.

(f) **Fiduciary risks have a moderate probability of affecting the PDO in an adverse way.** Detailed procurement and FM assessments have been carried out to assess the fiduciary risks associated with the project and appropriate mitigating measures have been identified for implementation. Detailed mitigation measures are found under the FM and procurement sections.

VI. APPRAISAL SUMMARY

A. Economic and Financial (if applicable) Analysis

64. **Similar to MSTAP, this project has not calculated the standard economic rate of return**. The main objective of this project is to continue the efforts initiated under MSTAP to strengthen the capacity for policy formulation and implementation in the MOF, MSPL, Central Bank and some related financial sector entities. While the benefits from such investment in human resources and institutional development cannot easily be measured in monetary terms, the project is expected to generate the following tangible economic benefits:

(a) Components related to macro-fiscal management, financial sector, and social welfare will support activities aimed to improve public sector capacities to deliver sound policies and analyses, as well as strengthen regulatory frameworks. Better policies and analytics will contribute to set effective, efficient, and transparent decision-making processes in the fiscal area and banking and social protection sectors, as well as deliver more reliable and predictable budgets, reduce risks from the banking sector, and improve the design of social welfare programs. All these will represent strong improvements in service delivery, expenditure efficiency, and risks control.

(b) Improved capacities and tools for financial and investment management and for targeting social programs will improve expenditure allocative efficiency and potentially expenditure productivity efficiency. These gains will improve the quality of expenditure contributing to government savings, better capital investments, and expanded social coverage.

65. **The project is also not amenable to standard financial analysis as the MOF, MLSP, Central Bank, and other relevant entities have very limited opportunities for significant cost recovery.** Therefore, only marginal financial returns are expected from this project. However, there can be several fiscal impacts through the Government's increased ability to generate fiscal savings. First, improvements in the fiscal policy should result in a more efficient budgeting process and public expenditure management. Second, there would be an increase in government savings generated from efficient management of government finances for public investment.

B. Technical

66. **The proposed operation uses custom-tailored approaches that will support the Government to strengthen public resource management, finance and markets, and social protection.** The World Bank Group will support the GoM in areas where it has a comparative advantage and will complement others in which donor partners have been working extensively. The World Bank Group designed and identified the project activities based on lessons learned in the country, in particular under MSTAP, as highlighted earlier in the document.

67. **The proposed project was designed after extensive consultations with beneficiaries and builds on activities that the World Bank initiated earlier,** such as MSTAP, the ongoing Mongolia Public Expenditure Review (P161057), and the Mongolia Governance Partnership Facility (P150325). It supports the Government's Action Plan and hence has substantial GoM ownership of the proposed activities. Similarly, the project is aligned with the CPS for 2013–2017.

68. The team has designed institutional arrangements and an implementation support plan that draws on the existing arrangements of MSTAP to ensure that if capacity problems arise, these will be addressed promptly.

C. Financial Management

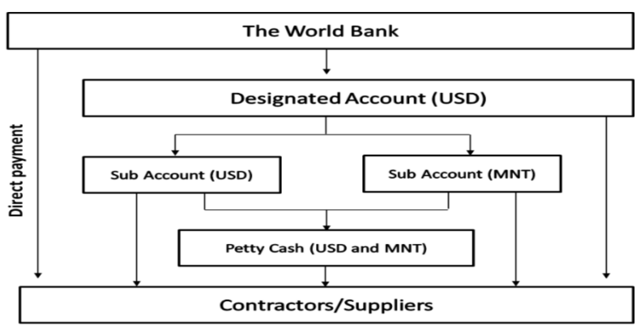
69. **The MOF will be responsible for the overall project oversight and coordination and a PSC will be established at the MOF for this purpose.** The existing PIU for the MSTAP and the Export Development Project at the MOF will carry out day-to-day implementation of the project. The World Bank loan proceeds, including overseeing the Designated Account (DA), will be managed by the PIU. An FM capacity assessment was conducted by the World Bank at the MOF and actions to strengthen its project FM capacity have been identified. The FM assessment has concluded that with the implementation of these proposed actions, the FM arrangements will satisfy the World Bank's requirements under OP/BP 10.00. Further, the PIU will be guided by the Disbursement Guidelines for Investment Project Financing, the Loan Handbook for World Bank Borrowers, dated February 2017, OP/BP 10.00 on a daily basis and an FM Manual created with the purpose of strengthening FM capacity.

