

Inclusive and Sustainable Growth Assessment

Mongolia
2017–2020

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CURRENCY EQUIVALENTS

(as of 15 March 2017)

Currency unit	–	togrog (MNT)
MNT1.00	=	\$ 0.000407
\$1.00	=	MNT2,457.8

ABBREVIATIONS

ADB	–	Asian Development Bank
DRM	–	disaster risk management
CPS	–	country partnership strategy
FDI	–	foreign direct investment
GDP	–	gross domestic product
IMF	–	International Monetary Fund
INDC	–	intended nationally determined contribution
MDG	–	Millennium Development Goals
PRC	–	People's Republic of China
SDG	–	Sustainable Development Goal
SMEs	–	small and medium-sized enterprises

NOTE

- (i) In this report, "\$" refers to US dollars.

GLOSSARY

<i>aimag</i>	–	administrative unit (provincial)
<i>dzud</i>	–	local natural disaster (harsh winter)
<i>ger</i>	–	traditional tent
<i>soum</i>	–	administrative unit (subprovincial)

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INCLUSIVE AND SUSTAINABLE GROWTH ASSESSMENT

I. RECENT GROWTH, POVERTY, INEQUALITY, AND ENVIRONMENTAL DYNAMICS

A. Economic performance

1. **Current economic situation.** A progressively worsening external environment—characterized by plummeting foreign direct investment (FDI), falling commodity prices, and growth moderation in the People’s Republic of China (PRC)—led to a deceleration in Mongolia’s gross domestic product (GDP) growth from 17.3% in 2011 to 1% in 2016. The slowdown resulted in job losses and eroded incomes, particularly among the vulnerable and poor, who are disproportionately affected during crises. In 2012–2014, the government launched expansionary fiscal and monetary policies to stimulate the economy and foster employment; however, these failed to significantly spur growth and instead aggravated macroeconomic imbalances. The economic slowdown was compounded by high levels of off-budget expenditure ahead of the general elections in June 2016, which resulted in a large fiscal deficit of 15.4% of GDP. Rapid credit growth during the mining boom years, dollarization, weak financial supervision, and inadequate provisioning have strained banks and financial stability. Balance of payments pressures persist in the context of currency depreciation, reserves depletion, and meager FDI inflows.

2. **Improved prospects under the IMF program.** Debt repayments in 2017–2018 (over \$1.2 billion due) undermine debt sustainability. In April 2015, the International Monetary Fund (IMF) assessed Mongolia as being at high risk of debt distress and advised that substantial fiscal adjustment (among other measures) would be required to put the country’s public finances back on a sustainable path.¹ Excluding central bank foreign liabilities, the country’s public-debt-to-GDP ratio was 86.5% in 2016, compared to 32.7% in 2011. Higher commodity prices and the return of FDI inflows to two large mining projects are expected to contain GDP losses in 2017. The implementation of the IMF program, which aims at stabilizing the economy, restoring debt sustainability, and improving fiscal and monetary management, will boost growth in the medium term.² Under the program, GDP growth is projected to average 6.5% in 2019–2020.

3. **Long-term growth and transformation.** The current economic difficulties notwithstanding, Mongolia’s economy has been broadly characterized by rapid growth and transformation since it began the transition from central planning in the early 1990s. The move to a market economy is now nearly complete. From a base of virtually nothing in 1990, the private sector currently generates about 80% of GDP and 70% of total employment. GDP growth has been rapid for much of this period—averaging about 7% per annum since the beginning of the new millennium—pushing Mongolia into the ranks of middle-income countries in 2011. The country’s growth has been driven at various times by mining, construction, animal husbandry, services, and inward remittances. Mongolia has also progressively opened up to FDI, which grew rapidly following the discovery of vast new mineral deposits—especially of copper, coal, and gold—since 2007.

4. **Recurring boom-and-bust cycles.** Mongolia’s dependence on mining for growth and foreign exchange earnings make it susceptible to boom-and-bust cycles as the mining sector accounts for about one-fifth of GDP and 80% of exports. Mongolia’s economy is also heavily dependent on the PRC, which receives over 80% of the country’s exports. The economy is

¹ IMF. 2015. *Mongolia: Staff Report for the 2015 Article IV Consultation*. Washington, D.C.

² A 3-year arrangement under the IMF Extended Fund Facility was announced on 19 February 2017 and is expected to be approved in May 2017.

vulnerable to copper concentrate price and production fluctuations, as this commodity constitutes nearly half of exports. In addition, the mining sector depends heavily on inflows of FDI and external demand for its output, making the economy highly vulnerable to external shocks due to swings in international commodity prices and the economic cycles of major trading partners. This has resulted in recurring periods of slow economic growth and macroeconomic instability since 1991.

B. Political economy context

5. **Long-term political stability.** One of the keys to Mongolia's long-term economic success has been a democratic polity that has managed political transitions peacefully while remaining committed to market-based economic principles. Seven parliamentary elections have been held since the country turned to a multi-party competitive rule in 1990 and all have been deemed free and fair by international observers. The country's two major political parties have generally been able to achieve a bipartisan consensus on major economic issues, including in response to the severe economic crisis of 2008–2009 and in making major decisions on investment policies in the mining sector. However, in recent years, political factors have driven large capital expenditures off-budget in avoidance of normal budgetary approval processes, resulting in significant fiscal pressures.

