

ASIAN DEVELOPMENT BANK

PCR: MON 31597

PROGRAM COMPLETION REPORT

ON THE

**Governance Reform Program
(Loan 1713-MON[SF])**

TO

MONGOLIA

December 2002

CURRENCY EQUIVALENTS

(as of 10 November 2002)

Currency Unit – Togrog (MNT)

		At Appraisal	At Program Completion
		2 July 1999	30 October 2002
MNT1.00	=	\$0.00093	\$0.00092

ABBREVIATIONS

ADB	–	Asian Development Bank
BOM	–	Bank of Mongolia
CGA	–	Customs General Administration
CS	–	Cabinet Secretariat
FFS	–	Fiscal framework statement
GDP	–	Gross domestic product
GRP	–	Governance Reform Program
GDNT	–	General Department of National Taxation
IAS	–	international accounting standards
IMF	–	International Monetary Fund
MOFE	–	Ministry of Finance and Economy
MTEF	–	Medium-term expenditure framework
NSO	–	National Statistical Office
PIP	–	public investment program
PRGF	–	Poverty reduction and growth facility
PSMFL	–	Public Sector Management and Finance Law
SAIC	–	State Audit and Inspection Committee
SASC	–	State Administrative Services Council
SBP	–	strategic business plan
SDR	–	special drawing rights
SOE	–	state-owned enterprise
TA	–	technical assistance
TSA	–	treasury single account
WB	–	World Bank

NOTES

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

This report was prepared by Mr. Ramesh Subramaniam, Senior Corporate and Financial Governance Specialist, East and Central Asia Department.

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BASIC DATA

A. Loan Identification

1.	Country	Mongolia
2.	Loan Number	Loan 1713
3.	Program Title	Governance Reform Program
4.	Borrower	Mongolia
5.	Executing Agencies	Ministry of Finance and Economy and the Cabinet Secretariat
6.	Amount of Loan	SDR18,238,000
7.	PCR Number	PCR: MON 31597

B. Loan Data

1.	Appraisal		
	– Date Started	23 June 1999	
	– Date Completed	2 July 1999	
2.	Loan Negotiations		
	– Date Started	16 September 1999	
	– Date Completed	17 September 1999	
3.	Date of Board Approval	2 December 1999	
4.	Date of Loan Agreement	24 January 2000	
5.	Date of Loan Effectiveness		
	– In Loan Agreement	24 April 2000	
	– Actual	2 March 2000	
	– Number of Extensions	none	
6.	Closing Date		
	– In Loan Agreement	31 October 2001	
	– Actual	3 September 2002	
	– Number of Extensions	3	
7.	Terms of Loan		
	– Interest Rate	1% annum during the grace period 1.5% per annum thereafter	
	– Maturity (number of years)	24	
	– Grace Period (number of years)	8	
8.	Disbursements		
a.	Dates		
	Initial Disbursement	Final Disbursement	Time Interval
	3 March 2000	3 September 2002	2 years, 6 months
	Effective Date	Original Closing Date	Time Interval
	2 March 2000	31 October 2001	1 year, 7 months

b. Amount

Original Allocation	Amount Cancelled	Amount Disbursed	Undisbursed Balance
SDR18,238,000		SDR18,238,000	
\$25,000,000.00		\$24,318,458.01	

C. Program Data

1. Program Performance Report Ratings

Implementation Period	Ratings	
	Development Objectives	Implementation Progress
From January 2000 to December 2000	Satisfactory	Satisfactory
From January 2001 to January 2002	Satisfactory	Satisfactory
From February 2002 to September 2002	Satisfactory	Partly Satisfactory

D. Data on Asian Development Bank Missions

Name of Mission ^a	Date	No. of Persons	No. of Person-Days	Specialization of Members
Fact-Finding	5-17 April 1999	1	13	Senior Economist
Appraisal	21 June – 3 July 1999	4	13	Senior Economist, Economist (2), Counsel
Inception	20-24 March 2000	1	4	Senior Economist
Review Mission 1	21-26 October 2001	1	6	Governance Specialist
Review Mission 2	4-13 February 2002	3	17	Director (Governance, Finance and Trade Division) Financial Economist Governance Specialist
Review Mission 3	2-9 March 2002	1	7	Financial Economist
Review Mission 4	6-11 May 2002	1	5	Financial Economist
Review Mission 5	29 June – 10 July 2002	1	10	Financial Economist
Program Completion Review ^b	Headquarters – September-October 2002	1	10	Senior Corp. and Fin. Governance Specialist

^a Country Director, Mongolia Resident Mission supported all the reviews.

^b The program completion report was prepared by Ramesh Subramaniam, Senior Corporate and Financial Governance Specialist.

I. PROGRAM DESCRIPTION

1. In December 1999, the Asian Development Bank (ADB) approved the Governance Reform Program (GRP) loan for \$25 million equivalent,¹ along with three technical assistance (TA) grants totaling \$1.8 million.² The GRP aimed to facilitate the transition to a new structure of public sector governance in Mongolia by establishing a sound public sector financial management and accountability system, and a transparent data and information dissemination system. In order to achieve this, the GRP focused on (i) improving aggregate fiscal discipline, (ii) strengthening the public sector's budget formulation and execution, (iii) enhancing the public sector's operational efficiency, (iv) addressing the social impact and financing needs of the reforms under the GRP, and (v) preparing the groundwork for continuation of the reforms.

2. The first tranche of the GRP loan, equivalent to special drawing rights SDR9,119,000 (\$12.213 million), was released in March 2000. The GRP includes nine policy conditions for the release of the second tranche, 28 other monitorable conditions, and four end-of-program conditions. ADB has closely monitored program implementation through continuous policy consultations with the Government and review missions.³ Program implementation has been effective, although the complexity of the GRP and a change in the Government midway delayed the implementation of a few components. The GRP has laid the foundation for improving public sector management, and pilot tested reforms related to budget management and execution at the central level and within two selected *aimags* (or provinces).

II. EVALUATION OF DESIGN AND IMPLEMENTATION

A. Relevance of Design and Formulation

3. In comparison with the other transition economies in the East and Central Asian region, Mongolia managed its transition well until the mid-1990s. The output decline in the early years of the transition was reversed in a short span of 4 years, and real gross domestic product (GDP) grew at 1% in 1994, and further by 6% in 1995. Inflation declined significantly and the fiscal deficit was brought down from 13% of GDP in 1990 to 7% by 1995. However, the initial gains were not sustained due to various structural rigidities in a number of areas. As a result, the fiscal deficit increased again to 8% of GDP in 1996 and further to 14% of GDP in 1998.

4. Pressures on the budget emerge from the large size of the Mongolian public sector, measured against a relatively small population of 2.45 million. Over 7,000 public sector entities rely on budgetary support in Mongolia, which works out to be about one public sector agency for every 350 people. Public administration is highly decentralized including 21 aimags and the Ulaanbaatar capital city administration that are further subdivided into 330 *sums* (municipalities), which provide services at the lowest tiers of government. At the central level, 45 ministries and public sector bodies formulate policy and administer central functions. Around 295 aimag administrations and public sector agencies deal directly with the Ministry of Finance and

¹ ADB. 1999. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to Mongolia for the Governance Reform Program*. Manila.

² ADB. 1999. *Technical Assistance to Mongolia for the Initial Phase of Public Administration Reform*. Manila; ADB. 1999. *Technical Assistance to Mongolia for the Public Expenditure Management*. Manila; ADB. 1999. *Technical Assistance to Mongolia for the Study of Central-Local Government Aspects of Reform Implementation*. Manila.

³ The three attached TAs as well as earlier TAs starting in 1996 have contributed to the establishment of a core team of local experts on public sector reforms. Two review missions were launched each in 2000 and 2001, and three review missions were undertaken in 2002. The resident mission has interacted with the Government on key developments.

Economy (MOFE) for budget negotiations to secure the release of funds. The governors of the sums deal with the aimag governors for budgetary transfers.

5. While the Government adopted various decentralization measures in 1995 aimed at improving the delivery of public services to the population, the size of the public sector has in effect curtailed the benefits of decentralization, given the multiplicity of agencies performing similar tasks. Fiscal profligacy in the mid-1990s was further exacerbated by a variety of factors, including (i) weak budget management, reporting, and control frameworks resulting in inadequate checks and balances; (ii) full devolution of expenditure responsibilities to lower tiers of governments without strategic prioritization; (iii) weak revenue administration; (iv) inadequate treasury controls; (v) weak political will and bureaucratic commitment to maintaining overall fiscal discipline; and (vi) weak operational and financial practices adopted by budgetary bodies and state-owned enterprises (SOEs).

6. In view of the rising public expenditures from 1995 and the consequent macroeconomic effects, the Government launched a debate on public sector reforms with support of ADB TAs.⁴ The Government formulated a comprehensive program of public sector governance reforms,⁵ to be implemented over 10 years, 1999–2009, and sought ADB's support through the GRP to implement the initial phase of reforms over 1999–2002. It also drafted the Public Sector Management and Finance Law (PSMFL) to provide the overall legal framework to strengthen governance within the public sector. The complexity of reforms influenced both the design of the GRP and its focus on the implementation of a pilot reform program for selected central bodies and aimags.

B. Program Outputs

7. The policy framework for the GRP included 5 components that were structured around 8 policy conditions that were complied with prior to ADB Board consideration, 9 core policy conditions that were met in compliance with the release of the second tranche, and 40 monitorable and 4 end-of-program conditions.⁶ The centerpiece of the GRP is the introduction of public sector governance reforms on a pilot basis in selected budgetary agencies. All the key reform measures under the GRP were first introduced in five major public service agencies, termed “bunch 1” agencies: the General Department of National Taxation (GDNT), Customs General Administration (CGA), State Audit and Inspection Committee (SAIC), State Administrative Services Council (SASC), and the National Statistical Office (NSO). Based on a review of progress that was conducted by the Government on an ongoing basis in the bunch 1 agencies, GRP also supported the introduction of public sector administration and financial management reforms in a set of 11 ministries and agencies in bunch 2. These include the Ministry of Finance and Economy (MOFE); Ministry of Labor and Social Security; Ministry of Justice and Internal Affairs; Ministry of Education, Culture, and Science; Ministry of Health; Ministry of Environment; State Financial Inspection Department; Environmental Protection Agency; Land Administrative Authority; State Meteorological Agency; and Clinical Hospital No.1.

⁴ The TAs included: ADB. 1996. *Technical Assistance to Mongolia for Institutional Support for Local Government and Decentralization (Phase I)*. Manila; ADB. 1996. *Technical Assistance to Mongolia for Restructuring and Staff Rationalization*. Manila; ADB. 1997. *Technical Assistance to Mongolia for Institutional Strengthening of the Local Government and Decentralization (Phase II)*. Manila; ADB. 1997. *Technical Assistance to Mongolia for the Initial Phase of Civil Service Reforms*. Manila; ADB. 1996. *Technical Assistance to Mongolia for Strengthening of the Taxation System*. Manila; ADB. 1997. *Technical Assistance to Mongolia for Program Preparation of Governance Reforms*. Manila.

⁵ Appendix 1 of the Report and Recommendation of the President for the GRP provides details on this program.

⁶ Appendix 1 provides the Program Framework and Appendix 2 presents the Progress on Compliance with Program - Monitoring, Second Tranche and Program-end Conditions.

