

ASIAN DEVELOPMENT BANK

CAP: MON 2002-12

COUNTRY ASSISTANCE PROGRAM EVALUATION

IN

MONGOLIA

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CURRENCY EQUIVALENTS

Currency Unit – togrog (MNT)

		1991	1994	2000	2002
MNT1.00	=	\$0.04	\$0.0024	\$0.00106	\$0.00091
\$1.00	=	MNT25	MNT409	MNT944	MNT1,097

ABBREVIATIONS

ADB	–	Asian Development Bank
ASP1	–	first Agriculture Sector Program
ASP2	–	second Agriculture Sector Program
CMEA	–	Council for Mutual Economic Assistance
CAP	–	country assistance plan
CAPE	–	country assistance program evaluation
COS	–	country operational strategy
CSP	–	country strategy and program
DMC	–	developing member country
EA	–	executing agency
EIA	–	environmental impact assessment
ETSW	–	economic, thematic, and sector work
FSP1	–	first Financial Sector Program
FSP2	–	second Financial Sector Program
FSU	–	former Soviet Union
GDP	–	gross domestic product
GRP	–	Governance Reform Program
HRD	–	human resources development
IMF	–	International Monetary Fund
ISP	–	Industrial Sector Program
Lao PDR	–	Lao People's Democratic Republic
MARA	–	Mongolia Asset Restructuring Agency
MNE	–	Ministry of Nature and Environment
MID	–	Ministry of Infrastructure Development
NGO	–	nongovernment organization
NSO	–	National Statistical Office
PCR	–	project completion report
PPAR	–	project performance audit report
PRC	–	People's Republic of China
SOE	–	state-owned enterprise
TA	–	technical assistance
UN	–	United Nations
UNDP	–	United Nations Development Programme

NOTES

- (i) The fiscal year (FY) of the Government of Mongolia ends on 31 March.
- (ii) In this report, "\$" refers to US dollars.

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BASIC DATA

Selected Economic Indicators	1997	1998	1999	2000	2001
GDP per capita (\$, current prices)	444.7	405.0	382.0	388.0	390.0
GDP Growth (% , constant prices)	4.0	3.5	3.2	1.1	1.1
Total External Debt (% of GDP) ^a	57.4	85.3	102.5	94.7	87.8

^a Excluding unresolved claim owed to the Russian Federation, but including payments on Council for Mutual Economic Assistance debts that have been converted via formal intergovernmental agreements.
Source: ADB Country Strategy and Program Update, 2002.

Selected Social Indicators	Unit	1990	1995	Latest	Year
Total Population	million	2.1	2.3 (1996)	2.4	2000
Annual Population Growth Rate	% change	2.4	1.3	0.8	2000
Poverty Incidence	%		36.3	35.6	1998
Rural			38.5	34.1	
Urban			33.1	32.6	
Maternal Mortality Rate	Per 100,000 live births	120	—	150	1999
Infant Mortality Rate	Below 1 year/1,000 live births	73	65	30	2001
Child Malnutrition	% below age of 5	—	—	13	1999
Adult Literacy	%	—	—	62.3	1999
Primary School Gross Enrollment	%	97.2	88.1	100.1	2001
Secondary School Gross Enrollment	%	87.7	68.0	84.8	2001
Public Education Expenditure	% of GDP	12.9	6.0	5.7	1997
Human Development Index		0.554	0.545	0.569	1999
Rank		—	—	116	
Human Poverty Index		—	—	27.9	1999
Rank		—	—	44	
Gender-related Development Index		—	—	0.566	1999
Rank		—	—	104	

Source: ADB Country Strategy and Program Update, 2002.
— = not available.

Joined ADB	1991					
Country Operational Strategies	1991 (interim), 1994, 2000; next planned for 2003					
Economic, Thematic, and Sector Work	Number			Years		
Economic	8			1993–1999		
Thematic	8			1995, 2000–2002		
Sector	9			1992–1999		
Loans	Number			Amount (\$ million)		
Total	29 ^a			505.1		
Of which: program loans	10			195.5		
Active	15					
Closed	14					
Technical Assistance	Number			Amount (\$ million)		
Total (including supplementary projects)	106			49.2		
Of which: advisory	76			35.3		
Performance Summary	Total	HS	S	PS	US	None
Project Completion Reports	9	6		2		1
Project Performance Audit Reports	6	1	2	3		
TA Completion Reports ^b	19	18		1		
TA Completion Reports ^c	37	28		1		8
TA Performance Audit Reports	15	8		5		2

HS = highly successful, S = successful, PS = partly successful, US = unsuccessful.
Note: the rating system was changed from three categories to four in 2000.
^a For 25 projects including four sector development programs.
^b For stand-alone TAs.
^c For TAs attached to loan projects.
Source: Asian Development Bank.

ADB = Asian Development Bank, GDP = gross domestic product, TA = technical assistance.

EXECUTIVE SUMMARY

When Mongolia joined the Asian Development Bank (ADB) in 1991, its economy was in crisis and the country was undergoing significant changes. Transition required a transformation of institutions, policies, the economy, and the financial sector. The Government had taken first steps toward reform, but assistance was required to stem the crisis, stabilize the economy, and complete the transition process. Financial support previously provided by the former Soviet Union had stopped and technical advisors had been withdrawn. Physical infrastructure, particularly power and heating supply, were on the verge of collapse. After a long period of complete isolation, officials lacked exposure and experience with market-oriented principles and thus faced enormous challenges in learning about a market-oriented economy while reforming Mongolia's system and managing daily crisis situations. External factors such as the Asian and Russian financial crises, and adverse weather conditions created further challenges to managing the transition process.

Under these very difficult circumstances, ADB supported Mongolia's transition process with loans worth \$505 million approved between 1991 and 2001 for 25 projects in the agriculture, education, energy, finance, health, industry, telecommunications, transport, and urban development sectors. An additional \$49 million was approved for technical assistance (TA) grants in the same sectors and in support of governance reforms. Overall the portfolio performed well, despite fiscal constraints that delayed implementation, and made a significant contribution to the transition process of Mongolia.

This country assistance program evaluation was conducted to assess whether ADB chose to support the right priorities over the past decade, whether assistance was well designed and implemented, and what ADB's contribution was to the transition process. The evaluation included analyses of ADB's economic, thematic, and sector work, country strategies and programs, loans, and TAs. It involved preliminary assessments based on document reviews, discussions with stakeholders in Mongolia, visits to project sites, and presentations of evaluation methodology, design, and initial findings. The evaluation was structured around the main transition themes of building capacities, reforming policies, reorienting and diversifying the economy, and transforming the financial system. A case study was also conducted on the environment, given its importance to Mongolia.

ADB's economic, thematic, and sector work provided insights into a broad range of economic and sector issues and trends. The results of these studies were not well used in formulating country operational strategies (COSs), or for country program management and design of capacity building assistance. Process flaws, resulting in poor timing and selection of analytical work, uncertain and multiple purposes that diverted from its main objective, and lack of guidance on required content, can be held responsible for this shortcoming. The adoption of new guidelines for country strategy and programs, which foresee that analytical work is done as part of strategy preparation, should rectify this problem.

ADB's three successive COSs (the first was an interim one) were responsive and relevant to country needs. In the early years, this entailed quick-disbursing assistance and investments in ailing infrastructure sectors. Over the entire period, the COSs were good at raising key concerns of transition (capacity building, policy reforms, economic reorientation, and transformation of the financial system), although these were not derived from economic, sector, and thematic work. Right choices were made in highlighting governance in the later years, environment, and poverty as the main development objectives of Mongolia. Key concerns of

transition and development objectives reflected important issues for Mongolia's transition process and were in line with ADB's institutional priorities.

While the COSs suggested incorporating these themes and objectives into operations across the board, strategic guidance was not given on how to accomplish this task. As a result, country-level goals were not well integrated into sector strategies, or the choice, sequence, and design of projects. Themes like capacity building and policy reforms were taken up across all sectors, albeit through varying approaches. The issue of economic reorientation was never fully articulated, implicitly following a hands-off approach that emphasized policy reforms, while early investments in infrastructure sectors aimed to address technical and structural issues. Assistance to transform the financial sector was responsive to crisis situations as they arose. However, in the early years, the COSs limited guidance to highlighting the importance of the sector and the need to provide assistance. The absence of an articulated sector strategy rendered the early ADB TA program reactive and, possibly, delayed an earlier and more profound transformation. These shortcomings notwithstanding, the COSs were in line with main transition issues.

The COSs suggested that in addition to project lending, program lending and TA grants be used as two of the prime modalities. This choice was reflected in the operational program, although during the first years, program loans did not disburse as quickly as desired. The choice of providing extensive TA grants was correct, given the need for capacity building and advisory services.

Assistance for capacity building took place in difficult circumstances. Institutional parameters (roles, responsibilities, structures, etc.) needed defining, while staff appointments tended to change with changing governments. The transition processes had to be managed at the same time as capacities were built. Institutional diagnostics were conducted only in a few cases, resulting in capacity-building efforts designed on the basis of less information than would be desirable. Instead, design and implementation were driven by inputs: training and consultants. In public resource management, one of the two key areas for capacity building, assistance covered many steps of the process, although without its being conceived as a program directed at improving the process of public resource management. As a result, some parts of the process were assisted (such as training for tax inspectors, planning, budgeting, and use and administration of funds), and isolated results were achieved in training staff and in providing tools.

However, this fragmented approach lost sight of the key concerns of fiscal discipline (budget control) and a professional civil service, and of process improvements as a whole. The more recent Governance Reform Program has aimed to address some of these issues by employing a more holistic approach, but during implementation attention at the working level has focused on the mechanics of output-based budgeting rather than the goal of public expenditure control. Sector management capacities were built in all sectors that ADB assisted, although with considerable variations across sectors. In some areas, assistance was confined to addressing technical and financial issues, particularly during the early years when absorptive capacity was limited. In other sectors, such as education and health, capacity building has been extensive, involving central and local levels, administration, service delivery, and quality control functions. While still under implementation, these projects promise to contribute significantly to building sector management capacities. Policy reforms that prescribed changing the role of government agencies have largely been effective, even though capacities for policy making (including policy analysis, formulation, and decision-making processes), one of the major new roles, still require further assistance.

Policy reform assistance was all-encompassing. Government programs for privatization were supported and resulted in a major change in ownership patterns, whereby the private sector now accounts for over 75% of gross domestic product. However, assistance was geared toward numerical targets rather than ensuring privatization of key areas such as cashmere industries and copper mining, which remain largely in state hands. Professional management of privatized entities is still lacking in many cases. Major assistance was provided for creating a competitive environment by removing trade and price controls. Policy changes were in line with macroeconomic policy suggestions of the International Monetary Fund and World Bank, although the sequence of assistance could have been better. While import tariffs were reduced, domestic industries were subjected to higher taxes and thus disadvantaged vis-à-vis importers during the early years of transition when domestic industries were extremely vulnerable. This example notwithstanding, assistance resulted in significant changes in trade and price policies and led to an improvement of the policy framework for private sector development. However, license regulations, tax policies, and high levels of social security contributions created disincentives for establishing or expanding businesses beyond a certain size, resulting in a large number of small and informal enterprises.

The goal of reorienting and diversifying the economy was least well articulated, which possibly led to an assumption in the 2000 COS that infrastructure investments played only an insignificant role in private sector development and poverty reduction. Loans were made to productive and infrastructure sectors, the former focusing on policy reforms and the latter leading to technical improvements and the foundation for commercialization. Investments in the infrastructure sectors contributed to improved technical performance, reflected in performance indicators such as the reduced number and duration of interruptions in power supply, expanded coverage and number of subscribers to telecommunications services, and increased traffic counts. Equally important, these investments laid the foundation for unbundling the industries and allowed some private sector involvement. This will eventually lead to privatization and further disengagement of the public sector, which at present still holds large shares in utilities. Private enterprises benefited in the locations where all such infrastructure services were improved, probably contributing to company formation.

The financial system has received considerable TA over the past 11 years. The TAs addressed specific, crisis-triggered problems that needed resolving; supported training of central bank staff; and assisted with the financial and regulatory framework and accounting standards. A program loan in the financial sector in 1996 assisted the Government in its effort to restructure the banking sector. First improvements in the sector were, however, short-lived, which was partly due to insufficient reforms (not resolving fundamental problem assets) and were reversed by the Asian and Russian financial crises that set in during the second half of the 1990s. The financial sector has, though, seen a recovery over the last 2 years with the ratio of nonperforming loans falling, while the ratio of capital to assets for the banking sector rose above 10%. Several of ADB's loans aimed to increase access to credit for specific target groups. The 2000 COS grouped the more recent projects under a financial sector strategy. However, during processing the potential impact of these projects on the financial sector seems to have been overtaken by concerns over access to credit of specific groups.

While the importance of the environment was recognized early on and requirements made to include environmental considerations in all projects, no specific strategy was worked out on how this agenda should be operationalized. This was possibly due to the overwhelming number of issues that had to be dealt with at the time and the desire to give sufficient liberty to each sector to address environmental concerns as it saw fit. Measures were taken by a number of sectors, although no quantification of these contributions to improving the quality of the

environment has been attempted. Direct environmental concerns were addressed through building capacities for environmental impact assessments, which—even though in place—suffer from resource limitations and do not capture environmental impacts of informal sector developments. More importantly, institutional conflicts between the main environmental agency and line ministries affect overall performance in terms of environmental issues.

Overall, ADB's program contributed significantly to Mongolia's ongoing transition, which was the primary goal of the first two COSs. Poverty reduction was an associated goal from the beginning, but without any articulation of strategy other than counting on private sector development, induced by policy reforms, to create employment. Since 2000 has poverty been moved into the central focus of attention, although private sector development remains, correctly, the main aspect of the COS. The impacts of policy reforms and other ADB initiatives on poverty levels have been mixed and do not lend themselves to quantification, particularly in view of strong external influences, which included the Asian and Russian financial crises and two recent harsh winters that caused large losses in livestock, impoverishing the rural poor.

I. BACKGROUND

A. Mongolian Context

1. Mongolia occupies a geographic area that is half the size of India, with a total population of 2.4 million or half the population of the Lao People's Democratic Republic (Lao PDR), which has a land size one fifth of Mongolia's. These geographic and demographic facts result in an extremely low population density of two persons per square kilometer. Almost 1 million people now live in the capital Ulaanbaatar, while the rest reside in *aimag* (province) and *sum* (district) centers, or are nomadic herders. The population is largely homogenous, except for a Kazakh minority group in the far west of the country. The mainstay of the rural population is herding. Low population densities in rural areas and the small size of towns impose challenges to cost-efficient and reliable delivery of public goods and social services. The country is affected by a harsh climate with short summers and extreme winters. It neighbors the Russian Federation to its north, the People's Republic of China (PRC) to its south and east, and Kazakhstan to its west.

1. Starting Point

2. When Mongolia became a member of the Asian Development Bank (ADB) in 1991 its economy was in crisis. Seventy years of central planning and integration in the Council for Mutual Economic Assistance (CMEA) came to an end as the former Soviet Union (FSU) and the CMEA disintegrated in the early 1990s. At the time, the Mongolian economy was geared toward producing and exporting raw materials based on mining and animal husbandry, the two prime sectors of the economy. Imports were sourced from other CMEA countries. Industries had been developed according to the Soviet model and were equipped with technologies that were outdated by the early 1990s. Products were not competitive internationally and prices were geared toward internal CMEA trading rather than reflecting international market prices. The central planning system resulted in inefficient resource allocation and the trade pattern burdened the country with significant international debt to CMEA partners, mainly the FSU. In spite of these inefficiencies, the system provided secure employment and income for many, if not all, universal education and health services, and a high level of urban service provision.

3. The dismantling of the FSU deprived Mongolia of the support system on which much of its economy was built. Shops were empty after CMEA trading partners and favorable trading conditions were lost. Essential equipment, spare parts, and inputs (agriculture and manufacturing) were unavailable, resulting in the collapse of most industries and some utilities, such as energy supply and heating. Most technical personnel returned to the Russian Federation, leaving a gap in managerial and technical skills needed for operating plants and equipment, and for working large state-owned farms. Goods that were produced and internationally traded were valued much lower than previously, as artificial prices and exchange rates were replaced with prices and rates reflecting international markets. The economic collapse and loss of trade revenue were further compounded by the discontinuation of transfers from the FSU that previously amounted to an estimated 30% of total government budget. Subsequent financial crises in Asia and the Russian Federation added to the hardship of economic transition, while two harsh winters resulted in substantial losses of livestock that affected agriculture growth and increased rural poverty.

4. These conditions resulted in hardship for the people. The urban population experienced food shortages, and the collapse of the heating system deprived people of living conditions in which to survive temperatures of -40° centigrade. Infrastructure (heating systems and housing)

was severely damaged as pipes froze, burst, and needed replacing if heating systems were to work again. People, who had lost jobs, income, and possibly their homes, rejoined relatives and became herders in a coping mechanism that worked for as long as winters did not decimate the number of livestock and some basic government services were provided in rural areas. Levels of deprivation unknown before resulted in rising poverty levels, as indicators (now included in the Millennium Development Goals) started to deteriorate.

5. A move to a market economy was inevitable given the previous dependence on the FSU that now neither would or could continue its support. Before joining ADB, Mongolia had already introduced the first reforms to start the transition to a market-based economy. Programs were under way to privatize parts of the state-run economy (notably livestock), to liberalize prices and the exchange rate, and to reform the tax system to adapt it to market economy needs. The central bank was established as a first step in moving away from the mono-banking system (para. 19). During 1991–2001, successive governments broadly maintained that move toward a market-oriented economy, albeit the dramatic adjustments that this required often caused instability, partly of a macroeconomic and fiscal nature, and partly resulting from frequent political change. Therefore, the speed and depth of the transition process differed depending on the parties' political outlook, their perception of public opinion, and whether the Government commanded a stable majority in parliament.

2. The Past Decade: 1991–2001¹

6. **Economic Growth.** Official statistics of the National Statistical Office (NSO) demonstrate economic growth trends over the period 1991–2001. The pattern in gross domestic product (GDP) trends is familiar to many transition economies. GDP fell considerably by 20.3% over a relatively short period (1990–1993), but recovered to steady growth rates of 2.3–4.0% between 1994 and 1999.² Because of large contractions in the agriculture sector, only modest growth was recorded for 2000 and is estimated for 2001 (just above 1%).

7. **Structural Changes.** The services sector grew consistently from a 25.3% GDP share in 1995 to 37.2% in 2000. The vast majority of services sector expansion took place in Ulaanbaatar, and included wholesale and retail trades (including equipment repair), hotels and restaurants, transport and communications, and financial services. The services sector as a whole overtook mining and manufacturing as an economic activity, and in the year 2000 was for the first time a more important contributor to GDP than agriculture. The share of agriculture in GDP ranged between 33.4% and 43.8%, but structural changes occurred within the sector. The livestock sector expanded with the privatization of livestock,³ but contracted considerably in 2000 and 2001 when severe winters decimated herds. In the crop sector, cultivated land area, yields, and total output contracted throughout the period. Copper, gold, and coal dominate the mining sector, which has been active over the past 3–4 years since the Mineral Law was passed (1995) and revised (1997); this sector holds the greatest prospect for economic growth in the coming 5–10 years. The manufacturing sector declined over the 1995–2000 period from 12.1% to 5.6% of GDP. While traditional industries have declined and in some cases collapsed, the textile and garment industry (excluding leather processing) has expanded rapidly. Investors have been drawn to the cashmere industry, but the expansion has been largely driven by the

¹ Data in this section are based on sources from the National Statistical Office, World Bank, and ADB.

² There was an above-average growth rate of 6.3% in 1996 that was attributable to high international copper prices.

³ The livestock sector has not responded to price signals from the cashmere market, possibly because price variations were too dramatic. Prices per kilogram fluctuated around \$60 in 1989, \$14 in 1993, \$40 in 1995, and \$15 in 1998.

“no-quota” status of Mongolia under the international Multifiber Arrangement.⁴ New contributions to the economy are remittances from overseas workers, estimated at over \$60 million annually, although no official data exist to verify these figures.

8. **Trade.** In 1990, 77% of all imports were from, and 78% of all exports were to, the FSU. At the time, trade with the PRC accounted for just 2.4% and 1.7% of imports and exports, respectively, but expanded rapidly after 1990. In 2001 it represented 53.7% of all exports by value (as against 21.7% in 1997), mainly because of the redirection of copper exports from the Russian Federation to the PRC. In contrast, although imports from the PRC also grew and represented 19.3% of all imports by value in 2001 (as against 12.9% in 1997), the Russian Federation still accounted for 36.4%. Imports from the Republic of Korea also grew significantly, more than doubling to 9.7% of all imports since 1997.

9. **Ownership.** Private ownership emerged relatively rapidly for a transition economy. In 1989, only 3.3% of GDP was produced by the private sector, but by 1999 this figure had reached 71.8%, and at the end of 2001 was estimated to be close to 80%. Considerable progress has been made in privatizing state-owned enterprises (SOEs) and state-owned assets, although emphasis has largely been on small SOEs. Of the significant number of SOEs (473 in 2001) that remained in state hands after the first 10 years of privatization, some are currently being prepared for offer,⁵ while others are being prepared for privatization⁶ or further sale of shares.⁷ In addition, large numbers of new enterprises have been established during the transition period (totaling 24,503 by 2001), although it is not clear that this is directly indicative of increased economic activity.⁸

10. **Private Domestic Investment.** Domestic investments are reflected in the large number of private companies that have been registered since liberalization. Sole traders are the largest group of registered companies, although numbers of new registrations declined rapidly when the Enterprise Law was changed in 1997 and removed the legal requirement for these businesses to register. At the same time, minimum capital requirements for limited liability companies were reduced to MNT1 million in 1998, resulting in a steeper increase in number of companies of this type. Assuming that each registered limited company had only the minimum required capital, domestic investments for this type of companies alone amounted to almost \$300 million between 1994 and 2001. The informal sector expanded rapidly once price and other controls were abolished and people were given the freedom to travel. The PRC became an attractive market for small traders to source their goods.⁹ Surveys of the informal sector¹⁰ estimated its size as between 15% and 35% of recorded GDP, making significant contributions to containing poverty levels.

⁴ Manufacturers from PRC; Republic of Korea; and Taipei, China set up factories in Mongolia in order to escape quota limits and benefit from low tariffs on imports from Mongolia.

⁵ Gobi Cashmere, NIC (petrol distributor), MIAT (airline), and two state insurance companies.

⁶ A number of power generation and distribution companies, but not yet power plant no. 3, assisted by ADB. The power transmission system is envisaged to remain state owned until at least 2005.