C. Labor market developments

6. **Main characteristics.** Mongolia's labor market is characterized by limited formal employment opportunities in rural areas, shortages of skills in certain sectors, skill mismatches, dependence on seasonal and temporary employment, gender inequalities, and unique age-specific challenges for both young and old.³ About one-third of the economically active population is involved in agriculture, where productivity, wages, and salaries are comparatively low. Given the sparse population and extreme weather variations, employment in Mongolia is highly seasonal, particularly in the agriculture and construction sectors. Labor force participation in Mongolia is slightly below that of other countries in the region at a similar level of per capita income with only about two out of three working-age adults (15+) considered economically active. The formal unemployment rate stood at 8.6% in 2016.

7. **Women's lack of empowerment.** Labor force participation for women is lower than that for men—in 2014, female labor participation was 55.4%, compared to 68.1% for men.⁴ Despite higher educational attainment, the relatively low participation of women in the labor market is due to their domestic caregiving responsibilities, lower retirement age, and weak enforcement of relevant laws and government policies. When women enter the labor market, they are less likely to be in higher level positions and are paid less than men. In addition, occupational gender segregation results in fewer women in high demand and better-paying jobs, perpetuating male dominance in key sectors. Women are also more likely to be employed in the informal sector, with the majority (65.5%) engaged in wholesale trade and services, and other similar low-return business activities.⁵ In 2015, the national average wage for men was 12.5% higher than that for women, down from 18.9% in 2013.⁶

³ F. Gassman, D. Francois, and L. Zardo Trindade. 2015. *Improving Labor Market Outcomes for Poor and Vulnerable Groups in Mongolia*. Rapid Social Response Multi-Donor Fund. Ulaanbaatar.

⁴ National Registration and Statistical Office. 2015. *Mongolia Statistical Yearbook 2014*. Ulaanbaatar.

⁵ National Registration and Statistical Office. 2015. *Labor Force Survey*. Ulaanbaatar.

⁶ Wage gap data measuring gender-differentiated “pay for equal work” are not available in Mongolia.

8. Women generally lack the requisite experience and access to business networks or finance to engage in and set up businesses in the formal sector. Women's businesses tend to be smaller, demonstrate lower turnover rates, and have fewer employees. Moreover, their enterprises tend to be established as family businesses or with the support of family. Neither sex-disaggregated data on small and medium-sized enterprises (SMEs) nationwide, nor private sector-related data disaggregated by gender, ownership status, and types of industries, are available. However, a 2013 enterprise survey by the International Finance Corporation indicated that an estimated 37.8% of firms had female participation in ownership, while 35.6% of firms were led by female managers.⁷ Gender inequality in asset ownership is also a constraint on women's economic empowerment, with only 19.2% of married women in rural areas owning land individually or jointly with their husbands.⁸

D. Gender equity trends

9. **Global benchmarking.** Irrespective of women's lack of empowerment in the labor market, Mongolia does reasonably well on gender equity in the global rankings. The country was ranked 58 out of 144 countries in the World Economic Forum's 2016 Gender Gap Index, with a score of 0.705 (1.00 signifies full gender equality).⁹ Mongolia does exceptionally well in terms of life expectancy, sex ratio at birth, literacy, and enrollment in secondary and tertiary education. However, the country lags significantly in political empowerment. Further, the Index does not capture important negative trends, such as the rise in gender-based violence.¹⁰

10. **Some significant reverse gender gaps.** There are some significant reverse gender gaps in Mongolia. For example, the average mortality rate of adults per 10,000 people is 29.1 for men versus 14.5 for women. Gender balance in school enrolment and completion is roughly equal early in the education cycle, but significant disparities emerge later. In the 2013–2014 academic year, the gender enrolment ratio of girls to boys was 0.96 in primary education, 0.99 in lower secondary education, 1.16 in upper secondary education, and 1.41 in higher education.¹¹ The primary completion rate in the same academic year was 98.8% for girls and 97.9% boys. The reverse gender gap in educational attainment among young adults has provoked social concerns, especially in rural areas, where more boys than girls tend to drop out to support their families in herding and other income-generating activities.

E. Poverty, inequality, and human development trends

11. **Significant but fragile progress in poverty reduction.** The 2014 poverty data for Mongolia indicate that the incidence of poverty fell to 21.6%, which is a significant reduction from 38.8% in 2010.¹² Although strong economic growth since 2001 has substantially boosted average incomes and reduced poverty incidence, one in five Mongolians still live in poverty and largely depend on welfare benefits for basic subsistence (i.e., one-third of their income comes from pensions and welfare payments). Nomadic families, households headed by women, and urban migrants have a particularly high incidence of poverty and are more vulnerable to the country's extremely cold winters.

⁷ IFC. 2014. *Enterprise Surveys: Mongolia Country Profile*. Washington, D.C.

⁸ Swiss Agency for Development and Cooperation. 2015. *Gender Analysis in Pastoral Livestock Herding in Mongolia*. Ulaanbaatar.

⁹ World Economic Forum. 2010 and 2015. *Global Gender Gap Reports*. Geneva.

¹⁰ Based on a review of national police administrative records and recent media attention.

¹¹ Ministry of Education and Science. 2014. *Statistical Yearbook for Education and Science 2013–2014*. Ulaanbaatar.

¹² National Statistical Office and World Bank. 2015. *Poverty Profile in 2014: Results of the Household Socioeconomic Survey 2014*. Ulaanbaatar.

12. **Many are still vulnerable to falling back into poverty.** The 2014 Household Socio-Economic Survey (footnote 12) also found significant clustering just above the poverty line indicating that many households are near poor and thus vulnerable to falling back into poverty due to shocks or prolonged economic stress. For example, the 2014 data indicate that about 11% of the country's population has incomes of no more than 10% above the poverty line. From a broader perspective, 35% of the Mongolian population has a monthly per capita consumption of MNT150,000–250,000. Considering that the 2014 poverty line is MNT146,500, a much larger cohort of people lives at a level close to the poverty line.