In addition, GRP also focused on two pilot *aimags*, Arhangai and Selenge, and the Nalaikh District Administration, a jurisdiction within Ulaanbaatar City, to pilot test administrative reforms at the provincial and subprovincial levels. Extensive TA support⁷ has been provided to the bunch 1 and bunch 2 agencies, and to the pilot provincial administrations.

1. Improving Aggregate Fiscal Discipline

8. In accordance with the GRP, and in line with the 1997–2000 Poverty Reduction and Growth Facility (PRGF) of the International Monetary Fund (IMF), the budgets for 1999 and 2000 aimed at reducing the deficit levels. The budget deficit declined from 12.2% of GDP in 1999 to 6.8% of GDP in 2000 and to 5.3% in 2001.⁸ This trend is impressive given that it has been achieved despite the expenditure overruns prompted by the recurrence of the *dzuds* (dry summers followed by harsh winters) in 2000 and 2001, and the recent hikes in public sector wages and pensions, which would increase their share in GDP from 4.9% in 1995 to over 9% by 2002. Improved collection of tax and non-tax revenues that contributed to a rise in the revenue-to-GDP ratio from 27.2% in 1999 to 38% of GDP in 2001, and the recovery of gold prices in international markets, have helped compensate for the expenditure overruns. However, recognizing the need to improve the quality of fiscal management and the pressures emerging from the volatility in the international prices of the key export commodities, the Government under the PRGF, is committed to restoring expenditure discipline, by containing public sector compensation to manageable levels. The Government is formulating a civil service reform strategy with support from the World Bank and IMF in the context of the ongoing discussions on the 2003 budget.

9. To strengthen the overall fiscal framework and coordination in the budgetary process, the GRP supported the development of medium-term macroeconomic forecasts and the adoption of a fiscal framework statement (FFS). The Government formulated and adopted the FFS for 2001–2003 and 2002–2004. The FFS aims to develop sustainable fiscal deficit forecasts over the medium term by ensuring consistency with the strategic growth priorities and projections, and external and domestic borrowing capacity.

10. The GRP helped introduce a sound system for monitoring and reporting contingent liabilities. Starting from 2002 budget, the Government has established two special reserve appropriations amounting to 0.7% of GDP, to plan for some contingencies, such as *dzuds* and other natural disasters, and other unpredictable events. However, work done in 2001 under an ADB TA did not uncover any significant accumulation of contingent liabilities.

11. As part of the broader efforts to harden the budgetary constraints on public sector agencies, the Government initiated the closure of all off-budget bank accounts. Subsequently, as per the agreements reached between the Bank of Mongolia (BOM) and MOFE, all Government deposits are being transferred into a treasury single account (TSA), with all transactions being conducted at the Treasury. A formal coordinating task force has been appointed and is overseeing the implementation of the TSA project and suggesting refinements. BOM and MOFE are in the process of confirming the medium-term membership and funding arrangements.

⁷ Under the *Public Administration Reform TA* (footnote 2), a team of well-qualified domestic experts was trained by the international consultants on international best practices in public sector resource management. Following this, the domestic consultants' team has been fully involved in the implementation of reforms and in ensuring that the momentum for reforms is maintained.

⁸ Appendix 3 presents data on macroeconomic and program indicators.

2. Strengthening the Public Sector's Budget Formulation and Execution

12. The GRP supported the formulation of a 3-year rolling public investment programming (PIP) framework as an integral part of medium-term planning. The PIP framework is integrated with recurrent budgets to ensure adequate maintenance of the capital investments undertaken. The PIP is now being presented to external assistance agencies and finalized annually based on confirmed commitments. The Parliament has adopted PIP for 2002–2004.

13. The Government's overall strategic development priorities are outlined in the Development Vision for 2003–05, Economic and Social Development Guidelines for 2002, and the Action Plan of the Government of Mongolia for 2000–04. In order to better implement these priorities, the GRP has supported the adoption of a 3-year, output-based medium-term expenditure framework (MTEF), including the development of a system of forward estimates of expenditures, to improve the linkages between planning and budgeting. This process first established a system for integrating the requirements of the line agencies into the MTEF, which was initially piloted in the five bunch 1 agencies. Starting with the formulation of strategic priorities, the actual process of designing the MTEF has involved a number of steps, including: (i) macroeconomic forecasting and assessment of resource availability; (ii) issuance of indicative sector budgetary ceilings approved by the Cabinet of Ministers; (iii) determination of subprograms by ministries and agencies; (iv) negotiations between MOFE and line ministries over the programs and subprograms; and (v) submission for approval of the Cabinet of Ministers and Parliament.

14. As part of the GRP, the Government, with support from IMF, introduced the TSA system on a pilot basis in 2001. In the first phase of reforms implemented over the second half of 2001, all foreign currency deposits of the central Government were transferred to the TSA. The Government then extended the system to 11 public sector agencies,⁹ which were required to conduct all their financial transactions through zero-balance accounts at BOM. Based on a review by the Government and IMF, MOFE and BOM subsequently introduced a centralized payment system in favor of zero-balance accounts. This has involved transfer of all government deposits in the banking system into a single account at BOM to centralize all disbursement and accounting responsibilities at MOFE. The Government has also closed all off-budget bank accounts held by the ministries and public sector agencies. Based on the successful outcomes in the pilot agencies, effective July 2002 the TSA has been extended to cover the entire public sector. A joint MOFE-BOM resolution has been adopted outlining the TSA arrangements, and a formal task force established to examine the reporting and data-sharing arrangements between the Government and BOM, aimed at improving expenditure controls.

15. To complement the TSA, the Government, with World Bank support, is designing a modern and integrated treasury financial management information system, which aims to integrate (i) administration and oversight of tax collections; (ii) administration of the treasury's banking transactions; (iii) execution of core financial management functions, including monitoring of accounts payables and receivables, asset management, and inventory control and management reporting; and (iv) management of all borrowings. System design has been completed, and the Government has launched a competitive bidding process to procure the necessary hardware and software. A debt management system has been designed to achieve improved asset-liability matching in terms of composition as well as maturity. The purpose of the new system is to smooth the debt repayments over the medium term, by avoiding repayment peaks and spreading out the burden evenly over time. With World Bank support, risk

⁹ Under Government Decree 132 of 2001.

management procedures and protocols have been developed to effectively manage risks relative to debt and investments.

3. Enhancing the Public Sector's Operational Efficiency

16. Under this component of the GRP, the Government has introduced a number of significant process-oriented measures aimed at improving administration within the public sector and its operational efficiency. The reform measures supported can be classified into: (i) financial reporting and forecasting, (ii) strategic planning and budgeting, and (iii) performance and personnel management.

a. Financial Reporting and Forecasting

17. A system for preparing ex post and forecast financial statements has been instituted in all the pilot agencies. A key step in this process has been to shift the emphasis in financial accounting from a cash basis to accrual and output basis in a gradual manner. The financial statements of all the bunch 1 entities have been verified for their quality as well as that of the underlying financial control systems. The SAIC audits and certifies these statements, a role reconfirmed under the recently enacted PSMFL. SAIC has expanded its role over the last 3 years, as reflected by the total number of audits conducted at the central level, which rose from 92 in 1999 to 131 in 2001.¹⁰

18. The forecast financial statements prepared by the key agencies include a statement of responsibility from the general manager of the agency; a statement of the accounting policies adopted and the forecasting assumptions employed; a balance sheet covering a 3-year planning horizon; a statement of the changes in the net-worth position of the agency over this period; and a statement of cash flows. Formulated in this manner, the medium-term forecasts for assets and liabilities have enhanced the quality of strategic budget planning.

b. Strategic Planning and Budgeting

19. Under the GRP, all bunch 1 and bunch 2 agencies have been guided in the formulation of their strategic business plans (SBPs); preparation of financial statements; specification of the outputs produced, including description, quantity, quality, and cost; preparation of output-based forward estimates; and formulation of and adherence to performance contracts. All agencies in bunch 1 (for 2001-2003 and 2002-2004) and bunch 2 (for 2002-2004) have prepared SBPs, incorporating an overall vision statement, the strategic priorities, outputs planned for the period, forward appropriation estimates and forecast financial statements, and a linkage between the functions of the agency and the overall strategic priorities of the Government. The SBPs provide strategic planning directions and priorities to the budgetary bodies, and fully integrate the output requirements and the projections for budget appropriation estimates.

20. With the help of the financial forecasts and SBPs, all bunch 1 agencies prepared their budget appropriation estimates on an output-basis for 2001 and 2002, which were presented to the Parliament with the overall Government budgets for the respective years. The model for presenting budget appropriation was formatted to meet the requirements of the PSMFL.

¹⁰ Audit Victoria (the Auditor General's Office of the State of Victoria, Australia) has provided TA support to verify the quality of the financial statements and the underlying systems. Inspectors of SAIC have received training in risk management and audits of financial statements prepared on the basis of accrual/output-based accounting methods. Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) has an ongoing capacity-building program at SAIC to enhance overall audit quality.

Application of this model for the bunch 1 agencies facilitated greater understanding of the practical implementation aspects of the provisions of the PSMFL. This process is under way in all the ministries under bunch 2 as well as other ministries, which will submit appropriations in accordance with the PSMFL from mid-2003, for 2004 budgets.

c. Performance and Personnel Management

21. As outlined in para. 3, the Mongolian public sector has a plethora of administrative layers and a large number of budgetary entities. To streamline the functions of the public sector and eventually reduce its size, the GRP supported (i) a functional review of the core and noncore functions of all bunch 1 and bunch 2 agencies to derive lessons that could be applied in extending such reviews to the whole public sector, and the (ii) introduction and implementation of a system of output-based contracting for provision of services and merit-based selection and promotion of civil servants in the pilot agencies.

22. Within the framework of GRP, SASC issued Guidelines on Selection and Recruitment in Budgetary Bodies. Based on these general guidelines, each of the five bunch 1 agencies has developed and published its own guidelines for selecting and recruiting staff at all levels. SASC has also formalized the system for compiling data on public sector vacancies and coordinating employment announcements to the public; these are being published in major newspapers in May of each year. Open competitive examinations are held 45 days after the announcements. The examination system results in the finalization of a roster of potential candidates who are qualified for public sector positions. Public sector agencies with vacancies are legally required to interview candidates from the roster and recruit suitable candidates who meet their needs.

23. SASC has also developed general guidelines and templates for performance monitoring and evaluation. The chairpersons (general managers) of all bunch 1 agencies have entered into performance agreements with their reporting authorities. The general manager performance agreements outline the strategic objectives of the agency; the responsibility, obligations, and personal performance of the general manager, including targets to be met (for example, tax revenues); monitoring and reporting requirements; and the roles and responsibilities of the portfolio minister or any higher authority to whom the general manager reports.

24. All bunch 1 and bunch 2 agencies have developed performance agreements in the form of individual work plans and appropriate evaluation criteria for all staff positions. In particular, the bunch 1 agencies have begun implementation of streamlined performance monitoring. The evaluation process in these agencies leads to classification of employees into different performance groups, to enable the formulation of appropriate incentives commensurate with their productivity during the reporting year.¹¹

4. Addressing the Social Impact and Financing Needs of Reforms under the Program

25. The Government earmarked \$5 million equivalent in counterpart funds generated from GRP ban proceeds to support implementation of the reform measures under the GRP. The bunch 1 agencies have been allocated \$2.3 million, central ministries \$1 million, and other budgetary agencies \$0.5 million; the capital city and six selected aimags have been earmarked to receive \$1 million; and \$0.2 million has been set aside for public awareness activities. With the exception of CGA, all other bunch 1 agencies have utilized these allocations primarily for

¹¹ GDNT and NSO have attempted a pilot to offer performance-linked wage increases and bonuses.

internal information dissemination and capacity-building activities, including design of overseas training programs in some cases, in relation to public sector administration reforms. The CGA has primarily used the proceeds for upgrading its customs equipment, based on the justification that modern methods are critical for enhancing transparency in its operations and delivery of services. The Cabinet Secretariat (CS) has utilized the proceeds for an efficient public outreach campaign on the Government's reform agenda and dissemination of information relative to the PSMFL. MOFE is in the process of verifying funds utilization in the central ministries.