⁷ Mongolian Telecom.

⁸ Legislation on company registration requirements and the structure of taxes raised on company profits resulted in a large number of new company registrations. For instance, tax rates rise from 15% to 40% once profits are MNT100 million or above. It is reported that larger entrepreneurs set up new companies once they reach the profit margin that would make them liable to higher taxation rates.

⁹ Proximity, quantity, and quality of available goods, prices, and the absence of visa requirements for Mongolians traveling to the PRC played important roles.

¹⁰ World Bank. 1997. *The Size, Origins and Character of Mongolia's Informal Sector*. Washington, DC. USAID/DAI. 2000. *The Mongolian Informal Sector; Survey Results and Analysis*. Washington, DC.

11. **Foreign Direct Investment.** The encouragement of private ownership and the corresponding liberalization of investment regulations under the Foreign Investment Law led to a rise in gross foreign direct investment. The Foreign Investment and Foreign Trade Agency reports that a total of \$481 million was invested over the last decade, of which almost 90% was invested since 1996. For 2001 alone, the Agency reports total foreign direct investments of \$125 million in actual disbursements. However, these figures do not tally with NSO's statistics, which reported only \$56 million of foreign investments between 1997 and 2000.

12. **Poverty and Social Indicators.** Although, poverty was not recorded before the transition process started, it was evident that the poverty incidence rose rapidly as the socialist system fell apart. High levels of unemployment coincided with the crumbling of the social security system. Maternal mortality rates rose, as government funds were cut for maternal care (ante- and postnatal). School enrollment rates dropped to their lowest rates in the mid-1990s. The poverty incidence was first estimated in 1995 and since then has been around 36%, with variations occurring more in location than in overall incidence. The earlier higher level of urban poverty declined more rapidly than rural poverty (comparing 1995 and 1998), as the outreach to the poor in urban areas was easier than in remote, sparsely populated, rural areas. However, this trend might have been countered by the recent severe winters, which caused large losses in livestock and reportedly induced rural-to-urban migration.

13. The transition process was supported by external assistance that quickly replaced previous financial and technical support from the FSU and continued Mongolia's aid dependency. From 1991 onward, ADB (as the largest multilateral agency operating in the country) supported Mongolia's transition with loans amounting to \$505.1 million for 25 projects in the agriculture, education, energy, finance, health, industry, telecommunications, transport, and urban development sectors. In addition to these sectors, a Special Assistance Loan was provided, and governance reforms and social security were supported. Technical assistance (TA) worth \$49.2 million was provided in the same sectors. Section II.C provides details on the operational program.

B. Purpose and Methodology of the Evaluation

14. The purpose of the country assistance program evaluation (CAPE) was to assess the contributions that ADB assistance made to the transition process of Mongolia and aimed to answer the following questions:

- (i) How well were ADB's country strategies formulated and put into practice: *Were the right things done?*
- (ii) How well were ADB's operations designed and implemented: *Were things done right?*
- (iii) What was the outcome: *What were ADB's contributions to the transition process of Mongolia?*

15. Country operational strategies (COSs) do not lend themselves to evaluation, because goals are not expressed in measurable terms and indicators contained in the COSs relate to country performance rather than to ADB contributions. To overcome this problem, the CAPE analyzed ADB's COSs to assess choices made therein and to identify whether key issues of transition (para. 19) were embedded in them (para. 33). A number of projects¹¹ was then chosen to examine how these key issues of transition were addressed and to assess initial

¹¹ Projects in this context include program and project loans and TA projects.

outcomes. The CAPE methodology was presented to ADB staff during a briefing in January 2002. Feedback provided during that meeting was incorporated in the evaluation design.

16. The CAPE covered the entire period of cooperation between Mongolia and ADB (1991–2001). With its country-level focus, the CAPE included an assessment of analytical work, strategic planning directions, lending, and TA, but did not aim to review the efficacy of each project. Instead, the CAPE evaluated the contributions that operations made, individually and/or collectively, to the transition process of Mongolia, and uses typical project examples for illustration purposes. Benchmarks for performance assessment were (i) guidelines and staff instructions, (ii) understood definitions (implied in staff instructions), and (iii) goals defined in COSs and projects.

17. The desk review of the strategic directions of the ADB program included analyzing economic, thematic, and sector work (ETSW), COSs, and country assistance plans (CAPs).¹² It led to identifying four key transition themes (capacity building, policy reforms, reorienting and diversifying the economy, and transforming the financial system), as well as the theme of the environment.¹³ Teams consisting of international and Mongolian experts¹⁴ undertook case studies on each theme, including detailed desk reviews of projects, meetings with stakeholders, site visits, and surveys, and discussed government initiatives and assistance provided by ADB and other external agencies. Fieldwork took place from 29 April to 21 June 2002. Initial findings were presented during stakeholder workshops in Ulaanbaatar and Manila. The work of the teams was complemented by desk reviews of ADB's self-evaluation mechanisms, such as portfolio reviews (para. 123), project and TA completion reports (para. 42), and existing evaluation reports (para. 43).

18. The CAPE brings together the information from all of these in-depth studies. The initial draft was presented at a workshop each in Manila and Ulaanbaatar in August 2002. For the latter, the draft was translated into Mongolian. Suggestions made during these workshops and through the formal review process were incorporated in the final draft.

II. COUNTRY OPERATIONS

19. For ADB, Mongolia was the first developing member country (DMC) that was undergoing a radical transformation from the FSU model to a market-oriented economy. Experiences in other DMCs of the region did not provide examples for easy application. FSU states in Central Asia joined ADB later, but in 1991 there was only little experience and expertise to develop assistance programs in support of transition. Transition here is defined as moving from a centrally planned economy to one that is driven by competitive market forces, including a complete overhaul of institutions, policies, economic structure, and financial system, and covers:

¹² Since 2001, COS and CAP have been combined into a country strategy and program.

¹³ The CAPE chose to focus on these themes for in-depth analysis, given that they were of central importance to attaining the COS goal and that they were pursued consistently over time and in all sectors. This approach allowed to focus on transition processes and compare experience across sectors to form an assessment for the overall country perspective.

¹⁴ Capacity building: Caroline Heider, Principal Evaluation Specialist and team leader for the CAPE, and Namjil Narantuya; policy reforms: Steven Tabor and Unenburen Narantsetseg; economic reorientation and diversification: Christopher Knee, Sodnom Bekhbat, and Dorligjav Batjargal; transforming the financial system: Steven Gilbert and Sodnompil Baljinnyam; and environment: Ivan Ruzicka and Erden Bardach. The reports of each group, representing the views of the consultants and not of the CAPE team as a whole or those of ADB, are available as supplementary appendixes. Renato Lumain undertook the desk study on portfolio performance and supported the team in collecting data in a number of areas.

- (i) **Capacity building.** Institutions have fundamentally different roles in a state-planned context than a market-oriented economy. Transition required that institutions (and individuals) moved away from central planning to creating an institutional environment that fostered private sector initiative. Responsibilities and roles of institutions, decision-making processes, performance criteria, skills and competences of individuals, etc., all had to be developed to build capacities for implementing reforms and managing sectors under different parameters.
- (ii) **Policy reforms.** Policies had to be changed from centrally planned norms to a market-oriented economy, where demand, supply, and prices would not be dictated by central plans, but by market forces. Policy reforms were sometimes seen as central to the reform process, assuming that the right policy framework was sufficient to transform the economy to a market-oriented system.
- (iii) **Economic reorientation and diversification.** During the socialist period, central plans determined the structure of the economy, resource allocation, and investments into economic activities regardless of whether these were profitable or not. In a market-oriented economy, these decisions are left to the market and individual entrepreneurs. Transition required changing ownership patterns, but also addressing market imperfections that would impede private sector development.
- (iv) **Transforming the financial system.** State-planned economies operated with a mono-banking system that handled transfers between government agencies and SOEs. That system was an ineffective tool for financial intermediation and was not geared toward handling the variety of transactions and the risks that are inherent in a market-oriented economy.

20. To assess what choices were made in ADB COSs, the CAPE examined the analytical underpinnings that informed these choices by assessing the role and quality of ETSW in strategic planning. This analysis was followed by a review of the quality of the COSs to assess whether they (i) defined goals and expressed them in measurable terms and ensured that the operational program and resources were geared toward attaining defined goals (para. 29); (ii) were selective, setting priorities and thus focusing resources on core areas (para. 30); (iii) were effectively translated into CAPs, including some areas while excluding others (para. 31); and (iv) selected the appropriate choice of modalities that were in line with country goals (para. 32).

A. Economic, Thematic, and Sector Work

21. ADB has no formal guidelines for ETSW, defining the purpose and role of this type of work or setting standards for its preparation. However, operational procedures,¹⁵ staff instructions,¹⁶ a special evaluation study,¹⁷ and the new business processes¹⁸ provide insights into the common purposes of ETSW. These can be reflective (monitoring country performance and managing country program performance through feedback on issues affecting

¹⁵ ADB. 1997. *Operations Manual Section 32: Operational Procedures*. Manila.

¹⁶ Staff instructions (1996) on the country economic report stated that these reports “will, like the ERBOP [economic report and bank operations paper], be the principal economic background document on the DMC for the Board, Management, and Projects and Programs Departments.”

¹⁷ ADB. 2001. *Special Evaluation Study on Selected Economic and Sector Work*. Manila.

¹⁸ ADB. 2002. *Business Processes for the Reorganized ADB*. Manila.

implementation) or forward looking (supplying inputs for strategic planning and forming the basis for capacity-building assistance). In the case of Mongolia, the following observations can be made.

- (i) Economic work provided details on the economy and on sectors that were sufficient for monitoring country and sector performance. Sector strategies, prepared less frequently, quite rightly did not attempt to serve this purpose.
- (ii) There was no apparent link between ETSW and the management of country program performance. Data were not analyzed and interpreted in such a way that consequences for ADB's program were apparent. In addition, the country program management process followed its own cycle without links to ETSW.
- (iii) Purely in terms of timing, the overview in Appendix 1 shows that ETSW was not timed in line with the cycle of preparing COSs. Annual economic reports were less related to ADB's strategic planning exercise than to coordinating with International Monetary Fund (IMF) and World Bank missions. In terms of content, the absence of prioritized options would have affected the use of ETSW in strategic planning. Be that as it may, there is no evidence in COSs that they referred to ETSW.
- (iv) Institutional issues were largely dealt with in sector work and, in as much as training needs were concerned, in a thematic study on the legal framework. Capacity-building suggestions generally addressed some institutional needs, and often just training needs, without providing a systematic and sequenced action plan for capacity building and institutional development, as discussed further in section III.A.

22. As noted in the special evaluation study (footnote 17), ADB's planning process for ETSW did not result in a systematic assessment of the type of ETSW needed or a phased program for its implementation. These process flaws, combined with uncertain or multiple definitions of purpose, affected the choice and timing of ETSW, effectively disconnecting analytical work from strategic planning. This problem may be overcome with the business processes for the reorganized ADB (footnote 18), which require that ETSW be done prior to the formulation of the country strategy and program (CSP) (footnote 12). Analytical gaps and the absence of specific recommendations for ADB programming and/or program management limited the utility of ETSW reports as a management tool or for strategic planning. In addition, until recently, most ETSW documentation was not translated into Mongolian and was therefore of limited use to decision makers in the country. Appendix 1 provides a detailed analysis of ETSW undertaken in Mongolia.

B. Country Operational Strategies and Country Assistance Plans

23. Between 1991 and 2001, three COSs – one of them interim – were formulated. They determined ADB's strategic country goals to be attained with policy dialogue, TA, and lending, and set ADB's country-specific thematic and sector priorities.¹⁹ The COSs, therefore, should be the benchmark for measuring country program performance and development impact at the country level.

¹⁹ ADB. 1996. *Guidelines on Operational Procedures Section 45*. Manila.

1. Content

24. In 1991, the interim COS aimed to support the restructuring of the economy in line with its comparative advantage and by increasing international competitiveness to overcome the country's economic isolation. The sector focus was on developing the agro-industrial base (assistance to the agriculture and industry sectors) and rehabilitating the infrastructure base (assistance to the energy, and transport and communications sectors).²⁰ Assistance to all sectors was to address also environmental concerns and aimed to strengthen institutions, including human resources development (HRD), in areas such as national statistics, financial sector reforms, external trade policies, and institution-wide capacity building. The program was to be delivered through TA and lending, which, in response to the need for budget support to cover the costs of transition, consisted of quick-disbursing program loans.

25. The 1994 COS maintained the aim of restructuring the economy to increase the efficiency of resource utilization and to support the development of a vigorous and competitive private sector. To achieve these goals, an environment conducive for competitive and efficient markets was to be created,²¹ human resources and skills developed,²² and infrastructure built.²³ In addition to support to infrastructure sectors, the strategy included agriculture (at policy and institutional levels, and through the Employment Generation Project²⁴), industry and mining (through assistance to improving banking and credit services, privatization, policies and legal framework, and training), and TA to the health sector for policy and organizational reforms.

26. The 2000 COS maintained the pursuit of an enabling environment for the private sector and HRD, but replaced infrastructure investments with support to governance reforms. It aimed at generating income and employment through private sector development to address poverty reduction concerns. Assistance to financial and capital market institutions, industrial and agribusinesses, and tourism, and to reorienting the public sector was to remove barriers to increased private sector development and economic diversification. Poverty concerns were to be addressed through employment generation, maintaining human development achievements, and strengthening the reform of social protection. The governance agenda included assistance to developing a medium-term capacity-building strategy and public sector reforms.

27. Poverty reduction was discussed in all three COSs. All of them advocated promoting economic growth through private sector development to create jobs and prevent people from falling into poverty. The first two COSs considered infrastructure an essential input to private sector development (and assumed that these investments would automatically address poverty reduction concerns), while the 2000 COS focused on governance²⁵ and emphasized the importance of poverty reduction.²⁶ The latter also aimed to support improvements in social services delivery to enable people to participate in economic activities and thus counter growing

²⁰ Assistance to social sectors was considered unnecessary for two reasons: (i) performance indicators for social sectors were good; and (ii) public resource allocations for social sectors were considered too high and it was recommended that efficiency gains should be attained before making further investments. However, no assessment was made whether TA would have been in place to assist the process.

²¹ Policy reforms, redefining the role of government, price liberalization, trade promotion, privatization, financial sector reform, and assistance to the legal and regulatory system.

²² Assistance to training institutions and providing training to managers, accountants, lawyers, and entrepreneurs.

²³ Transport and communications, storage and distribution of agriculture produce, and energy supply.

²⁴ Loan 1290-MON(SF): *Employment Generation*, for \$3 million, approved on 16 December 1993.

²⁵ ADB's first guidelines on governance were issued in 1995 (footnote 42), but operations became geared toward this objective only in the second half of the 1990s.

²⁶ Poverty reduction was made ADB's overarching goal in 1999. The *Poverty Reduction Strategy* (ADB 1999) was adopted in the same year. The COS was aligned with these institutional goals.

poverty. Mongolia was the first country to sign a partnership agreement for poverty reduction with ADB in 2000.²⁷ The partnership agreement was in line with the 2000 COS, with poverty concerns to be addressed primarily through labor-absorbing private sector development and social services delivery. Indicators defined in the agreement included income poverty, human development, and economic conditions (growth, per capita income, job creation), while targets were defined in terms of international development targets (now part of the Millennium Development Goals).

28. CAPs, which presented 3-year rolling plans for ADB's operational program, were prepared in the years 1997 to 2000. They provided information on the performance of ongoing operations and details about the scope of and resource allocation in each sector and thematic area. The 1997 plan also summarized the overall operational plan in terms of programs for policy support and capacity building, whereas later plans contained information about sectors and crosscutting concerns such as environment. These summaries gave background details but did not necessarily bridge the gap between country goals and operations.

2. Analysis

29. **Goals.** The COSs stated broad goals but did not specify measurable targets to be attained at the end of the strategic planning period. The discussion of supporting the transition was based on the assumption that there was only one model for a market-oriented economy and failed to consider the variety of options that existed. The link between goals and objectives were not well articulated, implying assumptions about the necessity and sufficiency of interventions. For instance, it was assumed that private sector development would result from policy reforms without analyzing whether the right policies were sufficient to stimulate growth and without recognizing the differences between privatization and private sector development. Objectives lent themselves to various interpretations that, sometimes, were clarified to some degree when analyzing the content of the COS. For instance, the aim of "developing the agro-industrial base to diversify and broaden international trade" focused on diversifying trading partners rather than subsectors or products, as the focus remained on the traditional export sector, i.e., livestock (1991 COS). In other instances, objectives and lending programs were inconsistent with macroeconomic goals (fiscal constraints versus sector investments) or within the COS and CAP: the objective to support HRD faced the Government's unwillingness to borrow for the education sector, although the Government's position changed 2 years later (para. 31). These shortcomings in the links between strategic goals and CAP content point to inconsistent strategic planning with the potential risk to jeopardize achieving country goals, as they were not supported well by or integrated into operations. As such, the goals set in COSs were formulated in ways that country program performance could not be monitored or measured without interpreting goal statements.

30. **Selectivity.** The interim COS (1991) did not specify selection criteria for choosing areas for providing assistance, which was probably due to the emergency situation in which the strategy and lending program were drawn up. The COS was relatively lean with few sectors selected for assistance. The 1994 COS recognized the need for selectivity and suggested that areas be selected where maximum impact could be expected, although without stating which areas these were. Instead, it listed a number of selection criteria including government priorities (reform and investment priorities), financial and absorptive capacity of sectors, recurrent expenditure effects, project size, and possibilities for cofinancing. This range of selection criteria

²⁷ ADB's *Poverty Reduction Strategy* (footnote 26) required poverty partnership agreements to be signed between ADB and its DMCs. These partnership agreements were to cement the commitment on both sides to address poverty concerns and to meet attainable and measurable targets for poverty reduction.

did not ensure a well-focused and selective strategy. Instead, it reflected a multitude of demands that led to a complex mix of strategy components (sectors, thematic priorities, processes, and modalities). The 2000 COS selected sectors for “their potential for strengthening economic activities in the private sector, generating employment aimed at poverty reduction, and contributing to human development”—a statement broad enough to allow inclusion of a wide range of sectors and projects, but not specific enough to make deliberate choices in support of private sector development. The increasing number of thematic areas that required addressing and attempts at illustrating linkages across themes, sectors, and processes added to the impression of a less focused and selective program.

31. **Effectiveness of Choices.** The 1991 and 1994 COSs attempted to limit involvement in the social sectors (education, health, social security, and urban development). The first COS found that social indicators were satisfactory, but that public expenditure in these sectors was too high. The second COS explained the Government’s unwillingness to borrow for the education sector by the need to rationalize public expenditure in the social sectors. However, a loan to the education sector²⁸ was approved only 2 years after the COS was adopted. A similar situation arose with the 2000 COS, which explicitly excluded infrastructure investments from ADB assistance. However, at the time of its preparation, a road investment was approved²⁹ and a third ADB loan to the same sector is being considered this year. Assistance to the road sector was retained as a result of the review of the partnership agreement for poverty reduction (para. 41), which found it necessary to reduce regional disparities.

32. **Modalities.** The COSs emphasized the need for quick-disbursing funds, particularly in the early years of crisis, and for capacity-building TA. The operational program included both of these modalities and project investments in the infrastructure sectors. The first loan was approved in 1991³⁰ in response to the urgent need to bridge the financing gap that resulted from the sudden stoppage of transfers from the FSU.

3. Key Issues of Transition and Development

33. All three COSs were good at recognizing issues central to the transition process (para. 19), namely building capacities, reforming policies, reorienting the economy, and transforming the financial system. These key issues formed a consistent thread for the entire period 1991–2001 and across all sectors, including governance. In some sense they were themes that connected work in various sectors and could link sectors and strategic country goals. Whether this opportunity was seized is analyzed in section III. In addition, the importance of the environment to the development prospects of Mongolia was also recognized from the beginning. The agriculture sector, and in particular the livestock subsector, contributed a significant share to the economy. The sector depended on the environment, while at the same time posing a potential threat to a fragile ecosystem. The industry sector and utilities inherited problems typical of former socialist countries: equipment that was not designed with environmental concerns in mind, was outdated, and performed poorly. Addressing environmental concerns was not central to transforming the economy. However, transition had implications for the environment, and once transition was completed, further development of the country depended on an environmentally sound basis.

²⁸ Loan 1507/1508-MON(SF): *Education Sector Development Program and Project*, for \$15.5 million, approved on 19 December 1996.

²⁹ Loan 1700-MON(SF): *Second Roads Development Project*, for \$25 million, approved on 30 September 1999.

³⁰ Loan 1109-MON(SF): *Special Assistance Project*, for \$30 million, approved on 29 October 1991.

C. ADB Operational Program 1991–2001

1. Lending

34. Between 1991 and 2001, ADB approved 29 loans totaling \$505.1 million, all of which were financed from the Asian Development Fund, ADB's concessional lending window. These loans funded 25 projects, of which 12 are completed and 13 are still under implementation. Viewed over time, the loan approvals show the large number of sectors that ADB supported during the past decade, sometimes with a series of investments in the same sector, sometimes with, so far, only one approved project.

35. Up to 1995, lending concentrated on infrastructure sectors (energy, transport, and telecommunications), agriculture, industry, and the early special assistance (footnote 30). From 1996 onward, the sector mix changed in that the social sectors and financial sector assistance were included. Assistance to the energy sector continued until 1997, while lending to the transport sector for roads is ongoing. For 2000 and 2001 (the 2 years under the most recent COS), lending has gone to the agriculture, financial, social security, and urban development sectors. Between 1991 and 2001, the transport sector absorbed the largest share in total lending to Mongolia (21.8%), followed by energy (18.6%), and agriculture (14.6%). All the social sectors collectively received 12.9% of total lending, while the financial sector received 10.5%. The remaining 21.6% financed lending for governance reform, industries, special assistance, and telecommunications. However, these sector allocations do not necessarily reflect actual fund transfers to the sectors, as proceeds from program lending were made available to the central agencies of government (para. 76).

36. Annual lending levels peaked in 1995 at \$84.0 million, but declined from between \$60 million and \$70 million for most of the 1990s, to \$32 million in 2000 and \$36 million in 2001. This decline was due to resource constraints of the Asian Development Fund, which required reducing the indicative planning figure for Mongolia (as well as for other DMCs). No loans were approved in 1998 due to political instability. During 1991-1994, the proportion of program lending to total lending volume (in dollar terms) was 35.9%, and increased to an average of 40.1% of total lending for 1995-2001. This percentage was high in comparison to DMCs in transition in Southeast Asia,³¹ but comparable to other Central Asian republics.³² Table 1 shows loan approvals by year and sector. Sector development programs were approved starting in 1996 to finance a combination of policy reforms (program loans) and investments (project loans). These sector development programs were approved for the education (1996), health (1997), and agriculture (2000) sectors, and for social security (2001). All 29 loans are listed in Appendix 2.