13. **Current economic difficulties are impacting the poor.** Results from focus group discussions conducted for the Poverty and Social Impact Assessment for Social Welfare Support Program of the Asian Development Bank (ADB) indicate that poor households have been significantly affected by the current prolonged economic crisis and are coping by (i) reducing food consumption and its quality; (ii) limiting health expenditure; (iii) increasing debt; and (iv) absorbing the impacts of delayed wages and reduced employment opportunities.¹³ As a result—the assessment found—many households are increasingly reliant for their basic needs on the regular payments from the child money and food stamp programs. Lessons from the 2008 food and fuel crisis show that it took poor households more than 18 months to recover from that economic shock.¹⁴

14. **Some progress in tackling inequality.** Income inequality, as measured by the Gini coefficient, fell from 0.36 in 2008 to a still high 0.32 in 2014. Despite this progress, inequality differences remain stark between urban and rural areas, especially those in the remote western regions. Greater efforts are needed to address the income gap through income distribution policies, the provision of equal opportunities, and a more inclusive pattern of growth.

15. **Better progress in human development.** Reflecting the significant decline in measured poverty, Mongolia has also made steady progress in terms of human development. The *Human Development Report 2015* puts Mongolia's Human Development Index value for 2014 at 0.727.¹⁵ This ranks Mongolia in the “high” human development category, the first time the country achieved that distinction, and placed it 90 out of 188 countries and territories. The steady improvement in the Index indicates that economic growth has been relatively inclusive and that the benefits of rapid economic growth have resulted in relatively broad-based improvements in overall social welfare.

F. Progress toward achieving the Millennium Development Goals

16. **Mixed progress.** By the end of 2015, Mongolia had achieved its Millennium Development Goals (MDG) targets of reducing under-five child mortality, limiting and preventing the spread of HIV/AIDS, and developing new information and communication technologies and building an information society.¹⁶ Mongolia also made significant progress on the MDG targets related to reducing poverty and malnutrition, improving maternal health, and providing universal access to primary education. However, Mongolia fell short of achieving many of the targets related to the MDG goals of ensuring environmental sustainability, developing a global

¹³ ADB. 2015. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Mongolia for the Social Welfare Support Program*. Manila.

¹⁴ Institute of Development Studies. 2009. *Global Financial Crisis, Developing Countries and Policy Responses*. Sussex.

¹⁵ United Nations Development Programme. 2015. *Human Development Report*. New York.

¹⁶ Government of Mongolia. 2013. *Achieving the Millennium Development Goals: Fifth National Progress Report 2013*. Ulaanbaatar; and ADB staff assessments.

partnership for development, promoting gender equality, and improving women's participation in political decision-making.

17. **Early adoption of the Sustainable Development Goals.** With the release in April 2016 of the *Sustainable Development Vision 2030*,¹⁷ Mongolia signaled its intention to focus its development efforts on achieving the Sustainable Development Goals (SDGs), making the country one of the global early adopters of the SDGs. The *Vision* outlines important priorities over 2016–2030 to achieve sustainable development, emphasizing national accountability. It sets out an ambitious set of goals centered on human development and inclusive growth, including the SDGs, and commits Mongolia to regular monitoring of progress in achieving its stated goals.

G. Environment, climate change, and disaster risk issues

18. **Increasing environmental degradation.** The pollution of air, water, and soil has emerged as a serious concern in Ulaanbaatar and other urban areas because of rapid urbanization and industrial growth. In winter, Ulaanbaatar's air quality is widely considered to be among the most polluted in the world. Deforestation, overgrazing, and the conversion of virgin land to agricultural production have also led to increased soil erosion from wind and rain, and in many instances led to desertification. In addition, the rapid expansion of mining activity is competing with the traditional herding sector for land and scarce water resources, which imposes significant environmental costs while creating major societal frictions. Because of these trends, Mongolia ranked 114 out of 178 countries on Yale University's 2016 Environmental Performance Index.¹⁸

19. **Climate change impacts.** Climate change is expected to result in more intense and extreme weather events, increased fire activity and pressures on fragile ecosystems, and the potential for even greater loss of lives and economic assets from Mongolia's extreme weather patterns. Numerous impacts are already evident. For example, Mongolia's annual mean air temperature increased by 2.07°C between 1940 and 2014, with the 10 warmest years in the last 70 occurring since 1997.¹⁹ Annual precipitation has decreased over the same period, while seasonal rainfall patterns have also changed, gradually increasing in winter and decreasing in summer. Further, the frequency of extreme weather events has doubled since 1996 and is expected to increase by a further 23%–60% by 2050; the frequency and spatial extent of forest and steppe fires have also increased since the 1950s.²⁰

20. **Recurring natural disasters.** Mongolia is highly susceptible to natural disasters, with *dzuds*, forest and grassland fires, dust and sandstorms, and flash floods being the most frequent. Recurring *dzuds* and droughts since 2006 have severely impacted the rural population.²¹ For example, the 2009–2010 *dzud* resulted in losses of 25% of the total livestock in Mongolia, affecting the livelihoods of nearly 100,000 poor herder households. Extreme weather was experienced again during the winter of 2015–2016, with 90% of the country covered with snow and temperatures down to –50°C, devastating grazing conditions for herders

¹⁷ State Great Khural of Mongolia. 2016. *Mongolia Sustainable Development Vision 2030*. Ulaanbaatar.