However, the existing MSTAP PIU possesses fundamental knowledge and experience with regard to managing World Bank-financed projects, thus reducing existing risks, and will carry out implementation of the project in collaboration with the World Bank.

70. **Disbursement and flow of funds arrangements.** The disbursement and the flow of funds for the proposed project will be similar to the existing MSTAP and are expected to be smooth and efficient. The project has four disbursement methods available: advance, reimbursement, direct payment, and special commitment. The primary methods of disbursement will be advance and reimbursement. The supporting documents for the World Bank disbursements will be the Withdrawal Applications, Summary Sheets, Statements of Expenditure, or records such as contracts and invoices. The detailed requirements will be laid out in the project Disbursement Letter to be issued by the World Bank.

71. **Designated Account.** A segregated U.S. dollar DA will be opened by the PIU at a commercial bank, on terms and conditions satisfactory to the World Bank, including appropriate protection against set off, seizure, and attachments. The PIU will be directly responsible for the management, maintenance, and reconciliation of the DA activities of the project. The ceiling of the DA will be discussed and agreed between the World Bank and the recipient and will be specified in the Disbursement Letter. Authorized representatives of the MOF and the PIU will be signatories on the DA. Further advances from the DA can be made to two sub-accounts to be maintained in U.S. dollars and Mongolian tugriks. The authorized signatories from the PIU will approve payments from these sub-accounts. The PIU will be responsible for conducting regular reconciliation of the DA, the sub-accounts, and petty cash balances. The project can use petty cash up to an agreed ceiling. Specific arrangements with account management and payment authorization will be documented in the project's FM Manual.

Figure 1 General Flow of Funds for the Project



72. The project proceeds will be disbursed against eligible expenditures according to table 2.

Table 2. Financing Allocated

Category	Amount of the Portion A of the Credit Allocated (SDR, millions)	Amount of the Portion B of the Credit Allocated (SDR, millions)	Percentage of Expenditures to be Financed (inclusive of Taxes)
Goods, works, non-consulting services, and consulting services, training and incremental operating costs for the project.	6.0	2.8	100
TOTAL AMOUNT	6.0	2.8	100

73. **Budgeting.** The PIU will continue to prepare annual and quarterly budget/disbursement plans. The annual budget/disbursement plan will be discussed and approved by the PSC and the World Bank and reflected in the state budget. The PIU will include variance analyses in the interim financial reports during project implementation to explain reasons for significant differences between the planned and actual expenditures and aid the management in taking the necessary corrective actions.

74. **Accounting and financial reporting.** The project accounting will follow the Government's accounting framework which is based on accrual IPSAS. IPSAS was adopted by Mongolia in 2003. The Government is still in the process of implementing full accrual IPSAS. For this project, the PIU will set up the project accounting and reporting using a new commercially available computerized accounting software package which meets the financial reporting requirements.

75. The PIU will prepare interim financial reports, inclusive of the above reports, on a quarterly basis, directly from the accounting software and submit the reports to the World Bank for review within 45 days after the end of each calendar quarter. The project's financial statements shall include the following in addition to the local reporting requirements:

- Balance sheet.
- Project sources and uses of funds.
- Uses of funds by project activity.
- Designated account statement
- Notes to the financial statements.
- Disbursement reports.

76. **Internal control.** The FM Manual will be updated to lay out procedures related to proper authorization for payment requests, segregation of duties, and other specific internal control procedures and practices relating to the project's FM. The procedures identified in the updated FM Manual will have to be closely followed by all the parties involved in project implementation. In addition, regular oversight by the PSC, periodic supervision missions by the World Bank's task team, annual financial audits by independent external auditors, and reports of public internal auditors will serve as mechanisms to ensure that the project's FM systems function effectively.

