

REFORMING SOCIAL PROTECTION SYSTEMS WHEN COMMODITY PRICES COLLAPSE: THE EXPERIENCE OF MONGOLIA

by: Wendy Walker, Asian Development Bank¹ and David Hall, Sechaba Consultants²

Background Paper for Conference on the "The Impact of the Global Economic Slowdown on Poverty and Sustainable Development in Asia and the Pacific",
28-30 Sept 2009, Hanoi

1. INTRODUCTION

1. Coming on the heels of the food crisis in early 2008, when Mongolia experienced the highest inflation rates in all of Asia, the worldwide drop in mineral prices as a result of the financial crisis had a direct impact on Government budget which receives 40% of its revenue from mining. During the commodity boom, the Government was able to expand social benefits significantly, partially funding a 'Child Money Program' (CMP) that disbursed 5.6% of fiscal expenditure from a special fund generated from mining revenues. The collapse of copper and other mineral prices in 2008 had immediate fiscal consequences for the budget, exposing the dependence of key social transfers on commodity prices. The crisis highlighted the risks of channeling mining revenue through the welfare sector and underlined the lack of mechanisms for targeting the poor when resources are limited.

2. Lessons learned from the Asian financial crisis in 1997 demonstrate that falling demand for exports have an economy-wide, systemic impact that is difficult to counter, without very significant reserves. The 2008 crisis has underlined the validity of this lesson for Mongolia. An overview of transmission channels of the impacts in Mongolia confirms the systemic links between key sectors, notably mining, banking, construction, agriculture and retail, and the consequences for employment and social welfare. A further lesson from the 1997 crisis is that Government expenditure to protect the poor and sustain social services is critical. Because of the fiscal constraints experienced during a crisis, effective targeting becomes even more important. The current crisis has demonstrated the importance of this lesson for Mongolia which failed to build up the necessary fiscal reserves during the commodity boom and to establish mechanisms for targeting social benefits for the poor.

3. Without a sufficient fiscal surplus from earlier years, in March 2009, the Government's fiscal position became difficult as a result of declining revenue from the lower commodity prices. With the assistance of donors, the Government has begun a reform of the social welfare system that aim to achieve fiscal sustainability, target resources to the poor and consolidate the wide range of existing benefits built up, in part, during the commodity boom. This paper describes the impact of the collapse of commodity prices on Mongolia, the transmission channels of impact, and how government and donors have attempted to respond to ensure that fiscal sustainability is ensured and the poor are protected.

4. The paper is written in the context of rapidly evolving reforms and decision-making. For this reason, it is import to underline that the paper shares the on-folding experience of Mongolia's response to falling commodity prices, from the point of view of reforming social protection, but does not offer definitive

¹ Wendy Walker is a Social Development Specialist with ADB, based in Manila.

² David Hall is a Social Impact Assessment specialist working as a consultant in Africa and Asia.

conclusions as these would be premature.

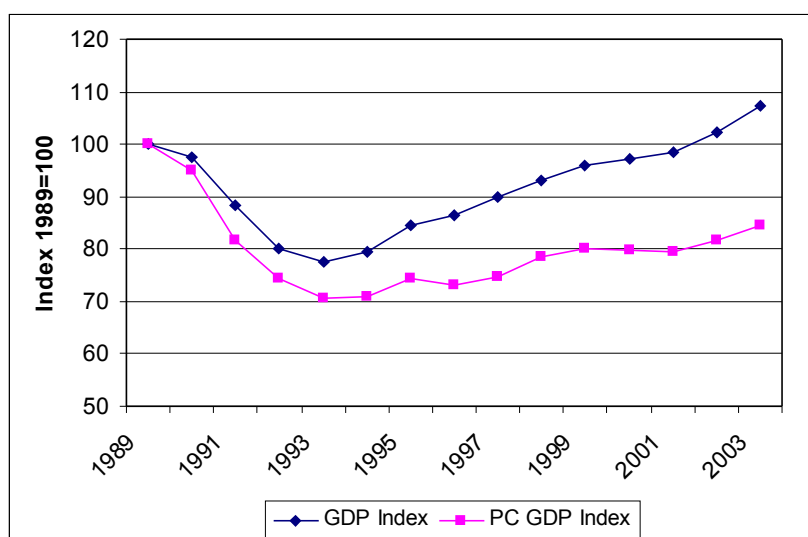
2.RAPID GROWTH, SOCIAL WELFARE EXPANSION AND THE COLLAPSE OF COMMODITY PRICES

2.1

Rapid Growth

5. Mongolia went through a difficult period of economic transition from a socialist to free market economy in the early 1990's. The withdrawal of Soviet funding resulted in a virtual collapse of the state budget and drastic cuts in subsidies and welfare programs. Between 1990 and 1994, the economy experienced a GDP per capita contraction of around 30% due to the withdrawal of assistance from the former Soviet Union and the break up of the related trading system. Economic restructuring and privatization led to massive retrenchments in the public sector and to the closure of many nonviable state enterprises.³ Social sectors were heavily impacted by the transition with severe budget cuts.