¹⁸ Yale University. 2016. *Environmental Performance Index 2016 Report: Global Metrics for the Environment*. New Haven.

¹⁹ United Nations Framework Convention on Climate Change. 2015. *The Intended Nationally Determined Contributions for Mongolia*. Ulaanbaatar.

²⁰ Amy Hessl et al. 2012. Reconstructing Fire History in Central Mongolia from Tree-Rings. *International Journal of Wildland Fire*. 21. 86–92. Melbourne.

²¹ Mongolia ranks 48 in the Germanwatch's Global Climate Risk Index 2017.

and their livestock, with an estimated loss of 1.2 million animals. Rural inhabitants were already reeling from the severe summer drought of 2015 that resulted in a 40% reduction in wheat harvests.

H. Business environment

21. **Sound frameworks in place but enforcement is weak.** The move from central planning to a market economy initiated in the early 1990s is well advanced (paragraph 3). As of 2017 Mongolia has not significant entry or exit barriers for businesses and the economy is highly open to foreign trade and investment. The Competition Law, passed in 2010, provides a good legal framework to address anti-competitive behavior by firms. The Investment Law, passed in 2013, eliminates restrictions on private foreign investment and offers an array of investment incentives for both national and international investors. Mongolia has one of the least restrictive trade and capital control regimes in Asia and the Pacific region. The tax burden is also among the lowest in the world across the spectrum of taxation. There is little direct state intervention in goods markets and few state-owned enterprises are operating. Corporate governance laws generally encourage disclosure and protection of shareholder rights. Overall, the main elements of a sound legal and regulatory framework are in place, but enforcement capacity and implementation are weak.

22. **Enabling environment benchmarks poorly.** While Mongolia ranked a respectable 64 for overall ease of doing business in the World Bank's *Doing Business Survey 2016*, the World Economic Forum's *Global Competitiveness Report 2016–2017* ranked Mongolia 102 out of 138 countries in terms of overall competitiveness.²² Mongolia lags in infrastructure, public institutions, macroeconomic environment, financial market development, market size, business sophistication, and innovation. In addition, the government still maintains a predominant position in some key sectors, such as public utilities and social services. Although the scope for private sector initiative in several subsectors (e.g., higher education, municipal services) has expanded in recent years, Mongolia still requires significant reforms, including but not limited to the financial sector, to boost its competitiveness.

I. Development prospects

23. **Avoiding the resource curse.** Mongolia's enormous mineral wealth—valued at between \$1–\$3 trillion for a population of 3 million people²³—significantly enhances the country's long-term development prospects. The fiscal and balance of payments surpluses that large mining projects can generate provide scope for vast improvements in living standards. However, international experience indicates that managing a process of mining-led growth is difficult. Many resource-rich developing countries have encountered significant challenges in translating their favorable resource endowments into long-term sustainable growth, falling prey to the so-called “resource curse.”²⁴ To avoid the “curse,” efforts are needed to develop strong legal frameworks and government institutions; transparency in government policymaking, especially in making fiscal policy and capital investment decisions; and economic policies that promote diversification and reduce dependence on natural resources for growth and job

²² World Bank. 2016. *Doing Business Survey 2016*. Washington, D.C., and World Economic Forum. 2016. *Global Competitiveness Report 2016–2017*. Washington, D.C.

²³ IMF. 2015. *Mongolia: Staff Report for the 2015 Article IV Consultation*. Washington, D.C.

²⁴ The resource curse refers to the paradox that countries with an abundance of natural resources tend to have less economic growth and worse development outcomes than countries with fewer natural resources.

creation.²⁵ The current economic difficulties (para. 1) are highly instructive of the pitfalls of mining-led growth.

II. KEY IMPEDIMENTS TO INCLUSIVE AND SUSTAINABLE GROWTH

A. Weak economic governance

24. Weaknesses in economic governance, some of which are contributing to the current macroeconomic instability, are widespread and constrain Mongolia's efforts to foster inclusive and sustainable growth.

25. **Slow progress on key structural reforms.** There is a large unfinished structural reform agenda. Mongolia's failure to put in place an effective prudential supervisory framework of the banking system to ensure adequate capitalization and timely resolution of nonperforming loans by banks is particularly problematic. While some progress has been made in reforming Mongolia's extensive social welfare system, further reforms are required to improve targeting and consolidate duplicative programs to sustain benefit payments to those in need (para. 36). Further, establishing a sovereign wealth fund could help the country to better manage the benefits of its natural resource development and avoid the recurring boom-and-bust cycles.

26. **Weak budget planning and execution.** The Government of Mongolia's budgetary planning and implementation framework is weak.²⁶ The initial budget formulation approved by parliament typically lacks credibility and does not provide the basis for sound fiscal management, including the efficient delivery of goods and services by line agencies. Revenue forecasts tend to be overly optimistic, resulting in frequent budget amendments during the year and persistent breaches of fiscal consolidation targets. Efforts to control expenditures and make fiscal policy more resilient to economic fluctuations have been undermined by off-budget spending. For example, the Fiscal Stability Law that went into effect in 2013 has been amended several times to accommodate higher-than-budgeted fiscal deficits and external debt levels. Wide-ranging reforms and institutional strengthening are needed across the broad spectrum of Mongolia's budgetary process to bring discipline to fiscal policy.