26. Under the reforms implemented thus far with GRP support, there has been no adverse social impact, in terms of increased unemployment, forced retirement, or other forms of worker displacement. However, the Government is aware that any expansion of the reform measures would have a significant impact, and is committed to allocating sufficient budgetary resources to cushion any adverse outcomes.

5. Preparing the Groundwork for Continuation of the Reforms

27. The enactment by the Mongolian Parliament of the PSMFL on 27 June 2002 is a major step forward in furthering governance reforms. The first draft of the PSMFL was prepared in 1998,¹² and the law has been extensively debated at different levels over the last 4 years. The PSMFL, as a comprehensive legislative act based on the New Zealand model of public sector reforms, intends to provide a trans-government mandate for good governance within the public sector. The objective of the law is to integrate strategic planning at all levels closely with budget formulation and execution, while infusing budgetary discipline through enhanced accountability and transparency in the determination as well as application of budgetary funds. To achieve these objectives, the law defines fiscal and operational relations within the different executive branches of government at various levels, and between the executive and the elected representatives.

28. The PSMFL stipulates all ministries, public sector agencies, parliamentary bodies, and local-level governments and their units to (i) clearly delineate the strategic priorities through the adoption of an SBP; (ii) formulate, adopt, and execute the budget based on accrual accounting principles; (iii) adopt output-based budgeting, management, and overall reporting and delegation of decision making to the chief executives of the concerned bodies; (iv) integrate recurrent and capital budgetary needs in a medium-term framework, and formulate proper appropriation estimates for each year; (v) prepare annual and forecast financial statements on an accrual basis; and (vi) adopt transparent merit-based employment policies and performance-based career progression. Further, it requires the SAIC to undertake certification audits of the financial statement audits of all budgetary bodies and SOEs.

29. The PSMFL will be effective from 1 January 2003. The Government has adopted an implementation plan, to be phased over 4 years, to gradually introduce all the requirements of the PSMFL. This plan also forms an integral part of the recently adopted Poverty Reduction Strategy Paper of the Government. The Government has also assessed the need for local government reforms and formulated a time-bound implementation plan to guide the broadening and deepening of governance reforms across the country. Subsequently, significant training has been provided to officials in Arhangai and Selenge aimags, chosen by the Government on a pilot basis, as well as officials from the bunch 1 and bunch 2 agencies. The focus of the training program has been on the (i) functional, management, and organizational changes needed to

¹² Under the *Program Preparation of Governance Reforms TA* (footnote 4).

adopt governance reforms; and reforms to planning approaches, including formulation of SBPs, and (ii) budgetary, accounting, and treasury system reforms.

30. As a part of its efforts to expand governance reforms to SOEs, the Government under the GRP has attempted to reorient the management and planning process in selected SOEs. Three central-level SOEs (Khunstech Corporation, Mongol Tamga, and Bio-chemical Factory) and three local level SOEs (National Recreation Center, Bus Company No.2, and Ulaanbaatar Road Maintenance Company) have adopted SBPs, based on a similar but simplified framework to that of the bunch 1 agencies. The State Property Committee has formulated guidelines to improve the transparency of identification and appointment of Board members in these SOEs. As the Government holds a majority of the shares in these SOEs, the Management Board comprises representatives from MOFE, the State Property Committee and respective line ministries, in line with the legal framework.

C. Program Costs

31. ADB supported the GRP with a loan for SDR18.24 million (\$24.4 million). The loan was fully disbursed in two equal installments. The total cost associated with the implementation of the GRP is estimated at \$29.4 million. In addition, three TAs were provided to support the implementation of the GRP in the amount of \$1.83 million.

D. Disbursements

32. The proceeds of the loan were withdrawn in accordance with ADB's standard disbursement procedures.

E. Program Schedule

33. The GRP was approved on 1 December 1999 and became effective 2 March 2000, upon which the first tranche was released. At the time of appraisal, it was envisaged that the second tranche of GRP would be released in April 2001, subject to satisfactory compliance with all the relevant conditions. However, the second tranche was released in September 2002, almost 17 months behind the original schedule, due in part to the complexity of the reform measures and the uncertainty over the adoption of the PSMFL. Given the sensitive and time-consuming nature of the reform measures, the appraisal disbursement schedule was unrealistic. For programs of this type, with major process-oriented changes requiring adoption of new legislation, it is desirable to allow at least 2 years for the implementation of reforms. ADB launched several review missions to work closely with the Government and the Executing Agencies (EAs) to guide them in taking corrective actions. The loan was financially closed in September 2002 and the program completion review has been under way since that time, at the request of the Government to pave the way to support the second phase of public sector reforms in a timely manner.

F. Implementation Arrangements

34. The GRP had two EAs. CS was the EA for governance reforms as a whole, with a specific focus on public sector administration reforms. It also oversaw program implementation in National Statistical Office, State Audit Board and State Administrative Services Council, and under the decentralization component. MOFE was the Borrower and Executing Agency for the budget reform process and program implementation in GDNT, CGA and the ministry itself. A steering committee and an operational working group were established to assist the EAs in

implementing the GRP. The steering committee comprised of the Prime Minister (PM), the Minister of Finance, the Minister of Justice, the Head of CS, the Economic Advisor to the President, the Senior Policy Advisor to the Prime Minister, and two representatives from the Parliamentary Working Group on Governance. The operational working group comprised of the head of the Strategic Management Division of CS, the head of the Fiscal Policy Department in MOFE, the economic and social policy advisors to the Prime Minister, the chairpersons from the five bunch 1 agencies and representatives from Arhangi and Selenge aimags. CS has acted as the main counterpart for GRP review and submission of reports to ADB.

G. Conditions and Covenants

35. The August 2002 progress report to the ADB Board of Directors on the GRP reported that all of the nine core policy conditions for the release of the second tranche were fully complied with. All other monitorable and program-end conditions of the GRP have also been complied with.

H. Related Technical Assistance

36. Of the three TAs supporting GRP implementation, two have been substantially completed. The TA on public expenditure management provided 6 person-months of international consulting inputs to support the formulation of FFS, PIP, and MTEF, and assess the contingent liabilities. The advisory support under this TA has been timely, and the TA has helped establish a robust framework for medium-term budget planning. The TA also supported a 2-month training program at the Australian Treasury on medium-term planning for a senior budget official and a macroeconomist of MOFE.

37. The TA on center-local aspects of reform implementation provided 5 person-months of advisory services in Arhangi and Selenge provinces. The objective of the TA was to enhance the capacity of the provincial officials on the key financial and performance management aspects envisaged under the PSMFL. It has significantly enhanced awareness in these two provinces. The TA has also helped demonstrate the complexities involved in adopting an entirely different system of financial planning and human resources management.

38. The TA on initial phase of public administration reforms is under implementation, as the services of international as well as domestic experts have been phased throughout the GRP implementation period.¹³ The TA initially provided for 16 person-months of international consulting inputs, and 162 person-months of domestic consulting services. A highly beneficial outcome of this TA is effective domestic capacity building. A team of six domestic consultants has provided significant support for information dissemination, liaison within and between line ministries on various aspects of the PSMFL, and training and capacity building in the 17 bunch 1 and bunch 2 pilot agencies. Their services have been extended until December 2002 to provide support for implementation of the PSMFL. The domestic team has formulated and published a detailed explanatory guide on the practical implementation aspects of the PSMFL, and this is being widely distributed to all ministries and public sector agencies.

39. While the team of international advisors for the TA on the initial phase of public administration reforms provided initial advisory as well as program assessment support, the delay in the implementation of the PSMFL has affected the sequence of their services. The team's performance was affected by some personnel changes on the team. A key lesson from this TA is the need for clearly defining: (i) the specific terms of reference for each individual

¹³ TA completion reports will be prepared upon the completion of all the TAs.

consultant, and (ii) the specific reporting requirements. There has been only one substantial report produced, with the outputs of the individual consultants not presented clearly. Action has been initiated to cancel the remaining 5 person-months of international consulting inputs, and to consolidate the savings to mobilize advisory support for PSMFL implementation.

I. Procurement and Performance of Consultants

40. The GRP did not provide for any procurement of goods or consulting services, besides the advisory support provided through the grant TAs.

J. Performance of the Borrower and the Executing Agency

41. The overall performance the Borrower (MOFE) and the EAs (MOFE and CS) is rated satisfactory. While the prolonged debate on the PSMFL delayed program implementation, it helped create a strong sense of ownership, enhance understanding of the planned reforms, and solidify the Government's commitment to the policy reforms under the GRP. The capacity of the program implementation units within the EAs was adequate. The Government has met all requirements for the submission of reports, and its own program completion report is in preparation.

K. Performance of ADB

42. ADB's performance was satisfactory. ADB closely monitored implementation of the GRP through the Mongolia Resident Mission and seven missions from headquarters, which engaged in active dialogue with relevant government officials on the conditions, and in extensive policy and legal consultations with various Members of Parliament. Senior staff also interacted at ministerial levels to facilitate the implementation of the GRP. ADB closely coordinated its implementation with the work of other agencies, notably IMF and the World Bank.

III. EVALUATION OF PERFORMANCE

A. Relevance

43. The Government views the GRP essentially as phase 1 of its 10-year public sector governance reform program, to be implemented over 1999–2009. Hence, the design of the GRP has focused on introducing the reforms on a pilot basis in the bunch 1 and bunch 2 agencies over 1999–2002, to be expanded to cover the entire public sector and civil service in the subsequent phases. The design of GRP has remained highly relevant in the broader context of the (i) lack of fiscal discipline at the central and local levels; and (ii) weaknesses within the Mongolian public sector and civil service, stemming partly from the geographic spread of the country as well as other structural rigidities.

44. While all program components have played significant roles and complemented each other, the adoption of a sound legal framework in the form of the PSMFL assumed growing significance over GRP implementation. Also essential has been a realistic review of progress in bunch 1 agencies, to guide the expansion of reforms in bunch 2 agencies and the rest of the public sector.

45. The ongoing developments with regard to civil service wage and pension increases, wherein the Government has announced annual increases of 25% every year for four years until 2004 to enable more than doubling of wages by that time, underscore the importance of the

overall premise of the GRP. It is essential to achieve an appropriate balance between the overarching goals of macroeconomic management and fiscal prudence, which together are fundamental in ensuring a stable economic growth pattern for an otherwise vulnerable economy prone to exogenous shocks. At the same time, appropriate incentives should be provided to the civil servants and public sector agencies in ensuring that their services are delivered in an efficient and expeditious manner to support poverty reduction and equity objectives.