Figure 1: GDP during the transition from Socialism



6.

Source: ADB, 2009, Mongolia Country Poverty Assessment, Manila

7. During the period transition, economic reforms were undertaken in the areas of price liberalization and privatization, giving Mongolia one of the least restrictive trade regimes in Asia, and a relatively liberal foreign investment regime. During the same period new democratic laws and institutions were put in place, media freedom was established and civil society was allowed to function freely.

8. From 1995, Mongolia's economy started to show signs of recovery and growth. By the early part of the decade, economic reforms, combined with a buoyant world economy had put Mongolia on a strong growth trajectory. Between 2003-2007, sustained growth was achieved with an average GDP growth rate of about 9%.

Table 1: Economic Indicators 2003 – 2007

Indicator	2003	2004	2005	2006	2007
Exports of goods (\$ mn)	627.3	872.1	1066.1	1543.9	1950.7

³ : ADB, 2009, Mongolia Country Poverty Assessment, Manila

(% yoy change)	19.7	39.0	22.2	44.8	26.4
Copper exports (% yoy change)	14.7	94.8	27.7
Imports of goods (\$ mn)	826.9	971.3	1165.6	1407.7	2003.1
(% yoy change)	21.6	17.5	20.0	20.8	42.3
Current account balance (\$ mn) ⁽²⁾	-102.4	24.1	29.7	221.6	264.8
(% of GDP)	-7.1	1.3	1.3	7.0	6.7
Foreign direct investment (\$ mn)	131.5	128.9	257.6	289.6	360.0
External debt (\$ mn)	1240.3	1311.8	1360.0	1413.9	1528.7

Source: MOF, World Bank

9. The dramatic rise in the value of exports in dollar terms, driven largely by soaring international commodity prices, gave the Government unprecedented financial strength, with the current account balance being turned from - \$102.4 million to + \$264.8 million in four years.

10. The extent to which the poor benefited from the economic boom remains questionable. Survey data from 2003 and 2007 show little change in the proportion of poor households nationally, with the figure remaining stubbornly close to one third of the population, at around 35%, underlying the need for a clear social safety net program to address their needs.

11. The rapid growth in the economy fueled inflation, which was further exacerbated by the impacts of the global food and fuel crisis. The inflation rate reached 33% in May 2008, which was much higher than in most other Asian countries. The prices of wheat (primarily imported) and meat (domestically produced) contributed to nearly half of the overall inflation, with oil prices accounting for a small but growing proportion. This spike in food and oil prices threatened to push large numbers of people back below the poverty line in Mongolia.⁴

12. There were many causes for hyper-inflation in Mongolia, including rising demand fuelled by rapid increase of wages, social transfers, and remittances, monetary expansion; increases in the prices of government services (i.e., hospital charges, school fees, and electricity tariffs) and opportunistic behavior in the domestic market. The immediate impacts of the inflation hit particularly hard at the household level. Poor households reported consuming less food and food of lower quality; cutting back on expenditures for schooling and medicines; limiting travel; substituting energy sources and moving in with relatives to reduce costs, particularly of food and heating.⁵

2.2

Social Welfare Expansion

13. The period of economic boom allowed the Government to be generous, with large wage increases in the public sector. It also allowed for an increase in social welfare expenditures, comprising social insurance, social assistance allowances and active labor market programs. Overall, coverage of benefits administered by Ministry of Social Welfare and Labor (MSWL) and its agencies increased 7.6 times from 2004 to 2007. As a percentage of GDP, the overall MSWL budget, without the financial crisis, would have increased from 7% in 2006 to 23% in 2009.

Table 2: Social Welfare Budget 2006 to 2009

(MNT '000)

⁴ Palanivel, T. 2008. *Policy Note on the Soaring of Food and Oil Prices in Mongolia: Causes, Consequences and Responses at the Macro Level*. Colombo: United Nations Development Program/Regional Center in Colombo (UNDP/RCC).

⁵ ADB, Food and Nutrition Social Welfare Support Program and Project, November 2008.

Item	2006	2007	2008	2009 Planned Budget	% Increase in 4 yrs
Pension and benefits	15,964	28,475	52,667	63,144	61.1
Veterans and elders	3,243	4,248	18,594	17,958	121.8
New family program	11,814	29,724	17,500	17,500	63.8
Honored mothers	4,909	8,876	11,625	108,625	315.4
Child money	36,104	131,457	148,650	166,008	96.3
Services for disabled	1,630	1,397	5,005	6,279	89.9
Community-based social welfare service	1,120	1,503	17,223	28,941	382.7
Total for Welfare Services	74,783	205,680	271,264	408,456	85.8

Source: Ministry of Social Welfare and Labor. September 2008.