27. **Limited progress in strengthening procurement.** The Government of Mongolia has stepped up efforts to prepare the country's public sector management system for the challenges of a resource-driven economy. Mongolia has moved to introduce strong financial management and procurement legislation and has put governance structures and operational systems in place, which have been further aligned with international standards. For example, the revised Public Procurement Law, adopted in 2013, introduced significant changes to the public procurement system. Responsibility for procurement was transferred to a newly created Government Procurement Agency. The revised law also includes provisions to make procurement processes more transparent and participatory. While progress has been made, significant risks remain in procurement; the portion of procurement carried out by the Government Procurement Agency declined from 46% in 2014 to 11% in 2015 due to resistance from line ministries.

28. **Modest success in combating corruption.** Mongolia has also taken some preliminary steps to improve accountability and transparency in the public sector as well as to

²⁵ See for example: ADB. 2015. Research Paper 3, *TA-8241: Mongolia: Promoting Inclusive Growth*. Manila; and P. Gupta, B. Li, and J. Yu. 2015. From Natural Resource Boom to Sustainable Economic Growth: Lessons for Mongolia, *IMF Working Paper WP/15/90*. Washington, D.C.

²⁶ World Bank. 2015. *Mongolia Public Financial Management Performance Report*. Washington, D.C.

institutionalize citizen participation in government affairs through legislation. In addition, the Independent Authority against Corruption has implemented public education campaigns. As a result, Mongolia improved its ranking on the Transparency International's Corruption Perception Index to 87 out of 176 countries in 2016 from 94 in 2012.

B. Uneven progress on social and human development

29. While Mongolia's track record of rapid long-term growth has facilitated good overall progress on social and human development dimensions, these gains are uneven and fragile (paras. 11–15), making the country vulnerable to social instability. These vulnerabilities stem in part from gaps in the delivery of social services. An additional challenge to social stability is the rapid internal migration and urbanization, which is overwhelming urban infrastructure and the government's capacity to provide basic social services in some areas.

30. **Disparities in access to health care.** Access to health care remains a challenge, especially for the poor. Out-of-pocket expenses for health services are high in Mongolia, accounting for 41% of total health expenditure for the individual. At the household level, one-third of out-of-pocket expenses go to drugs due to high prices and overuse of non-essential medicines. Although over 90% of the population is covered by health insurance, the utilization of health services by the poor is 2.5 times lower than that of the non-poor segments of the population. Financial and non-financial barriers, such as civil registration, migration, high user fees (including co-payments), additional charges for drugs and food, and the high cost of transportation, constrain access to health services. The government has had difficulties in enrolling the informal sector in the health insurance system because of complexities in enforcing contribution payments.

31. **Unequal education opportunities.** Disparities in access to quality education have become more pronounced since 2004, after a series of education sector reforms undertaken during and after the transition from the 10- to the 12-year education system. These reforms have benefited mainly a small number of schools in Ulaanbaatar and *aimag* centers that are already better off in terms of educational infrastructure and resources. In contrast, schools in remote rural areas are particularly disadvantaged in these dimensions. Completion of the 9 years of compulsory education remains difficult, especially for disadvantaged groups such as students from poor households, herder families, and minority groups, and those with disabilities and other special needs. Continuous migration to Ulaanbaatar and other cities has made kindergarten places and classrooms scarce, resulting in lower gross enrollment ratios at the pre-primary level and larger class sizes and multiple shifts at primary and secondary levels.

32. **Problems with the school-to-work transition.** Mongolia's education and training systems have not succeeded in adequately equipping students with skills that are in high demand. Accordingly, making a smooth school-to-work transition is one of the major challenges confronted by students in senior secondary education, technical and vocational education and training, and tertiary education. Reflecting these challenges, the employment rate of graduates from technical and vocational education and training, and tertiary education currently averages just above 50%. The unemployment rate for youths aged 20–24 has been persistently high at around 18% since 2014 (with the rate for young women being several percentage points higher than those for young men), well above the national unemployment rate of 7%–9%. Due to the lack of quality and relevance of curricula and teaching-learning methods, Mongolia's education and training systems have resulted in skilled-labor shortages and skills mismatches.

33. **Impacts of rapid urbanization.** Mongolia has urbanized rapidly as people have moved from the countryside to escape deteriorating livelihood opportunities, pushing the country's urbanization ratio to about 72% in 2017. The rapid influx of migrants is overwhelming the available infrastructure and capacity to deliver basic services and threatens to undermine progress in poverty reduction and human development. Ulaanbaatar has been the main destination of this migration and is now home to over half of the country's population. About 60% of the city's population lives in *ger* areas with limited access to running water and sanitation.²⁷ Traffic is gridlocked, many schools run three shifts a day, and providing heating and power is increasingly difficult due to a lack of infrastructure in these areas.

34. **Declining quality of urban life.** The lack of basic urban services is causing heavy pollution that affects residents' health. Unimproved individual coal stoves used by most *ger* area residents during the winter also generate severe air pollution, while households' heavy reliance on open pit latrines and poor solid waste collection create unsanitary living conditions. A lack of long-term planning and land use regulation compound these problems, resulting in uncontrolled development and haphazard urban land use, limited availability of space for public facilities, poor access to social services, reduced access to livelihood opportunities, and unsafe neighborhoods (particularly for women and girls) that serve to marginalize *ger* area residents.

35. **Persistence of significant gender gaps.** Significant gender gaps persist in Mongolia (paras. 7–10) despite some recent progress. Disparities in socioeconomic spheres, poor implementation and prioritization of legislation intended to redress gender discrimination, and the downgrading of the National Committee on Gender Equality in early 2015, are some of the key impediments constraining further progress. While Mongolia has in place comparatively good legislation on gender equality, implementation is inadequate. The reasons include a lack of political will; limited accountability for gender mainstreaming; weak capacity of governance institutions resulting in gender-blind policymaking; and a lack of sex-disaggregated data and/or use of the data that does exist for gender-specific analysis, policy planning, and budgeting. The remaining gender disparities appear to be mostly correlated with lingering social problems such as access to health and education, internal migration, and poverty. However, there are other significant concerns, such as gender-based violence and alcoholism associated with men's frustration over not being able to provide livelihoods for their families in line with social norms, that dictate male dominance in this sphere.