³¹ Cambodia, Lao PDR, and Viet Nam.

³² For Kazakhstan this ratio is almost 50%, and in the Kyrgyz Republic it is about 32%.

Table 1: Loan Approvals by Year and Sector
(\$ million)

Sector	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total	%
Agriculture			3.0		35.0 ^a				9.9	17.0 ^b	8.7	73.6	14.6
Education						15.5 ^b						15.5	3.1
Energy		3.8		40.0		10.0	40.0					93.8	18.6
Financial Sector						38.0 ^b				15.0 ^a		53.0	10.5
Governance Reform									25.0 ^a			25.0	4.9
Health							15.9 ^b					15.9	3.1
Industries			30.0 ^a									30.0	5.9
Social Security											12.0 ^b	12.0	2.4
Special Assistance	30.0 ^a											30.0	5.9
Telecommunications				24.5								24.5	4.9
Transport			36.0		49.0				25.0			110.0	21.8
Urban Development							6.8				15.0	21.8	4.3
Annual Total	30.0	3.8	69.0	64.5	84.0	63.5	62.7	0.0	59.9	32.0	35.7	505.1	
Program Loans	30.0		30.0		35.0	41.5	4.0		25.0	22.0	8.0	195.5	
% of Total	100.0		43.5		42.7	65.4	6.4		41.7	68.8	22.4	38.7	
Cumulative Total	30.0	33.8	102.8	167.3	251.3	314.8	377.5	377.5	437.4	469.4	505.1		

Note: Sectors refer to the Asian Development Bank database and do not reflect lending to the corresponding line ministry.

^a Program loans.

^b Includes both program and project lending.

Source: ADB

37. Under the loan classification system valid between 1992 and 2000,³³ projects served the primary strategic development objective of economic growth (15), human development (5), and poverty reduction (1). This primary classification was in line with the overall thrust of the program to stimulate economic growth as the means of development, although the secondary goal of poverty reduction was less well reflected in the portfolio. Two economic growth projects had poverty reduction as a secondary classification, while one each was classified as human development and women in development. Since the introduction of the new classification system,³⁴ 7 projects approved in 2000 and 2001 were classified as poverty intervention, and 4 as not directly related to poverty reduction. Under the thematic classification, human development (6), governance (4), and economic growth (2) were the most common themes, indicating also a shift in classification away from economic growth projects.

2. Technical Assistance

38. TA approvals totaled \$49.2 million from 1991 to 2001 (Table 2). This pattern shows a fairly strong involvement in a large number of sectors over the entire period of ADB involvement. Annual advisory technical assistance approvals ranged from \$1.1 million to \$5.1 million (peaking in the mid-1990s) with an annual average of \$3.2 million. Project preparatory technical assistance was provided in all years except 1991 and 1998, and averaged \$1.5 million per year.

³³ The classification system had five categories, namely economic growth, poverty reduction, human development, women in development, and environment. Projects had a primary (mandatory) and a secondary (additional) strategic development objective.

³⁴ Under ADB's poverty reduction strategy, a new classification system was introduced to emphasize the focus on poverty reduction. The primary classification marks a project as a poverty intervention (or not), while the secondary classification defines a thematic priority area. The system is formally applied to loans approved from 2001 onward, but was piloted on 2000 loans. The above list adds up to more than 25 projects because of this dual classification in 2000.

Table 2: Technical Assistance by Year and Sector
(\$ million)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total
Agriculture		0.8	1.3	0.6	1.6	0.8	0.7			2.4	0.5	8.6
Education		0.5		0.4		1.0			0.7			2.7
Energy		1.8	0.5	0.7	0.1	1.0	0.2	0.5	0.7			5.4
Financial Sector	0.2	0.1	1.1	0.6	0.7	1.3	0.1		0.2	0.6		4.9
Governance Reform		0.5	0.5	0.6	1.5	0.3	3.4		1.8		1.7	10.2
Health				0.5	0.6	0.1	0.6				0.6	2.4
Industries	0.6	0.5										1.2
Other	0.2	0.4		0.6		0.4		0.9				2.5
Social Security				0.1			1.0					1.1
Telecommunications		0.6		1.2								1.8
Transport		1.2	0.9		1.5		0.5		0.7			4.7
Urban Development						0.6	1.0	0.9		0.6	0.7	3.7
Annual Total	1.1	6.5	4.2	5.2	6.0	5.5	7.4	2.2	4.1	3.6	3.5	49.2
Cumulative Total	1.1	7.6	11.8	17.0	23.0	28.5	35.9	38.0	42.1	45.7	49.2	

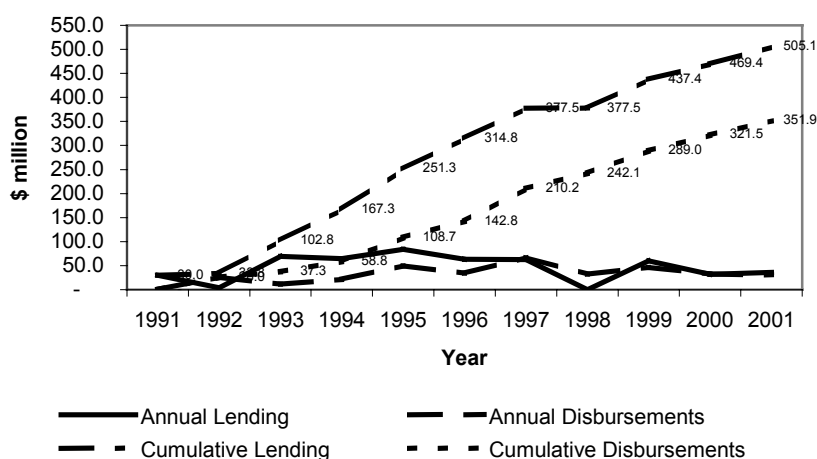
Source: ADB

39. Governance or reform-related activities received the largest share of TA funds (26.4%),³⁵ followed by agriculture (14.3%), and the financial sector (14.0%). The high proportion of TA to lending in dollar terms (9.9%) was in about the same range as in Cambodia (12.1%) and the Lao PDR (9.7%). By comparison, Kazakhstan, Kyrgyz Republic, and Viet Nam had TA to loan ratios of 4.0–5.5%. Appendix 3 provides a complete list of TAs.

3. Disbursements and Implementation

40. Annual disbursements ranged between \$11.3 million and \$67.4 million, with an average of \$32.0 million. The ratio of cumulative disbursements to cumulative approvals was lowest in 1993 and 1994 (36% and 35%, respectively) – the years when quick-disbursing funds were needed – because of the lack of familiarity with ADB procedures. Since 1997, the ratio has been consistently above 64%. A similar trend has been observed in other transition economies with high program lending volumes, such as Kazakhstan and the Kyrgyz Republic, while the ratio has been growing steadily from around 50% to over 70% in the Lao PDR, which received fewer program loans (para. 36). In Viet Nam, this ratio has been much lower. The figure provides a summary of annual and cumulative loan approvals and loan disbursements.

Summary of Loan Approvals and Disbursements



³⁵ A number of TAs included in this count was classified as "others." However, based on TA content they were here grouped under the governance category.

4. Reporting on Performance

41. The first annual review of the partnership agreement for poverty reduction (para. 27) reported that national trends in income poverty remained stagnant, but that a number of health indicators had improved over the 1994–2000 period. It summarized the Government's new action plan³⁶ and illustrated how ADB's COS and poverty agenda were consistent with this plan. However, the review also made the point that regional disparities needed recognition rather than focusing entirely on urban poverty, as the 2000 COS had done. The review's report on the ADB program was limited to loan approvals rather than outcomes for which it was too early. The second review, conducted in 2001, updated details on government initiatives, summarized changes in ADB's program and recent loan approvals, and provided updates on agreed targets, reflecting improvements in social indicators. The review also highlighted the issue of debt sustainability, as the Government and IMF agreed on targets for external debt, and concluded that "ADB should (i) assist the Government in mobilizing foreign direct investment and grant funds; (ii) focus strategically on activities that promote private sector led growth; and (iii) continue to support reforms in public sector management to improve efficiency."

42. Completion reports were prepared for nine projects, six of which were rated successful,³⁷ two partly successful, and one was not rated. These reports pointed out some weaknesses in project implementation, and highlighted a number of issues related to (i) project design (definition of target beneficiaries, sequencing of sector reforms, stakeholder awareness and ownership), (ii) sector reform implementation, depth, and sustainability (industrial and financial sectors), and (iii) the continuous need for capacity building. Completion reports were also prepared for 56 TAs, with 46 TAs rated successful, 2 partly successful, and 8 not rated. The reports pointed to the need for a flexible approach to implementing TAs to make them responsive to changing needs in a highly dynamic transition context. More involvement of stakeholders and thus greater ownership and commitment to change (as expressed in TA objectives) were essential to formulating frameworks for reforms and institutional change, and for implementing and attaining reform agendas and sustaining training results.

43. Project performance audit reports (PPARs) were prepared for six projects, three being rated successful, and three partly successful. The findings of these PPARs are summarized in Appendix 4 and are drawn on in relevant sections of the CAPE. In addition, 15 TAs were evaluated through PPARs, with 8 rated successful, 5 partly successful, and 2 not rated. Overall the results of self-evaluation through completion reports and independent evaluation through PPARs, particularly the absence of any unsuccessful projects and TAs, compare favorably with the ADB-wide averages, indicating a solid performance in Mongolia.

III. SUPPORTING TRANSITION

44. For each of the key issues of transition, background information is provided on the Mongolian context in which ADB assistance was delivered, followed by an analysis of strategic directions, design and implementation issues (operational realities), and initial outcomes.³⁸

³⁶ The *Action Program of the Government of Mongolia, 2000–2004* was adopted by the Government that was elected in 2000.

³⁷ ADB's rating system was changed from three categories to four in 2000. Successful rating in paras. 42–43 includes: generally successful (old system), and successful and highly successful (new system).

³⁸ Less than 50% of the projects have been completed and that, relatively recently. Therefore, impact assessments are preliminary.

A. Building Capacities and Developing Institutions

45. Capacity building and institutional development have long been recognized as important parts of development to enable government and stakeholders to take ownership of development processes and decisions. They become even more important in transition economies where the roles of government and other economic actors need redefining.

46. Between 1990 and 1993 the foundation was laid for a democratic organization of the state, codified in a new Constitution (adopted in 1992), which separated previously centrally held powers to vest them in the executive, legislative, and judicial branches of government. From 1994 to 1996, the public administration was reformed to embody new principles of a professional rather than party-appointed civil service. The reform involved adopting the Law on Government Service of December 1994. This was followed by a phase of devolution, documented in the Mongolian State Policy on Reforming Government Processes and the General System of Structure of 1996. Among its nine priorities were the development of management capacities and the reform of the public administration and civil service, including the devolution of powers to local levels.³⁹ The policy included notions of strategic planning, performance standards, and results-based management principles at all levels of government. Since 2000, focus has shifted to increasing the efficiency and impact of civil services through improving the quality of output and productivity. The Action Program adopted in 2000 (footnote 36) included a Policy of Overcoming Governance Crisis and Strengthening Public Order and Discipline, which contained a large number of areas for institutional development such as streamlining the administration and building capacities of government institutions, largely focusing on staff skills and knowledge. One of the subprograms aimed to improve the accountability of public services, addressing both questions of ensuring a professional civil service (competent and free of political pressure) and of tightening and improving the efficiency of the control on the budget.

1. Strategic Directions

47. Capacity building and institutional development were integral parts of ADB's COSs from the beginning. The first COS recognized that economic managers were not yet familiar with the information needs and decision-making techniques suitable to a market-oriented economy and suggested providing training. The 1994 COS realized that changing the role of government agencies required considerable time and support to develop institutions and administrative skills. The COS identified the need for support in areas of policy making and the legal framework, for training of managers, accountants, and lawyers to introduce new skills, and for institutional strengthening and HRD to strengthen administrative and technical skills. Capacity-building assistance was to be provided across all agencies. In the 2000 COS, the emphasis was shifted toward governance reforms to strengthen public expenditure management capacities, although assistance to building sector management capacities was maintained as well.

2. Operational Realities

48. **Key Objectives.** Each project developed individual initiatives as seen fit for the sector, although in retrospect it can be seen that these projects served two main objectives: improving

³⁹ Local governors and local parliaments are self-governing entities. Responsibilities for financial management are vested at the local level, regardless of whether revenues are generated by the local administration or received through transfers from the central Government. The "new business model" (contained in the 1996 policy) described the relationship between central and local government, and gave a role to nongovernment organizations (NGOs) as alternative agencies for policy implementation.

various aspects of public resource management (1995–2001),⁴⁰ and developing sector management capacities (1993–2001),⁴¹ including an early attempt at injecting market-oriented management skills in industry (1993).

49. **Definitions.** The concept of capacity building evolved to broaden the focus from individuals (training and competence building) to institutions and their interdependencies, as experience showed that training was insufficient to change institutions and manage development processes. An understanding of this more comprehensive definition was reflected in ADB staff instructions.⁴² However, in the operational program, capacity building and institutional development were equated with training and provision of consultants. This simplistic definition (common among stakeholders) results in an input-driven approach to design and implementation rather than one that is focused on the type of institutions that should exist, once projects are completed.

50. **Missing Agenda.** The absence of strategic guidance, combined with an operational definition that was input-focused, had implications for selecting, sequencing, and designing projects. Assistance for public resource management was not based on an understanding of the process as a whole and the role of each agency in it, missing the opportunity to contribute to defining roles and eliminating overlapping responsibilities.⁴³ Initiatives assisted different aspects of the process without building on potential synergy effects or assessing whether areas selected for assistance focused on core deficiencies in the process. This disconnected evolution of assistance was surprising: economic work identified weaknesses in fiscal discipline from 1993 onward and could have—together with thematic work on fiscal systems (undertaken in 1995)⁴⁴ and staff instructions of the same year (footnote 42) that gave impetus to capacity building in a broader sense—led to a structured program of assistance. Reasons for not linking country-level work with operations are not documented, although public resource management might have been considered the domain of other agencies such as IMF (macroeconomic stability and fiscal policies) or the Organisation for Economic Co-operation and Development (taxation).

51. **Discontinuity.** In Mongolia, institutions underwent a string of swift changes, while at the same time having to manage the transformation of the economy. This situation created testing circumstances for institutions and staff, and a challenging environment for capacity-building assistance. It appears that the frequent and radical shift in institutional responsibilities was not anticipated, although in hindsight it seems a natural part of redefining the role of the state and

⁴⁰ Assistance ranged from revenue generation (taxation system), strategic planning and budgeting, to managing and administering the use of funds (resources for welfare and procurement regulations). A total of 14 TAs (approved in 1994–2001 for \$7 million), and Loan 1713-MON (SF): *Governance Reform Program*, for \$25 million, approved on 2 December 1999,) were provided for this purpose.

⁴¹ Loans across all sectors (agriculture, energy, industry, social sectors, and transport) included objectives for building capacities for sector management, sometimes financed from loan proceeds or through associated TAs. Institutional goals were pursued through policy dialogue and policy conditions, and provision of consulting services and training. A total of \$10.8 million was provided for TAs. Loan proceeds are not always clearly earmarked for capacity building (e.g., consulting services may include capacity building among other duties), but might have amounted to \$48.6 million over the past decade.

⁴² ADB. 1995. *Governance: Sound Development Management*. Manila. “Capacity building activities and assistance for legal reform are expected to become the central pieces in the Bank’s efforts to help improve governance in DMCs. The focus in respect of capacity building should be on sector-level and national institutions in DMCs, aiming to enhance the effectiveness of public administration and development management. Where appropriate, it should also cover institutional development of the local/provincial agencies and the private sector.” (para. 10)

⁴³ A number of agencies handle various government social support programs. An institutional review and process analysis would indicate potential for efficiency gains, shortening the process, or opportunities to shrink the government machinery.

⁴⁴ ADB. 1995. *Mongolia’s Fiscal System in Transition*. Manila.

institutions.⁴⁵ If the almost inevitably disruptive nature of the institutional formation process had been recognized at the time, opportunities might have been seized to support that formation process (through dialogue about roles, responsibilities, allocation of powers, and checks and balances) rather than training staff of still-forming institutions.

52. Insufficiency of Tools. Principals and deans of secondary schools, who attended training courses provided under ADB's Education Sector Development Project (footnote 28), enthusiastically embraced new management techniques. They had a full grasp of concepts and had applied them, but reported that the main difference from previous plans was greater ownership rather than changes in content or managerial decisions, which were constrained by inflexible budgets and unavoidable costs. By contrast, the output-based budgeting system introduced under the Governance Reform Program (GRP) (footnote 40) faced different problems: support was not unanimous while a distorted incentive system and a focus on learning a sophisticated technique diverted attention from the key issue, namely that of attaining budget discipline while increasing efficiency and improving management.⁴⁶

53. Absent Monitoring Functions. Neither area (public resource management and sector management) considered monitoring and evaluation an integral part of good management practices. The effectiveness of output-based or results-oriented budgeting, envisaged under the GRP, depends on capacities to analyze actual outcomes and assess whether public resources were efficiently and effectively spent. Under the GRP, reports are submitted to Parliament or relevant standing committees, but these are geared toward reporting on implementation rather than outcome. Sector management equally requires monitoring capacities to assess how the sector and economic actors respond to policy measures. In both domains, it appears that ADB either trusted that the existing monitoring and evaluation units were equipped to fulfill their role, and thus did not require capacity-building assistance, or did not recognize the importance of monitoring.

3. Initial Outcomes

54. Public Resource Management. On the revenue side, support was limited to setting up a training institution for tax inspectors and collectors, which is operational and provides regular courses. While counterparts expressed disappointment that assistance had not extended beyond the first TA,⁴⁷ the training institute benefited from allocations made under the GRP and used these to procure computers, television sets, and other equipment. A survey of tax

⁴⁵ Efforts to build strategic planning and aid coordination capacities were lost as the responsibility shifted from the National Planning Board (nonexistent today), to the Ministry of Foreign Affairs, and to the Ministry of Finance and Economy, now the new partner for aid coordination assistance from ADB and others. Similarly, the Industrial Sector Program aimed to establish a unit for small and medium enterprises, which was discontinued when the ministry was merged with that of agriculture in the mid 1990s, and is now being restarted.

⁴⁶ Counterparts (managerial and working levels) had a general understanding that fiscal discipline was necessary and desirable and that output-based budgeting could help increase efficiency and control public expenditure. However, core agencies participating in the pilot phase believed that being part of the GRP should entitle them to higher budget allocations. Submissions for medium-term budget forecasts were double their previous budget, and disappointment was expressed when old allocations were maintained in spite of efforts that had been put into preparing output-based budgets. Staff in charge of preparing output-based budgets (in addition to the traditional budget submissions) was given the impression that savings would be used to pay staff incentives, thus there would be no savings to the government budget as a whole.

⁴⁷ TA 2606-MON: *Strengthening of the Taxation System*, for \$100,000, approved on 9 July 1996.

inspectors⁴⁸ generated positive feedback on the results of training. However, these results at the micro-level (staff competence) cannot be corroborated at an institutional level for the lack of benchmarks of institutional performance indicators related to TA objectives, such as staffing levels (inspector to taxpayer ratio), percentage of tax evasion, or time required to settle tax disputes. As part of the more recent GRP, the tax authority introduced business planning, performance contracts, and other management methods associated with output-based budgeting, which are expected to result in improvements in institutional performance.⁴⁹ Further assistance for training of tax inspectors is planned under Japanese bilateral aid.

55. On the planning and budgeting side, early efforts to build strategic planning capacities are hard to trace after the dismantling of the National Development Board (footnote 45).⁵⁰ Initiatives of the GRP and associated TAs to introduce medium-term budget frameworks, public investment plans, and output-based budgeting tools are too recent to evaluate outcomes.

56. TA for the reform of the social insurance administration⁵¹ set up a nationwide computerized system and trained staff. The system is still in operation, although software will be updated to increase its user-friendliness and versatility in applications.⁵² To measure the extent to which this system increased efficiency in fund administration and data reliability would have required information about institutional performance: number of transactions handled per staff (before and after the project), staffing levels, number/percentage of incorrect payments (amounts, doubles, or omissions), etc. Without baseline data, an accurate assessment is not possible, but the system appears well administered. However, an opportunity for streamlining institutions involved in administering public resources was missed by the narrow focus of assistance on a few selected social funds.

57. Assistance to improve procurement practices was conceived more in the context of project implementation requirements rather than as part of public resource management. That “procurement is central to public expenditure management” is recognized only now,⁵³ and that possibly still not as an integral part of operations. ADB provided two TAs to introduce procurement principles in 1991 and 1992,⁵⁴ and organized three procurement seminars in more recent years (para. 123). In addition, loans in infrastructure sectors provided the services of consultants to ensure that the basic principles of international procurement practices were

⁴⁸ A survey of 50 inspectors from five aimags and Ulaanbaatar showed that 70% of respondents applied what they had learned in their daily work, 90% of the total stating that training had introduced new working methods. The theoretical part of courses was found relevant to their work by more than 75% of respondents, while 65% found practical examples, which constituted 40% of course time, helpful. Efficiency gains were reported by 55% of respondents, either stating that they were achieving more in the same number of working hours or producing the same in less time.

⁴⁹ The reported increase in total amount of tax collected may result from improved performance of inspectors, but it may also be due to higher tax rates and therefore is, in itself, not a reliable indicator for measuring institutional performance.

⁵⁰ TA 2069-MON: *Strengthening State Strategic Planning and Coordination in the National Development Board*, for \$562 million, approved on 14 March 1994.

⁵¹ TA 2371-MON: *Administrative Reform of Social Insurance*, for \$900,000, approved on 28 July 1995. Assistance was also provided to the National Poverty Alleviation Program. However, ADB’s involvement was minor in comparison to that of UNDP and the World Bank.

⁵² Under Loan 1836/1837-MON(SF): *Social Security Sector Development Program*, for \$12 million, approved on 28 August 2001.

⁵³ ADB. 2002. *The Governance Brief*. Issue 3. Manila.