14. The large increase in expenditure can be attributed to the introduction and expansion of benefits that fulfilled electoral promises, had pro-natalist objectives and benefitted large populations without any means testing requirements. In addition to the CMP, two other large one-off benefits were introduced in 2006: 500,000 MNT for newlyweds and 100,000 MNT for new-born children.

15. In 2005, the Government introduced the CMP benefit at the modest amount of 3,000 MNT per month for children under 18 years of age.⁶ The CMP was introduced as conditional cash transfer for poor households. The cash transfers were conditioned on children being immunized, living with their parents, and not engaging in intolerable forms of child labor. For those with children aged 8 to 18 years school enrollment was also required. In addition to meeting these conditions, beneficiaries had to pass a proxy-means test (PMT), making the CMP the first social assistance intervention to target the poor.⁷

16. Despite the conditions attached to CMP and use of a PMT, by the end of 2005 the CMP had reached over 600,000 children, from about 300,000 of the country's 500,000 households. As this was considered to be twice the number of poor households in the country it was evident that targeting was not meeting its objectives and that there was a serious "inclusion" error. Overall, based on 2006 data, the World Bank estimated that 19% of the poor were excluded from the program and 61% percent of the non-poor were included. When the data were disaggregated by quintile of household per capita consumption it was found that 19% of the households in the poorest two quintiles were excluded from the program, while 55% of those in the richest two quintiles received benefits; the two poorest quintiles accounted for only 50% of total beneficiary households (see Figure 2). The data clearly showed that, as a result, there were large cost-inefficiencies. The World Bank raised concerns about this and the fiscal sustainability of the rapid increase in expenditure on this single benefit (1.4% of GDP in 2006).⁸

17. While the CMP may have had weaknesses in its implementation, due largely to it being a new program pioneering new approaches with limited local capacity, it was, nevertheless, considered to be a useful tool to support poor households with children that needed to be strengthened.⁹

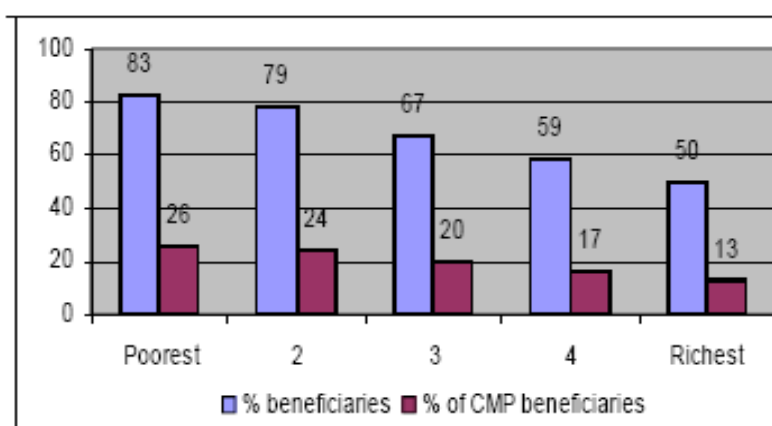
⁶ The child money program currently provides cash transfers of MNT3,000 (\$3) per child per month and MNT100,000 (\$100) lump sum per child per year.

⁷ M. Caridad Aruajo, Assesment of the Child Money Program and Properties of its Targeting, World Bank Working Paper, Paper No. 2006-1.

⁸ Ibid.

⁹

Figure 2: Percent of CMP Beneficiaries by Quintile



Source: Araujo, C. 2006¹⁰

18. At this critical juncture, the Government could have chosen to review the targeting methods to reduce inclusion errors and maintain expenditure at sustainable levels. However, in July 2006, in response to political pressure and access to new mineral revenue, Parliament enacted an amendment which made “child money” an entitlement to which all children below 18 would be eligible. Six months later, in January 2007, the benefit was increased from 36,000 MNT per annum to 136,000 MNT per annum. This increase of 100,000 MNT was disbursed as 25,000 MNT in quarterly payments and funded by the Mongolian Development Fund. The Fund was established to make use of revenue from Windfall Profits Tax on copper and gold. With the introduction of universal quarterly benefits, the number of CMP beneficiaries soared from less than 160,000 in 2004 to more than 1 million (40% of the population) in 2006 and subsequently expenditure rose by 173%. By 2008 more than 80% of social welfare beneficiaries were those receiving “child money”.

19. Although no study has been done to quantify the costs of the CMP in terms the administrative burden, there is anecdotal evidence from interviews¹¹ with Social Welfare and Labour Office (SWLO) staff suggesting that CMP administration seriously distracted the country’s nascent social work services from the wider range of tasks envisioned for them in the 2003 Social Security Sector Strategy Paper. Staff complained that the CMP was not social work at all, but simply a wealth redistribution mechanism imposed on the SWLO to administer.