36. **Incomplete reform of social welfare programs.** Mongolia's extensive social protection system²⁸ has played a prime role in fostering and safeguarding the country's gains in poverty reduction—the poverty rate would be an estimated 10 percentage points higher in the absence of such programs.²⁹ However, challenges persist that must be addressed to safeguard social stability. In 2015, the Government of Mongolia allocated the equivalent of 2.7% of GDP to social welfare, exceeding the average of 1.6% of GDP in emerging economies.³⁰ Social welfare programs in Mongolia are generally pro-poor, with about 35% of the benefits reaching the poorest 20%.³¹ By comparison, about 20% of benefits in Thailand reach the poorest 20% (footnote 30). Many social welfare programs are unnecessarily expensive because they do not

²⁷ Water consumption in *ger* areas is low, at about 8 liters per capita per day (half the recommended minimum by the World Health Organization). *Ger* residents pay 2–10 times more than non-*ger* area residents for water.

²⁸ Social protection in Mongolia has three major components: social welfare, social insurance, and labor market programs.

²⁹ National Statistical Office and the World Bank. 2015. *Poverty Profile in 2014: Results of the Household Socioeconomic Survey 2014*. Ulaanbaatar.

³⁰ World Bank. 2014. *The State of Social Safety Nets*. Washington, D.C.

³¹ World Bank. 2015. *Review of the Mongolian Social Welfare Program Design and Beneficiary Profile*. Washington, D.C.

target only the poor. Moreover, the fragmentation of programs results in the duplication of benefits and high administrative costs.

C. Narrow economic base

37. Mongolia's dependence on mining and propensity to boom-and-bust economic cycles underscores the need for a more diversified economic structure to ensure economic and social stability. Further, mining is not labor-intensive, employing only 3.7% of the labor force in 2015, and thus its rapid growth over the past decade has not translated into improved lives for ordinary Mongolians.

38. **Limited progress in developing agricultural value chains.** Agriculture, which accounted for 12.2% of GDP and 31.1% of employment in 2015, is pivotal to any economic diversification effort. Developing value chains for Mongolia's agricultural resources provides significant potential for economic diversification and job creation.³² Despite rich and unique primary agricultural products (e.g., wool, cashmere, animal skins, meat, raw milk, and wild berries), only a small fraction are processed domestically as the agro-processing subsector, which consists primarily of SMEs, has limited capacity in production, marketing, quality assurance, and access to finance. Recurrent outbreaks of transboundary animal diseases have also caused harm to animal health and safety, threats to human health, and significant economic losses.³³ These outbreaks also make Mongolia vulnerable to trade restrictions, particularly on its meat exports. Stronger measures are thus needed nationally and through regional cooperation efforts to strengthen sanitary and phytosanitary measures to facilitate increased exports of processed agricultural products.

39. **Constraints on agricultural production.** There are significant constraints on livestock development, which contributes over 80% of agriculture sector output, including the absence of proper pasture and water resource management, which have caused overgrazing, desertification, poor livestock health, and poor quality of products. These constraints, which are exacerbated by extreme climatic events such as *dzuds*, limit the development of the livestock subsector. While Mongolia still relies heavily on external trade for most vegetables and fruits, significant scope exists for increased domestic production to substitute for imports. For instance, efforts to revamp crop production since 1990 have brought the country to near self-sufficiency in wheat today. Extreme weather, inadequate rainfall, limited access to finance, low-quality seed materials, and outdated equipment and technology are among the factors constraining Mongolia's crop production.

40. **Untapped potential to develop tourism.** Sustainable tourism has significant potential to contribute to economic diversification and job creation. Tourism also provides excellent opportunities to benefit local livelihoods and *aimag* economies, but rural communities have thus far received few benefits from the growth of tourism due to limited capacity and financial resources to develop business enterprises. Many areas lack a long-term vision for tourism, have poor solid waste and wastewater management facilities, and lack adequate business-enabling infrastructure. Further, the rapid expansion of tourist numbers and camps in certain regions is largely uncontrolled. These interlinked issues threaten Mongolia's protected wilderness areas, particularly the quality of many of its pristine water resources. Lessons learned from protected

³² In 2015, the agriculture and manufacturing sectors were the first (370,000) and fourth largest (64,900) employers in Mongolia. Based on the substantial share of agro-processing (57.4%), more than half of employment in the manufacturing sector stems from agro-processing.

³³ These include foot and mouth disease, porcine reproductive and respiratory syndrome, and highly pathogenic avian influenza.

areas globally indicate the need for well-planned tourist concessions, basic public infrastructure, and inclusive planning.³⁴

41. **Disorderly urbanization inhibits economic dynamism.** The urbanization process itself has the potential to boost economic diversification and job creation by catalyzing the development of local economies. For this to occur, the urbanization process will need to become more holistic by providing an integrated package of affordable housing, access to reliable electricity and heat supply networks, and a range of other urban facilities and services to improve basic living conditions (paras. 33–34). Once the quality of life improves and new urban residents are more confident of meeting their basic needs, they will begin demanding a more sophisticated array of goods and services that will create economic dynamism in urban areas, which in turn will create new growth and livelihood opportunities.