77. **Audit arrangements.** The project's financial statements will be audited in accordance with auditing standards acceptable to the World Bank. Accordingly, similar to other World Bank-financed projects in Mongolia, the MNAO will appoint an independent external auditor, acceptable to the World Bank, to conduct an annual audit of the project accounts in accordance with International Standards on Auditing or International Standards of Supreme Audit Institutions and under terms of reference satisfactory to the World Bank. The annual project audits will be financed from the credit proceeds.

78. The auditors will (a) express an opinion on the project's financial statements, (b) determine whether the DA has been correctly accounted for and used in accordance with the Legal Agreement, and (c) determine the adequacy of the supporting documents and controls surrounding the use of Summary

Sheets/Statements of Expenditure as the basis for disbursement. The auditors will also furnish a separate Management Letter, which will (a) identify significant weaknesses in accounting and internal control and asset management, (b) report on the degree of compliance with financial covenants of the Financing Agreement, and (c) communicate matters that have come to the attention of the auditors which might have a significant impact on the implementation of the project.

79. The annual audit report on the project's financial statements will be due to the World Bank within six months after the end of the reporting date (June 30 of each calendar year). This requirement is stipulated in the Financing Agreement.

D. Procurement

80. **Applicable procurement rules and procedures.** Procurement will be carried out in accordance with the Procurement Regulations for IPF Borrowers, dated July 2016, and the provisions stipulated in the Financing Agreement. Alternative procurement arrangements will not be used in the project. National competition will be used for small-value contracts for goods and non-consulting and consulting services.

81. **Procurement arrangements based on Project Procurement Strategy for Development.** Works are not anticipated in the project. All procurement will be for goods and non-consultant and consultant services.

(a) **Procurement of goods and non-consultant services.** Relatively large-value goods contracts, such as updating the information technology systems for the relevant beneficiaries, will be procured through open competition by approaching international markets, considering that there are no local manufacturers or suppliers. One-envelope, single-stage requests for bids will be used without prequalification or initial selection considering the nature and complexity of the goods to be procured. For non-consultant services and relatively small-value goods contracts, open competition by approaching national markets will be applied. For all goods and non-consultant services, Request for Proposals are not anticipated. Requests for Bids or Requests for Quotations will be adopted depending on the value of the contract to be procured. Direct selection may be used for some non-consultant services in exceptional cases where the service provider is unique, such as public awareness promotion through radio and TV service providers, publication of books, production of relevant videos or audio materials, and so on.

(b) **Procurement of firm consultant services.** Most firm consultant services will be procured through Open Competition by approaching international markets considering that there are no qualified local consultants available. Quality- and Cost-Based Selection and Selection Based on Consultants' Qualification will be used in most contracts. Though the selection will be conducted by approaching international markets, a fair number of local experts will be needed in the team composition considering the advantages of including local experts with respect to the local language, knowledge, and expertise. For relatively small-value consultant contracts, open competition by approaching national markets may be applied if it is demonstrated that there are sufficient number of qualified firms in the local market. Direct selection is not anticipated for procurement of firm consultant services.

(c) **Procurement of individual consultant services.** Most individual consultant services will be procured through Open Competition. Direct Selection may be used in exceptional cases where the individual consultant has relevant experience and qualification of exceptional worth to the assignment or where the assignment is with a total expected duration of less than six months.

82. **Procurement risk assessment and mitigation measures.** Procurement will be carried out by the PIU in the MOF. However, day-to-day contract implementation will be supervised by relevant government beneficiaries, including the MOF, MLSP, BOM, FRC, and DICOM.

83. The PIU in the MOF is responsible for carrying out procurement in the existing MSTAP. The PIU has gained experience in procurement for World Bank-financed projects. Its current procurement-dedicated staff have worked in the ongoing MSTAP for several years. From the World Bank's experience during the implementation of MSTAP, procurement risks will include the following:

(a) Although the PIU has been set up for several years, it normally experiences staff turnover from time to time during project implementation especially after government elections. The new staff normally have little knowledge and experience about procurement in World Bank-financed projects.