B. Efficacy in Achievement of Purpose

46. The goal of the GRP was to assist in laying the foundation for the transition to a new system of public sector governance in Mongolia through the establishment of (i) an efficient public sector financial management system, (ii) a sound public sector accountability system, and (iii) a transparent data and information dissemination system. The financial management and institutional reforms, summarized below, have helped the Government achieve the goals of the GRP. The Government has worked closely with ADB and shared the FFS, PIP, MTEF documents and the SBPs and assessments of the reforms within the pilot agencies, through the operational working group established for the GRP. Quantifiable progress has been made in GDNT and CGA, partially through the performance-management reforms.

a. Financial Management Reforms

47. The fiscal realities facing the Mongolian local government administrations have had a strong impact on the nature, objectives, and scope of the GRP. With the exception of Ulaanbaatar City Administration, and Darkhan and Orhon aimags, which can carry out the policy mandates of the center predominantly with their own resources, the remaining 19 jurisdictions rely on central Government transfers for more than 60% of their revenue needs. Recognizing the issue, the Government, as part of the fiscal reforms initiated with support from the IMF, centralized all revenues from value-added, customs, corporate, and excise taxes at the end of 2001. The revenues are then to be redistributed back to the *aimags* on a per capita basis, with some equalization elements built into the revenue-sharing process. The Government is formulating a consistent set of formulas and guidelines on earmarking funds against specific expenditure categories, in order to ensure a fair distribution of resources, enhance the incentives for improving local revenue collections, and minimize scope for cross-subsidization between expenditure categories at the local levels. In this context, GRP has provided a framework to enhance public sector accountability at all levels of the Government, to ensure fairness in the distribution of resources across the different fiscal jurisdictions.

48. The FFS aims to achieve sustainable medium-term planning, by prescribing specific targets for expenditures. It also specifies controls on the contingent liabilities and other off-budget expenditures of the Government. The 3-year rolling MTEF adopted will rationalize public expenditures in line with strategic priorities and infuse discipline and coherence in the process of budget formulation. The MTEF includes a 3-year PIP and integrates it with the recurrent budget. A fuller application of the MTEF and output-based budgeting measures will gradually strategize overall expenditure planning at all levels of the Government with the economic priorities. The Government has also introduced measures to reduce recourse to off-budgetary funds and ad hoc transactions from the central to local governments or between budgetary bodies on a barter basis.

49. The GRP has efficiently leveraged reforms in overall treasury management jointly with the TSA reforms being implemented with IMF support, covering cash and debt management, as well as coordination and control of the relation between budget entities and commercial banks.

Significant capacity building support has been provided to guide the transformation of public sector accounting to an accrual system based on international accounting standards from the current cash-based system. CGA and GDNT improved their performance during 1999–2001, partly because of the performance management and other reforms introduced as part of the pilot program under the GRP.¹⁴

50. The process-oriented changes introduced under the GRP are yet to be broadly and effectively implemented for them to translate into tangible gains in terms of reducing current expenditures. The data on Government finance (Appendix 3) show that current expenditures as a share of total expenditures and net lending have increased from 70% in 1997 to 75% in 2001, although a declining trend was evident over 1998–1999. There has been a short-term aberration in the Government's efforts to reduce fiscal deficits, caused by the recent measures to increase civil service wages. As a result, the overall deficit is projected to increase from 5.3% of GDP in 2001 to 6.1% in 2002. While appropriate incentives need to be provided, there is growing recognition within the Government that ad hoc increases in wages and pensions in isolation of the much needed civil service reforms will disrupt fiscal sustainability. The Government has embarked on formulating a civil service reform strategy with support from ADB and World Bank. ADB will help the Government undertake a functional review of the public sector to achieve consolidation and reduce recurrent expenditures. The short-term expenditures will gradually be rationalized against the competing objectives of fiscal prudence and performance management, once the overall reform measures initiated under GRP are fully implemented throughout the Mongolian public sector.

b. Institutional Reforms

51. While financial efficiency of the Mongolian public sector has been eroded due to the lack of budgetary discipline, operational efficiency in budgetary bodies has been affected by the lack of a proper incentive structure. The GRP supported the adoption of performance contracting and merit-based recruitment and promotion procedures in the pilot agencies. While these reforms have to penetrate deeper into the pilot agencies as well as the rest of the large civil service, the PSMFL calls for adoption of a number of critical measures to enhance transparency in civil service recruitments and promotion.

52. One of the most successful outcomes of the GRP is its contribution to enhancing awareness of the need for, and the direction of, the public sector administration and financial management reforms that are under way. In particular, the PSMFL has triggered a debate on the desired level of autonomy of the budgetary bodies at the *aimag* and *sum* levels within the overall framework of the Mongolian Constitution. While retaining a considerable degree of decentralized decision making in day-to-day operations, the PSMFL requires local bodies to deliver their outputs in accordance with the overall policy priorities and performance contracts established by the sector ministries and other relevant bodies that coordinate economic activities at the central and local levels. These provisions have been discussed extensively and reviewed by stakeholders (including the budgetary bodies and provincial-level officials) and all political parties.¹⁵

¹⁴ Appendix 3, Tables A3.2 and A3.3 present data on customs and overall tax revenue collections over the Program period.

¹⁵ The GRP was negotiated with the Government of Prime Minister Mr. R. Amarjargal, led by the Mongolian Democratic Party. Subsequently, the elections in July 2000 led to a major change in the composition of the various parties in the Parliament. The current Government of Prime Minister Mr. Enkhbayar (led by the Mongolian People's Revolutionary Party, which was in the opposition during 1996–1999) has been extremely supportive of governance reforms and particularly for laying a sound groundwork for continuation of reforms.

53. An earlier draft of the PSMFL was submitted to the Parliament and its first reading was completed in June 1999. Following the elections in July 2000, a revised draft of the PSMFL was submitted to the Parliament in the 2001, and it was modified to incorporate the comments of the key standing committees of the Parliament. Subsequently, it was reviewed by an 18-member working group established by the Budget Standing Committee and the State Structures Standing Committee of the Parliament. The version adopted on 27 June 2002 contains all of the key provisions that the Government and ADB had agreed to during formulation of the GRP. Thus, despite the delay in its adoption, the PSMFL will provide a sound legal framework to expand the reform measures under the GRP to the entire public sector.

54. The stakeholders of GRP include (i) the general public who will be ultimately affected by any significant changes in the delivery of public services that may result from a full adoption of the measures initiated under GRP; and (ii) officials from the bunch 1 and bunch 2 agencies that have participated in the pilot process, all other ministries and public sector bodies that will be affected by the adoption of the PSMFL, and the *aimag* and *sum* level administrations. The Parliamentary process over 1997–2002 ensured that the various provisions of the legal framework were explained by the people's representatives to the general public. Local-level concerns were discussed in various forums held between the Standing Committees of the Parliament and groups of *aimag* governors. Within the civil service, the overriding concern has been in relation to the (i) possibility that lower-level agencies may lose their independence and control; (ii) uncertainty with regard to the legal framework, until the adoption of the PSMFL; and (iii) capacity constraints, which would impede effective implementation of reforms. The 17 pilot agencies that have gone through the process have generally provided positive feedback. Although other lower-level agencies and administrations at *aimag* and *sum* levels have expressed concerns, they nevertheless recognize the need for reforms.

C. Efficiency in Achievement of Purpose and Outputs

55. The establishment of a high-level steering committee under the Prime Minister with the participation of senior ministers significantly facilitated the flow of information to high-level policy makers concerning issues that arose during program implementation. This in turn facilitated in-depth policy consultations between ADB missions and ministers of finance and CS. The steering committee held frequent close consultations with various Parliamentary Standing Committees to update Members of Parliament as well as *aimag* governors on progress in implementation of the GRP.

56. While there has been a significant delay in complying with the program conditions, the complexity of the reform measures justifies the long consultative process within the country leading to the adoption of the PSMFL. Given the political sensitivities and initial concerns over the constitutionality of some of the PSMFL provisions, ADB provided only advisory support, without influencing the content or course of adoption of the legal framework.

57. The Government has efficiently utilized the TA inputs provided, and it has leveraged bilateral and multilateral support in a complementary manner. The operational working group has worked closely with the domestic experts supported under ADB TA, who also made several presentations on technical issues to the steering committee and Parliamentary Standing Committees.

D. Preliminary Assessment of Sustainability

58. The GRP has laid a sound and sustainable foundation to guide public sector administration and financial management reforms in Mongolia. The adoption of the PSMFL in its current form confirms that the country is on an irreversible path of governance reforms in the foreseeable future. The process-oriented and procedural reforms adopted, particularly with regard to budget formulation and execution, including the adoption of FFS, MTEF, integration of PIP, and accrual accounting are sustainable in the medium and long terms upon their full implementation. A key measure that has been introduced as part of the PSMFL is output-based budgeting. Given the past problems in the determination and execution of budgets, output contracting is perceived as a critical step in ensuring effective utilization of scarce public resources. However, a key constraint has been the difficulty involved in clearly defining the output to be produced at the entity level in a number of cases. In particular, outputs may not be tangible or immediately evident in agencies responsible for policy formulation and execution as in the case of public sector entities responsible for production of physical outputs. Hence, a full-scale implementation and long-term sustainability of output contracting will depend on advisory support and capacity-building measures.

59. Initial feedback on the outcomes in bunch 1 agencies demonstrates that the implementation of performance agreements has led to improved transparency and accountability. However, while there is general acceptability within the civil service of the need for merit-based personnel management, as well as the fact that the pilot agencies have introduced basic reforms, a number of key budgetary agencies and ministries have not embraced a competitive process for recruitment or career progression. In general, the complexity of the reform measures adopted through the PSMFL calls for a coherent implementation strategy for the reforms to be sustainable. The Government is committed to pursuing these reforms over the medium to long term.

E. Environmental, Sociocultural, and Other Impacts

60. The GRP was classified as Environment Category C as it had no direct environmental impact. It has had a substantial positive impact on the institutional environment, by essentially changing the public sector financial and performance-management systems. The GRP has put in place a sound policy, operational, and legal framework to help sustain the public sector governance reforms in Mongolia.

IV. OVERALL ASSESSMENT AND RECOMMENDATIONS

A. Overall Assessment

61. The GRP is rated successful.¹⁶ The measures introduced under the GRP have significantly changed the course of public sector administration and financial management in Mongolia. The design of the GRP components has fully corresponded to the critical need to (i) put in place a sound MTEF, accompanied by clear macroeconomic-fiscal linkages as outlined in the FFS; (ii) integrate capital budget planning; (iii) restore fiscal discipline gradually by paving the way for accrual accounting, and consolidation of all extra-budgetary funds; (iv) link resource allocations with targeted and actual performance of the spending units; (v) streamline public sector personnel management processes; and (vi) enhance ex-post budgetary controls through

¹⁶ This PCR is a part of a sample of PCRs independently reviewed by the Operations Evaluation Department. The review has validated the methodology used and the ratings given.

financial and operational performance audits. The adoption of these measures will enhance the transparency, reliability, and quality of public services.

62. A significant positive factor in the GRP's success is its approach to introducing reforms on a pilot basis in key public sector entities, which would enable a fuller integration of reforms across the entire public sector based on the lessons learnt from the pilot agencies. This approach has also enabled the building up of the required consensus for public sector reforms. While output specification and costing have been relatively difficult to comprehend and implement, the performance management measures will significantly strengthen the public sector. The pilot agencies can act as models and function as trainers in furthering program implementation throughout the public sector.

63. Major changes in the Parliament's composition and the Government midway through its implementation slowed progress for some time. However, the complexity of the reform measures fully justifies the long consensus-building process. Moreover, the delay did not result in any real costs, since all the provisions of the PSMFL were already under way in the pilot agencies, and their impact has been demonstrated through the improved performance in taxation and customs areas. Budget management reforms, in particular the adoption of medium-term budget planning, have proceeded as planned.