2.3

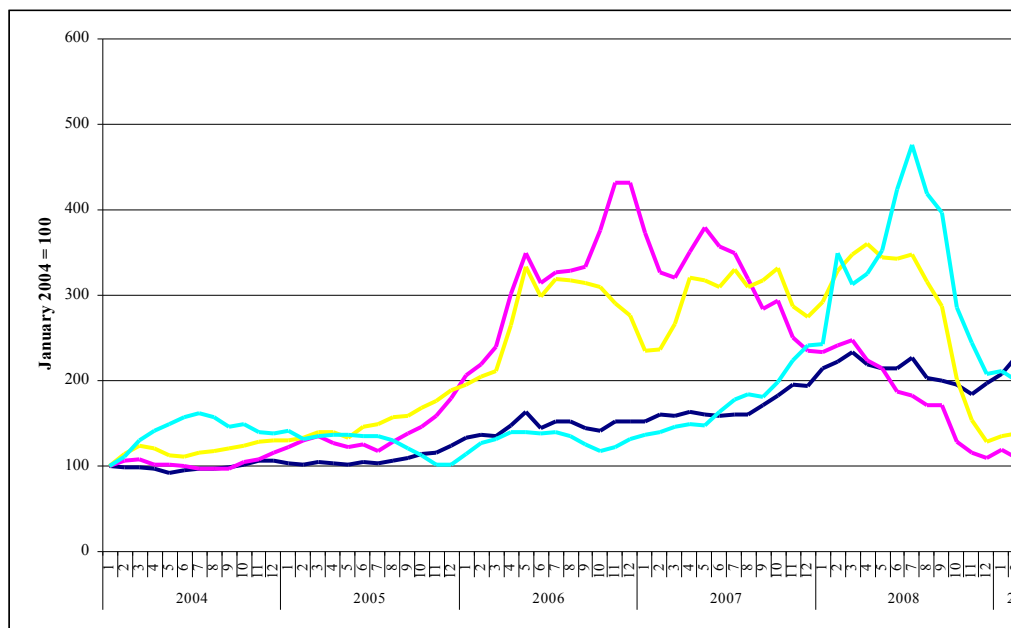
Collapse of Commodity Prices

20. If commodity prices had not crashed in 2008 the CMP may have proven to be an effective mechanism for the redistribution of the country’s mineral wealth. However, by March 2009, the price of copper had fallen by 60% from its peak in April 2008 down to US\$3500/ton. The graph below shows the rise and fall of copper and other mineral prices from 2004 to April 2009.

¹⁰ M. Caridad Araujo, Assesment of the Child Money Program and Properties of its Targeting, World Bank Working Paper, Paper No. 2006-1.

¹¹ ADB,SSSDP Evaluation. September 2009.

Figure 3: Key Mineral Prices 2004-2009



Source: IMF (in Tuvshintugs, 2009)

21. This fall had immediate and very negative consequences for the fiscal account, the real economy, the balance of payments, the exchange rate and Government's capacity to sustain social transfers. With one third of Mongolia's population living in poverty, Government was faced with the challenge of managing an orderly adjustment to this external shock, or risk potentially unwinding the gains of recent years.

22. The one benefit of the rapid fall in commodity prices was that inflation also plummeted, easing the pressure on the poor. By September 2009 the annual rate had fallen to 4.9%.¹² However, the long term consequences of the survival measures taken by the poor households during the food crisis will extend well beyond the period of high inflation, into the financial crisis, as households are now faced with poorer health and poorer education outcomes resulting from the reductions of expenditure in these. For this reason disaggregating the impacts of the two crises can be problematic at household level. However, as indicated below, the transmission channels can be disaggregated.

3. TRANSMISSION CHANNELS AND THEIR IMPACTS

23. As noted in the introduction, the collapse in commodity prices had an economy wide systemic impact which affected many sectors through a variety of channels. Because declining revenue in the private sector impacted Government revenue, this contributed to cuts to public welfare budgets, including social welfare.

3.1 Declining Exports, Imports, Tourism and Remittances

24. The main transmission channels of the financial crisis can clearly be linked to falling commodities prices and exports. Mineral exports, a key source of Government revenue, were hard hit. Although the volume of copper exports was maintained, the value dropped by 56% in dollar terms over a 12 month period (June 2008 to July 2009). Gold production fell 50% and with no exports at all in

¹² Bank of Mongolia. 17th September 2009.

June and July of 2009 (due in part to labour disputes and a license being revoked). Overall, exports for the first six months of 2009 were down 37.4% from the same period in 2008.¹³

25. Declining commodity prices impacted the rural economy strongly because of its reliance on cashmere and other livestock products. As a result of a sharp fall in cashmere and meat prices, combined with the residual impacts of high inflation rates that preceded the financial crisis, reports emerged of rural families being increasingly unable to afford school fees, textbook and to afford essential medical care¹⁴.