42. **Geographic isolation and poor infrastructure.** Mongolia's geographic isolation, vast and sparsely populated land area, and landlocked position between the PRC and Russia pose challenges to economic diversification. These geographic challenges are exacerbated by poor infrastructure, which makes transport costs high and Mongolia's non-mining exports uncompetitive. The World Economic Forum's 2016–2017 *Global Competitiveness Report*³⁵ ranks Mongolia's infrastructure at only 110 out of 138 countries. The mining industry largely relies on rail transport because of its comparative advantage in forwarding bulk commodities over long distances, but massive investments will be required in road infrastructure to make Mongolia's non-mining exports more competitive. Weak trade facilitation at the border results in excessive delays, poor supply chain management, and cargo flow imbalances. In addition, the country's border trade and food sanitation requirements are highly complex and inconsistent with those of its two large neighbors. In a reflection of this, the World Bank's 2016 *Logistics Performance Index*³⁶ ranked Mongolia only 108 out of 160 countries.

43. **Limited benefits from regional cooperation.** Deeper regional cooperation and integration will be essential to strengthening Mongolia's competitiveness and diversifying economic activity. Despite receiving considerable technical and financial support, trade facilitation at Mongolia's key border crossings has not significantly improved. The government must take better advantage of the opportunities afforded under the Central Asia Regional Economic Cooperation initiative to position itself as a central piece in the expanding trade route from East Asia to Europe.

44. **Limited access to finance.** The financial system is not sufficiently developed to support broad-based access to finance. Commercial banks continue to dominate the financial sector. No fully licensed foreign bank operates in Mongolia, impairing competition and alternative product availability. Although SMEs make up 90% of registered businesses and provide about 50% of all jobs, up to 90% of the country's 36,800 such enterprises do not have regular access to finance from banks. This limits their chances to grow and ability to realize their potential contribution to growth and job creation. Further, their access to lending is constrained by a lack of recognized collateral, high lending rates, and banks' own liquidity constraints on long-term lending. Other constraints are an inadequate credit information base, burdensome requirements imposed on SMEs when applying for credit, their poor understanding of financial management, and underdeveloped loan underwriting capabilities at banks. Access to lending and financial services is limited in rural areas and urban areas outside the capital. Financial literacy is also

³⁴ United Nations Development Programme. 2014. *Tourism Concessions in Protected Natural Areas*. New York.

³⁵ World Economic Forum. 2016. *Global Competitiveness Report*. Geneva.

³⁶ World Bank. 2016. *Logistics Performance Index*. Washington, D.C.

weak, especially among women, and an effective regulatory framework for financial consumer and investor protection does not yet exist.

45. **Lack of long-term financing.** The economy has vast long-term financing needs that exceed local financial market capacity. Banks are impaired by funding constraints to offer longer term loans. There are very limited financial market instruments available to private borrowers in the country's illiquid and inefficient bond and equity markets. There is also no effective interbank or secondary market for government bonds. The underdeveloped primary government bond market constrains the creation of a corporate bond market. Moreover, the small private equity sector focuses only on mining projects.

D. Environmental degradation and climate change

46. Mongolia's rapid growth, harsh climate, unique geography, and proclivity toward natural disasters, combined with the economic dominance of mining and pastoralism, create significant environmental challenges and complicate Mongolia's efforts at inclusive and sustainable development. These challenges are amplified by the impacts of climate change, which have become increasingly evident since 2010 recent years.

47. **Unsustainable natural resource use.** Water scarcity is a major constraint to sustainable development. Groundwater resources, accounting for 80% of water use in Mongolia, are limited and often withdrawn at rates that exceed recharge. Ulaanbaatar obtains about 98% of its water from groundwater. Improved management of groundwater is needed to meet current demand and ensure adequate water quality. In addition, about 70% of grasslands, which occupy 80% of Mongolia's territory, are impacted by desertification, primarily because of overgrazing, deforestation, and land conversion for agriculture. Logging, most of which is illegal, and fires are the main drivers of deforestation. Current timber extraction rates for construction, firewood, and fencing are about four times sustainable levels. To mitigate degradation of land, water, and forest resources, the government needs to commit to sustainable natural resources management as an integral part of its national development strategy.

48. **Climate change vulnerabilities.** Mongolia's unique geography and climate and its specific socioeconomic conditions based on a traditional nomadic way of life and associated economic activities make it very vulnerable to the impacts of climate change (para. 20). Mongolia's propensity to weather-related natural disasters amplifies this vulnerability. Considering the anticipated magnitude of climate change impacts, Mongolia included an adaptation component in its Intended Nationally Determined Contribution (INDC).³⁷ The INDC also included an ambitious plan for a 14% reduction in total national greenhouse gas emissions (excluding land use, land-use change, and forestry) by 2030, compared to the projected emissions under a business-as-usual scenario.³⁸ The INDC further indicates that animal husbandry, arable farming, human health, and natural resources, including water, forests, pastures and soils, are most vulnerable to climate change impacts.

49. **Weak capacity to implement disaster risk management.** The Government of Mongolia has developed a legal framework, strategy, and action plan for disaster risk management (DRM). Although these offer a framework for DRM nationally and locally, they predominantly focus on emergency response. A much-needed shift in practice toward a more

³⁷ United Nations Framework Convention on Climate Change. 2015. *The Intended Nationally Determined Contributions for Mongolia*. Ulaanbaatar.