64. ADB will continue to engage in periodic policy consultations with the Government on all aspects of furthering governance reforms, besides continuing to monitor progress on reforms initiated under the GRP. In particular, the Government needs to be supported in the implementation of the PSMFL in a gradual manner.

B. Lessons Learned

1. Public Sector Reforms need to be Sequenced Properly

65. While the GRP has introduced key reform measures and the pilot process has been implemented well, the program design did not allow for a proper sequencing of all the steps needed. First, capacity constraints were identified, but the medium-term cost implications of program implementation were not fully analyzed, vis-à-vis the likely benefits or savings stemming from the adoption of all the reform measures. Given the significant capacity building needs, it is essential that the Government coordinate all external funding agency activities effectively to channel grant funds to support training and information dissemination. ADB plans to steer its follow-up support in an integrated manner, by coordinating its interventions in public sector reforms with ongoing and proposed support in health, education and other sectors. Second, reservations on moving towards output-based budgeting were noted, but its applicability in certain sector ministries and agencies was not fully evaluated. It has to be recognized that a broad-based application of output-based budgeting across the entire spectrum could not be a realistic goal for future interventions. Third, a functional review of the public sector is a critical first step in introducing reforms. While this has been accomplished in part, it needs to be extended to cover all ministries and major public sector institutions prior to moving further. This issue is currently being addressed through ADB TA.

2. Risks Associated with the Implementation of the PSMFL should be Managed Well

66. While there has been a genuine commitment and debate with regard to the PSMFL, there are significant risks associated with the implementation of the proposed reforms. There

are underlying tensions that the PSMFL will recentralize authority and reduce provincial autonomy, given that Mongolia has had powerful sector ministries in the past. In particular, there are concerns that the reforms will demand an increase in accountability without any concomitant increase in authority or independence to achieve the desired objectives. There is little doubt that the budget constraints need to be hardened, which will need a streamlined top-down approach in policy formulation, planning, budgeting and execution. However, such discipline in public administration and financial management should strike a proper balance between accountability and responsibility.

3. Civil Service Reforms are Critical to Ensure Sustainability of Public Sector Reforms

67. Public sector employment, at 166,700 employees, accounted for 21% of total employment in 2000, and the Government wage bill stood at 8.5% of GDP, in comparison with 4–5% that is found elsewhere in the East and Central Asian region. Total Government expenditure as a share of GDP remains high in Mongolia, at about 38% of GDP, in relation to about 28% in Kazakhstan, for instance. Wages account for close to 20% of total public expenditures.

68. However, average civil service salaries at different levels are about 35–50% lower than average private sector compensation at comparable levels. In order to overcome this disparity, the Government embarked on a 4-year plan in 2000 to increase civil service wages by 25% every year, to enable more than doubling of the public sector compensation by 2004. In light of the growing public expenditures, the Government is carefully reviewing the increase proposed for 2003,¹⁷ given the serious budgetary implications. For governance reforms to have a sustained long-term beneficial impact, it is essential that the Government implement a wide-ranging civil service employment and wage reform program, aimed at arriving at an optimal size of the public sector labor force. The World Bank is expected to provide advisory support in this area.

69. Mongolia does not have a permanent, merit-based, or well-managed civil service. While a proper implementation of the provisions of the PSMFL will bring about changes, the current practice of senior-level appointments and promotions being made on political or other affiliations is not conducive to the formation of a strong cadre of civil servants. There have been frequent changes of personnel in key positions, which partly has been a reason for the lack of real commitment across various levels of the Government for public sector reforms. The measures introduced under the GRP will be sustained through ADB TA support, aimed at strengthening the capacity of SASC and deepening reforms in this area.

4. An Appropriate Balance needs to be found between Local Government Autonomy and Public Sector Efficiency and Accountability

70. In a number of *aimags*, there appears to be a significant overlap of activities between provincial and subprovincial administrations. The implementation of the pilot program and the subsequent training initiatives at the *aimag* levels have demonstrated the need for consolidation of administrative and service-delivery functions at the subprovincial levels. While it is a complex issue, it needs to be addressed given the state of inter-governmental fiscal dependence. In particular, the number of *sums* and the activities that they perform need to be rationalized. This would have a favorable impact on reducing the overheads and operational costs involved in

¹⁷ In consultation with the World Bank and IMF.

public sector administration. The Government has recently embarked on establishing regional development centers to facilitate targeted development of selected areas with the highest growth potential. This in turn could facilitate the consolidation of administrative functions on the basis of regional or subregional cluster-type arrangements. ADB will provide TA support to undertake a functional review of the need for and scope of such consolidation.

71. It is essential that the Government work with local governments to ensure that the reforms to the center-provincial relations that are under way now penetrate down to the subprovincial levels as well. Efforts in this area should be undertaken along with a careful monitoring of how contractual and subcontractual relations emerge at the provincial and subprovincial levels under the PSMFL.

5. Process-oriented Reforms can Substitute for Capacity Constraints

72. GRP has demonstrated that process and procedure-oriented reforms bring about clarity of purpose, help define objectives properly, set appropriate levels of expectations, and launch institutional changes to facilitate transition. While capacity is lacking in the Mongolian public sector, the measures introduced under the GRP have changed the way key institutions function. ADB's sector interventions have demonstrated that there is no dearth of technical knowledge and skills in the Mongolian public sector. However, the challenge is to improve public sector governance through the introduction of reforms at all levels and provide appropriate incentives to leverage the existing capacity.

6. Social Impact should be Monitored and Managed Well

73. Given the pilot nature of the reform measures adopted, there has been no discernible social impact as a result of GRP thus far, as anticipated during program design. While attempts to reduce fiscal deficits in a low growth environment are likely to have an adverse social impact, both health and education expenditures have grown by 20% in nominal terms and about 12% in real terms over 2000–2002. However, fuller implementation of the PSMFL and the mainstreaming of reforms in various sectors may initially have a negative impact on the labor market and reduce access of the poor to social services. It is essential that adequate compensation measures are designed and implemented. ADB TA support includes a component on monitoring the impact and designing such measures. ADB will also maintain continuous consultation with the Government to ensure that sufficient budgetary allocations are made to cushion any adverse impact of the reforms. These efforts will also be coordinated with the World Bank's proposed structural adjustment loan to support general reform measures under the Government's Poverty Reduction Strategy, currently being finalized.

C. Recommendations

1. Program-Related

74. Further policy dialogue should take place between ADB and the authorities to
- (i) formulate a gradual, well-sequenced, and time-bound action plan to implement the provisions of the PSMFL. This needs to be accompanied by an ongoing process of awareness building and information dissemination to ensure that the reform measures and objectives are well-understood during implementation;

- (ii) sequence appropriate measures for consolidating various public sector administrative functions across the country, before increasing public sector compensation across the board;
- (iii) formalize the taxation and revenue sharing arrangements in line with the arrangements stipulated in the PSMFL;
- (iv) broaden the tax base, along with measures to strengthen the overall revenue administration of GDNT and CGA;
- (v) ensure that MOFE's capacity is significantly enhanced in many areas including: full implementation of MTEF, output-based budgeting, and oversight of budget execution;
- (vi) put in place a system within a short period of time for MOFE to begin negotiating budgets at the sector-level rather than with individual budget entities; and
- (vii) ensure that the social impact of the implementation of the PSMFL and related reforms is carefully assessed, monitored and effectively managed. Particular attention needs to be given to the impact on: poverty; public expenditures for social protection; labor markets; adequacy, quality, and timeliness of delivery of public services; human development; and broad-based public participation in the decision-making process.

75. The following developments should be monitored to ensure that the

- (i) reforms initiated in the bunch 1 and bunch 2 agencies are fully leveraged and utilized as workable models for furthering reforms across all levels of the Government, particularly during the first 2 years of the implementation of the PSMFL;
- (ii) counterpart funds allocated to the ministries and agencies are efficiently utilized and fully accounted for by June 2003;
- (iii) policy-coordination arrangements between MOFE and BOM are fully formalized by April 2003;
- (iv) MOFE installs an upgraded and improved treasury financial management information system without further delay beyond April 2003;
- (v) Government undertakes a functional review of at least 15 additional central and local budgetary bodies by April 2003; and
- (vi) SASC strengthens the process of benchmarking public sector compensation with private sector salaries at appropriate levels, by June 2003.

76. In order to allow for sufficient time for the intended benefits of the GRP to filter through different layers of the public sector, it is recommended that the Program Performance Audit Report be prepared in 2005.

2. General

77. Public sector resource management and governance reforms, in particular of a complex nature that Mongolia has committed to, constitute a long-term undertaking. The Government has clearly recognized this by formulating a 10-year program over 1999–2009 covering central Government, local governments and state-owned enterprises. The GRP has supported the first (pilot) phase over 1999-2002. The second phase envisages mainstreaming of the different governance components within the rest of the public sector, and to the extent possible, incorporating strong governance elements in other sector-specific interventions. The Government envisages that the final phase will entail mainstreaming of good governance throughout the economy, through direct interventions as well as trickle-down effects.

78. While the costs of implementing these reforms are substantial, the benefits are likely to be significant as well. In recent years, particularly in 2000 and 2001, Mongolia has achieved better than budgeted fiscal deficits as a proportion of GDP. The forward-looking reform agenda should effectively channel the scarce budgetary resources to targeted public sector interventions. Where possible, corporatization and commercialization measures should be implemented to ensure that the Government does not crowd out the private sector. Expenditure and revenue assignments should be rationalized at all levels of the government, based on efficiency (choice and economies of scale) and equity (access) considerations, to improve the alignment between overall macroeconomic priorities and the fiscal functions of the Government. The PSMFL provides a sound legal framework and political conduit to implement these reforms. ADB should explore various modalities to facilitate and deepen reforms over the second phase in the near future, and subsequently in the longer term.

PROGRAM FRAMEWORK

Design Summary	Indicators and Targets ^a	Monitoring Mechanism	Risks and Assumptions
<p>Goal</p> <p>Assist in the transition to a new system of public sector governance in Mongolia through the establishment of an efficient public sector financial management system, a sound public sector accountability system, and a transparent data/information dissemination system</p>	<p>An increasing pattern of budgetary bodies embarking on the administrative reforms following the review of the experience of the pilot agencies</p> <p>The degree of focus achieved on the core functions of the public sector and the resulting reduction in the size of the civil service compared with the baseline level at the beginning of the Program</p> <p>The level of fiscal deficit in proportion to Gross Domestic Product (GDP)</p> <p>The availability of funds under the recurrent budget for capital investment projects</p> <p>The maintenance of a close match between approved and disbursed appropriations that indicate absence of expenditure control by cash rationing</p> <p>Improved revenue collection due to a more efficient functioning of the General Department of National Taxation (GDNT)</p>	<p>National statistics</p> <p>ADB review missions</p> <p>Reports by the program steering committee</p> <p>Ministry of Finance (MOFE) and Bank of Mongolia (BOM) reports to ADB</p>	<p>Government's high commitment to reforms prevails.</p> <p>Parliament's micro-management of reforms will not interfere with the Program.</p> <p>Immediate budget crisis does not undermine efforts at reform.</p> <p>Political stability prevails.</p>

^a Base-line values can be established for many of these indicators (e.g., number and quality of audits, compared to those performed at the beginning of the program implementation).