(b) The World Bank's new Procurement Regulations for IPF Borrowers became effective in July 2016 and will be applied in the project. This means that even the existing staff are still not familiar with the new regulations.

(c) In practice, there is a tendency to use complicated procurement procedures even for small-value contracts, which can follow simple procedures.

(d) The Evaluation Committee members normally do not have knowledge and experience in procurement for World Bank-financed projects and their evaluation may not be conducted in accordance with the World Bank's Procurement Regulations for IPF Borrowers and the provisions stipulated in the Credit Agreement and Project Agreement.

(e) A selected contractor/supplier/consultant may not be able to perform the contract. In that case, the contract has to be terminated and re-procured. This may happen, in particular, to consultant contracts for both firm and individual consultants.

(f) Contract implementation may suffer delays due to insufficient coordination and communication among the PIU in the MOF and relevant implementing government agencies. This may also cause delayed payment to the selected contractor/supplier/consultant arising from delayed acceptance/assessment of the works, goods, and consultant deliverables that are the milestones for the client to make the payment.

84. **Mitigation actions are proposed to build the capacity and mitigate the identified risks.** These actions include the following:

(a) The World Bank team's procurement specialist will deliver training to the PIU staff about procurement in World Bank-financed projects and the new 2016 Procurement Regulations for IPF Borrowers. Such trainings will be provided during project preparation and during project implementation on a regular basis.

(b) Appropriate prior review, especially for relatively large-value contracts, will be executed by the World Bank team to ensure that the PIU staff are familiar with the required rules and procedures. Procurement post review will be conducted annually and relevant findings and recommendations will be shared on time with the PIU to ensure, that in future, similar issues with procurement activities are not repeated.

85. **Procurement oversight and monitoring arrangements.** The responsibility of procurement oversight and monitoring rests with a PSC headed by the MOF and comprising other beneficiaries, including the MLSP, BOM, FRC, and DICOM. In addition, procurement will also be subjected to an annual government audit.

86. **Procurement documentation reference.** There is a Project Implementation Manual already in use in the ongoing MSTAP. It sets rules, procedures, and frameworks to be followed for FM, procurement, and safeguards. The manual will be revised to adapt it to the proposed project. It will be filed in the project portal. A Procurement Plan for the whole project implementation period or at least for the first 18 months will be prepared by the PIU and relevant government agencies responsible for project implementation, and will be made available on the World Bank's external website. The Procurement Plan will set forth the thresholds for procurement methods and prior/post review and will be updated annually, or as required, to reflect implementation needs and improvements in institutional capacity.

E. Social (including Safeguards)

87. **Social impact.** Component D of the proposed project aims to consolidate the social welfare system, help the Government improve poverty-targeting social welfare programs and expand pro-poor benefits in Mongolia. This is a continuation of MSTAP, which helped establish necessary infrastructure for better targeting of social welfare, such as a PMT and a PMT-based Integrated Household Database. Such policy reforms will help improve existing fragmented social benefit programs and contribute to a positive social impact on poor and vulnerable populations in the country. It will include training and capacity building of the relevant institutions and personnel, as well as establishing appropriate service standards and guidelines to improve service quality. There will be no significant adverse social impact from the project's activities on indigenous peoples and no physical relocation of people or acquisition of private land is anticipated.