⁵⁴ TA 1585-MON: *Institutional Support for Procurement and Disbursement*, for \$248,000, approved on 29 October 1991, and TA 1703-MON: *Seminar on Bank Operational Policies and Procedures*, for \$40,000, approved on 25 May 1992.

followed. More recently, TA was provided to help draft procurement laws and set up a procurement monitoring office, which is expected to contribute to anticorruption efforts.⁵⁵

58. **Sector Management.** The new role of line ministries required them to fulfill functions of strategic planning, policy making, regulating and setting standards, monitoring compliance, and improving the efficiency and quality of public service delivery. The cross-sector variation of ADB assistance meant that not all of these functions were addressed systematically.

59. Strategic planning was part of a number of the early infrastructure projects, which required preparation of corporate plans for line ministries and agencies. Consultants prepared these plans, which now are updated by ministry staff, who stated that if a new corporate plan were required, additional assistance would be needed. In addition, it was anticipated that the preparation of master plans could also serve capacity building in strategic planning. The concept implies that long years of experience of consultants could be transferred during a relatively short period of time, during which the primary task is to produce a master plan. This assumption has not proven correct,⁵⁶ in Mongolia and elsewhere.

60. In civil aviation, staff training together with investments in equipment resulted in increased overflights, while investments in the road sector resulted in increased traffic (para. 92). Output and reliability in the energy sector improved (para. 89), although efforts to build capacities for financial management still need to bear fruit. Urban services, such as water supply and sanitation, in five aimags improved. Individually, each of these initiatives produced positive results. However, the extent to which they contributed to improving sector management capacities as a whole remains to be seen, as they were not comprehensive enough and did not have a clear link to performance indicators for the sector. In the social sectors, capacity building for service improvement was broader and involved nationwide training programs as well as setting up accreditation and licensing boards, which aimed to ensure that quality standards in the profession were met.⁵⁷ First indications are that performance indicators for these sectors are improving, albeit at a cost (para. 71).

B. Reforming Policies

61. Since the mid-1980s, the Government had “reduced the role of central planning in resource allocation.”⁵⁸ However, in 1991 the economy was in crisis, requiring short-term responses to immediate problems. Defining policies with medium- or long-term horizons was virtually impossible in the circumstances. Reforms were required across all domains of the economy, and more importantly management capacities were needed to determine correct policy responses to the reactions of the market. Soaring inflation, dwindling reserves, budgetary imbalances, and the need to establish a convertible currency required macroeconomic policy reforms. In the financial sector, policies were needed to regulate financial intermediation (section III.D). Transferring responsibilities in the productive sectors (agriculture and industry) from the public to the private sector required a policy framework that regulated private ownership, deregulated prices and trade, and created competitive markets and space for private

⁵⁵ TA 3628-MON: *Establishment of a Central Procurement Monitoring Office*, for \$600,000, approved on 2 February 2001.

⁵⁶ ADB. 1999. *Technical Assistance Performance Audit Report on Advisory and Operational Technical Assistance Grants to the Energy Sector in Mongolia*. Manila.

⁵⁷ While these institutions are relevant and a logical response to the need to improve quality, they are not able to overcome a tendency to pass students regardless of their test results. This problem is pervasive in the entire education system and, being informal by nature, bypasses formal quality control channels.

⁵⁸ ADB. 1992. *Mongolia. A Centrally Planned Economy in Transition*. Manila.

enterprises and households to save, plan, and invest on the basis of market signals (section III.C).

62. In Mongolia, policies tend to be codified in the form of laws with the consequence that the former need to be written to meet requirements of legislation and need to pass through the formal process of adoption of laws.⁵⁹ In the early 1990s, the pool of staff with experience in drafting laws was limited,⁶⁰ and those with experience in market-oriented regulation were even fewer. Property rights, commercial laws, and the like were new concepts that needed grasping. Today, a multitiered system for adopting laws, and thus policies, is in place.⁶¹ The preference to reflect policy reforms in laws, rather than strategies or guidelines issued by ministries, provides for greater involvement of democratic institutions in the process (subjecting policies to greater scrutiny, debate, and political consensus building), albeit it is a lengthier and less flexible process.

1. Strategic Directions

63. The 1991 interim COS was limited to providing general principles for policy reforms, such as supporting a coherent set of policies in areas such as pricing, institution building, and privatization in each sector, and called for policy prescriptions to be interwoven with macroeconomic policies. The 1994 COS reviewed progress made since 1991, assessed macroeconomic performance and transition costs, and discussed medium-term stabilization and structural reform challenges. Policy reform goals and objectives for each sector were identified and details were provided for each sector on starting points and principal policy constraints. While the 1994 COS was far more detailed in its description of policy constraints and sector requirements, it provided little evidence that the recommended policy reforms had been based on an assessment of their feasibility, desirability, or appropriate sequencing of events.⁶²

64. The 2000 COS contained a more candid and nuanced discussion of policy change and constraints, and provided a fairly comprehensive description of ADB's policy reform program in each sector. It also highlighted weaknesses in government capacity for managing policy reform, and suggested ADB provide assistance for building capacities in this area. However, it provided little in terms of strategic guidance, as the content of policy reforms was based almost entirely on what had already been agreed in projects and programs developed in the previous years. A holistic perspective of how sector policies would jointly assist in transition was not given. New policy challenges emerging from the progression from a transition to a development agenda were not analyzed—although the COS noted that transition was complete—nor were targets specified for policy reforms, nor lessons from the transition experience in Mongolia or other countries presented.

⁵⁹ Externally funded assistance programs are also accorded the legal status of treaties, subjecting them to parliamentary scrutiny and approval.

⁶⁰ ADB. 1995. *Developing Mongolia's Legal Framework: A Needs Analysis*. Manila.

⁶¹ The need for a policy is identified (within ministries or by concerned groups), investigated and analyzed; this leads to the preparation of a draft policy/law. Drafts are screened by the Cabinet and then go through several hearings of Parliament. After adoption, the implications of the law need to be worked into the budget, and policies become enforced and communicated to the public.

⁶² This approach may have been driven by a desire to harmonize ADB-supported sector reforms with those advocated by IMF for the economy as a whole (i.e., privatization, liberalization, subsidy removal, and fiscal consolidation). Indeed, the main policy reform message of the 1994 COS can be interpreted as "follow the standard policy prescriptions" rather than assess carefully what policy reforms would be most appropriate in the evolving Mongolian context.

2. Operational Realities

65. Similar to capacity-building assistance, the broad-based approach meant that policy reforms were integrated in projects across all sectors (para. 48). The emphasis on policy reforms also resulted in a relatively high proportion of policy-based lending in the overall portfolio (para. 36). Despite the absence of explicit strategic guidance, sector policies showed a high degree of consistency. Viewed individually, the list of policy reforms pursued in each sector includes a large number of reform measures. However, in aggregate, policy reforms can be summarized as supporting three fundamental areas of transition: establishing a policy and legal framework for private ownership, adopting policies for a competitive environment, and consolidating the public sector and redefining the role of government agencies.

66. **Private Ownership.** Ownership of productive assets is one of the key characteristics distinguishing a state-planned from a market-oriented economy. In Mongolia, as much as in other transition economies, privatization of state assets was the main focus of transition, particularly in the early years. ADB supported the Government's privatization plans by setting numerical targets for the number of enterprises or farms to be privatized, aiming to facilitate the momentum of reducing the Government's role in the productive sectors.⁶³ While numerical targets were met, more important industries remained in state hands, the Government continued providing directed credit to a number of enterprises, and management approaches did not change simply with the change of ownership patterns.⁶⁴

67. The objective of the first Agriculture Sector Program (ASP1)⁶⁵ of promoting markets in land use rights has been achieved with the exception of pastureland. With the passing of the revised Land Law in 2002, long-term lease of cropland is now transferable and can legally be used as collateral. As for pastureland, current efforts are directed at formulating long-term lease instruments to be issued to herder groups to encourage proper management of pasturelands.

68. In the social sectors, policy recommendations were made to introduce private sector involvement in service delivery. Policy reforms focused on creating both the necessary legal and regulatory framework, and the guidelines and standards to regulate private provision of services. The policy framework and other conditions were conducive to setting up private tertiary schools and private practices, albeit with a concentration in Ulaanbaatar. However, policies for privatizing hospitals, particularly at the sum level, met with resistance.

69. **Competition.**⁶⁶ The Government had already moved aggressively on removing trade and price controls before assistance was provided. ADB supported the Government's program to liberalize trade and prices and to remove subsidies. Trade barriers were perceived to aggravate Mongolia's remoteness. Their removal was pursued through ADB's Special Assistance Project (footnote 30) and the Industrial Sector Program (ISP),⁶⁷ which aimed at

⁶³ This approach did not necessarily convey fundamental concepts such as improved management and operations and reduced government support to productive sectors.

⁶⁴ A different approach was chosen for Loan 1364-MON(SF): *Roads Development Project*, for \$25 million, approved on 22 August 1995. Construction and maintenance workshops of MID were commercialized first, providing assistance to develop corporate planning, accounting, human resource management, and performance contracting practices. However, while the foundation was laid for privatization, the Government changed its policy and privatization was delayed and will affect only some of the workshops.

⁶⁵ Loan 1409-MON(SF): *Agriculture Sector Program*, for \$35 million, approved on 5 December 1995.

⁶⁶ Creating a competitive environment is an essential counterpart to private ownership, as otherwise private entities might operate as inefficiently as public enterprises, or may not be able to compete with public enterprise if these operate under preferential conditions.

⁶⁷ Loan 1244-MON(SF): *Industrial Sector Program*, for \$30 million, approved on 17 August 1993.

removing the state order system and controls on foreign trade licenses, exports licensing and registration systems, and export prices, and resulted in shifting trade patterns (para. 8). Assistance for deregulating prices started in 1991 under the same two loans and was also included in ASP1. These three loans covered all goods, inputs and outputs of the industry sector, petroleum products, and basic food products such as meat, flour, and flour products. Policies aimed to allow markets to influence prices. However, the unfulfilled expectation that macroeconomic conditions (inflation and exchange rates) would stabilize meant that consumers and enterprises were exposed to vast price escalations.

70. Tariffs for utilities, fees for services, and interest on credit were to be revised to reflect market rates, improve the potential for generating returns on investment (and thus making investments more attractive to the private sector), and enhance the revenue base of service providers. Policy reforms were included in assistance to the civil aviation authority (overflight charges, para. 92) and to sectors such as energy (tariffs), roads (diesel and gasoline taxes, road fund), agriculture (fees for veterinary services), and education (textbooks). Policy reforms were intended to increase cost recovery linked to service provision, assuming sufficient autonomy for tariff setting and accountability vis-à-vis customers of service providers. In reality, revenue generated was captured by the central Government and added to general revenues. Augmenting resources in this way is understandable in times of financial duress. However, the essential link between cost recovery for services provided and inherent obligations to deliver quality standards was lost, or in some cases service delivery was lost altogether.

71. **Public Sector Consolidation.** Resource constraints resulting from the withdrawal of support of the FSU (para. 3) necessitated consolidating the public sector to make it affordable and cost effective. Cost recovery was introduced in some sectors (para. 70), while assistance to the two social sectors involved downsizing (education) and developing alternative service delivery approaches (health). Both sectors accounted for one third of government spending, and thus were targeted for consolidation early on (footnote 20). In the education sector, this meant barring the construction of new school buildings and rationalizing staff. Measures to reduce staff were effective for the 3-year period for which retrenchment was designed. However, this policy measure was introduced during a period of high dropout rates. Since then, enrollment rates have increased, necessitating reemployment of previously redundant teachers. In the health sector, service providers were moved closer to patients, i.e., out of hospitals with higher overheads and other charges. A capitation fee introduced the concept of paying for services provided to patients rather than one based on occupied hospital beds,⁶⁸ thus having the potential to reduce costs of health care. The referral system requires patients to pay hospital costs (equivalent of \$50) if they request services without referral; this promises greater efficiency in care provision.

72. **Social Protection.** The change in economic system went hand-in-hand with the collapse or privatization of SOEs with the consequence that employment and associated benefits (e.g., company housing) could not be guaranteed. Rising unemployment and costs of living required the development of a new social security system. ADB's support initially focused on the Government's antipoverty policies and program and included policy recommendations to raise minimum pensions and to allocate resources to a support fund for low-income groups. In other sectors, ADB recommended that the Government adopt policies to better target the poor for provision of services while rationalizing the system. The most recent project in this area (footnote 52) requires the Government to prepare a comprehensive social security policy that

⁶⁸ For hospitals, budget allocations are still provided based on the number and duration of occupied hospital beds, which creates an incentive to provide in-hospital care even when not needed.

includes social insurance and social assistance measures. Over the past decade, government policies have required the private sector to contribute significantly to social insurance, which now adds 29% to the cost of hiring labor. This burden on the wage bill has adverse effects on employment creation (through domestic and foreign investments) and reflects difficulties in trying to combine the Government's diverse policy objectives of ensuring universal coverage of social services while trying to encourage private sector growth.

73. **Stakeholder Participation.** In many cases, policy dialogue in preparation for policy reform took place over an extended period. The small size of the Government and openness made key policymakers, among them the "champions of reform", accessible to ADB teams. However, the general commitment to change was not necessarily based on a good understanding of reform implications, as policymakers were not familiar with market principles and were thus limited in their ability to assess policy content. The lack of translations of key documents into Mongolian further inhibited the extent to which government officials could familiarize themselves with policy reform requirements. In retrospect, some policymakers expressed concern over committing to policies that were not fully understood at the time. In addition, policy dialogue involved only central-level government, and excluded subnational government, NGOs, and other stakeholders from the process, sometimes leading to misinformation and disagreements over policy directions.

74. **Policy-making Capacities.** To support the policy-making process, assistance was provided to NSO to improve accuracy and credibility of statistical data.⁶⁹ Problems arose from the conversion from the old system to an internationally accepted one and from the large informal and migratory sector. In the eyes of policymakers, the quality of statistical data is improving, although data quality and timeliness are perennial concerns. Capacities for policy formulation are relatively weak across sectors, with some exceptions. This is partly due to ADB assistance tending to focus on preparing draft policies with capacity-building outcomes as an aside. High staff turnover, frequent reorganizations, and occupying ministries with project implementation responsibilities have made it difficult to develop requisite policy-making capacities. This situation affects the extent to which ministries can fulfill their changed role of policy making and regulating.

75. **Policy Analysis.** Policy recommendations were based on analyses of sector constraints and of strengths and weaknesses of existing policies. A fairly thorough analysis was undertaken in most sectors, although without analyzing different policy options or institutional or financial implementation capacities. Questions that remained unanswered included whether policy choices were affordable and the kind and level of public services/goods expected from the Government. Much trust was vested in the assumption that the correct policy framework would be sufficient to foster private sector development, an assumption that did not materialize (para. 80).

76. **Adjustment Costs.** A public expenditure review conducted in 2002 by the World Bank would have been needed earlier to assess resource allocation and monitor the impact of policy

⁶⁹ Statistical procedures have evolved over the period, making an exact comparison between recent and 1990 statistics difficult. NSO moved to reporting GDP according to the International Standards for Industrial Classification in 1995, which affects comparison of post-1995 and pre-1995 data. In 1999, NSO for the first time included a survey-based estimation of informal sector activity in national GDP statistics, rather than a return of trading licenses issued by local authorities, as had been the case previously. Other data show inconsistencies across different sources so that the trends indicated in this report are only indicative. ADB, Eurostat, IMF, Technical Assistance for the Commonwealth of Independent States from the European Union, United Nations and several of its agencies, the World Bank, and other donors provided assistance to NSO.

change and injections of capital (via program loans). Instead, sector analyses provided information for decisions at sector level without capturing the aggregate picture. In the education sector, a clear link was established between staff redundancies and adjustment costs. However, the actual retrenchment costs were 40% less than the amount budgeted, while retrenchment conditions were far more generous than in other sectors.⁷⁰ In the health sector, funds were used for start-up costs for family group practices and the social security loan (footnote 52) was partly used to cover arrears to the social insurance fund. Funds from ASP1 and ISP aimed at augmenting funding for sector development in general. However, public expenditure in these two sectors dropped during the program implementation period. It appears that, in reality, policy-based lending was used for general budget support and that ADB funds complemented stabilization funds provided by IMF.

77. **Reform Implementation.** Policy reforms have been implemented with few exceptions.⁷¹ Some of the conditions (preparation of action plans, etc.) were supported with ADB TA without which requisite plans might not have been prepared. Other loan conditions were “front-loaded” prerequisites for loan approval, while second tranche conditions were generally designed so that they could be met easily within the given implementation schedule. Monitoring of policy reforms was largely related to meeting tranche conditions. Ministerial monitoring and evaluation units tended to observe sector performance trends, however, without linking sector performance data with policy reforms or project performance. Such linkage would be needed to assess the impact of policy reforms and inform decision makers of necessary policy changes. Instead, policy adjustments were made in the context of follow-up loans, such as a reversal of policies on veterinary services, which first were to be privatized without external support, while later it was recognized that assistance was required.

3. Initial Outcomes

78. **Efficiency Gains.** Consolidating public expenditure was expected to result in greater efficiency of the public sector. Goals to downsize the education sector had to be reversed and the improvements in the health sector, while promising some savings, do not address large budget allocations to tertiary care. Outcomes of output-based budgeting introduced under the GRP remain to be seen; first indications are that pilot agencies doubled their budget projections rather than streamlining them.

79. **New Role.** Policy reforms contributed to the change in the role of government, which has become divested from large parts of the productive sectors (para. 9). However, the policy-making role of ministries has been hampered by inadequate support to building policy-making capacities (para. 73) and their continuing role in project implementation and supervision. Regulatory agencies have been set up for licensing, quality control, accreditation, and for tariff setting in agriculture, education, energy, health, road, social insurance, and telecommunications as well as for land leases. The regulatory agencies are operational: they have issued licenses for private operators in each of these sectors, are recovering some of the operational costs, and have started setting up information systems to underpin sector planning and management.

⁷⁰ Personnel received up to 3 years of redundancy payments, while in the rest of the public sector the amount is limited to 3 months.

⁷¹ The only areas in which reforms were implemented partly or reversed were export policies for cashmere (to protect local industries), energy tariffs (for political reasons), emergency fodder supplies and subsidized credits for the farming sector (to counter detrimental impacts of climatic disasters). ADB and the World Bank adopted a common position on the Government's export ban on cashmere, which as a result was converted into an export tax. The World Bank's Country Assistance Evaluation noted that a more considerate approach would have analyzed whether the Government's concerns over unfair trade conditions were justified, and recommended appropriate policy responses.

However, they have commonly suffered from staff and funding shortages, limited regulatory independence, and a lack of agreed and well-understood procedures. A transition in mindset in terms of responses to rules before 1991 and now, has still to be accomplished.

80. **Policy Framework for Private Sector Development.** ADB assistance contributed to the privatization efforts of the Government.⁷² However, in areas where a gradual strategy was pursued, privatization has been minimal, although the policy framework allowed new private entrants into the sectors (road construction, higher education, and tertiary health care) and created competition for public providers. The abolition of the state order system and deregulation of trade and prices created an environment that allowed fair competition and thus should be conducive to new entrants to the private sector. However, impediments arose from a number of assumptions inherent in the policy reform process. ASP1 and ISP assumed that private enterprises could turn to a functioning banking sector for credit. However, as shown in section III.D, the financial system remained in distress for most of the 1990s. The passage of commercial laws was assumed to be implemented and thus to provide the legal and regulatory framework for private sector development. However, judicial reforms took longer than expected, partly hindered by conflicting legislation, extensive licensing requirements, varying interpretations of regulations, and weaknesses in accounting and corporate governance—all of which make law enforcement difficult. Policy prescriptions for taxation and social security shifted economic growth to the informal sector (para. 10), depriving the Government of revenues and contributions to the social security system, but also affecting the structure and potential growth of the private sector.

81. **Productive Sectors.** The livestock and cashmere sectors performed well over the past decade;⁷³ much of this performance can be attributed to policy changes. The Government's privatization policy (para. 66) led to increasing herd sizes, and trade and price policies pursued in ASP1 (para. 69) resulted in a switch in herd composition in response to increases in cashmere prices. However, the discontinuation of state fodder reserves under ASP1 has been held responsible for the loss of animals over the past two winters. Crop production fell by 77% in 1991–2000, largely due to policies pursued under ASP1, but this decline may have signaled a rational allocation of resources in the economy. On the positive side, liberalization opened up opportunities for small-scale, independent vegetable producers.⁷⁴

C. Reorienting and Diversifying the Economy

82. Until 1990, the centrally planned economy operated with minimal, if any, private economic activities. Prices and production were centrally determined and there were large producer and consumer subsidies. Concepts of private sector operations, public goods, and the facilitating role of government needed redefining. While universal education was common, the education system was geared toward a state-planned system and offered no understanding of the market economy or commercial principles. The performance of the real sector over the past

⁷² The World Bank's role focused on macroeconomic stability, diagnostics and advisory services on the investment climate, and assisting in the implementation of the investment promotion strategy, including organizing investment promotion forums. Legal and judicial reforms were supported by ADB, the World Bank, and others.

⁷³ Total animal numbers increased by 17% between 1990 and 2000 (followed by a more than 20% drop because of the last two harsh winters), meat production increased by 24%, and cashmere production increased by a substantial 119%.

⁷⁴ Vegetable production does not require large capital investment at an early stage (labor being the principal input) and therefore returns to capital are reported to be strong. Moreover, upstream and downstream dependencies are limited, producers being able to secure supplies of seed and fertilizer from the PRC and to sell directly in local markets or through a single intermediary. However, local demand is still limited.

decade is summarized in paras. 6–11; the following paragraphs discuss ADB’s contribution to observed trends.

1. Strategic Directions

83. Economic reorientation was an explicit objective of ADB’s COSs. Throughout the period 1991–2001, the importance of private sector-led growth was emphasized. The 1991 COS proposed addressing “outdated technology, poor maintenance of equipment and shortages of skilled manpower.” Changing ownership patterns (privatization) and expanding the range of trading partners were also emphasized in line with the Government’s strategy. It appears that, at least initially, private sector development was equated with privatization, and an implicit hands-off approach was taken. The 2000 COS suggested a combination of microcredit and training to foster private sector development, obviously focusing on small enterprises. An ADB strategy was not articulated that would have described the interplay of policies, institutions, infrastructure, finance, and human resources needed for the private sector to thrive. The absence of such a framework arguably contributed to the perception among authors of the 2000 COS that investments in infrastructure were irreconcilable with poverty reduction goals. This led to an exclusion of infrastructure projects, with the exception of road construction, from the current portfolio.

2. Operational Realities

84. **Choice of Sectors.** The linkages between economic reorientation and project selection were often not explicit or obvious. The failure to elaborate the process of economic reorientation left the choice of projects to be determined by government priorities, both political and economic (para. 30). While no program as such was formulated to address reorientation questions, the CAPE assessed the role of investments in infrastructure, productive, and social sectors for their contributions.