Design Summary	Indicators and Targets ^a	Monitoring Mechanism	Risks and Assumptions
	<p>Improved customs revenue collection</p> <p>Number and quality of audits performed by the State Audit Board</p>		
<p>Objectives</p> <p>Improve aggregate fiscal discipline</p> <p>Strengthen the public sector's budget formulation and execution</p> <p>Enhance the public sector's operational efficiency</p> <p>Address the social impact and financing needs of reforms</p> <p>Prepare the groundwork for continuation of the reforms</p>	<p>Downward pattern (shown by percentage points decline) of fiscal deficit in proportion to GDP.</p> <p>Basic principles of public expenditure management adhered to (see Policy Matrix items intended to achieve primary objectives A and B)</p> <p>Public sector's operations become performance-based (see the policy matrix items intended to achieve primary objective C)</p> <p>See policy matrix items intended to achieve primary objective D</p> <p>Implementation strategy developed to apply requirements of the Public Sector Management and Finance Law (PSMFL) to local governments and state-owned enterprises (policy matrix primary objective E)</p>	<p>National Statistical Office and MOFE reports</p> <p>Budgetary proposals to Parliament and statistics on budget execution.</p> <p>Performance agreements of implementing agencies as evaluated by consultants</p> <p>Reports from the steering committee, ADB review missions</p>	<p>Continued commitment to strong structural adjustment measures.</p> <p>MOFE builds sufficient capacity to be able to implement public expenditure management.</p> <p>Implementing agencies have developed sufficient capacity.</p> <p>There is strong commitment to address social impact.</p> <p>The PSMFL is approved by Parliament.</p> <p>There is strong political commitment.</p>
<p>Outputs</p> <p>The immediate budgetary crisis eased (by 2000)</p> <p>The general requirement for fiscal responsibility in the budgetary process is</p>	<p>Supplementary budget for 1999 and the budget document for 2000 contain deficit reduction measures</p>	<p>Budget documents.</p>	<p>Parliament approves the budgets</p>

Design Summary	Indicators and Targets ^a	Monitoring Mechanism	Risks and Assumptions
enhanced Financial policy coordination is strengthened	Aggregate public expenditure is linked to macroeconomic forecasts (September 2000).	Independent report by consultants.	MOFE has built sufficient capacity.
	Contingent liabilities of the Government are better monitored and reported (starting in September 1999).	Budgetary documents.	Same as above.
A strategic focus in the budgetary formulation process is instilled.	BOM and MOFE agree to better coordinate banking and financial relations (by July 2000).	Memorandum of agreement signed.	An agreement is reached.
	The task force for information and data sharing between BOM and MOFE is formed (by December 2001).	MOFE reports to ADB	
	Medium-term development Strategy is coordinated with the public investment plan and aid's fund availability (starting at time of the donors meeting in 2000).	Documents prepared for the Consultative Group meeting in 2001.	MOFE's capacity is sufficient.
	A medium-term development expenditure framework is built based on the above and used as a base for budgetary strategic objectives (September 2000).	Report from MOFE to ADB	Same as above.
The public sector's banking and cash flow management is improved	Monitoring of public sector bank accounts is strengthened (March 2001).	Report by consultants.	Capacity at MOFE is strengthened.
The Public sector's debt and investment management is upgraded	Treasury management function within MOFE is established in compliance with the MOFE's agreement with the World Bank	Reports by the Government, by consultants	Same as above.

Design Summary	Indicators and Targets ^a	Monitoring Mechanism	Risks and Assumptions
<p>A strategic and performance focus in the budgetary process is instilled at the portfolio level.</p>	<p>(December 2000). Risk management policies improved in accordance with requirements of the World Bank fiscal technical assistance (TA) (March 2001). Budgetary units develop strategic business plans, conduct functional reviews, and plan for separating noncore functions (December 2001).</p>	<p>Report by consultants</p>	<p>Sufficient capacity building is accomplished.</p>
<p>The accounting practices of the public sector are upgraded</p>	<p>Accounting practices of the implementing units are upgraded (December 2000).</p>	<p>Report by State Audit Board and consultants</p>	<p>Same as above</p>
<p>The scope and availability of information on personnel management practices of the public sector are improved</p>	<p>Personnel management practices of the public sector are improved and made more transparent (May 2002).</p>	<p>Reports available to the public and ADB</p>	<p>Same as above</p>
<p>The efficacy of performance contracting in the public sector is evaluated</p>	<p>General managers are appointed to implementing units with whom agreements are signed and implemented (depending on the time of approval of the PSMFL).</p>	<p>Consultants reports</p>	<p>Same as above. Political commitment in place</p>
<p>Provision of sufficient budgetary resources to the implementing units to properly implement the reforms is assured.</p>	<p>Costs are estimated by the Government and provided for in the budget (January 2001).</p>	<p>Report to ADB and the budget document</p>	<p>Same as above.</p>
<p>A trans-governmental mandate for continuation of the reforms is provided</p>	<p>The PSMFL is approved by Parliament (May 2002).</p>	<p>Parliamentary record</p>	<p>Political commitment in place.</p>
<p>An implementation strategy to apply the requirements of the PSMFL to local governments is prepared.</p>	<p>An implementation plan is prepared (December 2000).</p>	<p>Government decree</p>	<p>Same as above.</p>

Design Summary	Indicators and Targets^a	Monitoring Mechanism	Risks and Assumptions
The performance structure of public enterprises is reformed.	State-owned enterprises prepare statements of intent, annual reports, and adopt an open process of Board member appointment (January 2002).	Reports by the Government, and ADB review missions	Same as above.
Inputs ADB loan on governance reforms (\$25 million) ADB technical assistance of \$1.8 million. World Bank Fiscal TA of \$5 million. International Monetary Fund –Extended Structural Adjustment Facility and technical expertise. Other bilateral grants and technical support.	Successful Program disbursements. Successful implementation of the TAs. Successful implementation. Program on track. Successful implementation.	ADB review missions and various reports. Same as above. World Bank reviews. International Monetary Fund missions and reports	Government's commitment Same as above Same as above. Same as above.

**PROGRESS ON COMPLIANCE WITH PROGRAM-MONITORING, SECOND TRANCHE
RELEASE AND PROGRAM-END CONDITIONS**

(Second Tranche Release Conditions appear in **Bold**)

Program Conditions	Status of Compliance
Primary Objective A: Improve Aggregate Fiscal Discipline	
1.1 Adopt a supplementary budget for 1999.	Complied with (prior to Board consideration)¹.
1.2 Adopt a budget for 2000 with the objective of further reducing the deficit in proportion to gross domestic product (GDP).	Complied with. The overall budget deficit declined from 12% of GDP in 1999 to 6.8% in 2000 and 5.3% in 2001. While some expenditure consolidation was achieved, emergency spending triggered by two successive harsh winters and wage and pension increases have constrained efforts to reduce public expenditures. Revenue collection has improved over the last 2 years.
2.1 Develop a system, acceptable to ADB, linking the medium-term macroeconomic forecast with corresponding binding parameters on aggregate public expenditures and budget deficits, and publish a fiscal framework statement (FFS) for the 2001 budget, acceptable to the Asian Development Bank (ADB), outlining these parameters.	Complied with. With advisory support under ADB Technical Assistance (TA) 3317, the Government formulated a FFS, initially for the 2001 budget and subsequently for 2002–2004, incorporating: (i) a 3-year rolling macroeconomic framework; (ii) medium-term revenue forecasts, and expenditure allocations by budget entity; (iii) a 3-year public investment program (PIP); and (iv) a medium-term finance and debt plan. The FFS is to be repeated for subsequent budgets.
2.2 The Ministry of Finance and Economy (MOFE) submits a position paper to the Parliament, acceptable to ADB, on the provision in the draft law pertaining to local government borrowing.	Complied with (prior to Board consideration).
2.3 Include as part of the budget statement for 2000 a memo item indicating the extent of contingent liabilities of local and central budgetary bodies.	Complied with (prior to Board Consideration).
2.4 Establish a system, acceptable to ADB, to monitor the contingent liabilities of the Government, including those of state-owned enterprises (SOEs) and private banks, and integrate a table (with appropriate explanations) into the annual budget documents, specifying all the contingent liabilities of the Government.	Complied with (Program End Condition). With advisory support under ADB TA 3317, a system to monitor contingent liabilities on an ongoing basis was developed. Guidelines have also been drafted to incorporate details on contingent liabilities in the annual budget documents, and the FFSs for 2002–2004 include estimates of such liabilities. The budget documents for 2003 are being drafted with appropriate accounting of the contingencies.
3.1 Bank of Mongolia (BOM) and (MOFE) to enter into an agreement on their banking and financial relations.	Complied with. As a part of the broader efforts to harden the budgetary constraints on public sector agencies, the Government initiated the closure of all off-budget bank accounts. Subsequently, as per the agreements reached between BOM and MOFE, Government deposits are being transferred into a treasury single account (TSA), with all transactions being conducted at the Treasury.

¹ Of these, eight conditions were met before Board consideration, but compliance under these was monitored to ensure continuity and consistency of the Program.

Program Conditions	Status of Compliance
3.2 BOM and MOFE to negotiate the structure, membership, reporting responsibilities, terms of reference, and funding arrangements for a formal task force that will be responsible for recommending improvements in coordination and data sharing and, upon concluding these negotiations, to establish the task force.	Complied with. A formal coordinating task force has been appointed and is overseeing the implementation of the TSA project and suggesting refinements. BOM and MOFE are in the process of confirming the medium-term membership and funding arrangements.
Primary Objective B: Strengthen the Public Sector's Budget Formulation and Execution	
4.1 Submit a medium-term development strategy to funding agencies that will be the basis for the 3-year public investment program (PIP).	Complied with (prior to Board consideration).
4.2 Develop a 3-year PIP framework, acceptable to ADB, that integrates capital and recurrent expenditures, and prepare a draft PIP based on the framework.	Complied with. With support under ADB TA 3317, the Government has adopted a 3-year rolling PIP framework integrating capital and recurrent expenditures. The Parliament has adopted the PIP for 2002–2004.
4.3 Finalize the PIP based on commitments from funding agencies.	Complied with. The PIP framework is being continuously updated on an annual basis to guide investment planning, based on annual funding agency commitments.
4.4 Develop the underlying conceptual basis for a medium-term expenditure framework (MTEF) that builds on the PIP framework and is acceptable to ADB.	Complied with. The conceptual framework of the MTEF adopts an output-based system of budget estimates for 3 years on a rolling-basis. The MTEF aims at achieving greater integration of the PIP and recurrent budgets and sound linkage between policy and budgeting.
4.5 Establish explicit Government strategic objectives and set corresponding (top down) sector budgetary parameters for ministerial portfolios in accordance with the MTEF.	Complied with. The action plan of the Government of Mongolia, the Economic and Social Development Guidelines for 2002, and the Development Vision for 2003–2005, define the strategic objectives of the Government over the medium term. The MTEF, building on the PIP, integrates bottom-up forward cost estimates submitted by line ministries and budget bodies with the top-down strategic priorities and the binding sector budget ceilings established by the Government.
5.1 Develop and implement control arrangements over the opening, closing, and operation of bank accounts of the public sector.	Complied with. In the first phase of reforms over the second half of 2001, all foreign currency deposits of the central Government were transferred to the TSA. A pilot program was initiated under which 11 budget entities initially routed all their payments through zero-balance accounts at BOM. Based on a review, MOFE and BOM have introduced a centralized payment system in favor of a zero-balance system. Budgetary agencies have been barred from opening new commercial bank accounts. Full implementation of the TSA was initiated on 1 July 2002.
6.1 Strengthen the treasury management function within MOFE including a corresponding treasury management computer system.	Complied with. The treasury system aims at improving the risk management processes and gradually introducing a modified accrual budgeting system. The