26. With fewer exports came fewer imports. Imports declined 40% in dollar terms from a year earlier, with industrial goods falling most sharply, reflecting the slowdown in industrial production in Mongolia. Food product imports fell less dramatically as food demand is less dependent on the domestic slowdown and exchange rate depreciation than the other types of imports.¹⁵

27. The global recession also reduced income from tourism and remittances from Mongolians working abroad. This, combined with declining exports, contributed to a current account deficit of 15.2% of GDP by the second quarter of 2009.¹⁶

3.2 The Banking Crisis and the Consequences of the Credit Freeze

28. The decline in revenue from commodities was soon felt in the banking sector as people struggled to repay their loans. The number of 'toxic assets' grew rapidly, curtailing the capacity of the country's nascent commercial banking sector to play a role in economic recovery. Over a 12-month period, from July 2008 to August 2009, the number of "bad loans" increased 3.6 fold to 353 billion MNT, or 13.7% of outstanding loans. Several banks were reported to be unable to meet capital asset requirements and the total short-fall was estimated to be 76.2 billion MNT.

29. The construction sector, a key employer during the economic boom of recent years, developed the highest ratio of non-performing loans (NPLs) total loans at 28.7%. By February 2009, sales of houses and real estate had slumped by 90% and prices had fallen by 20-30%. By August 2009, statistics revealed that 440 constructions projects had come to a standstill. Over 7,800 household were impacted by this, having already paid in advance for houses or flats from these projects. Of Mongolia's 2.4 trillion MNT in circulation, 998 billion MNT was now locked in frozen construction sector projects.¹⁷

30. Given the collapse of commodity prices it is not surprising that mining and quarrying come a close second with regards to the ration of NPLs, 27.4%. Overall, between the second quarter of 2008 and the second quarter of 2009, NPLs and loans in arrears increased by 274.1 percent.

31. As the NPLs increased rapidly the banks became extremely cautious in granting new loans, with their main concern being to reduce loan amounts and to control bad-debt risks. Newly issued loans dropped 43% 593 billion MNT in the second quarter of 2009 from 1,041 billion MNT in the second quarter of 2008.¹⁸ This, in turn, impacted on economic growth as existing businesses that were

¹³ World Bank, Mongolian Monthly Economic Update, August 2009.

¹⁴ ADB, Participatory Poverty Assessment, 2009.

¹⁵ World Bank, Mongolian Monthly Economic Update, August 2009.

¹⁶ World Bank, Mongolian Monthly Economic Update, August 2009.

¹⁷ <http://www.business-mongolia.com/mongolia-business/1-trillion-mnt-is-at-halt/>

¹⁸ World Bank, Mongolian Monthly Economic Update, August 2009.

unable to obtain credit curtailed their expansion plans and new businesses failed to launch. The banks ability to recapitalize was constrained by the limited number of shareholders and private entities willing to invest in banks. Without urgent recapitalization the banks have been unable to play an effective role in re-starting the economy.¹⁹

32. The cost of imports and difficulties in obtaining credit impacted business. Sales revenue declined by 15.7% when comparing the first quarters of 2008 and 2009. This caused a decline in company income (before tax) of 64.4 percent and a corresponding decline in company taxes paid.

3.3 Falling Government Revenue and Cross-the-Board Budget Cuts

33. All the factors discussed above impacted on Government revenue which fell by 29% in real terms in January-July 2009, compared to a year earlier. Areas of declining revenue include all areas of tax revenue (corporate income, windfall profit, VAT, excise, import duties).

34. One option for governments during a financial crisis is to increase public expenditure to stimulate the economy. This requires either substantial reserves or access to credit. In the case of Mongolia insufficient use had been made of the economic boom when commodities prices were high to build up fiscal surpluses. As a result of the increased social transfers and salary hikes of earlier years, the Government had insufficient reserves in 2008 to sustain current expenditure, let alone to offer any economic stimulus package. Unable to raise further revenue and unable to obtain low-cost credit in the crisis, the Government had no choice other than to cut expenditure.

35. The cuts in the national budget impacted all sectors. Infrastructure projects in all sectors were hard hit: planned capital investments to replace and repair boilers, transmission lines, and distribution systems for the main power system had to be sharply scaled-back.

36. The cuts in the state budget did not result in the public sector retrenchments. However there is strong evidence of private sector retrenchments. By the end of July 2009 the number of people registering themselves as unemployed at Social Welfare and Labour Agency offices grew by 29.4% over the same period in 2008 to 40,700.²⁰ This figure is a reflection of people previously employed now searching for new employment, as the long term unemployed and informal sector workers do not make use of the Agency services. The number of people formally registering as unemployed (at around 3.8% of the labour force) is considered to be less than one fifth of the total number actually unemployed.²¹

37. Assessing the consequences for the poor of the impacts described above is difficult as the necessary household-level data have not yet become available. However, According to a World Bank assessment, based on the historic correlation between economic growth and poverty, it is estimated that the current economic slow down means that between 20,000 to 40,000 fewer Mongolians (0.7% and 1.4%) would be lifted out of poverty in 2009.