88. **Indigenous Peoples (IP).** OP 4.10 is not triggered because the project activities are nationwide and focused on strengthening existing systems and administrative processes, to enhance fiscal management and FM. With regard to Component D, the project will further strengthen the design, targeting, operations, and performance of existing social welfare programs, based on the current PMT targeting system and mainstreamed practices under MSTAP. The previous project supported the piloting and national roll-out of the PMT for determining the eligibility of beneficiaries of social welfare programs. This roll-out carried the risk of exclusion of IP. Therefore, for MSTAP an Indigenous People Planning Framework was designed introducing a number of specific tools to seek the identified ethnic

minorities' views and take into account their concerns. While OP 4.10 is not triggered, a detailed work plan for Component D, to be prepared by the implementing agency, will be reviewed by the World Bank, before its implementation

F. Environment (including Safeguards)

89. The proposed project will support technical assistance and institutional strengthening activities in the areas of macroeconomic, fiscal, financial sector and social protection in the country. There are no civil works or construction activities included in the Project, and the Project is not anticipated to lead to downstream investment activities. The Project it is not anticipated to have any environmental safeguard issues. As per OP4.01, the Project is assigned Category C from an environmental perspective. No environmental assessment instrument was prepared.

G. Other Safeguard Policies (if applicable)

Not applicable.

H. World Bank Grievance Redress

90. Communities and individuals who believe that they are adversely affected by a World Bank (WB) supported project may submit complaints to existing project-level grievance redress mechanisms or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit *http://www.worldbank.org/en/projects-operations/products-and-services/grievance-redress-service*. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

VII. RESULTS FRAMEWORK AND MONITORING

Results Framework
COUNTRY : Mongolia
Strengthening Fiscal and Financial Stability Project

Project Development Objectives

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.

Project Development Objective Indicators

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
Name: Aggregate deviation of expenditures is reduced to 15% or less and commitment controls are in place.		Text	Aggregate deviation is >15% and no commitment controls in place	Aggregate expenditure deviation is contained within 15% and commitment controls in place	Annual	MOF	MOF, PIU
Description: At the end of the project, team will take the average of three years to measure this indicator.							

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
Name: Financial sector stability improved by decreasing percentage of non-performing loans		Percentage	12.10	10.00	Annual	Supervision Department BOM	BOM
Description: Non-performing loans below 10%							
Name: Aggregate poverty-targeted social welfare support going to the poorest 20% is increased		Text	2016: 17	2022: 25.5		MoLSP. PMT based Integrated HH Database	MoLSP, PIU
Description: Baseline (2016): Food Stamp Program is the only poverty targeted social welfare benefit with a total budget of MNT 17 bln. End Target: Aggregate amount of poverty targeted social welfare benefits (including the FSP and other/s) going to the poorest 20% is increased by 50% to MNT 25.5 bln.							

Intermediate Results Indicators

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
Name: Component A1: Fully operational comprehensive revenue forecasting model and financial model for mega-projects.		Yes/No	N	Y	Annual	MoF	MoF, PIU

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
Description:							
Name: Component A2: Government Debt management strategy and action plan are updated and approved by MoF.		Yes/No	N	Y	Annual	MoF	MoF, PIU
Description:							
Name: Component B1: GFMIS upgraded to version 7 and accounting and financial reporting functionality operationalized to support IPSAS implementation.		Text	Current version of the GFMIS is not integrated and reporting is done in stand-along systems.	Financial reporting is fully integrated into version 7 of Free Balance (GFMIS)	Annual	MoF	MoF, PIU
Description:							
Name: Component B2: Policy document on budget control and risk management is drafted and approved by MoF.		Yes/No	N	Y	Annual	MoF	MoF, PIU

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
Description:							
Name: Component B3: Public outreach activities on proposed changes to legislation conducted.		Text	0	2 at the end of the project life	Annual	Beneficiaries.	PIU
Description: At least 1 public consultation and 1 broad media coverage event on proposed legislation conducted.							
Name: Component B4:The PIM Guideline for regulating the procedures and responsibilities of PIM project strategy/planning, appraisal, selection/prioritization and budgeting developed. and endorsed by MoF.		Yes/No	N	Y	Annual	MoF	PIU
Description: No PIM Manual, guidelines and procedures in place/PIM Manual, guidelines and procedures drafted.							
Name: Component C1: Financial Sector Medium-term Development Strategy: 2017-2025 is prepared and submitted to Parliament.		Yes/No	N	Y	Annual	MOF	MOF, PIU
Description:							