85. **Project Design.** The ISP anticipated that “competition will encourage a general restructuring of the economy and is expected to lead to reduced concentration and the emergence of small and medium enterprises,” without assessing whether other parameters, such as infrastructure and human resources, were in place to enable enterprise development. As the PPAR for the ISP noted, “future program loans need to be based on the premise that though policy reforms are necessary, they are not sufficient on their own to make the industry sector efficient or competitive.”⁷⁵ This statement implies that the ISP should have gone deeper into the issues of privatization, industrial restructuring and corporate governance to assist in the structural transition process. It was also expected that “restraints on [resource] mobility will be removed and market signals will provide incentives for ... labor and capital to relocate,” but no analysis or provisions were made to address sufficiently the implications of such resource mobility, namely the collapse of a significant number of companies. In the agriculture sector, ASP2⁷⁶ complemented the earlier reliance on policy reforms under ASP1 by investments in infrastructure, and support to extension and veterinary services needed for the functioning of the sector.

86. In the case of the infrastructure program, much of the investment logic in terms of facilitating private sector development was hidden behind the technical requirements of the sector being assisted. In most projects, mention was made of the investment being “a catalyst

⁷⁵ ADB. 2000. *Project Performance Audit Report for the Industrial Sector Program*. Manila.

⁷⁶ Loan 1821/1822-MON(SF): *Agriculture Sector Development Program*, for \$17 million, approved on 21 December 2000.

for economic growth” or removing the “increasing power constraint to economic development”, even though attention soon focused on technical issues of physical infrastructure and technicalities of unbundling the industries rather than on expected impacts on private sector development and employment creation (poverty reduction). This may have led to a misunderstanding of the role of infrastructure rehabilitation in economic reorientation and an undervaluing of such investments.

87. **Onlending Agreements.** In all cases when the executing agency (EA) has been a commercial entity, albeit state owned, responsibilities for loan repayment have been passed on. Initially, onlending agreements were inadequately structured, but have been drafted more tightly since the mid-1990s. More importantly, EAs do not have the commercial freedom to set tariffs at levels that ensure repayment capacities. This is particularly the case with the Energy Authority and the commercial entities that were formed from the Energy Authority in 2001. The Government controls energy prices, and although the 1997 increases put the Energy Authority in a profitable position for a short time, inflation has now eroded their value. As a result, the new commercial entities are placed in a position where, at present, they cannot realistically repay the monies due to the Government, affecting its debt servicing capacity.

3. Initial Outcomes

88. **Education.** ADB’s Education Sector Development Program (footnote 28) required the Government to prepare a policy for technical and vocational education, which the education sector strategy did to some extent.⁷⁷ The strategy pointed to the need for the “systematic study of the current situation and projections of future needs [of the private sector labor market] in order to be able to tailor the [technical and vocational education] system to the jobs of the future.” At the same time, ADB was cautious about engaging in technical and vocational education, as it is an expensive form of training where returns materialize only if the private productive sector is sufficiently involved in the provision of training and guarantees the absorption of trainees.

89. **Energy.** The initial reasons for investments in the energy sector were to keep generating plants operating, to maintain service provision, and to prevent the heating system from collapsing. Physical infrastructure was in poor condition, using outdated technology, and complex to rehabilitate. After 10 years of assistance, the system as a whole has improved: the number of blackouts was reduced from 214 in 1992 to 16 in 2001. The total number of megawatt-hours lost fell from over 60,000 in 1992 (worth \$10 million in lost revenue, if the 2002 retail value were applied) to 3,368 in 2001. The increased system reliability also led to a reduction of energy imports from the Russian Federation, saving \$8.2 million annually in 2002 retail values. However, these system-wide improvements cannot be attributed only to ADB, which financed about one quarter of total assistance provided to the sector.⁷⁸ The ADB-funded rehabilitation of power plant no. 3 contributed to the increase in its gross power output by 73% between 1994, the year the loan was approved, and 2001. During the same period, fuel consumption per kilowatt-hour of power generated declined by 9%, leading to both financial and environmental gains. Total generating costs have recently declined to give a MNT10 per kilowatt-hour margin to the plant. The significance of this improved financial performance, made possible through technical improvements, lies in the fact that individual generating companies will in the future compete to supply electricity and heat to independently owned and operated

⁷⁷ The strategy was prepared with ADB TA approved in 1999.

⁷⁸ Other donors included Germany, Japan, Republic of Korea, United States, and the World Bank. The World Bank’s early contributions focused on the coal sector, which according to its Country Assistance Evaluation (2002) (footnote 120) was too narrowly focused on a small set of problems without resolving sector performance issues.

transmission and distribution networks. These infrastructure improvements laid the foundation for structural reforms such as unbundling, commercialization, and eventual privatization.

90. **Productive Sectors.** Impacts on the productive sectors (agriculture and industry) were largely due to policy reforms (para. 81).

91. **Telecommunications.** Rapid progress has been made in this sector. Structural reform, although not yet complete, enabled the separation of telecommunications operations from loss-incurring postal services, enabled the separation of the regulatory function from operations, and was instrumental in attracting foreign investment.⁷⁹ Private involvement in the sector is significant and growing, including further potential for privatizing state-owned infrastructure over the 2002–2005 period and preparing the sale of more government shares in 2003.⁸⁰ The ADB-financed installation of new exchange lines, external lines, and digital links⁸¹ meant that the volume of traffic that Mongolian Telecom could handle, and the speed at which it could handle it, grew enormously. In the three target cities of Ulaanbaatar, Erdenet, and Darkhan, which account for some 65% of GDP, the numbers of subscribers increased from 41,300 to 73,700 in the 1993–2000 period. Moreover, the number of landline calls made in the five aimags eventually covered by the project grew by a factor of 4.1 over the 1997–2001 period. At project completion, the financial internal rate of return was higher than appraisal estimate, despite higher company tax rates.⁸²

92. **Transport.** In civil aviation, ADB's projects resulted, among other things, in improved safety and air traffic control systems, which in turn led to increased use of Mongolian airspace generating around \$20 million per annum in revenues from overflight rights.⁸³ The projects were also successful in unbundling air traffic regulation from infrastructure provision and airline operations, and for improving commercialization within the sector, paving the way for possible future private investment. ADB has taken the lead in civil aviation reform, and can claim credit for the improvements made during the decade, even though further efforts are required to address shortcomings in domestic aviation services. In road transport, the first project (footnote 64) upgraded the road from Ulaanbaatar via Darkhan to Altanbulag on the border to the Russian Federation, which continues to be a major trading partner of Mongolia. In addition, the project built strategic bridges on the road from Darkhan to Erdenet, where Mongolia's largest copper mine is located. These road works have resulted in traffic volumes growing in the 1997–2001 period by 67% between Ulaanbaatar and Darkhan and by 17% between Darkhan and Altanbulag. The investment generated an economic rate of return of around 15%⁸⁴ and resulted in expansion of economic activities in road-influenced areas. Company formation in the Darkhan-Uul aimag outstrips that in Ulaanbaatar, and Altanbulag has become a free trade zone. Further assistance is under way to establish a link to the PRC border.⁸⁵ While these are positive contributions, their effects are localized and do not remove bottlenecks in the transport system as a whole.

⁷⁹ Korea Telecom took a 40% stake in Mongolian Telecom in 1995, and two private mobile telecommunication joint ventures were established in 1995 and 1999.

⁸⁰ Assets are to be transferred to Mongolian Telecom and the number of government shares increased; a proportion of these shares will then be tendered internationally.

⁸¹ The number of which exceeded the appraisal estimates by up to 160% (digital links), due to lower than budgeted unit costs.

⁸² ADB. 2001. *Project Completion Report on the Telecommunications Project*. Manila.

⁸³ ADB. 2002. *Project Performance Audit Report Ulaanbaatar Airport and National Air Navigation Development Projects*. Manila.

⁸⁴ ADB. 2001. *Project Completion Report on the Roads Development Project*. Manila.

⁸⁵ Loan No. 1700-MON(SF): *Second Roads Development*, for \$25 million, approved on 30 September 1999.

D. Transforming the Financial System

93. In 1990, the foreign trade and commercial finance functions of the former State Bank were transferred to the newly formed Trade and Development Bank and the Investment and Technological Bank. With the passage of the new banking law in 1991, the Bank of Mongolia (the central bank), the Agricultural Bank, and the People's Bank (for consumer savings) were established. In addition to these structural changes, initial regulatory requirements were put in place,⁸⁶ which however provided relatively low entry barriers and thus promoted the chartering of commercial banks in excess of demand for financial services. The supervisory skills of staff at the central bank and the portfolio analysis and loan appraisal abilities of staff at the commercial banks were limited. Monetary instability and the poor performance of SOEs (increasing the ratio of nonperforming loans in total bank portfolios) further exacerbated initial start-up conditions.

94. In 1996, major restructuring of the banking sector took place with the assistance of ADB's first Financial Sector Program (FSP1),⁸⁷ involving the closure of two large but insolvent banks, chartering two new government-owned commercial banks, establishing the Mongolia Asset Recovery Agency (MARA), and changing the financial and regulatory environment. These changes generated positive results: deposits grew, the ratio of nonperforming loans declined, the capital adequacy ratio of the consolidated banking system rose above 12%, liquidity in the system increased, and profitability improved. However, by 1998 the repercussions of the Asian and Russian financial crises on the Mongolian economy showed, affecting the banking sector. Declining profitability and financial distress of major export companies reduced liquidity in the financial system and weakened the system. At the same time, management and governance problems at one of the banks established in 1996 affected the performance of the system as a whole and eventually led to the liquidation of this and another bank. The banking sector started recovering toward the end of 1999. The recovery has been characterized by a steady decline in the reported level of nonperforming loans in both relative and absolute terms, with the capital adequacy ratio for the banking sector rising above 10%.

95. Since mid- to late 2001, there has been strong loan growth throughout the banking sector, and most of that growth has been funded by deposit expansion. These positive trends are encouraging, particularly since much of the growth has been to smaller businesses. Many of the banks reported that they have begun to focus on lending to small businesses (largely traders) and individuals, and that focus has proven to be a profitable decision. Repayments are reportedly high, in excess of 98%.⁸⁸ The improvements in the performance of the sector can be traced to the regulatory enhancements enacted in 1996 that brought about prudential measures more in line with international standards, and probably more importantly, to the maturation of the business environment for both the financial and real sectors. However, the banking sector remains fragile due to the sensitivity of funding sources to real or perceived institutional and systemic problems. Confidence in the banking sector, eroded during earlier banking crises, has not been fully restored. To attract deposits, interest rates have to be high. Lending rates tend to remain excessive due to high credit risk, as the banking sector's trust in the productive sectors was undermined during the economic downturns. A spread of consistently above 20% since end-1997 and liquidity of about 40% illustrate the banks' response to perceived credit risk and lack of sound lending and investment opportunities.

⁸⁶ Key upgrades to prudential standards, including accounting requirements, loan classification and provisioning, and capital adequacy, helped set the stage for a more soundly based banking sector.

⁸⁷ Loan 1509-MON(SF): *Financial Sector Program*, for \$35 million, approved on 17 December 1996.

⁸⁸ The leader in this type of lending has been the Agricultural Bank, which reports that as of May 2002, it has made more than 186,000 individual loans for more than MNT44.6 billion, of which 30,809 were to small businesses for a total amount of MNT30.2 billion.

96. Nonbank financial institutions, in the form of informal moneylenders, set up of their own accord soon after liberalization of the economy, although details are not documented. By now, an estimated 2000 moneylenders exist, largely in Ulaanbaatar and aimag centers, and lend at rates as high as 10–12% per month to those without access to the formal credit system. Savings and credit unions started in 1996 as a spin-off of one of ADB's loans (footnote 24). Other parts of the financial system such as capital markets, insurance, finance, and leasing companies are not yet well developed.

1. Strategic Directions

97. As with private sector development, the need for transforming the financial sector was recognized from 1991 onward. The first two COSs expressed general support to the sector, suggesting the provision of TA and assistance in policy and regulatory reform. The 2000 COS proposed first to deepen financial reforms of the banking sector, followed by a second phase (starting in 2003) of broadening assistance to establish the necessary financial infrastructure beyond the banking sector.⁸⁹ Targeted onlending to small and medium enterprises, rural enterprises, and for housing was presented as part of the 2000 COS (in the section on financial sector strategy). The importance of the financial sector to the transition process, while only mentioned generally in the COS, appears to have been well understood, as ADB took an active role early on to try to build sector capacity.

2. Operational Realities

98. Up to the end of 2001, ADB provided five loans⁹⁰ associated with the financial system and 13 TAs, amounting to a total of \$83.9 million or about 53% of total assistance provided to the financial system by all external aid institutions. TA started as early as 1991, supporting the establishment of the Mongolian Stock Exchange, and continued throughout the decade with a heavier concentration around 1996 when FSP1 was approved. TAs were designed to address specific and relatively narrowly defined issues and responded to crisis situations. FSP1 supported the Government's first systematic effort at restructuring the banking sector (para. 94) and the associated TA loan⁹¹ provided assistance for capacity building.

99. **Major Partner.** ADB was the lead agency in the sector, but the lack of strategy undermined its ability to constructively play this role. TAs and loans did not constitute a set of projects that aimed to address systemic financial sector issues in a methodical fashion. For instance, the importance of creating a sound and comprehensive prudential regulatory framework at the beginning of sector reforms was not recognized. No provisions were made for identifying key issues that required reform, a sequence in which they should be addressed, or a strategy (no ETSW was done for this sector). Instead, developing a sector strategy was left until the preparation of FSP1 and the follow-on program, FSP2,⁹² although without project preparatory TA to undertake a sector diagnostic and to assess priorities and needs. With hindsight, priority should have been given in the early 1990s to revising banking laws and regulations to conform more closely with international standards, increasing the capacity of the central bank to supervise an array of commercial depository institutions, determining lending

⁸⁹ While not specified in the COS, this could include insurance, pension, and finance companies; leasing, savings, and credit unions; and capital markets.

⁹⁰ Lending included two projects in support of the financial sector, and three loans to support social causes (employment generation, rural finance, and housing finance) by increasing access to credit.

⁹¹ Loan 1510-MON(SF): *Upgrading Skills and Systems of Commercial Banks*, for \$3 million, approved on 19 December 1996.

⁹² Loan 1743-MON(SF): *Second Financial Sector Reform Program*, for \$15 million, approved on 22 June 2000.

patterns and interest rates through the market, curtailing lending to loss-incurring SOEs by the state-owned banks, and designing a system to deal with the existing bad debt portfolio.

100. **Overwhelming Agenda.** At the beginning of transition, existing institutions and staff had had no exposure to the requirements of a financial system in a market-oriented economy. The reform agenda was challenging as it encompassed various institutional layers, regulatory and legislative frameworks, and professional standards and skills—to name only a few. At the same time, external conditions were extremely difficult with the economy collapsing and two regional crises affecting Mongolia. These circumstances created a formidable challenge for staff trying to manage transition while learning about the new system. The continuous flow of TA funding provided necessary support to tide over crisis situations, but otherwise was short term in nature and produced volumes of reports that were difficult to absorb under the conditions.⁹³ With hindsight, longer-term hands-on assistance (through long-term consultancy or a structured series of linked TAs) or the permanent presence of ADB would have been helpful to manage the complex transition period. The opening of ADB's resident mission in Ulaanbaatar helped address some of these problems.

101. **Bank Restructuring.** The restructuring of the banking sector was hampered by limited analysis and absence of a well-defined goal for institutional development that would have specified the institutional framework to be created as a result of assistance from ADB and others.⁹⁴ MARA was established, but without being given adequate legal powers, staff, and techniques to allow it to perform its role. Restructuring the banking sector properly included the separation of good and bad assets from their supporting liabilities, but it never fully included an operational restructuring of problem institutions. Nor was there the kind of comprehensive follow-through to ultimate resolution of problem assets that would have put the underlying properties back into private, productive hands. Instead, problem assets tended to stagnate with MARA. A continued focus on problem asset resolution and credit risk management might have brought a swifter and longer-lasting recovery. Instead, the bulk of financing for restructuring came from the issuance of bonds, which have only recently begun to be retired by the budget. This delay has led to increased costs through interest charges and inefficiencies.

102. **Understanding Underlying Issues.** While the 2000 COS recognized that assistance that introduced financial intermediation to other sectors was or should be part of the sector strategy (para. 97), in reality these projects were not developed with an understanding of the overall financial system in mind. The early Employment Generation Project provided credit with the intention that this would stimulate private sector growth and employment creation. Credit was to be channeled through the banking sector, which, however, at the time (early to mid-1990s) was ill suited to deliver credit. Similarly, the recently approved Rural Finance⁹⁵ and Housing Finance⁹⁶ loans were developed to address the symptoms of flagging access to credit, aiming to establish an institutional framework for providing targeted credit to specific groups (and providing resources to these institutions). The level of existing liquidity in the financial system and its sufficiency (or lack thereof) were not assessed or approaches developed to

⁹³ Dealing with crisis situations might have prevented at least some staff from reading detailed reports, which often were not translated into Mongolian. In addition, the technical content would have required greater familiarity with the operations of financial systems in a market-oriented economy, and thus might not have been easily understood.

⁹⁴ The World Bank supported FSP1 with a bank and enterprise sector adjustment credit. However, as noted in the World Bank's evaluation (footnote 120), the lack of agreement between ADB, World Bank, and IMF on a long-term strategy for restructuring the sector, combined with modest resources provided by the World Bank, limited the effectiveness of assistance.

⁹⁵ Loan 1848-MON(SF): *Rural Finance Project*, for \$8.7 million, approved on 25 October 2001.

⁹⁶ Loan 1847-MON(SF): *Housing Finance (Sector) Project*, for \$15 million, approved on 18 October 2001.

reduce credit risk that limited access of borrowers, particularly in the agriculture sector.⁹⁷ The hoped-for results, namely increasing lending to rural areas and for housing purposes, may therefore not be achieved as the underlying problem of credit risk might not be removed.

103. Underestimating Technology Change. The TA loan (footnote 91) aimed to introduce a standardized management information system for banking to Mongolia. Starting from scratch and with a small and relatively homogeneous banking sector, the project planned to purchase software, adapt it to the needs of Mongolian banks, and then multiply it across all banks. The project underestimated resource requirements, both for system purchase and adaptation and, on the part of commercial banks, procurement of equipment. The approach ignored the fact that institutions have disparate operating cultures, business focuses, geographic and branch profiles, and product differences that make a universal system less attractive. Project implementation was delayed until 1998 (being approved in 1996) and is still not complete.

3. Initial Outcomes

104. Unfinished Agenda. The banking sector's performance has shown a substantial improvement since the early 1990s, though it remains short of international best practice. The strengthening since 2000 appears to be well diversified and more soundly based. ADB-supported bank restructuring showed initial improvements in the sector. The creation of MARA and the attendant "carving out" of problem assets from the banking sector under FSP1 had an immediate effect in 1996–1997. The improvement was only temporary as the level of nonperforming loans peaked in late 1998 to about 50% of total loans, but it dropped to 15% by the end of 2001.⁹⁸ Lingering problem assets (para. 101) appear to have cast continuing doubt upon the sector, and depressed public confidence in it, as suggested by the persistently excessive interest rate levels. This situation was further compounded by the inappropriate decision to create an additional bank to be run by former managers of banks with a weak management history. Another course of action may have been immediate liquidation of the institutions through individual asset sales or auction of various "pieces" of the institutions to other banks. In any event, the creation of additional institutions and attendant administrative/management structures was inconsistent with the fact that skills were in short supply.

105. Legal and Regulatory Framework. While the legal and regulatory framework, and oversight authority of the central bank relative to the banking sector, have been significantly strengthened, there has been little update to the regulatory apparatus supporting the prudential regulation of nonbank financial institutions. FSP2 will be addressing the issue, and there have been two TAs to diagnose the problems in this area; however, the Government has not moved forward with many of the recommendations made by TA consultants.

106. Accounting Standards. Mongolia was very quick to adopt international accounting standards (by law); however, the actual application of those standards remains predictably problematic. Furthermore, the adoption of international accounting standards outside the financial sector has not progressed, and financial information on enterprises is not generally reliable.

⁹⁷ The World Bank's evaluation (footnote 120) arrived at the same conclusion regarding two of its loans, approved in 1999 and 2000.

⁹⁸ However, the extent of nonperforming loans in 2001 was not reflective of the real conditions in so far as they were understated by the system of loan classification and provisioning, which falls short of international best practice due to the lack of credit skills coupled with the fact that the banking system is undersized relative to GDP.

107. **Training.** ADB supported the creation of the bank training institute under the auspices of the Bank of Mongolia, and this is an increasingly credible and self-sustaining institution. There is an excellent opportunity to further strengthen this institution and broaden its reach to the nonbank financial institutions.

108. **Managing Risk.** Possibly the most important part of transforming the financial system was the introduction of risk management principles. Key elements of risk management programs include the building blocks of sound corporate governance: improving transaction standards by increasing transparency and reducing conflicts of interest, and enhancing accountability by regulating fiduciary responsibility and monitoring compliance. To some degree, ADB has addressed all of these areas through various programs including upgrades to prudential regulations for banks, insider transaction standards, training, adoption of international accounting standards for transparency, and information technology systems support, etc. However, risk management, complex as it is, requires a lot of experience and possibly long-term training to gain confidence and competencies to deal with common and unique risk management characteristics.

IV. ENVIRONMENT

109. The environment is of particular importance in Mongolia with its fragile ecology (vast grasslands with thin top soils and little other vegetation), its extreme climates, and low quality coal reserves, which produce high levels of pollution when combusted. In addition to this natural setting, man-made challenges to environmental preservation include agriculture and animal husbandry practices that affected soil preservation and grasslands, mining industries (foreign financed and in the informal sector), outdated technologies of energy generation and industrial plants (which had not been designed with environmental consideration in mind), waste treatment (solid and water), and, increasingly, vehicle-based air pollution.

A. Strategic Directions

110. The importance of the environment was recognized during ADB's first mission in 1991 and was included in the 1991 COS, which pointed out that procedures for environmental impact assessment (EIA) should be developed to establish a common language and that all projects should consider environmental implications in their design. The 1994 COS was oriented toward developing environmental policies and strengthening institutions. The 2000 COS was less explicit about environmental goals and suggested strengthening the regulatory framework, leaving it to the Government to seek grants for environmental work. The COSs presented a broad-based approach without articulating specific environmental targets or providing guidance for addressing environmental issues in operations. Arguably such a framework was impossible to define, initially because of the dearth of information and an overload on other issues that had to be dealt with. However, the absence of an environmental strategy might have led to missed opportunities when environmental issues did not fall squarely under one sector or in the realm of one EA.⁹⁹ The gap has been filled in 2001 with the preparation of a country environmental analysis that has influenced the current TA pipeline and will inform the preparation of the forthcoming CSP.