5. GOVERNMENT'S RESPONSE TO THE CRISIS

¹⁹ Mongol Messenger, 2 Sept 2009.

²⁰ National Statistical Office, Social and Economic Situation of Mongolia, August 2009

²¹ World Bank, Mongolian Monthly Economic Update, August 2009.

38. The sudden fall in commodity prices in 2008 underlined Mongolia's overreliance on mineral revenues for the state budget. The downturn created a precarious fiscal situation leaving the Government with little choice other than to negotiate assistance from the international community.

39. In early March 2009, Mongolia negotiated a \$224 million stand-by agreement with the IMF based on an agreed budget deficit of 6% GDP for 2009 and 4% for 2010. Support was also forthcoming from the ADB, JICA and World Bank who offered assistance through a combination of policy development loans and grants worth \$150 million.

40. By the end of March, Parliament had approved an amended 2009 budget with a 5.4% GDP deficit. As part of the agreement, the Government committed itself to (i) reducing expenditure while (ii) still maintaining *“a social policy to ensure that the poorest segments of the society would be protected adequately through a comprehensive overhaul of social transfer programs, by improving targeting and raising the level of social support to the very poor”*.²²

41. In April 2009 the ADB and JICA negotiated a set of 12 policy reform conditions with the Government (relating to the proposed loan), the first of which committed the Government to: *“Social welfare reform to improve efficiency and protect the poor through (i) improvement in targeting (through proxy means-testing); (ii) consolidation of social welfare programs, including Child Money Program; and (iii) achievement of fiscal sustainability.”*²³

42. The World Bank also negotiated a Development Policy Credit with the Government which supports the reform. According to this the reform will *“Protect the poor during the downturn by retargeting social policies to the poor”*.²⁴

5.1 Impact on Ministry of Social Welfare and Labor

43. As with most ministries, MSWL found itself facing cuts of close to 20%. The 2009 amended budget for social welfare services was reduced by 74.8 billion MNT, a decrease of 18.6% from the 2009 approved budget, as shown below.

Table 3: 2009 MSWL Amended Budget (million MNT)

	2009 Budget	2009 Amended	Difference	% Decrease
Total Expenditure	405,855,665	327,409,304	-78,446,361	-19.3
Current Expenditure	405,419,665	327,023,304	-78,396,361	-19.3
Capital Expenditure	436,000	386,000	-50,000	-11.5

Source: 2009 Budget Amendments, MOF.

44. Overall, the Ministry of Finance's cuts would have reduced social welfare expenses by 32.6%, or 77.6 billion MNT. The reason given for having to cut the CMP so significantly was that this was dependent on the Development Fund, which was now depleted by the collapse of the copper price. The Ministry of Finance indicated that there may not be enough in the Development Fund to pay the third or fourth quarters of the CMP for 2009.

²² IMF, Standby Agreement, March 2009.

²³ ADB, Proposed Asian Development Fund Loan and Grant, and Technical Assistance Grant Mongolia: Social Sectors Support Program, RRP, Manila, 15 May 2009.

²⁴ World Bank, June 1, 2009. Mongolia Development Policy Credit, Report No. 48794-MN.

5.2 Findings Ways to Protect the Poor

45. The potential consequences of a sudden end to quarterly payments of the CMP were a cause of concern given the commitments made with the donors and the extent to which it was understood that poor households were relying on the benefits. Analysis by a World Bank consultant showed that straight cutting of the CMP quarterly benefit would increase the poverty rate by 3 percentage points.²⁵

46. Although there was general agreement between the international agencies and officials in the MSLW on the need for fiscally sustainable, targeted benefits it was also recognized that a sudden cut in the CMP in the middle of a financial crisis would be most detrimental to the poor. A series of alternatives were explored seeking to protect the poor while still making fiscal savings. The ideal option would have been to remove non-poor from the CMP rosters, however this was not possible for the following reasons:

- The lists of beneficiaries contained no socioeconomic data that would have facilitated identification of poor and non-poor.
- No national database of CMP beneficiaries existed. Therefore rapid identification of beneficiaries was not possible.
- Uncertainty existed about the quality of locally held information and the capacity of local government bodies to identify the poor and non-poor beneficiaries of the CMP.

47. A final proposal was made to maintain the a benefit for children, but make it progressive by providing marginally more money to successive children. This was justified on the basis that, given the higher poverty rate among families with more children, this reform would be more pro-poor than flat benefits for each child.