³⁸ Mongolia's total greenhouse gas emissions are marginal at less than 0.1% of the global total, but its per capita emissions are high at about twice the global average.

comprehensive approach, emphasizing disaster risk reduction and community engagement as well as emergency response is needed. However, there are significant challenges in implementing a DRM at the local level due to equipment and resource constraints. *Aimag* administrations have limited capability to reduce vulnerability and organize quick and effective responses to disasters. Hence, they are dependent on *soum* administrations and residents who have even less capacity. At the *soum* level, financial, human, and technical resources to reduce disaster risk, improve search and rescue, and provide acceptable emergency services are inadequate. Individual communities similarly have limited access to relevant tools and capabilities for fire prevention and fighting, including at the household level, and insufficient infrastructure to manage *dzud* and other extreme weather events. There are also important gender dimensions, such as women's greater vulnerability to post-disaster financial and psychological distress, that need to be incorporated into Mongolia's DRM framework.

III. IMPLICATIONS FOR ADB COUNTRY ENGAGEMENT

50. Mongolia has made impressive strides in per capita income growth and poverty reduction that has translated into broad-based gains in human and social development. However, these gains are fragile as one in five Mongolians still live in poverty and depend significantly on social welfare transfers for basic subsistence. Mongolia's resource-intensive growth process has also come at a high cost to the environment, with the poor particularly vulnerable to environmental degradation, climate change, and recurring natural disasters. The country's mining-led growth process is highly volatile and not very inclusive, and threatens to undermine much of this progress unless growth and macroeconomic stability are restored in the near term. Over the longer term, a more resilient and diversified economic structure must be created that can consistently deliver rapid, inclusive, and sustainable growth.

51. The Government Action Plan, 2016–2020³⁹ recognizes the primacy of these development challenges. The plan's main priorities are to "revitalize the economy expediently, restore its growth, support the social sectors, and improve significantly the livelihoods of the population." The government has affirmed its commitment to the *Mongolia Sustainable Development Vision 2030* (footnote 17), which seeks to transform Mongolia into an upper-middle-income country, with 80% of the population living in the middle and upper-income classes, and totally eradicate poverty by 2030. It also aims to achieve broadly shared gains in human development while preserving the country's ecological balance.

52. The focus of ADB's County Partnership Strategy, 2017-2020 is to help the Government of Mongolia restore macroeconomic stability and get back on a path of fulfilling its long-term development vision. Creation of a more diversified and labor-intensive economy is an essential prerequisite, as are efforts to foster a more inclusive social service delivery system to ensure social stability. This is crucial in the context of the economic downturn, rapid urbanization, and proclivity toward natural disasters. Efforts to address the rapid pace of environmental degradation and respond to the impacts of climate change must also be significantly enhanced. Given the all-encompassing and cross-cutting nature of these development challenges, ADB's strategy and operations must transcend the current sector-by-sector approach to one more specifically focused on addressing the key impediments to inclusive and sustainable growth discussed in the second section of this paper (paras. 24–49). In addition, cross-cutting concerns of strengthening public sector management and reducing gender inequality will also need to be addressed in tackling the impediments to Mongolia's development.

³⁹ Government of Mongolia. 2016. Government Action Plan, 2016-2020. Ulaanbaatar.

53. **Promote economic and social stability.** ADB will help the government to diversify the country's economic structure and foster job creation to ensure economic and social stability. This will include (i) assistance to encourage growth in labor-intensive sectors, especially by SMEs engaged in agribusiness and tourism; (ii) strengthened access to and government capacity to design and administer a broad range of essential social services to safeguard hard-won gains in poverty reduction and progress in human development from cyclical economic downturns and rapid internal migration; and (iii) support to ensuring the stability of the financial sector and to making social welfare programs more cost effective and fiscally sustainable.

54. **Develop infrastructure to support economic diversification.** ADB will step up efforts to mitigate the challenges posed by Mongolia's landlocked position to economic diversification, including poor infrastructure, which makes transport costs high and Mongolia's non-mining exports uncompetitive. Deeper regional cooperation and integration through improved physical connectivity and trade facilitation will be essential to strengthening Mongolia's competitiveness in agriculture exports, and diversifying economic activity. A more holistic and inclusive approach to urbanization will increase living standards and will catalyze the development of local economies and generate new and better livelihood opportunities for urban residents.

55. **Strengthen environmental sustainability.** ADB's efforts must focus on ensuring that Mongolia's key natural resources, such as water, grasslands, and forests, are not further degraded. ADB should also support Mongolia in meeting INDC targets through capacity building of relevant agencies as well as through selected infrastructure investments. Further, ADB should build on earlier support to help the Government of Mongolia implement its legal framework, strategy, and action plan for DRM, including by building strong institutional connections between disaster risk management and climate change adaptation.

56. As Mongolia's largest and most actively engaged development partner, ADB is well positioned to assume a lead role in assisting the Government of Mongolia in addressing these challenges. Specific activities will be selected for support based on their broader contribution to the strategic objectives, rather than alignment with individual sectors. The specific focus within sectors will also continue to evolve as ADB seeks to enhance its value addition and responsiveness by taking on increasingly complex operations as circumstances dictate, drawing on areas of its core knowledge and expertise.

57. The uncertainties of Mongolia's economic situation and the country's susceptibility to natural disasters, among other features of the development context (paras. 1–23), require a more flexible approach to country programming than is the ADB norm. For example, ADB needs to have the capacity and flexibility to respond quickly and decisively should country circumstances dictate a need to foster progress in key structural reforms and sustain budgetary expenditures in the context of macroeconomic adjustment. ADB will also have to be proactive in exploring the use of the full range of available financing modalities to achieve the targeted development outcomes in the Country Partnership Strategy, 2017-2020.