⁹⁹ This was the case for poverty reduction, where the link to environment was not established, and for air pollution, where experience from the regional TA Action Plans for Reducing Vehicle Emissions could have been shared with Mongolia.

B. Institutional Issues

111. The early goal of building environmental capacities was supported with two TAs provided to the Ministry of Nature and Environment (MNE). The objective of the first TA was to assist changing MNE's role to that of a regulator capable of dealing with a diverse set of potential polluters that increasingly included private sector entities.¹⁰⁰ The TA provided techniques and procedures for EIAs and corresponding training for MNE staff, and helped the Government comply with ADB requirements for EIA. The second TA supported the same objective and focused on developing proposals to institute a pollution permit system, widening and revising of environmental standards, improving environmental monitoring, and fostering public awareness of environmental issues.¹⁰¹

112. While having laid the foundation for EIA capacities, actual practices suffer from a complex mix of issues related to technical skills, institutional coordination, and compliance incentives. EIA provisions have not been closely integrated with other environmental laws and regulations, which created ambiguity or even conflict and required frequent regulatory amendments. In some cases the technical approach to EIA is not (or cannot be) easily codified, creating inconsistencies in EIA and suspicions of arbitrariness. Political influences impinge on environmental accreditation. Financial incentives for complying with environmental laws are low. The capacity-building assistance has been limited to one area (EIA) and one agency (MNE), leaving other needs at subnational level unattended.¹⁰²

113. Institutional issues arose on a number of occasions and have impeded the effectiveness of ADB's environmental assistance, although these conflicts were not limited to ADB projects. The relationship between MNE and line ministries was, at times, strained by unclear delineations of responsibilities and conflicts over authority, with line ministries wanting to self-regulate their environmental performance. In the case of the Cadastral Survey and Land Registration Project¹⁰³ the outcome of the TA¹⁰⁴ that was attached to it got mired in conflicting interpretations of mandates of the two designated implementing agencies. In the energy sector, the recently created Working Group on the Formulation of the Law on Energy Efficiency, chaired by the Ministry of Infrastructure Development (MID) has no representation from MNE. ADB's energy-related regional TAs are allocated to either MNE or MID without any systematic links that would make it possible to maximize the impact of assistance.¹⁰⁵ Amidst these institutional conflicts, responsibilities and capacities for environmental monitoring have been limited, and no explicit role has been assigned to NGOs. However, there are other examples where cooperation is more constructive: the development of a law on wastewater is now under way where MID, the Ulaanbaatar city government, and MNE work well together.

¹⁰⁰ TA 1647-MON: *Strengthening of Environmental Assessment Procedures*, for \$370,000, approved on 7 January 1992.

¹⁰¹ TA 2208-MON: *Strengthening the Environmental Management Capability of the Ministry of Nature and Environment*, for \$574,000, approved on 24 November 1994.

¹⁰² The findings of the CAPE conform with a separate evaluation conducted earlier: ADB. 2001. *Technical Assistance Performance Audit Report on Selected Technical Assistance in the Environment Sector in Mongolia*. Manila.

¹⁰³ Loan 1736-MON(SF): *Cadastral Survey and Land Registration*, for \$9.9 million, approved on 27 January 2000.

¹⁰⁴ TA 2299-MON: *Capacity Building for Cadastral Survey and Land Registration Project*, for \$990,000, approved on 27 January 2000.

¹⁰⁵ Elsewhere, it is MNE that appears to block progress: the Air Pollution Action Plan developed by the Ulaanbaatar city government has had the support of the Ministry of Health and MID, but not of MNE.

C. Sector Responses

114. **Agriculture.** ASP1 focused mainly on rationalizing the crop sector and recognized the effects of abandoning farmland, mainly a semi-permanent or permanent loss of the land's productive capacity given the pattern of regeneration in the Mongolian climate. However, no provisions were made to address the need for changing farming practices to alternatives such as low or no tillage. ASP1 called for a livestock strategy to be prepared with help of an attached TA,¹⁰⁶ which analyzed the sustainability of the subsector including its implications for the environment. The strategy was not implemented for lack of funds and only now are plans being developed to manage grasslands and grazing rights on a group-based system, which might provide the key to sustaining pasturelands in Mongolia. ASP1 started assistance to defining a new land law that would, eventually, allow private ownership of land. Environmental implications were relegated to a minor position, given political concerns over land ownership as such (para. 67). A follow-up loan and TA (footnotes 103 and 104) are affected by institutional issues between MNE and another implementing agency (para. 113).

115. **Energy.** Early on, alternative energy sources including hydropower were explored, but their harnessing had to be deferred for reasons of financial feasibility. This diversification of energy sources would have eased the burden of air pollution from coal-fired generation plants, although shifting the environmental burden to hydropower sources. Other loans and TA in this sector focused on improving plant operations,¹⁰⁷ rehabilitating existing facilities with resultant efficiency effects that also benefit the environment (para. 89), and on improving heat and energy efficiency¹⁰⁸ with the potential to contribute to reducing waste of resources at plant and end-user levels. The first project included an overhaul of a wet scrubber to make it suitable for high-ash and low calorific content of coal and conversion of some boilers to fluidized bed technology. While time-series data on emissions of the power plant are unavailable, overall pollution data for Ulaanbaatar indicate that annual concentrations of suspended particulate matter and sulfur dioxide emissions declined since 1999 in spite of the rapid growth in nonpoint sources of pollution (mainly individual stoves) and increasing energy output. The environmental impact of the second and third projects has not been quantified.

116. Two major regional TAs focused on energy and environment issues. The first project¹⁰⁹ assisted the Government in developing inventories of greenhouse gases in line with Mongolia's signing of the United Nations (UN) Framework Convention of Climate Change and began the process of identifying efficient greenhouse gas reduction. The project was effective in raising awareness of policymakers but its longer-term impact is uncertain due in part to the weak link between the implementing agency (MNE) and the institutional champion of the principal greenhouse gas-producing sector, i.e., MID (para. 113). The effectiveness of the second project¹¹⁰ faces a similar institutional problem.

117. **Roads.** In the road sector, feasibility studies for road projects covered environmental aspects of construction (adequate consideration of erosion control in roadside drains, culvert outlets and cut slopes, control of dust generation, prevention of spillages of fuel and hazardous

¹⁰⁶ TA 2458-MON: *Strengthening Land Use Policies*, for \$580,000, approved on 5 December 1995.

¹⁰⁷ Loan 1334-MON(SF): *Power Rehabilitation Project*, for \$40 million, approved on 24 November 1994.

¹⁰⁸ Loan 1492-MON(SF): *Energy Conservation Project*, for \$10 million, approved on 26 November 1996, and Loan 1548-MON(SF): *Ulaanbaatar Heat Efficiency*, for \$40 million, approved on 25 September 1997.

¹⁰⁹ TA 5592-REG: *Asia Least Cost Greenhouse Gas Abatement Strategy*, for \$8.2 million, approved on 4 August 1994.

¹¹⁰ TA 5972-REG: *Promotion of Renewable Energy, Energy Efficiency and Greenhouse Gas Abatement Projects*, for \$5 million, approved on 4 January 2001.

materials, and others), and of linking road construction and national park development. The projects included mitigation measures in the design of roads and during construction. Larger issues such as the creation of multitracks when road surfaces break down and drivers seek alternative routes (a practice that results in major soil erosion), were addressed only within the narrow confines of project investments and roads.

118. **Urban Development.** Urban services included wastewater treatment facilities and solid waste collection, which have had a positive environmental impact. Wastewater is again being treated in the recipient aimag centers. Vehicles were provided for solid waste collection, which functions well, although disposal sites were not developed as sanitary landfills. Instead, waste is dumped on open sites at the perimeter of towns.

V. OVERALL ASSESSMENT

119. The CAPE set out to assess whether ADB had chosen the right areas in which to work, whether assistance was done well, and what this assistance contributed to the transition process of Mongolia. The following paragraphs summarize the findings in these three areas, and reflect on the performance of the main stakeholders—the Government and ADB—and that of others.

A. Right Choices?

120. The early approach to provide assistance rapidly and on the whole to infrastructure sectors that were collapsing was correct and is still much appreciated today. Apart from providing much-needed assistance, it gained ADB the reputation of a reliable partner in times of need. The COSs were also good at raising key concerns of transition (para. 33), albeit without arriving at these issues through analytical work (ETSW) or developing strategic guidance on how these concerns should be reflected in operations. In a broad sense, ADB's choices were relevant and appropriate to the transition process of Mongolia and coincided with ADB's current core areas (growth, inclusive social development, and governance) and crosscutting themes (private sector development and the environment).

121. Right choices were made in highlighting governance, environment, and poverty as the main themes of the COSs, while gender concerns were integrated into social sector projects, benefiting mostly female teachers with extensive training and providing better health maternal health care. However, another gender issue, namely low enrollment rates of boys (due to their involvement in herding, which stops herder families from sending boys to boarding schools) has not been addressed. Regional cooperation was limited, though not absent, possibly due to Mongolia's location, distancing it from the Central Asian republics, while associating it geographically only with one of ADB's DMCs, namely the PRC, as the other large neighbor—the Russian Federation—is not a member country.

122. While key transition themes were raised, the main weakness of the COSs was that no strategic guidance or concepts were worked out for attaining broad country-level goals or translating the key themes into a well-defined operational program. Opportunities to place individual initiatives in a country context, as was the case with public resource management, were missed. None of the COSs foresaw a sequence of assistance in any one sector for the country as a whole, which is manifest in loan approvals over time (para. 34). The spread across sectors is indicative of a lack of selectivity and priorities. In spite of these weaknesses, the COSs were prepared in line with ADB guidelines and probably were of comparable quality as COSs for other countries.

B. Done Right?

123. **Overall Performance.** During the first 5 years of assistance, an average of six loans were administered per year, which increased to 14–15 loans per year between 1997 and 2001. Overall portfolio performance was satisfactory despite fiscal constraints, which affected counterpart funding, and institutional weaknesses, which resulted in delays in loan effectiveness and implementation. Between 1992 and 1997, all projects were given highest ratings during implementation. Thereafter, overall performance continued to be satisfactory, although some projects were rated partly satisfactory or unsatisfactory given slow implementation and partial achievement of project objectives. Delays were caused by late parliamentary approvals, which delayed loan signing and effectiveness in three cases by, on average, 16 months, as compared to an average elapsed time of 5 months. Fiscal constraints, including IMF prescriptions on public expenditure, limited the availability of counterpart funds in a number of projects, causing delays to the establishment of project management units and thus impeding implementation. Language barriers, lack of managerial skills, and unfamiliarity with ADB policies and procedures also caused implementation delays, especially for the first projects that were implemented. To address procedural problems, ADB conducted three procurement and disbursement seminars in Mongolia (1997, 1999, and 2002), and intensified the use of consultants to assist EAs during project implementation. In addition, the need for improving project accounting and auditing was noted.

124. **Program Lending.** While program lending smoothed the transition period in times of serious cash-flow constraints, it arguably might have contributed to extending Mongolia's dependence on aid and postponing hard decisions about controlling public expenditure. Policy matrixes tended to be overloaded with activities that were not necessarily policy reforms as such but rather milestones to monitor progress in the reform process. The difference between policies and other activities included in the matrixes thus became blurred, and with this the definition of desired reforms. In many cases, expected outcomes of policy reform were not defined, thus making it difficult to assess whether reforms accomplished what they set out to do, which would require differentiating between outputs (e.g., a new law) and outcomes (e.g., law enforcement and subsequent changes in behavior). Some conditions, such as preparing sector strategies, were met only with the help of additional ADB TA.

125. **Design Issues.** For capacity building, limited institutional diagnostics led to addressing narrow problems rather than understanding and trying to address institutional performance, as measured in institutional performance criteria. However, implementation modalities, namely the use of local consultants and extensive training, including training of trainers, were useful and appropriate in the Mongolian context. In policy reforms, single options were presented without alternatives being discussed.

126. **Cost Estimates.** Difficulties in accurately estimating the cost of infrastructure projects led in some cases to considerable changes in scope and to implementation delays. This was the case in the energy sector (footnote 107) where it was originally envisaged that seven boilers would be rehabilitated at power plant no. 3. Eventually three boilers were fully and one partially rehabilitated, but with the delivery of parts making full rehabilitation possible.

C. Contributing to Country Performance

127. Mongolia's economic and social progress in the 1990s was hampered by a series of external shocks, which drew attention to short-term relief measures rather than medium- or long-term policy reforms. These external shocks included the withdrawal of FSU support

(para. 3), commodity price variations, the Asian and Russian financial crises, and climatic disasters over the past two winters. The economy continues to be vulnerable to external shocks of this nature, and little was achieved in diversifying the economy and making it depend less on commodity exports.

1. Transition Complete?

128. Supporting the transition process was the main aim of ADB's early COSs. One way to assess how far the process has been completed is the level of engagement of the Government, particularly in the productive sectors, conditions for private sector development (policy framework and financial intermediation), and the degree to which the roles of government agencies have changed.

129. Against these three dimensions, Mongolia made considerable progress. The private sector has become a major player in the productive and some services sectors (para. 9) and a policy framework has been created that has the potential for fostering private sector development (para. 80), although further work will be required to reduce licensing requirements. Tax and social insurance policies will have to be reviewed to assess their impact on the private sector. Indications are that both are creating incentives for the expansion of the informal rather than the formal private sector, or for establishing businesses for the purpose of reducing tax burdens (footnote 8). The financial sector is recovering from an extended period of crisis, but is still fragile and not in the position to foster economic growth. However, it is essentially organized in line with market-oriented principles. The Government relinquished its role in the productive sectors. ADB's contributions to these achievements were significant with its involvement in almost all sectors of the economy, its broad-based approach to dealing with all key issues of transition, and the size of its assistance program. However, capacity building in policy making has been slow (para. 73) and experience in building sector management capacities is mixed (para. 58).

130. While the foundation has been laid to transform the economy, further work is needed to implement, enforce, and sustain structures, laws, rules, and regulations. Government agencies are not yet well positioned to fulfill their new roles to the fullest extent.¹¹¹

2. Poverty Reduction

131. Poverty reduction was a feature of ADB assistance from the beginning, although it moved into center stage in the 2000 COS. Initially, in view of positive social sector indicators, poverty reduction was considered a question of securing employment through private sector development. With deteriorating health indicators and school enrollment rates, it was recognized that assistance was needed in the social sectors, resulting in a shift of portfolio in the second half of the 1990s.

¹¹¹ The recently conducted governance assessment of ADB (in draft at the time this report was finalized) points to a number of outstanding issues.

132. Poverty reduction goals, other than being defined in rather generic terms, were not reflected in strategic directions.¹¹² In capacity building, the only explicit contribution to poverty reduction involved minor assistance to the National Poverty Alleviation Program (footnote 51). Otherwise, capacity building focused on improvements in institutions or competencies without an explicit agenda to introduce an awareness of poverty issues or capacities to develop antipoverty strategies. Nonetheless, improvements in the social sectors helped the poor with students from poor homes benefiting from better education and patients from poor households having better access to health care. These efforts have been worthwhile contributions to maintaining high social sector indicators, although whether improved social services will actually enable poor people to participate in economic activities remains in question, as private sector growth and employment creation are slow, but are needed to generate the requisite opportunities.

133. Policy reforms had mixed effects on poverty. ADB-supported policies for trade and price liberalization and to reduce the role of the state in the real sector contributed to unemployment, a reduction in consumer purchasing power in the early 1990s, and increased vulnerability of herders as vital fodder supplies were not available when needed. However, sustaining high subsidies and support to SOEs was not a viable alternative, as the international community would not have supported a continuation of strong state interventions across the economy. Also, the necessary reforms would have been delayed, possibly adding to rising poverty trends, as people would have remained employed in unviable SOEs incapable of paying wages and providing support services. Policies for tariffs and cost recovery aim to reduce the gap between charges for public services paid by households living in poorer urban areas, although political resistance reduces the impact of ADB's efforts.¹¹³

134. Deregulation created an economic space that was filled by small enterprises and the informal sector, amounting to a spontaneous coping strategy in response to high unemployment rates with few employment alternatives in the formal sector. However, otherwise, the pronounced goal of stimulating private sector growth to meet poverty reduction targets was not well supported with strategic directions, the operational program, or resources.

135. In the financial sector, reforms in banking aimed to transform it and make it viable, while related credit lines were established for providing targeted credit to people in rural areas and for housing purposes.¹¹⁴ As assistance has not addressed credit risk, which would be higher for poor people than the nonpoor (and which remains the underlying impediment to access to credit), it remains to be seen whether assistance will effectively reach the poor once the loans become fully operational. An evaluation of the National Poverty Alleviation Program found that

¹¹² Specific targets were formulated in the partnership agreement for poverty reduction (para. 27), which, while accepted internationally, capture Mongolia's progress as a whole rather than ADB's contributions to the Government's antipoverty efforts. For instance, GDP growth depended more on international commodity prices and on weather conditions than on ADB assistance, and is only a partial indication of poverty trends. Indicators on governance that were included in the partnership agreement did not illustrate the link between e.g., changed budget processes and poverty indicators, which would depend on the application of the output-based budget in favor of specific antipoverty targets.

¹¹³ Loan 1560-MON(SF): *Provincial Towns Basic Urban Services Project*, for \$6.8 million, approved on 30 September 1997, aimed to address some of the underpricing by raising water tariffs and by introducing charges based on consumption. However, political resistance has prevailed and blocked effective increases in water charges for residents in apartments with house connections, thus cementing the price differential that makes residents in poor urban areas without house connections pay 10 to 20 times more for water on a per liter basis.

¹¹⁴ A site visit to one of the target aimags revealed that local authorities were preparing model housing units for \$25,000 each to be financed from the ADB Housing Finance Loan. This amount is beyond the means of a poor borrower.

the accuracy of credit target mechanisms was questionable,¹¹⁵ and the evaluation of United Nations Development Programme's microstart project highlighted that the focus of the microcredit facility shifted from the poor to sound business concepts and to market-driven approaches that involved the "moderately poor and vulnerable nonpoor."¹¹⁶ These lessons should be considered in targeted poverty reduction interventions involving microfinance.

136. To gauge the overall impact of ADB-supported policy reforms on poverty reduction is difficult, if not impossible, due to elusive goals without a requisite operational strategy and program, and to significant external factors (economic collapse at the beginning of transition, the Asian and Russian financial crises, and the fall of commodity prices), which impacted on the economy and increased poverty.

D. Stakeholder Performance

1. Government

137. Government ownership varied across different aspects of ADB's cooperation with Mongolia. It was limited in areas of a broader, strategic nature: even while the COS 2000 stated that it had been prepared using participatory methods, few if any government officials engaged in a discussion of it during the CAPE mission. The project mix in the portfolio (especially the discontinuation of infrastructure investments) was criticized by some government agencies. During the early transition years, the limited exposure of policymakers to market-oriented policies affected their participation in policy dialogue and appreciation of implications of policy reforms. These limitations, however, did not reduce government ownership to the reform process as a whole. Ownership for individual projects and reform initiatives was generally strong,¹¹⁷ although in politically sensitive areas government decisions were not always consistent with overall reform objectives.¹¹⁸ Since 2000, however, the Government has seemed more ambivalent about ADB's focus on poverty reduction, or rather efforts to address poverty concerns, without investments into infrastructure to support private sector growth and employment creation.

138. ADB has neglected debt management as an area of assistance as, seemingly, has the Government. Borrowing in the early years was driven by a need to replace previous support from the FSU. This resulted in a build-up of foreign debt to \$905 million in 2001 (or 87.8% of GDP). Debt service increased from \$33 million (or 3.3% of GDP) in 1999 to \$56 million (or 5.4% of GDP) in 2001. The Ministry of Finance and Economy, now in charge of aid coordination, anticipates that the Government will accumulate an additional \$100 million net external debt annually over several years. The Ministry of Finance and Economy is confident that the Government can sustain and service its sovereign obligations, although this view is not shared throughout Government or by opposition parties. With grace periods coming to an end, the economy will have to record growth rates of 4–5% annually while access to concessional lending will need to be retained to sustain such levels of public debt.

¹¹⁵ Government of Mongolia/UNDP/World Bank. 1999. *Independent Evaluation of the National Poverty Alleviation Program and Options Post-2000*. Mongolia.

¹¹⁶ UNDP. 2001. *Final Evaluation Report, Microstart Mongolia*. Ulaanbaatar.

¹¹⁷ The evaluation of the German assistance program (footnote 121) similarly concluded high levels of ownership.

¹¹⁸ In the energy and water supply sectors, providers have been, or are being, prepared for commercialization and eventual privatization. However, the autonomy to adjust tariffs to ensure cost recovery is limited. Some parliamentarians perceive onlending rates for the housing sector as too high, which is affecting ratification of the loan agreement.

2. Asian Development Bank

139. ADB is much appreciated for its role during the early crisis years when assistance was provided in the time of need. ADB's responsiveness to financial needs, timeliness of interventions (especially the first [footnote 30]), and program lending (as de facto budget support) were regarded helpful and earned ADB a reputation as a reliable development partner.

140. However, as the early crisis situation, during which almost any assistance was useful, changed into more stable transition and development conditions, more was needed in terms of strategic choices and guidance. ETSW was of reasonable quality, but was not prepared so as to inform choices made in COSs and CAPs (para. 21). The COSs set out country goals and summarized program components, but they were not instrumental in providing strategic guidance to the operational program. There is no evidence on how far different options were considered or specific targets set for country or sector development. A focus on sectors, or sometimes individual interventions, prevented ADB from putting individual operations into a country context and in relation to each other. For instance, assistance for preparing sector legislation would have benefited from ADB staff having an understanding of the legal development framework. Or, as discussed in section III.A., a better grasp of public resource management as a process would have helped ADB staff identify key bottlenecks in the process as a whole, set targets for its improvement, and build a program of assistance leading to synergy effects.

141. ADB's internal organizational procedures were not well suited for dealing with transition economies and their frequent and rapid changes. Projects conceived and developed under one scenario were approved after conditions had changed in Mongolia. This has been the case for the recently approved Rural Finance and Housing Finance projects (footnotes 95 and 96), which aim to provide credit lines to an overliquid financial sector. TA completion reports recognized these shortcomings (para. 42), but necessary changes are beyond a TA, a group of projects, or one country, as they concern ADB's operating procedures as a whole.