48. The advantage of this strategy is that it required no means testing. However, the following weaknesses were recognized: (i) some non-poor household would receive the benefit; (ii) it would not replace the need for a benefit for the poor; (iii) politically it may be difficult to sell. Nevertheless, of the different options explored, progressive payments per child appeared to be the most feasible, despite its weaknesses. The table below shows how the progressive model would increase payments for households with larger number of children (who tend to be poor), decrease the amounts received by those with only 1 child, and still make a significant saving in terms of the overall budget.

Table 4: Budget saving from reformed progressive CMP

No. Children	No. Households	No. Children (Effective 2009)	Combined allowance per child per month 2009	Budget 2009 (MNT millions)	Proposed monthly benefit per child 2010	Budget 2010 (MNT millions)
1	202,412	202,412	11,333	30,578	5,000	13,177
2	174,628	349,256	11,333	52,762	8,000	36,377
3	76,502	229,506	11,333	34,671	11,000	32,869
4	26,166	104,664	11,333	15,811	11,000	14,989
5	7,508	37,540	11,333	5,671	11,000	5,376
6	1,644	9,863	11,333	1,490	11,000	1,413

²⁵ Paolo Verme, "The proposed budget cut to the Child Money Program (CMP) Implications and alternatives", Discussion Note. June 2009

7	866	6,060	11,333	915	11,000	868
8	220	1,761	11,333	266	11,000	252
9+	67	600	11,333	91	11,000	86
Total	490,013	941,662		142,256		105,407

Source: World Bank, August 2010

5.3 Consolidating and Reducing the Number of Benefits

49. The proposed reform of the CMP did not achieve sufficient savings to meet the broader fiscal objectives of reducing overall social welfare expenditure. To do this, a proposal to consolidate the number of benefits (under the MSWL) from 66 to 22. In addition to the reform of the CMP described above, the consolidation exercise included the following key features:

- Discontinuation of selected social welfare benefits not essential for the poor;
- Replacement of discontinued benefits with a temporary benefit (for 2010) for the poor, making use of the savings made through reforms to the CMP and discontinuation of selected benefits.
- Simplification and consolidation of the remaining existing benefits, clarifying the distinction between benefits and beneficiaries.

50. The main savings proposed came from the reform of the CMP and the discontinuation of benefits for newly-weds, newly borns, pregnant and breast-feeding women and twins. The old CMP and these essentially pro-natal benefits would now be replaced with the new 'progressive' Children's Benefit, starting in the fifth month of pregnancy.

51. The progressive nature of the new Children's Benefit only partially met the objective agreed with the IMF of "*improving targeting and raising the level of social support to the very poor*". To fully achieve this, further steps would be needed.

5.4 Need for National Database of the Poor

52. In the long term Mongolia aims to establish a national data base that will enable Government to readily identify the civil registration, social insurance and social welfare status of the population. 'Smart' identification cards will be issued to citizens to facilitate rapid identification, payment and overall management of the system. Progress towards this long-term goal has been made in recent years with the creation of new national databases for civil registration (by the CRO), welfare (by SWLA), social insurance (by SSIGO) and household demographic and socio-economic status (by NSO). However, it will still be some years before these separate initiatives can be cross-referenced and integrated in a manner that would allow for a smart card to be issued.

5.5 Initiation of the PMT

53. In the absence of any comprehensive database with the necessary variables, alternative means had to be found to use the savings achieved through consolidation to target the poor. The policy matrix agreed with the ADB and JICA clearly specified that this should be done through a proxy-means test (PMT), and, by the World Bank offered to provide technical support to develop a test that would be appropriate for Mongolia. This would require a nation-wide effort to

identify the poor, as well as a means of updating the information on a regular basis.

54. The proposal to establish a new PMT was accepted by MSWL but faces several challenges. The first PMT had generated many 'inclusion errors', possibly because it did not adequately accommodate difference between livelihoods in rural and urban areas. Second, the new system will have to be thoroughly tested before being applied nationally. This would take time and will be conducted under the Food Stamp Program initiated during the food crises. This Program particularly targets the poor and provides a specific food stamp benefit to ensure household consumption levels of the very poor. Third, in order to apply the PMT nationally, significant resources will need to be mobilized for the initial survey, to be carried out by independent enumerators, and for its maintenance by SWLA.

55. Given the challenges faced in establishing the PMT it was agreed that the process will be phased over a 16-month period, with full-scale implementation scheduled from January 2011. In order to protect the poor during this transition the MSWL has proposed that a temporary poverty benefit would be introduced equivalent to about 40,000 MNT per month for the poorest quintile of households. This will be targeted through the existing systems, whereby social workers at the district level of government propose a list of eligible households to Livelihood Support Councils to validate.