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
Name: Component C2:DBM's corporate governance structure is compliant with international standards.		Yes/No	N	Y	Annual	DBM, MOF	DBM, MOF, PIU
Description: For the standards, the team will refer to the WB toolkit on the corporate governance of SOEs							
Name: Component C3: Laws/regulations are revised to ensure that DICOM is properly mandated, operated resourced, and governed, with proper means to reimburse insured deposits of failed banks.		Number	5.00	10.00	Annual	BOM. MOF, DICOM	PIU
Description: It will be measured by DICOM compliance with the IADI's Core Principles. (total of 15 principles)							
Name: Component C4: Regulatory legislation for the non-bank financial sector prepared and submitted to Parliament.		Yes/No	N	Y	Annual	FRC	FRC, PIU
Description:							

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
Name: Component C5 Operational macro-prudential framework designed and web-based database system operationalized.		Yes/No	N	Y	Annual	BOM	BOM/PIU
Description:							
Name: Component D1: Amendments for social insurance legislation in line with the State Policy on Pension Reform (2015-2030) are submitted to the Parliament.		Yes/No	N	Y	Once by end of year 2	Proposed legal amendments are officially posted at the Parliament website.	MLSP
Description: Baseline – The State Policy on Pension Reform has not been implemented yet through concrete legislative changes required. End Target – Amended Legislations enable the implementation of the State Policy on Pension Reform (2015-2030).							
Name: Component D2: A plan for consolidation of the existing social welfare programs has been adopted by the MLSP.		Yes/No	N	Y	Once by end of year 3	A plan for consolidation of the existing social welfare programs has been officially posted at the MLSP website.	MLSP
Description:							

Target Values

Project Development Objective Indicators

Indicator Name	Baseline	YR1	YR2	YR3	YR4	End Target
Aggregate deviation of expenditures is reduced to 15% or less and commitment controls are in place.	Aggregate deviation is >15% and no commitment controls in place					Aggregate expenditure deviation is contained within 15% and commitment controls in place
Financial sector stability improved by decreasing percentage of non-performing loans	12.10	9.10	9.00	8.00	7.00	10.00
Aggregate poverty-targeted social welfare support going to the poorest 20% is increased	2016: 17					2022: 25.5

Intermediate Results Indicators

Indicator Name	Baseline	End Target
Component A1: Fully operational comprehensive revenue forecasting model and financial model for mega-projects.	N	Y
Component A2: Government Debt management strategy and action plan are updated and approved by MoF.	N	Y
Component B1: GFMIS upgraded to version 7 and accounting and financial reporting functionality operationalized to support IPSAS implementation.	Current version of the GFMIS is not integrated and reporting is done in	Financial reporting is fully integrated into version 7 of Free

Indicator Name	Baseline	End Target
	stand-along systems.	Balance (GFMIS)
Component B2: Policy document on budget control and risk management is drafted and approved by MoF.	N	Y
Component B3: Public outreach activities on proposed changes to legislation conducted.	0	2 at the end of the project life
Component B4:The PIM Guideline for regulating the procedures and responsibilities of PIM project strategy/planning, appraisal, selection/prioritization and budgeting developed. and endorsed by MoF.	N	Y
Component C1: Financial Sector Medium-term Development Strategy: 2017-2025 is prepared and submitted to Parliament.	N	Y
Component C2:DBM's corporate governance structure is compliant with international standards.	N	Y
Component C3: Laws/regulations are revised to ensure that DICOM is properly mandated, operated resourced, and governed, with proper means to reimburse insured deposits of failed banks.	5.00	10.00
Component C4: Regulatory legislation for the non-bank financial sector prepared and submitted to Parliament.	N	Y
Component C5 Operational macro-prudential framework designed and web-based database system operationalized.	N	Y
Component D1: Amendments for social insurance legislation in line with the State Policy on Pension Reform (2015-2030) are submitted to the Parliament.	N	Y
Component D2: A plan for consolidation of the existing social welfare programs has been adopted by the MLSP.	N	Y