Program Conditions	Status of Compliance
	system would also help improve the quality of fiscal reporting and support effective cash and debt management. The system framework has been designed, tenders have been announced, and the actual installation of the treasury financial management information system is expected by April 2003, with support from the World Bank's fiscal TA project.
6.2 Design and implement risk management policies for debt and investments.	Complied with. A debt management system has been designed to achieve improved asset-liability matching both in terms of composition as well as maturity. The purpose of the new system is to smooth the debt repayments over the medium term, by avoiding repayment peaks and spreading out the burden evenly over time. ADB TA 3317 has provided support in forecasting public debt and repayments over 2001–03.
Primary Objective C: Enhance the Public Sector's Operational Efficiency	
7.1 At least two pilot entities from the pilot agencies prepare financial reports for the year ended 31 December 1998.	Complied with (prior to Board consideration). Under the Program, five pilot agencies have been identified to implement public sector management reforms. These include, the State Administrative Services Council (SASC), General Department of National Taxation (GDNT), Customs General Administration (CGA), National Statistical Office (NSO), and the State Audit and Inspection Committee (SAIC). Of these, GDNT and NSO had submitted their financial reports for 1998.
7.2 The remaining three pilot agencies prepare financial reports for the year ended 31 December 1998.	Complied with. Ex-post financial statements have been prepared for SASC, CGA and SAIC. Subsequently, all five entities have completed the statements for the following years.
7.3 Financial reports prepared by the pilot entities in 7.1 are audited by an independent auditor with close cooperation from SAIC and the auditor's evaluation submitted to ADB.	Complied with. With TA support from the Australian Agency for International Development, two auditors of Audit Victoria, Australia, conducted an external audit of the ex-post financial statements of all the bunch 1 agencies, and found the audits satisfactory. The auditors' opinion and an activity completion report have been submitted to the Government and ADB.
7.4 The financial reports prepared by the remaining pilot entities are reviewed by SAIC.	Complied with. Auditors from Audit Victoria, Australia, in collaboration with auditors from SAIC have conducted an external audit of the ex-post financial statements of the three remaining pilot agencies. Australian auditors also conducted training in risk management to inspectors of SAIC to provide them with relevant knowledge on audits of financial statements prepared on accrual/output-based accounting methods.
7.5 The second group of pilot agencies prepare ex-post financial reports for the year ended 31 December 2000 in accordance with the recommendations based on the review and experience of the first group and the reports reviewed by SAIC.	Complied with. The following 11 agencies were selected as bunch 2 entities under the Program: (i) MOFE; (ii) State Financial Inspection Department under MOFE; (iii) Ministry of Education, Science, Technology, and Culture; (iv) Ministry of Health; (v) Hospital No.1; (vi) Ministry of Environment; (vii) three agencies under the supervision of the Ministry of Environment; (viii) Ministry of Justice and Internal

Program Conditions	Status of Compliance
	Affairs; and (ix) Ministry of Social Welfare and Labor. In addition, the Nalaikh District Administration within Ulaanbaatar City has also adopted the Program on a pilot basis. SAIC has carried out the auditing process of the financial outcomes of bunch 2 entities, and copies of the audit reports have been submitted to the State Great Hural.
8.1 The bunch 1 pilot entities submit appropriation estimates on an output basis to the Parliament in lieu of the current appropriation requirements.	Complied with. The budget appropriation estimates of these entities were developed in a manner consistent with the reform principles and concepts, and submitted to the Parliament. The Strategic Business Plans (SBPs) prepared by all the entities facilitated better linkage between inputs and output, which in turn enabled a closer link between outputs and the budget needs.
8.2. Based on the results of the review and the experience of the bunch 1 pilot entities, bunch 2 budgetary entities present appropriation estimates on an output basis to the Parliament.	Complied with. Output-based appropriation estimates have been prepared on a provisional basis for 2002–2004 for all bunch 2 entities, and the estimates have been tabled along with the budget documents presented to the Great Hural.
8.3 Bunch 1 pilot entities prepare and complete medium-term SBPs acceptable to ADB, including specified and costed outputs.	Complied with. The SBPs for the bunch 1 entities were completed in September 2000 in accordance with the format prepared with ADB TA support.
8.4 Based on the results of the review and the experience of the bunch 1 pilot entities, bunch 2 budgetary bodies will prepare SBPs, or adaptations thereof, that are acceptable to ADB.	Complied with (Program End Condition). The SBPs of all Bunch 2 entities have been finalized for 2002–2004 in accordance with the format prepared with ADB TA support.
8.5 Bunch 1 pilot entities conduct and complete a functional review to identify core and noncore functions.	Complied with (prior to board consideration). The identification of core and noncore functions of the five bunch 1 pilot agencies was undertaken, along with the formulation of their SBPs. Based on the outcomes, all the five entities have attempted to streamline their internal organizational structures and improve assignments of functional responsibilities to staff at different levels.
8.6 Ten other central and 20 local budgetary bodies conduct and complete a functional review to identify core and noncore functions.	Compliance under way. Eleven central level entities have undertaken a preliminary functional review, and the process is under way in selected local budgetary bodies.
8.7 At least three portfolio ministries conduct and complete a functional review to identify core and noncore functions and develop corresponding time-bound action plans to corporatize, privatize, or spin-off to non-government organizations their non-core functions.	Complied with. All six ministries included in bunch 2 have undergone a functional review. The Government through the State Property Committee, is at present engaged in formulating action plans for the restructuring of corporations and SOEs coming under the structure of these ministries.
9.1 Bunch 1 pilot entities prepare forecast financial statements in accordance with international accounting standards (IAS) for inclusion in SBPs.	Complied with. The forecast financial statements for 2001–03 and 2002–04 were completed in September 2000 and November 2001, respectively. In addition, SAIC has reviewed these reports in October 2001 for conformity with IAS.
9.2 Based on the results of a review and the	Complied with. Forecast financial statements have

Program Conditions	Status of Compliance
experience of bunch 1 pilot entities, bunch 2 entities prepare forecast financial statements in accordance with IAS for inclusion in SBPs.	been completed for all the bunch 2 agencies in accordance with IAS.
10.1 Make available to the general public (and announce in a newspaper that is available upon request) figures on the number of civil servants by ministry and within each ministry, by local and central governments by position classification and rank.	Complied with (prior to Board consideration).
10.2 Update the system of consolidating data on the size and structure of the civil service in accordance with any changes in the civil service law and begin publishing civil service personnel statistics according to any changes.	Complied with. Consolidated data on the size and structure of the civil service are being updated each year. The updated data system includes changes in public service employment patterns, gender indicators, share of public servants in the overall employment and population, number of public servants by type of economic activity, total government expenditure per employee, and information on civil service training and qualification exams.
10.3 Make available to the general public the current guidelines and procedures for recruitment and entry into the civil service.	Complied with (prior to Board consideration). The guidelines and procedures on recruitment and entry are regularly disseminated to the general public.
10.4 Develop and implement an improved competitive entry process for the core civil service based on a plan acceptable to ADB.	Complied with. Each year, SASC consolidates current vacancies and publishes announcements, along with civil service entry requirements and general guidelines in the month of May, about 45 days prior to holding centralized exams, in the <i>Zuunii Medee</i> (Century News) newspaper. In aimags and the capital city, the local state administrative service councils make announcements through local radio and <i>UB Times</i> newspaper, respectively. Under the Program, SASC issued Decree No. 6 (2001) and Decree No. 5 (2002) approving temporary template guidelines on selection and recruitment in budgetary bodies to be followed by bunch 1 and bunch 2 pilot entities. These entities, constituting a core of the civil service, in turn, have adopted their own transparent guidelines, which now govern the entry process for employment at all levels.
10.5 Establish and publish guidelines and procedures that promote the use of performance as a basis for promotion.	Complied with. The SASC, with support under ADB TA, has prepared template guidelines on general manager and employee performance agreements. These guidelines have been effectively implemented in all bunch 1 pilot entities. GDNT and NSO have implemented a performance-based bonus system on a trial basis for all their employees.
10.6 Develop a system for estimating private sector compensation across different generic positions for benchmarking public sector compensation.	Complied with. Paragraph 3.3 of Article 28 of the Civil Service Law provides the criteria for benchmarking for public sector compensation and stipulates that the average remuneration for a civil service position should be no less than 95 % of the average remuneration for a comparable private sector position. SASC has introduced a survey framework to compile data on a periodic basis.

Program Conditions	Status of Compliance
10.7 Begin publishing annual summary tables of civil service compensation across positions together with private sector benchmarks.	Complied with. Annual revisions to civil service salaries are published in official state gazette <i>Turiin Medeelel</i> (State Newsletter) of the Parliament Secretariat.
11.1 The Government appoints general managers to each of Bunch 1 pilot entities in accordance with guidelines and procedures established by the SASC.	Complied with. General managers of two government agencies in bunch 1 (namely, GDNT and CGA) are appointed by the minister for finance and economy, and general managers of the three Parliamentary bodies (namely, SASC, SAIC, and NSO) are appointed by the Parliament. The nomination and appointment process is in line with the SASC guidelines.
11.2 Government implements 1-year performance agreement for each of bunch 1 pilot entities in accordance with the guidelines and procedures established by SASC.	Complied with. GDNT and CGA have entered into performance agreements with the Minister of finance and economy, and the other three entities have formulated such agreements with the Parliament, through adoption of the SBPs.
11.3 The Government undertakes performance evaluation in bunch 1 pilot entities on 1-year contracts.	Complied with. In January 2002, the Cabinet Secretariat and SASC conducted performance evaluation of bunch 1 pilot entities. A participatory workshop was held in which the chairpersons of the bunch 1 agencies outlined the achievements of the reform measures. The assessment concluded that on the whole satisfactory progress has been achieved, although capacity constraints need to be addressed. An important lesson learned has been the need for careful definition and costing of outputs.
11.4 SASC revises guidelines and procedures on personnel management of the public sector based on a first review of experience of pilot entities with performance contracting.	Complied with. Based on a review of the outcomes in bunch 1 pilot entities, SASC has adopted revised templates and guidelines on general manager and employee performance agreements through SASC Decree No 4, April 2002.
11.5 Based on the first review of experience in bunch 1 pilot entities, the Government appoints general managers for selected bunch 2 entities in accordance with the revised guidelines and procedures of SASC.	Complied with. With regard to the six portfolio ministries, their state secretaries are designated as the general managers, who have been appointed in line with the SASC provisions. This process is under way for the nonministerial entities in bunch 2.
Primary Objective D: Address the Social Impact and the Financing Needs of Reforms under the Program	
12.1 The Government will provide the necessary budgetary support for the pilot entities to begin to implement administrative reforms.	Complied with. The Government, in line with the agreement with ADB, allocated \$5 million in the 2001 budget to support implementation of reforms in bunch 1 entities, selected ministries, aimags, and a few bunch 2 agencies.
12.2 The Government will provide the necessary budget support to cushion the social impact of the reforms as they are mainstreamed.	Complied with. During the 1999-2002 pilot phase of reforms under the GRP, no adverse social impact resulted from the reforms introduced in the pilot agencies or in the budget management process. However, the Government is acutely aware that any expansion of reforms will most likely have significant effects on society at large, and has committed to making sufficient allocations in the budget to mitigate any adverse social impact.