56. The proposals described above will achieve the three objectives: (i) reduce the fiscal burden of social welfare benefits; (ii) consolidate benefits and (iii) target the poor. The savings expected are shown in the table below:

Table 5: Anticipated budget savings before and after consolidation

	Nominal Terms m.t.	Real Terms 2008(1)	US Dollars m. (2)
Budget January 2008	265,766	265,766	227
Budget March 2009	265,766	217,663	169
Budget January 2010 after consolidation	195,059	155,251	135
Savings from Consolidation (base 2008)	70,707	110,515	93
Temporary Poverty Benefit 2010 and permanent benefit 2011	70,707	70,707	49
Budget January 2010 with new poverty benefit	265,766	211,528	146
2008-2010 Savings	0	54,238	81

Source: World Bank, August 2009

1) Inflation 2008=22.1%; inflation 2009=2.9% (est.)

(2) Exchange rates: January 2008=1170.24; March 2009=1569.92; August 2009=1449.8

5.6 Forging new Legislation

57. The consolidation and targeting of benefits requires a new legal framework. To this end, a new Social Welfare bill was drafted in August 2009 for review by relevant ministries, standing-committees and cabinet before

submission to Parliament in October 2009.

5.7 Developing an Action Plan

58. A new Social Welfare Action Plan is helping to guide the reform process and maintain its momentum. The Action Plan, which was agreed as part of the policy matrix linked to the ADB-JICA loan, lays out the reforms to be carried out between July 2009 and December 2010. The plan focuses specially on social welfare. It describes how the reform process that will result in changes in the legal, institutional and financial arrangements that govern the implementation of social welfare in Mongolia. It provides an assessment of the existing social welfare system, analyzes the aspects that require strengthening, and details the processes that need to be set in motion to meet the desired objectives.

6. CHALLENGES AHEAD

59. As this paper is written (September 2009) much uncertainty remains regarding the future of the proposals and the legislation described above. Specific challenges include:

- **Recovering commodity markets:** The impact of the financial crisis on government budget has provided an important opportunity to carry out needed reforms which will ensure social protection of the poor and create a financially stable social safety net. However, consensus building and implementation will take time. In the interim, government revenue is picking up as a result of increased commodity prices, reducing the incentive to act quickly, make hard choices about targeting benefit coverage and implementing change.
- **Sustaining Political Will:** On the one hand, Government has made a firm commitment to reforming social welfare, with the policy matrix agreed with ADB and JICA specifying that a PMT will be introduced. On the other hand, at the political level, the idea of targeting benefits to the poor is not universally accepted. As the CMP and the benefits for newly weds were originally based on electoral promises (in 2004), for politicians rescinding these runs the risk of being accused of breaking promises.
- **Timing of reforms and creation of new national benefits:** The timing for the reforms is also a delicate matter. In the most recent election campaign (for the 2009 Presidential election) both parties, once again, made exceedingly generous promises. This time the Democratic Party candidate proposed the idea of a "Wealth Sharing" benefit (from mining revenues) which would give every adult citizen of Mongolia – regardless of their status – 1 million MNT (approx US\$ 870), if they are voted into power. Not to be outdone, the MPRP candidate promised 1.5 million MNT for each adult and 10,000 MNT for each child. With the election of the Democratic Party candidate there are now high expectations amongst the electoral that 1 million MNT per person will be coming their way in the near future.
- Given (i) the fiscal deficit and (ii) the commitments made under agreements with the IMF, World Bank and ADB, it is not clear how the electoral promise for wealth redistribution will be realized, even if new mining agreements result in substantial payments to the Government. In August 2009 Government reached agreement with Ivanhoe Mines on the massive Oyu Tolgoi project that an advance would be paid to Government

of \$250 million on future revenue shares.²⁶

- **Public understanding of the reforms:** The social welfare reforms are at risk if wealth re-distribution is, once again, made the responsibility of the MSLW. The use of the MSLW and its agency to distributed benefits that are not targeted to vulnerable groups or means tested creates confusion in the public. It will be hard for current beneficiaries to understand why certain targets need to be ended and others targeted if Government, at the same time, requires the MSLW to make very substantial payouts to all citizens. Any arguments made regarding the need for fiscally sustainability will ring hollow.
- **Donor coordination and sustained engagement.** The reform process has benefited from excellent donor coordination and collaboration with Government. Successful implementation of the reforms will require sustained engagement and capacity building.

60. The fiscal crisis can, in fact, be used as an opportunity to introduce much needed reforms to a social welfare system. However, the reforms require strong commitment and serious consensus among politicians and public. One of the greatest difficulties is the time it takes to implement reforms and the difficulty of creating interim strategies to address the impacts of the crisis as they evolve. In the case of Mongolia, it is not yet clear if this will be achieved. However, it is apparent that a new understanding of social welfare will need to develop to facilitate the emergence of systems better designed to respond to economic cycles in a free market economy.

²⁶ Mongol Messenger, 19 August 2009.