142. ADB lent a large amount of concessional resources, and thus played a significant role in the debt buildup (para. 138). Total disbursements amount to nearly a third of the Government's external debt, with program lending accounting for about half of the disbursements.¹¹⁹ Rising debt levels were considered a possible risk to further lending, more seen as an impediment to the ADB portfolio than a problem of long-term sustainable economic development. Sector investments, particularly in the second half of the decade, were made without careful analysis of their revenue generation potential or impact on national debt and debt management capacities.

3. Others

143. ADB has been the largest multilateral agency in Mongolia, after Japan as the largest bilateral donor. This has given prominence to ADB in the overall assistance program, although a lead role was exercised only sporadically, because of the lack of a permanent presence until 2001. The resident mission now gives ADB greater opportunity for effectively playing this role.

144. Many positive examples of coordination and cooperation exist in a number of sectors, possibly because the administration is relatively small and concentrated in the capital and access to decision-makers is comparatively easy. This has not necessarily resulted in complementary or comprehensive assistance programs, but avoided unnecessary duplication.

¹¹⁹ By the end of 2001, cumulative ADB lending of \$505 million was equivalent to \$210 per capita, or over 50% of the GDP per capita of \$390.

For instance, in the energy sector a number of external agencies assisted in various aspects of coal mining, energy generation, and distribution. After the withdrawal of ADB from this sector, the United States Agency for International Development and the World Bank have taken the lead role in pursuing structural reform that was started, but not completed, with ADB support. Similar trends were observed in other infrastructure sectors from which ADB had withdrawn. This is most pronounced in the area of civil aviation, where ADB laid the foundation for important improvements (para. 92), and provided continued advice that may result in additional cooperation with the European Bank for Reconstruction and Development. In the telecommunications sector, the German Kreditanstalt für Wiederaufbau is following up ADB's early work in ensuring that the structural changes are carried through to completion, and infrastructure improvements are carried down to aimag level, while the Japan International Cooperation Agency is investigating the feasibility of strengthening sum-aimag links.

145. In the social sectors, cooperation is well established, in particular with the responsible UN agencies and one international NGO, which plays a leading role in project implementation. However, across ADB's operations as a whole there was little or no involvement of local NGOs or the business community. This was partly attributable to the absence of local NGOs and business associations in the early years, but it was surprising in later years, given the hope that the private sector would become the main engine of growth and provider of employment.

146. The World Bank recently evaluated its country program.¹²⁰ In its assessment of development impact, the report focused on four "principal challenges faced by successive governments in the 1990s":

- (i) "Consolidate the democratic process and ensure political and economic freedoms." The World Bank found that it had contributed indirectly to this agenda through supporting economic stability and reform. It acknowledged that other donors had contributed to this agenda as well.
- (ii) "Stabilize the economy, prevent a further collapse in output, and avert severe hardships for the population during the initial transition period." The World Bank found that it had played a major role in assisting successive governments in attaining this goal "through its balance of payments lending; rehabilitation support in sectors such as energy, transport, and copper; technical assistance; and mobilization of support from other donors." ADB provided similar assistance, and being the largest multilateral agency, it appears safe to say that ADB's contribution was equally significant.
- (iii) "Protect human capital development levels and support the vulnerable during the transition period." The World Bank played an important role, together with UNDP, in assisting the Government's National Poverty Alleviation Program. In other social sectors, it played an advisory role "but appropriately refrained from direct lending due to the significant presence of other donors." ADB's education and health projects made major contributions to attain this goal, which the World Bank assessed as largely achieved.
- (iv) "Establish policies and build institutions required to generate participatory and sustainable growth of the market economy." World Bank contributions to this only partially achieved goal were modest. As illustrated in the CAPE, ADB made major

¹²⁰ World Bank. 2002. *Mongolia Country Assistance Evaluation*. Washington, DC.

contributions to policy reforms and capacity building, although the latter could have been more effective if ADB had developed a strategy.

147. The German Government evaluated its bilateral program in 2001¹²¹ and arrived at similar findings. The evaluation revealed a number of key themes that are common to both the German and the ADB programs, where opportunities for greater cooperation could be sought.

VI. CONTINUING TRANSITION AGENDA

A. Lessons Learned

148. Lessons that can be drawn from the Mongolia program illustrate the extent to which development thinking has changed over the past decade. Initially, transition processes were not well understood and much faith was placed in ownership patterns, which had constituted the principal difference between the socialist and capitalist systems. The thinking has changed and the aid community has recognized that transition entails a far more sophisticated challenge.

149. The CAPE illustrates weaknesses in translating COS into operations. While key transition themes or processes were correctly identified, they were not systematically built into CAPs. This shortcoming does not apply only to Mongolia and reflects the gradual, still incomplete, transformation of ADB from a project-lending institution to a development agency with a country focus. The recent change in business processes (footnote 18), namely combining COSs with CAPs into CSPs, has been a first step toward addressing this shortcoming, the second one being the reorganization of ADB including the establishment of country teams. However, whether these changes in process and structure will actually effect a change in content and program will depend on each country team's ability to identify and analyze key transition or development issues that are specific and important to the country, and then translate these issues into an operational framework that specifies goals, targets, and modalities. This will require time and resources to be made available to the country teams for this purpose.

150. A sector focus, typical for ADB operations not only in Mongolia, sometimes resulted in ADB staff overlooking countrywide issues. One such example is the legal framework. A number of program loans included policy conditions to adopt laws. While legislation may have been needed from the sector point of view, these changes were not placed in the context of Mongolia's legal framework as a whole, or did not necessarily allow sufficient time for consultations according to established processes (para. 62). Some laws, such as the Public Sector Management and Finance Law, are based on an Anglo-Saxon model while the entire legal system of Mongolia is based on the German model. In other areas, inconsistencies exist between laws, e.g., on taxation that enables the Government to collect outstanding taxes from bank accounts and the banking law that ensures confidentiality of account information. These disparities in legal development could have been avoided, had a country perspective been adopted, supported with relevant analytical work to identify and understand countrywide issues, in addition to the traditional sector focus. The recently introduced thematic assessments, such as those of governance or of the private sector, have the potential to play an important role in improving ADB's understanding of development or transition issues and how these need to be reflected in lending and TA.

¹²¹ Bundesministerium für Wirtschaftliche Zusammenarbeit und Entwicklung. 2001. *Synthesebericht zur Länderevaluierung Mongolei*. Bonn.

151. Counterfactuals are hard to develop to prove that a strategic or more comprehensive approach is more effective than a fragmented one. However, the examples of sectors that, in Mongolia, covered interrelated aspects relevant to sector performance, indicate the value of structured and systematic assistance that has a medium- to long-term horizon with intermediate, specific milestones.

152. The narrow focus on solving institutional problems reflected a lack of comprehensive insights into institutions and processes, which combined poorly with the absence of institutional performance indicators. Together these factors resulted in assistance that addressed issues within a narrow frame, without considering whether overall institutional performance could improve as a result. This was the case in assisting public resource management, where TA and lending were not conceived to complement each other, even though they had the potential to do so. Had assistance to public resource management been perceived in a programmatic way (para. 50), goals could have been determined for overall process improvements that would reflect, for instance, whether the Government is in a better position to exercise fiscal discipline and increase efficiency (producing the same outputs/results with fewer resources). Capacities for making relevant choices and decisions, including policy formulation and strategic planning, should become part of such a systematic capacity-building process.

153. Policy matrixes tended to mix policy reform measures and milestones or means of monitoring the introduction of policy reforms. This practice resulted in complex policy matrixes and contributed to a confusion of what policy reforms (as opposed to monitoring mechanisms) entailed.

154. The amount of grant TA resources provided helped ease, to some extent, the burden of increasing foreign debt. Whether these resources were most effectively used and attained a commensurate impact was difficult to assess in view of the fragmented nature of the TA program and the absence of clearly defined links (in terms of outcomes) between TA and lending. Such links could be determined, if strategies and programs were developed around key transition (or development) issues and processes (para. 149).

155. Cross-sector variations occurred, particularly in the area of capacity building. These variations are not harmful, but it takes an exercise such as the CAPE to identify good practices and share them across sectors.¹²² The social sector projects (education and health) developed capacity-building solutions based on fairly detailed analysis of existing institutions and identification of missing ones. In the health sector, for instance, weaknesses were addressed across various levels, central and local: within the line ministry and local governments, licensing board, and sum hospitals, and family group practices. Nonetheless, both sectors will be facing difficulties in attaining their final aim due to underlying attitudinal issues that are difficult to address with external assistance, and are often not raised for reasons of sensitivity. For instance, attitudes toward health services are heavily biased toward hospital-based treatment with heavy medication, which would have to change if the country is to reap full benefits from ADB's assistance to the health sector.¹²³

156. Looking for models and applying ready-made solutions is always a temptation, especially when radical changes are needed. However, the drawback of trying to introduce systems that work in other places can result in a series of changes (copying approaches that might not always fit) rather than a solution to problems. For instance, when introducing a complex system

¹²² The CSP could fulfill a similar role.

¹²³ Loans 1568/1569-MON(SF): *Health Sector Development Program*, for \$15.9 million, approved on 4 November 1997.

such as output-based budgeting under the GRP (footnote 40), much attention is drawn to its technique and away from the problem of controlling public expenditure and introducing professional management into the public service. In this instance, it might have been more useful to have broad-based consultations with stakeholders at national and subnational levels to build consensus on problems and their root causes, and discuss possible solutions. ADB could support such a process—the consensus building alone helping build capacities in understanding problems and appropriate solutions—and bring a variety of potential tools to a dialogue of this nature.

B. Future Strategy and Program

157. CSPs should provide strategic guidance to operations rather than summarizing the content of assistance. Under the new business processes, there is potential to develop CSPs in this way because necessary background work (ETSW, poverty analysis, and CAPE) is supposed to be done in preparation. CSPs are the ideal instruments for setting out medium- to long-term strategies, which should be linked to country goals, using the logical framework approach. Setting goals in measurable terms (targets) will also help ensure that these are established realistically, corresponding to available resources.

158. The issues of poverty reduction and stimulating private sector development retain their validity in the forthcoming phase of Mongolia's development. To engage the private sector as the main engine of growth and employment generation, underlying impediments to its expansion need to be understood and a comprehensive strategy developed to address them. A main concern is the small size and fragmentation of, and long distances between, domestic markets that limit the commercial viability of economic activities in many places. The issue of reducing credit risk should be investigated in this context as well, which would be beneficial to the private sector and the financial sector. ADB's private sector assessment (planned for 2002) should play an important role in addressing these questions and in helping prepare an appropriate strategy that stimulates private sector development, which in turn provides employment opportunities and effectively helps counter poverty trends.

159. An integrated perspective on public resource management would be beneficial to the Government and ADB's program in that it could reintroduce more forcefully the key concerns of fiscal discipline and professionalism in public institutions. Output-based budgeting is a tool, which in itself will not attain these goals unless there is a common understanding of the goals, commitment by all parties, and agreed approaches for attaining them. Setting objectives for public resource management will require consensus building and awareness creation and entail:

- (i) agreeing on key issues, i.e., building consensus within government (at national and subnational levels);
- (ii) determining the type and level of public service (public goods) provision that the population demands and can expect, including building consensus with civil society on this;
- (iii) discussing resources available for public services (public goods) provision, untapped revenues, and impacts of taxation and fees on private sector development;
- (iv) identifying models for public resource management (output-based budgeting as one of them). The choice of model should be geared toward attaining the overall

objective of controlling public expenditure, and be based on a discussion of advantages and disadvantages of different methods to create awareness of how these models can be used (and misused); and

- (v) identifying service delivery mechanisms that ensure best value for money. This would include options for involving private sector or civil society in service delivery and benchmarking options for improving the performance of public sector entities.

160. Monitoring and evaluation should be a fully integrated function in the process of public resource management, engaging existing units and building their capacities, if needed.

ECONOMIC, THEMATIC, AND SECTOR WORK

Overview of Economic, Thematic, and Sector Work by Year

Theme/Sector	Year										
	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002 ^a
Country Programming and Country Publications											
Country Strategy ^b			ADB						ADB	EU	
Country Plan ^c						ADB	ADB	ADB	ADB	ADB	
Publications	ADB WB				ADB IMF				IMF UN	IMF	
Economic Work											
Economic Review	WB	ADB	ADB WB	ADB IMF	ADB	ADB IMF WB	ADB	ADB IMF	IMF	IMF	
Thematic Work^d											
Environment and Natural Resources				WB						ADB	
Gender				ADB							
Governance				ADB	WB				ADB		ADB
Poverty/Vulnerable Groups			WB	WB	WB						ADB
Private Sector	WB	WB					WB				ADB
Regional Cooperation											ADB
Sector Work^e											
Agriculture			ADB	WB		ADB					
Education			ADB WB					ADB			
Energy			ADB	ADB WB	ADB						
Financial Sector							WB				IMF
Health											
Industries											
Telecommunications	ADB										
Transportation	ADB							WB			
Urban Development											

ADB = Asian Development Bank; EU = European Union; IMF = International Monetary Fund; UN = United Nations, including UNDP and specialized UN agencies; WB = World Bank.

Note: the mention of the agency name means that at least one, but possibly more than one, ETSW was done during the indicated year.

^a Some of these economic, thematic, and sector work (ETSW) is planned or under preparation, while some have been completed and published.

^b ADB first adopted an interim country operational strategy, in 1991.

^c Country assistance plans or CSP updates.

^d Could cover the thematic issue as a whole or a subset, e.g., governance reform as a whole or auditing and accounting as part of financial governance.

^e Could cover the sector as a whole, a subsector, or a specific issue, e.g., agriculture sector strategy, or the wheat sector, or financing a particular sector.

Source: ADB and other relevant agencies.

A. Economic Reports

1. The work of the first economic mission, undertaken in 1991, was published in 1992.¹ It was one of the first publications on Mongolia since the country opened to the West and provided a comprehensive overview of economic, thematic, and sector issues. Economic reports started

¹ ADB. 1992. *Mongolia: A Centrally Planned Economy in Transition*. Manila: ADB and Oxford University Press.

in 1993 and were produced for 7 years continuously. This was an unusually large number of economic reports for one developing member country, which may be explained by frequent economic missions to coordinate with similar missions of the International Monetary Fund (IMF) and World Bank. The rapid changes that Mongolia was undergoing may also have warranted frequent reporting, and the relative small size of the economy made it easier to produce economic reports in such frequency than for more complex and less well-documented economies.

2. Country economic reports covered issues typically discussed in economic reviews,² but the relative uniformity in structure conceals variations in selecting specific issues for in-depth analysis under each of these headings, as observed in the Mongolia reports, which may have taken place for objective reasons (such as shifting areas of major concern in the country) or for subjective reasons (staff familiarity with subject areas). The reports were adequate to monitor country performance, although with two shortcomings. Data limitations,³ acknowledged in the reports, impeded the meaningfulness of analysis. The “excessive reliance on textbook models”⁴ resulted in simplistic statements such as “tighten money supply to control inflation”, but added little value. No explanation was given on how these generic policy prescriptions should be interpreted in the Mongolian context or how they could be implemented. Additional details would have been required to understand the reasons for what appears to be rather erratic macroeconomic and fiscal policy changes and to help assess the direction of future trends in the reform process. Government ownership of, and capacity to implement, policy advice was not discussed in the reports, although these factors might have been related to the erratic implementation of fiscal and monetary policies.

3. The aggregate nature of information about markets, typical of this kind of report, and compressed details about state-owned enterprises and the industry sector did not allow an assessment of prospects for reorienting or diversifying the real sector, which would have been important to gauge the potential for economic recovery and growth, for generating government revenue through taxation (as suggested in the reports), and for creating employment. Such an analysis would have been needed to support the focus on private sector-led growth and poverty reduction envisaged in country operational strategies (COSs). The only risks that were recognized in the reports were political instability and rising levels of poverty, both of which were considered potential threats to the reform process. In terms of risks to ADB lending and project implementation, the reports pointed to foreign debt and fiscal constraints that limited the Government’s ability to borrow and to disburse funds. The level of debt and its rapid growth were not discussed until the issue was raised in the review of the partnership agreement for poverty reduction. These analytical gaps and the absence of specific recommendations for ADB programming and/or program management limited the utility of this type of report as a management or strategic planning tool.

² The reports included information on: (i) macroeconomic stabilization; (ii) GDP growth, structure, and sector performance; (iii) consumption, savings, and investment; (iv) public sector finance, fiscal policies, and fiscal deficit; (v) monetary policy and the financial sector; (vi) external debt, trade, and the external sector; (vii) prices, inflation, and exchange rates; (viii) privatization and private sector development; (ix) employment, unemployment, and wages; and (x) poverty, inequality, and gender. Environmental issues were mentioned in the context of selected sectors, such as livestock, where problems occurred due to expanding herd sizes.

³ Different accounting systems made it difficult to interpret data according to international standards or to compare data over time. The CAPE team observed discrepancies in data that raise further questions about accuracy and utility of data.

⁴ Joseph Stiglitz. 1999. *Whither Reform? Ten Years of the Transition*. Keynote address at the Annual Bank Conference on Development Economics. World Bank. Stiglitz’s observation regarding transition responses in general also applies to the country economic reports for Mongolia.

B. Thematic Work

4. Thematic work is a more recent approach for ADB, with the exception of 1995 when three thematic studies were undertaken.⁵ Other thematic issues, such as poverty and additional governance issues, were generally covered in country economic reports, although not in as much depth as when they had been the subjects of separate studies. A comparison of the scope of thematic work is more difficult given the diverse nature of the topics. Each study provided details on their respective subject area and were informative, but not of use for monitoring performance of ongoing programs or of consequence to strategic directions. These studies seemed to have had less ambitious goals, limited to, for instance, identifying the training needs in the legal profession rather than providing inputs to country strategy preparation or even sector analyses. The study on accounting and auditing would have been well placed in the context of a (missing) strategy for transforming the financial system, and should have been undertaken earlier.⁶ Following ADB's new business processes, thematic studies in a number of areas are required in preparation of country strategies; they were under preparation at the same time as the CAPE was conducted. The explicit link between thematic work and strategic planning promises to improve timing, focus, and use of thematic work.

C. Sector Work

5. Sector work started in 1992 with the infrastructure sectors (telecommunications and transportation), followed by agriculture, education, and energy in the mid-1990s. The last sector study was undertaken in 1999 for the education sector. A total of nine sector studies were undertaken for five sectors; those sectors for which several studies were prepared covered different aspects of the same sector or were updates when sufficient time elapsed.

6. Sector work, while varying in content depending on the technical field, was similar in scope.⁷ This type of report was useful for sector planning in that detailed descriptions and analysis of sector conditions led to recommending sector development programs. However, these sector papers tended to suggest blueprint-style strategies without discussing alternatives or providing a process-type of approach with different scenarios to respond to changing circumstances. Given the rapid changes in Mongolia, the latter would have seemed more appropriate to help strategic planning and to identify issues that affect implementation and project performance after completion. Attempts were made to place sector strategies into a macroeconomic context, although sector recommendations tended to add demands on public expenditure rather than identify alternative financing strategies. The weakest aspects of the

⁵ These comprised a country briefing paper on women in development, an analysis of the fiscal system, and a diagnostic of Mongolia's legal framework.

⁶ The regional TA under which this study was prepared was a response to the financial crisis that indicated the need for strengthened financial management and governance.

⁷ Each study analyzed (i) current or basic conditions, including a description of physical assets and resources; (ii) macroeconomic context, institutions, policies, and cost recovery; (iii) demand and supply, and markets; (iv) support system, such as credit, human resources development, and extension services; (v) reform plans and needs; and (vi) recommended actions, including investment and TA.

strategies were the lack of sequencing of initiatives (essential for determining priorities) and the absence of clearly defined responsibilities (essential for moving agendas forward), affecting the usefulness for strategic planning purposes. Possibly, these weaknesses were due to consultants' reports recommending options that the Government would have needed to decide on before adopting strategies. It appears that the necessity of exercising choices was not recognized.

LOANS

No.	Title	Approval Date	Loan Amount		Rating	
			Approved (\$'000)	Actual ^a (\$'000)	PCR	PPAR
1	1109 Special Assistance	29 Oct 91	30,000	31,029	NR	GS
2	1152 Egiin Hydropower	9 Jan 92	3,800	3,707		
3	1244 Industrial Sector Program	17 Aug 93	30,000	32,174	GS	PS
4	1256 Ulaanbaatar Airport	12 Oct 93	36,000	37,294	GS	S
5	1290 Employment Generation	16 Dec 93	3,000	3,085	PS	PS
6	1300 Telecommunications	16 Jun 94	24,500	24,014	S	
7	1334 Power Rehabilitation	24 Nov 94	40,000	37,464		
8	1364 Roads Development	22 Aug 95	25,000	21,506	HS	
9	1370 National Air Navigation Development	5 Sep 95	24,000	20,733	GS	HS
10	1409 Agriculture Sector Program	5 Dec 95	35,000	33,253	PS	PS
11	1492 Energy Conservation	26 Nov 96	10,000	8,569		
12	1507 Education Sector Development Program	19 Dec 96	6,500	6,156		
13	1508 Education Sector Development Project	19 Dec 96	9,000			
14	1509 Financial Sector Program Loan	19 Dec 96	35,000	32,955	S	
15	1510 Upgrading Skills and Systems of Commercial Banks	19 Dec 96	3,000			
16	1548 Ulaanbaatar Heat Efficiency	25 Sep 97	40,000			
17	1560 Provincial Towns Basic Urban Services	30 Sep 97	6,800			
18	1568 Health Sector Development Program	4 Nov 97	4,000	3,844		
19	1569 Health Sector Development Project	4 Nov 97	11,922			
20	1700 Second Roads Development	30 Sep 99	25,000			
21	1713 Governance Reform Program	2 Dec 99	25,000			
22	1736 Cadastral Survey and Land Reform	27 Jan 00	9,900			
23	1743 Second Financial Sector Reform Program	22 Jun 00	15,000			
24	1821 Agriculture Sector Development Program (Program Loan)	21 Dec 00	7,000			
25	1822 Agriculture Sector Development Program (Project Loan)	21 Dec 00	10,000			
26	1836 Social Security Sector Development Program (Program Loan)	28 Aug 01	8,000			
27	1837 Social Security Sector Development Program (Project Loan)	28 Aug 01	4,000			
28	1847 Housing Finance (Sector)	18 Oct 01	15,000			
29	1848 Rural Finance	25 Oct 01	8,686			
Total Lending			505,108	295,783		

^a Actual loan amount for completed projects.

PCR = project completion report, PPAR = project performance audit report, GS = generally successful, HS = highly successful, S = successful, PS = partly successful, NR = not rated.

Note: the rating system was changed from three categories to four in 2000.