Program Conditions	Status of Compliance
Primary Objective E: Prepare Groundwork for Continuation of the Reforms	
13.1 Submit a draft public sector management and finance law (PSMFL) acceptable to ADB and Parliament.	Complied with (prior to Board consideration).
13.2 Secure Parliamentary approval of the PSMFL.	Complied with (Program End Condition). The Mongolian Parliament adopted the PSMFL on 27 June 2002. The PSMFL has three main components, which aim to (i) strengthen budget formulation and execution, at all levels of public administration; (ii) enhance accountability and transparency in the civil service through the adoption of medium-term SBPs, performance contracting and output-based budgeting; and (iii) streamline center-local fiscal relations, given the lack of fiscal prudence at local level. The Government and Parliament have demonstrated full ownership of this important legislation.
14.1 Establish a working group to develop a detailed plan and implementation strategy for mainstreaming the reforms in local governments.	Complied with. A working group comprising the deputy chief of the Cabinet Secretariat and selected local officials has been formed, and a detailed reform plan and an implementation strategy have been developed with support under TA 3316. Periodic discussions have been held with all the aimag governors on the scope and direction of reforms to be pursued. Further, the Government adopted Decree No. 10 in 2001 to form implementation councils in 6 pilot aimags, including Arkhangai, Darkhan-Uul, Selenge, Sukhbaatar, Uvs, and Khunsugul.
14.2 Prepare an implementation strategy (based on the provisions of the PSMFL) for mainstreaming public sector reforms in local governments and identify an aimag in which pilot experimentation will be undertaken as a basis for the formulation of the strategy.	Complied with. With ADB support, the Government has reviewed the local government aspects of reform implementation and formulated a draft time-bound plan to guide the expansion of governance reforms across the country in line with the provisions of the PSMFL. Subsequently, significant capacity building and training have been provided to officials in Arhangai and Selenge aimags, chosen by the Government on a pilot basis, as well as officials from the bunch 1 agencies. The focus of the training program has been on the functional, management, and organizational changes needed to adopt governance reforms; formulation of SBPs; and budgetary, accounting, and treasury system reforms.
14.3 At least three central level and three local level SOEs prepare statements of intent acceptable to ADB.	Complied with. Satisfactory statements of intent, modeled after the SBPs for the bunch 1 and 2 entities, have been prepared by three central-level (Khunstech Corporation, Mongol Tamga and Biochemical Factory) and three smaller local level SOEs (National Recreation Center, Bus Company No.2, and Ulaanbaatar Road Maintenance Company).
14.4 Ten central level and local level SOEs prepare statements of intent acceptable to ADB.	Complied with. Detailed instructions and templates have been prepared with ADB TA support, to help entities in preparing SBPs. The State Property Committee has confirmed that 20 SOEs have

Program Conditions	Status of Compliance
	submitted statements of intent that are in line with the templates.
14.5 SOEs prepare annual reports acceptable to ADB.	Complied with. Corporatized SOEs in Mongolia prepare their annual reports in accordance with the Company Law provisions, which are acceptable to ADB.
14.6 SOEs specified in 14.3 prepare an open process of board member identification and appointment that is acceptable to ADB.	Complied with. The Boards of the above SOEs consist of representatives from MOFE, State Property Committee, and the respective line ministries, in line with Mongolian legal framework.
14.7 SOEs implement the above open process of board member identification and appointment.	Complied with. Around 45 of the 67 SOEs with full state ownership have proper board structures, and the State Property Committee is pursuing the board member identification and appointment process in the remaining SOEs.

MACROECONOMIC AND PROGRAM INDICATORS

Table A3.1: Key Economic Indicators

Item	1997	1998	1999	2000	2001
A. Income and Growth					
1. GDP per Capita (\$, current prices)	444.7	405.0	382.0	388.0	390.0
2. GDP Growth (% , constant prices)	4.0	3.5	3.2	1.1	1.1
Agriculture	4.3	6.4	4.2	(16.8)	(17.2)
Industry	(3.3)	3.8	1.1	7.4	11.9
Services	9.0	0.3	3.5	17	10.0
3. GDP Growth (excluding agriculture) (% , constant prices)	3.8	1.7	2.6	11.5	10.7
B. Money and Inflation					
		(annual % change)			
1. Consumer Prices (annual average)	36.6	9.4	7.6	8.1	8.0
2. Broad Money (M2)	19.8	8.8	31.7	17.6	27.9
C. Government Finance					
		(% of GDP)			
1. Total Revenue and Grants	25.5	27.6	27.2	33.6	38.0
2. Total Expenditure and Net Lending	34.5	41.9	39.4	40.5	43.3
Of which:					
a. Current Expenditure	23.1	27.2	26.7	30.1	32.4
b. Capital Expenditure	11.4	14.6	12.7	10.4	10.9
3. Overall Surplus (Deficit)	(9.1)	(14.3)	(12.2)	(6.8)	(5.3)
D. Government Finance – Details					
		(MNT billion)			
1. Total Revenue	212.1	225.5	251.7	351.4	429.5
2. Total Expenditure and Net Lending	287.6	342.1	364.6	422.6	489.7
Of which:					
a. Current Expenditure	192.6	222.4	246.9	314.2	366.7
(i) Wages and Salaries	44.8	56.0	63.5	86.1	92.1
(ii) Goods and Services	83.1	99.6	100.7	124.7	162.6
(iii) Subsidies and Transfers	43.5	55.8	65.3	85.2	95.5
(iv) Interest Payments	21.2	11.1	17.3	18.2	16.5
b. Capital Expenditure and Net Lending	95.0	119.7	117.7	108.4	123.0
3. Share of Current Expenditures in Total Expenditures (%)	70.0	65.0	67.7	74.3	74.9
E. Balance of Payments					
1. Merchandise Trade Balance (% of GDP)	3.0	(12.4)	(12.5)	(14.5)	(14.6)
2. Current Account Balance (% of GDP) ^a	1.3	(13.2)	(13.7)	(17.4)	(15.8)
3. Export (\$) Growth (% , annual change)	34.5	(18.8)	(1.7)	18.0	(14.2)
4. Import (\$) Growth (% , annual change)	5.3	8.2	(2.6)	19.2	(9.7)
F. External Payments Indicators					
1. Gross Official Reserves (\$ million)	137.5	124.7	156.8	187.7	205.6
- weeks of imports	12.3	11.4	12.1	15.9	16.8
2. External Debt Service (% of exports) ^b	6.3	7.3	9.3	4.5	7.3
3. External Debt (% of GDP) ^c	57.4	77.4	93.9	81.2	82.4
G. Memorandum Items					
1. GDP (current prices, MNT billion)	832.6	817.4	925.3	1,044.6	1,130.5
2. Exchange Rate (MNT per \$, annual average)	790.0	841.0	1,022.0	1,077.0	1,097.6
3. Population (million)	2.31	2.36	2.39	2.42	2.45
4. Copper Price (\$, % change)	19.3	(38.1)	(5.8)	18.4	(13.3)
5. Gold Price (\$, % change)	(18.7)	(6.6)	(6.3)	(1.2)	(5.1)

GDP = gross domestic product

^a Excludes official transfers

^b Excludes unresolved claims estimated at MNT10 billion owed to the Russian Federation but includes payments on Council for Mutual Economic Assistance debts that have been converted via formal intergovernmental agreements.

^c Excludes unresolved claims estimated at MNT10 billion owed to the Russian Federation.

Sources: Mongolian authorities and International Monetary Fund.

**Table A3.2: Customs Tax Collection
(MNT million)**

Type	1996	1997	1998	1999	2000	2001	2002
of which:							
Customs duties	12,874.6	7,231.6	748.8	5,849.6	17,124.3	25,991.4	19,823.0
Excise duties on alcohol and tobacco	1,352.8	3,107.5	3,819.4	3,479.8	4,050.0	3,065.0	2,609.7
Excise duties on petroleum and diesel fuel	3,99.0	7,023.0	9,522.4	8,819.4	13,404.9	16,626.2	15,400.6
Excise duties on autovehicles	0.0	516.4	2,258.7	3,054.0	7,245.3	7,332.0	5,235.2
VAT	10,947.8	18,304.8	24,980.6	31,776.5	46,036.5	60,395.5	62,050.7
Duties on petroleum and diesel fuel	4,088.1	4,214.7	4,344.7	4,316.8	4,189.3	5,454.5	3,571.6
Export duties	1,042.4	1,559.0	760.2	3,161.4	5,153.1	1,027.3	788.4
Excise duties on beer	0.0	0.0	0.0	218.8	420.0	3,118.9	2,326.5
TOTAL	34,297.0	41,957.0	46,434.8	60,676.3	97,623.4	123,010.8	111,805.7

**Table A3.3: Overall Tax Revenue Collections by
General Department of National Taxation
(MNT million)**

REVENUE TYPE	1998	1999	2000	2001
Corporate tax	37,575.3	24,633.3	49,091.2	46,017.8
Personal income tax	9,954.2	12,564.2	14,944.8	20,757.2
Automobile license fees	2,064.2	2,625.5	2,951.5	3,457.2
Excise duties	9,640.8	11,820.3	15,962.3	23,954.3
Trade	11,120.7	1,856.9	199.7	460.5
Value-added tax	7,886.8	33,566.1	29,860.9	41,743.9
Immobiles	242.2	218	196.9	1,768.9
Tax on guns	114.3	119.3	115.2	128.1
Other fees	5,583.8	20,591.2	20,998.0	30,404.0
Hunting licence	696.8	815.7	976.9	1,647.5
Other	50.4	1,747.4	402.2	6,957.1
Payment from use of plants	19.1	98.7	47.1	32.0
Non-tax revenue	19,122.8	15,181.4	24,175.2	19,589.6
Other	7,196.6	5,268.4	3,732.9	5,561.2
TOTAL AMOUNT	103,305.1	123,176.2	158,495.7	188,281.5

Table A3.4: Counterpart Funds Allocated for Capacity Building in Bunch 1 Agencies

Pilot Entities	Funding to be Allocated (Resolution No.10) (\$)	Description and Purpose of Expenditure	Actual Expenditure to Date	
			\$	MNT ^a
1. National Statistical Office	500,000	1. Equipment	116,275.00	—
		2. Out-of-country training or study visit	27,086.00	6,738,240
		3. In-country training or workshops	—	—
2. State Audit and Inspection Committee	300,000	1. Equipment	299,994	
		2. Audit program		
3. State Administration Services Council	400,000	1. Equipment	31.344	
		2. Out-of-country training or study visit		
		3. In-country training or workshops		
4. General Department of National Taxation	600,000	1. Equipment	398,886	
		2. Out-of-country training or study visit	64,189	658,000
		3. In-country training or workshops	—	23,517,860
		4. Printing		22,417,037
5. Customs General Administration	500,000	1. Equipment (customs laboratory)	684,980	
6. Public Awareness (Cabinet Secretariat)	200,000	1. Mass media		300,000
		2. Out-of-country training & study visits	77,921	23,778,914
		3. In-country training or workshops		2,220,000
		4. Printing		11,227,620
		5. Equipment		39,989,419
7. Ministries (Bunch 2)	1,000,000		^a	
8. Agencies (Bunch 2)	500,000		^a	
9. Local Government	1,000,000		^a	
Total	5,000,000		1,700,675	130,847,090

— =not available.

^a \$1 = MNT1,110.

^b The Government has decided on the allocation of about \$1.09 million. The remaining \$1.41 million will be allocated and released in early 2003.