Source: ADB.

TECHNICAL ASSISTANCE

Advisory Technical Assistance

No.	Title	Amount (\$'000)	Approval Date
1	1536 Advisor to Mongolian Stock Exchange	100	17 Jul 91
2	1542 Training for the Mongolian Stock Exchange	95	24 Jul 91
3	1585 Institutional Support for Procurement and Disbursement	248	29 Oct 91
4	1586 Restructuring and Development of the Industrial Sector	635	29 Oct 91
5	1643 Institutional Support to the Mongol Bank	100	2 Jan 92
6	1647 Strengthening Environmental Assessment Procedures	370	7 Jan 92
7	1703 Seminar on Bank Operational Policies and Procedures	40	25 May 92
8	1750 Energy Audit, Efficiency and Conservation Study	408	4 Sep 92
9	1801 Human Resource Development and Education Reform	535	11 Dec 92
10	1811 Improving and Strengthening the Statistical System	500	22 Dec 92
11	1855 Institutional Strengthening of the Financial Sector	595	17 Mar 93
12	1929 Strengthening the Industrial Sector	545	17 Aug 93
13	1930 Developing Mongolia's Legal Framework	500	17 Aug 93
14	1963 Institutional Strengthening of the Civil Aviation Sector and National Air Safety Master Plan	850	12 Oct 93
15	1989 State Privatization Commission	490	22 Nov 93
16	1989 State Privatization Commission (Supplementary)	110	28 Jul 95
17	2020 Institutional Enhancement for Employment Generation	598	16 Dec 93
18	2035 CES Institutional and Tariff Study	500	27 Dec 93
19	2069 Strengthening State Strategic Planning and Coordination in the National Development Board	562	14 Mar 94
20	2095 Power System Master Plan Study	595	6 Jun 94
21	2101 Sector Reform	588	16 Jun 94
22	2102 Accounting and Management Systems and Tariff Reform	599	16 Jan 94
23	2105 Institutional Strengthening of Agriculture Banking Services	300	20 Jun 94
24	2105 Institutional Strengthening of Agriculture Banking Services (Supplementary)	205	29 Mar 96
25	2208 Strengthening the Environmental Management Capability of the Ministry of Nature and Environment	574	24 Nov 94
26	2219 Strengthening of the Commercial Banking System	600	5 Dec 94
27	2252 Strengthening Social Insurance	84	20 Dec 94
28	2279 Strengthening Health Insurance	500	29 Dec 94
29	2353 Strengthening of Financial Intermediaries	600	30 Jun 95
30	2371 Administrative Reform of Social Insurance	900	28 Jul 95
31	2380 Institutional Strengthening of the Road Sector	920	22 Aug 95
32	2390 Improving Accounting and Auditing Systems	600	5 Sep 95
33	2391 Institutional Strengthening of the Civil Aviation Sector (Phase II)	592	5 Sep 95
34	2457 Institutional Strengthening in the Agriculture Sector	800	5 Dec 95
35	2458 Strengthening Land Use Policies	580	5 Dec 95
36	2458 Strengthening Land Use Policies (Supplementary)	244	14 Aug 97
37	2543 Development of Procedures for the Reconstruction and Liquidation of Insolvent Banks	100	19 Mar 96
38	2549 Institutional Support for Local Government and Decentralization (Phase I)	100	26 Mar 96
39	2571 CES Accounting and Financial Management Systems Improvement	550	17 May 96
40	2602 Study of Extensive Livestock Production Systems	600	4 Jul 96
41	2605 Development of Bank Restructuring Strategies	100	9 Jul 96
42	2606 Strengthening of the Taxation System	100	9 Jul 96
43	2658 Strengthening of the National Poverty Alleviation Program	422	7 Nov 96
44	2659 Restructuring and Staff Rationalization	70	7 Oct 96
45	2697 Implementation of Bank Restructuring Strategies	100	3 Dec 96
46	2719 Institutional Strengthening in the Education Sector	950	19 Dec 96
47	2720 Strengthening the Supervisory and Restructuring Capacity of the Bank of Mongolia	1,000	19 Dec 96

No.	Title	Amount (\$'000)	Approval Date
48	2727 Restructuring and Capacity Building for the Ministry of Justice	56	23 Dec 96
49	2769 Institutional Strengthening of the Local Government and Decentralization (Phase II)	550	14 Mar 97
50	2797 Development of a Regulatory Framework for Non-Bank Financial Institutions	100	20 May 97
51	2868 Initial Phase of Civil Service Reforms	150	15 Sep 97
52	2881 Capacity Building for the Provision of Urban Services in Provincial Towns	825	30 Sep 97
53	2890 Housing Sector Policy	150	8 Oct 97
54	2890 Housing Sector Policy (Supplementary)	60	26 Mar 98
55	2907 Support for Decentralized Health Services	600	4 Nov 97
56	2964 Improving Accounting and Auditing Systems	688	23 Dec 97
57	2967 Retraining of Legal Professionals in a Market Economy	1,000	23 Dec 97
58	2990 Analyzing Development Issues in Mongolia	150	23 Feb 98
59	2993 Capacity Building in Project Accounting	150	10 Mar 98
60	3029 Improving Energy Authority's Billing and Collection System	450	10 Jun 98
61	3031 Development of Procurement Legislation and Guidelines	550	23 Jun 98
62	3090 Institutional Strengthening of the Housing Sector	800	19 Oct 98
63	3174 Education Sector Strategy Study 2000-05	150	12 Mar 99
64	3208 Strengthening Restructuring of the Banking System	220	17 Jun 99
65	3268 Policy Support in the Road Sector	670	30 Sep 99
66	3299 Capacity Building for Energy Planning	700	17 Nov 99
67	3316 Initial Phase of Public Administration Reform	1,100	2 Dec 99
68	3317 Public Expenditure Management	496	2 Dec 99
69	3318 Study on Central-Local Aspects of Reform Implementation	235	2 Dec 99
70	3395 Capacity Building for Cadastral Survey and Land Registration	990	27 Jan 00
71	3459 Strengthening Financial Sector Development	600	22 Jun 00
72	3603 Capacity Building in Agriculture	695	21 Dec 00
73	3628 Establishment of a Central Procurement Monitoring Office	600	2 Feb 01
74	3684 Improving Social Statistics	500	12 Jul 01
75	3709 Strengthening Policy for Social Security Reform	600	28 Aug 01
76	3811 Improving Aid Coordination and Management	300	18 Dec 01
Total Advisory Technical Assistance		35,288	

Source: ADB.

Project Preparatory Technical Assistance

			Amount	Approved
No.	Title		(\$'000)	(Date)
1	1648	Ulaanbaatar Airport Feasibility Study	600	3 Jan 92
2	1649	Livestock Feed Improvement	411	7 Jan 92
3	1649	Livestock Feed Improvement (Supplementary)	59	24 Mar 93
4	1653	Egilin Hydropower	1,400	9 Jan 92
5	1686	Telecommunications Development	600	1 Apr 92
6	1808	Agriculture Processing, Storage and Distribution	400	17 Dec 92
7	1820	Road Master Plan and Feasibility Study	600	23 Dec 92
8	1840	Employment Generation	100	8 Jan 93
9	1886	Irrigation Systems Rehabilitation	500	13 May 93
10	2093	Power Rehabilitation	100	25 May 94
11	2127	Agriculture Sector Program	300	25 Jul 94
12	2127	Agriculture Sector Program (Supplementary)	175	13 Jun 95
13	2228	Education Development	400	9 Dec 94
14	2350	Energy Conservation	100	26 Jun 95
15	2414	Health Sector Development	600	3 Oct 95
16	2582	Provincial Towns Basic Urban Services	600	7 Jun 96
17	2610	Ulaanbaatar Heat Rehabilitation	450	18 Jul 96
18	2731	Health Sector Resources Development	100	23 Dec 96
19	2819	Agriculture Sector Development Program	492	27 Jun 97
20	2827	Second Roads Development	500	22 Jul 97
21	2887	Egillin Hydropower Build-Operate-Transfer	150	3 Oct 97
22	2931	Program Preparation of Governance Reforms	967	10 Dec 97
23	2978	Social Safety Net	985	31 Dec 97
24	3016	Energy Rehabilitation		7 May 98
25	3351	Second Education Development	550	20 Dec 99
26	3397	Rural Finance	700	2 Feb 00
27	3406	Housing Sector Finance	600	2 Mar 00
28	3685	Integrated Development of Basic Urban Services in Secondary Towns	700	19 Jul 01
29	3686	Crop Production	500	23 Jul 01
30	3750	Second Health Sector	600	29 Oct 01
Total Project Preparatory Technical Assistance			14,239	

Source: ADB.

SUMMARY OF EVALUATION REPORTS

1. **Special Assistance Project.**¹ The generally successful rating of the Special Assistance Project was premised on the following: (i) economic difficulties during the severe economic downturn of 1991–1993 would have been more serious; (ii) quick economic recovery in 1994–1995 would not likely be achieved within a short time without Asian Development Bank (ADB) and other aid agency assistance; and (iii) financing of critical imports ensured a certain degree of social stability during a time of obvious difficulty by maintaining employment and health services and by ensuring adequate food supply. The project performance audit report (PPAR) noted some loan proceeds were used to finance inputs in industries that were in decline—leather and wool—due to general economic conditions and lack of competitiveness in the international markets. Nonetheless, by assisting these industries during the economic downturn, ADB ensured that the Mongolian economy had a base from which to develop and adjust in a continually changing economic climate.

2. Key issues identified in the PPAR² include the need to: (i) strengthen external trade (to avoid recurring foreign exchange problems) by developing an efficient and more diversified export sector and maintaining an exchange rate reflecting market value; (ii) strengthen aid coordination (i.e., multiplicity of external financing sources and limited number of experienced Mongolian counterpart staff) by developing appropriate institutions and skills in administration, finance, and economics to improve absorptive capacity and maximize use of external assistance; and (iii) focus efforts on capacity building to effectively enforce environmental regulations and monitor compliance (i.e., financing cleaner technologies and environmental services such as environmental quality monitoring equipment and database management). The PPAR recommended (i) training of staff in project implementation and provision of consultants to advise EAs and (ii) financing of projects to wool and leather industries that provide new, environment-friendly technologies.

3. **Industrial Sector Program Loan.**³ The program had been rated in the project completion report as successful, but was reclassified to partly successful at postevaluation. The PPAR⁴ noted that program-related policy changes have not led to the achievement of the basic objective of bringing about efficiency and international competitiveness in the industry sector. Likewise, negative program impacts were not mitigated. While the Government was committed to a market economy, this was not translated into an appropriate strategy with the necessary apparatus. Unfamiliarity with market instruments and lack of an overall framework for restructuring the economy led to a weakening of political support and commitment once the reforms imposed costs.

4. The program was successful in introducing liberalization, but the necessary restructuring and improvement in enterprise governance were not achieved. Some of the fundamental issues, such as pacing and sequencing of reforms, did not receive adequate attention at the design stage, due to the urgency to support Mongolia financially. At the time of evaluation, the program impact had had a negative impact on the industry sector in terms of growth of output and employment, market structure, and investments. Only few privatized units had achieved the desired efficiency gains or improved corporate governance as envisaged at the design stage. Capital market development remained weak and more time was required before effective

¹ Loan 1109-MON(SF): *Special Assistance Project*, for \$30 million, approved on 29 October 1991.

² *Project Performance Audit Report on the Special Assistance Project*. <http://adb.org/Documents/PERs/PE471.pdf>

³ Loan 1244-MON(SF): *Industrial Sector Program*, for \$30 million, approved on 17 August 1993.

⁴ *Project Performance Audit Report on the Industrial Sector Program*. <http://adb.org/Documents/PERs/PE563.pdf>

market controls were in place. The program was also weak in dealing with the negative social impacts of the reforms, including privatization. While a reversal of policy reforms was not expected, the social costs were large and had the potential to impede support for further policy actions in privatization unless they were addressed systematically.

5. Lessons identified at post evaluation include the need to: (i) systematically assess institutional capacities, skills, and human resources planning during program design; (ii) address postprivatization issues (i.e., diffused ownership, weak capital markets, residual state ownership, fiscal discipline, and budget constraints) either at the design or implementation stage; and (iii) strengthen project-level investments and ensure adequate financial resources to mitigate negative impacts of reform measures on employment and resource allocation.

6. The PPAR recommended strengthening government human and institutional capacity for policy analysis in determining a medium and long-term strategy, i.e., identify ways to mainstream a large and growing informal sector into the economy. At evaluation, the informal sector accounted for 35% of gross domestic product. The Government needs to identify niche areas and be selective to market these for resource mobilization. The PPAR also recommended building capacity for privatization through an ADB technical assistance and institutional support program. A large unfinished agenda remained, relating to the privatization program as well as to structural constraints facing the industrial activities in Mongolia. A systematic approach was needed to privatization and restructuring to maximize positive impacts and to stimulate financial sector development.

7. **Ulaanbaatar Airport Project (UAP) and National Air Navigation Development Project (NANDP).**⁵ The UAP and the follow-on NANDP were rated successful and highly successful, respectively, at postevaluation.⁶ With vast distances and low demand, aviation infrastructure in Mongolia is seen to be of limited financial viability but key to economic development and social cohesion. Under the two projects, ADB played a key role in identifying and helping develop the civil aviation sector in Mongolia, and in creating an enabling environment. The evaluation found synergy in the adoption of an integrated approach, whereby benefits of removing an infrastructure bottleneck from a project with relatively low rates of return (UAP) were enhanced by increases in institutional capacity generated from NANDP with its high rate of return. NANDP, while primarily serving international overflight traffic, generated foreign currency to support the government budget and showed that a commercial air transport sector can generate substantial revenue streams given sufficient market demand. In addition, institutional development impacts from both projects included the establishment of a body of aviation laws and regulations, improved processes and practices within CAA, and a general improvement in the capacity of the organizations. Policies opened up the air transport industry to both private international and domestic airlines.

8. The key objectives of both projects—to open up Mongolia to international markets, to improve air safety, and to upgrade civil aviation institutional and practices to international standards, thereby attracting new traffic—were largely met. Physical developments expected from the projects were all achieved, as were intangible outcomes of organizational improvement and attitudinal change in the aviation sector. The two projects proved financially viable and showed good economic returns. Their successful implementation also demonstrated that, for transition economies, ADB must play a proactive role in project preparation and implementation,

⁵ Loan 1256-MON(SF): *Ulaanbaatar Airport*, for \$36 million, approved on 12 October 1993, and Loan 1370-MON(SF): *National Air Navigation Development Project*, for \$24 million, approved on 5 September 1995.

⁶ *Project Performance Audit Report on the Ulaanbaatar Airport and National Air Navigation Development Projects*. http://adb.org/Documents/PERs/ppa_mon25306.pdf

combining strong policy and capacity building components with physical works. While there is now increased focus on the social sectors and governance issues in the 2000 country operational strategy, ADB must continue to play a role in civil aviation sector policy and investment.

9. Both projects are sustainable with demand for airport services and air navigation systems. The Civil Aviation Authority (CAA) has developed strong technical and management capability to maintain the infrastructure and services to a high standard. Likewise, there is strong government commitment to both projects. The UAP can achieve basic cost recovery, while NANDP is able to generate significant net earnings. The CAA is obliged to pay a large proportion of NANDP-attributed revenue to the Government, which constrains its financial autonomy. This limits the CAA's ability to fund major airport development, but does not constrain the sustainability of the projects themselves. The least likely sustainable outcome of the project is the constraint on financial autonomy imposed by the Government upon MIAT and the need for least-cost solutions to extend services in provincial airports, where they are profitable and bring social benefits to outlying areas.

10. The future development of the air transport sector in Mongolia is intrinsically linked to (i) the financial sustainability of the CAA, (ii) its ability to continue to invest in infrastructure and to maintain and enforce a strong regulatory capability, (iii) the commercial sustainability of the domestic airline sector and the role played by MIAT and private airlines, and (iv) the development of air safety standards across the sector.

11. **Agriculture Sector Program (ASP).**⁷ The ASP was partly successful in supporting the transition of Mongolian agriculture to a market-based sector. The Government actively participated in program design with generally strong ownership of the reform measures. Nonetheless, the design proved ambitious and overly broad. Its focus on policy reforms without adequate measures to address the key issue of agricultural financing led to a reversal of reform measures. About 75% of the ASP reform measures were accomplished or substantially accomplished. Farm privatization, price liberalization, and promoting markets for land use rights were largely achieved. The objectives of ensuring the sustainability of the extensive livestock and establishing agricultural extension systems were not achieved, although reforms in these areas have set a right direction and generated momentum for continued progress. Finally, the reforms to reduce government interventions in the state emergency fodder reserve and revitalize agricultural financing failed as the ASP did not provide alternative measures to resolve these issues. The ASP spent a large amount of TA resources, produced many action plans, but implemented few due to insufficient follow-up and financial support. ASP reforms on farm privatization, price liberalization, and land reform were largely completed and the reform direction has remained. The primary problem relating to sustainability are two major reversals relating to the state emergency fodder reserve and agricultural financing, as the Government has resumed its interventions in these areas since ASP completion. The sustainability of the agricultural extension system is less clear due to a lack of reliable funding sources.

12. The institutional development and other impacts were significant with ASP reforms leading to the enactment of a number of government regulations and laws, contributing to a better policy and regulatory environment for agricultural development. The program contributed to the better capacity of the Ministry of Food and Agriculture staff involved in the design and implementation of ASP reforms. The ASP may have contributed to stabilization of poverty in the country, not so much through its social measures as through the provision of needed funds to a

⁷ Loan 1409-MON(SF): *Agriculture Sector Program*, for \$35 million, approved on 5 December 1995.

country in severe financial difficulties. On the other hand, the program underestimated the negative impact of sector reforms on wheat production and focused on pushing through policy reforms without addressing farmers' lack of access to credit, thus contributing to the continued and sharp decline of wheat outputs in the country and the rising concerns on food security. The ASP experience provided the following valuable lessons:

- (i) The initial conditions in a sector determine the positive or negative impact of policy reforms in a transition economy. Supplementary measures are needed to offset any identified negative impact of the reforms.
- (ii) Policy reforms without effective measures to address government concerns underlying the interventions face the risk of policy reversal after program completion.
- (iii) Farm privatization and price liberalization are not final goals but means to achieve sector efficiency.
- (iv) It is more efficient if the program design focuses on addressing the most critical sector constraints so as to enable a full realization of the positive impact of the policy reforms.
- (v) The conduct of poverty impact assessments ensures awareness of the potential negative impact of the reform measures. Given the focus of program design on policy reforms, it is better if serious poverty reduction measures are designed as supplementary projects alongside a program instead of within it.

13. The evaluation⁸ identified the following key issues for the future:

- (i) **State support for wheat production.** The positive impact of state subsidies is limited and temporary, and its negative impact to the sector is significant and long term. There is a need to transform loss-incurring wheat farming into a viable and sustainable subsector using alternative mechanisms such as incentive measures to encourage agricultural lending, guarantee schemes to reduce lending risk, and supplementary supports for banks and farmers including training and technical advices.
- (ii) **Postprivatization support.** ASP established necessary but not sufficient conditions for efficient wheat farming in Mongolia, and the subsector remained inefficient and unsustainable. The program focused on reforms without sufficient attention to postprivatization support needed to address farms' ability to respond to the improved policy environment.
- (iii) **State emergency assistance and fodder reserves.** The evaluation found the need for a more cost-effective (with real impact) system of state emergency assistance such as facilitating herders to fully prepare for winter by building shelters for animals and keeping fodder stock at the household level. The limited state assistance should be targeted at the very poor through the distribution of "fodder purchasing coupons".

⁸ *Project Performance Audit Report on the Agriculture Sector Program* available in draft form at the time of finalizing the CAPE.

14. **Employment Generation Project.**⁹ The project was rated partly successful at postevaluation.¹⁰ The rationale to generate and retain jobs through the development of small and medium enterprises was relevant. However, a more rigorous institutional analysis was missing to assess the financial viability of the participating commercial banks and microfinance operational capabilities. Outcomes were below expectation. Employment generated through subloans was less than anticipated, even though savings and credit cooperatives were effective in employment retention. No effective mechanism was developed to reach the target low-income group. While being cost effective, the lending volume of savings and credit cooperatives failed to reach the appraisal target. The participating commercial banks collapsed due to problems in the banking sector that had been anticipated during loan processing, although these problems were insufficiently reflected in the project design.

15. The project concept of providing microfinance for small and medium enterprises has been sustained. The credit line provided under the loan is now re-lent to four commercial banks for onlending to small and medium enterprises, although sustainability depends on the viability of these banks. The savings and credit cooperatives, which continued expanding after the project, have been operating for over 5 years with little external assistance and are seen to be self-sufficient and sustainable. The institutional development impact of the project was significant, as technical assistance provided required skills for commercial based credit and business operations. Lessons identified include the need for (i) differentiating loans to microenterprises from that to small and medium enterprises, and tailoring project objectives and design accordingly; and (ii) making more prudent institutional assessment for performance and technical capabilities of the financial intermediaries, such as the participating commercial banks.

16. Key issues identified relate to conflicts between the financial viability and outreach to the poor for microfinance institutions. With the high cost of administering a large number of small loans, financial institutions tend to provide bigger loans to better-off clients. This suggests that the viability of financial institutions and outreach may be mutually exclusive. Microlending to those with no access to regular commercial bank services requires special lending modalities. Loan products and disbursement and repayment mechanisms should be designed according to the needs of the poor. This will involve appropriate loan amounts, loan terms, collateral requirements or substitutes and potentially compulsory savings or group contribution requirements. Microfinance projects targeting the poor should ensure that the designated financial intermediaries have incentives and capabilities to implement such losing operations. If no such intermediaries exist, the creation of an alternative microfinance institution should be considered.

17. To achieve financial viability and maximize outreach, institutions must be financially sustainable. They must cover all their costs, mobilize their own resources, protect their funds against erosion from inflation and nonrepayment of loans, and make profit to finance their expansion. Financial viability and outreach can be achieved together through various measures including removal of interest rate ceilings, saving mobilization lending through joint liability groups, and self-sustaining branch operations. It is important for microfinance projects to use financially sound, self-reliant institutions as intermediaries. Feasibility studies need to ensure that the preconditions exist for such institutions to be operational, such as a favorable financial sector climate, effective demand for microlending, and a financial institution's commitment to profitability and sustainability in microfinance operations.

⁹ Loan 1290-MON(SF): *Employment Generation Project*, for \$3 million, approved on 16 December 1993.

¹⁰ *Project Performance Audit Report on the Employment Generation Project* available in draft form at the time of finalizing the CAPE.