

INCLUSIVE AND SUSTAINABLE GROWTH ASSESSMENT

I. RECENT GROWTH, POVERTY, INEQUALITY AND ENVIRONMENTAL DYNAMICS

A. Growth Performance and Economic Governance

1. **Remarkable progress in 30 years of ADB membership.** Mongolia, which joined the Asian Development Bank (ADB) in 1991, is a lower-middle-income, landlocked, and resource-rich open economy that began its transition from a centrally planned to a market economy in 1991. Its gross domestic product (GDP) per capita has increased almost threefold since 2000 in real terms. However, economic growth was marked by boom-and-bust cycles and periodic shocks, revealing an underlying vulnerability linked to the country's rich natural resources.¹

2. **Major economic difficulties during 2012–2016.** Large external shocks hit Mongolia in the form of lower commodity prices and reduced capital inflows. This followed a major shock in 2009–2010 linked to the global financial crisis. These blows, combined with government overspending, left Mongolia with an unsustainable debt burden and significant economic and finance sector challenges. Economic growth decelerated from a peak of 17.3% in 2011 to 1.2% in 2016, as foreign direct investment (FDI) fell dramatically, exports plummeted, terms of trade deteriorated significantly, and large mining projects were delayed. Consequently, public debt rose to 109.1% of GDP in 2016, with a fiscal deficit of 15.3% of GDP in the same year.

3. **Decisive shift in macroeconomic policy during 2017–2020.** In May 2017, Mongolia agreed to a 3-year Extended Fund Facility with the International Monetary Fund (IMF). Boosted by stronger external demand and an FDI recovery, growth reached 5.3% in 2017, 7.2% in 2018, and 5.2% in 2019. The government used this to turn fiscal deficits into surpluses of 2.6% in 2018 and 1.4% in 2019, and to reduce public debt by 30 percentage points to 79.1% of GDP by 2019. This was a clear policy shift where the government for the first time reduced expenditures after a rise in revenues.² Despite this progress, debt remains high, and Mongolia faces external debt maturities of \$3.8 billion during 2022–2024. In monetary policy, the Bank of Mongolia lowered the policy rate by 9 percentage points in net terms to 6.0% since 2017. Average inflation was 6.8% in 2018, 7.3% in 2019, and 3.7% in 2020. Major challenges persisted in the banking system—the ratio of nonperforming and past-due loans reached 18.5% in 2020, and several commercial banks faced capital shortfalls. The IMF Program ended in May 2020, acknowledging the improved fiscal performance but also the continued challenges in banking.

4. **Economy under heavy pressure from COVID-19.** The restrictions imposed to manage the coronavirus disease (COVID-19) pandemic and the deep global contraction caused Mongolia's growth to decelerate by 5.3% in 2020. Despite a significant contraction in exports, the current account deficit fell by 10.3 percentage points to 5.1% of GDP because of a large drop in imports. FDI and portfolio inflows deteriorated, squeezing the balance of payments. Gross reserves dropped by 18.2% in the first half of 2020 to 4.5 months of imports, before recovering to reach 7.4 months by the end of the year. On the fiscal side, revenues fell by 12.9% in 2020, while expenditures rose by 22.1% through targeted support for vulnerable people and businesses. The overall deficit widened to 9.6% of GDP in 2020, up 2.4% from the approved 2020 budget, while the structural deficit added 12.3% of GDP, up 5.1%. Credit in the banking industry contracted for 13 consecutive months from February 2020 to March 2021, and all economic sectors, except agriculture, experienced a decline in credit. Recovery prospects are beginning to emerge thanks

¹ ADB. 2020. *Mongolia's Economic Prospects: Resource-Rich and Landlocked between Two Giants*. Manila.

² ADB. 2019. [Asian Development Outlook: Strengthening Disaster Resilience](#). Manila (Figure 3.10.10, p. 193).

to revived demand for coal exports, and growth is expected to reach 4.8% in 2021, but substantial downside risks remain amid the huge uncertainty that surrounds the COVID-19 situation globally.

5. Mining's dominance creates challenges for macroeconomic management and inclusive development (footnote 1). Mongolia enjoys significant deposits of copper, coal, oil, gold, iron ore, and rare earths. The three main mineral exports (coal, copper concentrate, and gold) account for 69.5% of exports and for 38.2% of GDP, while total mining exports account for 92.8% of total exports. Most exports (89.1% in 2019) are sold to the People's Republic of China (PRC). Such an export structure leaves Mongolia susceptible to economic prospects in the PRC and to fluctuations in mineral commodity prices. This price volatility caused huge swings in Mongolia's growth rates—between 1.2% and 17.3% since 2010 (footnote 1). Mining is a capital-intensive industry while employing only 4.6% of the labor force in 2019. Labor productivity is extremely low—even in the mining sector, where labor productivity is highest, it is lower than that of peers. In addition, large-scale mining development led to competition for land and scarce water supplies with the traditional herding system, resulting in major societal frictions.

6. Sound macroeconomic management critical to managing boom-bust cycle. The country's macroeconomic policy has historically been pro-cyclical and volatile, and periods of ill-discipline typically precede elections. Its monetary and finance sector policy accentuated the boom-bust cycle—commodity booms were associated with higher consumption and expanding monetary aggregates, credit growth, and inflation; economic contractions were characterized by reduced reserves, lower credit growth, and rising private sector debt. Mongolia has the elements of a sound fiscal framework through the Law on Fiscal Stability and the Future Heritage Fund, but their implementation, apart from 2017–2019, has not been strong. Downturns are closely linked to rising poverty, and the poverty headcount jumped by 8 percentage points from 2014 to 2016 because of economic difficulties.³ Countercyclical macroeconomic policy can be an important tool to support vulnerable people during shocks, but only if buffers were built up in good times.

7. Diversification as a multifaceted long-term goal. Dependence on mining has led to calls for increased diversification to broaden the export base and make growth more inclusive and less volatile. Mongolia has excellent potential to boost exports in agribusiness, tourism, renewable energy, some niche manufacturing products, and services such as digital technology. Despite this, the domination of mineral exports is unlikely to weaken in the near term since most FDI is directed to the extractive industries, and the large Oyu Tolgoi underground copper and gold mine is expected to start production in 2023. This indicates that export and FDI diversification can be useful for creating jobs and supporting future export industries but will not soon reduce exports' dependence on mining. Mongolia should consider diversification through different prisms. Geographic diversification provides the opportunity to boost economic hubs outside of Ulaanbaatar and could be facilitated by well-coordinated investments. Diversification of assets is another approach where the proceeds of mining revenue could be invested in non-mining assets outside of the country through the Future Heritage Fund. A further option is diversifying export destinations, possibly using mineral exports as trailblazers to open new markets. Finally, there are gains from diversifying within mining by adding more value in mining-related manufacturing or through services linked to mining, such as information technology and logistics. Regardless of the favored approach to diversification, investments must be made in human capital and enabling infrastructure to open new areas and ensure long-term success.

8. Institutional capacity and governance need to be improved. Key aspects of governance, such as the rule of law, transparency and accountability, and the presence of a high-

³ National Statistical Office and the World Bank Group. 2020. *Mongolia Poverty Update 2018*. Ulaanbaatar.

quality and impartial civil service, all need strengthening. Political instability has historically been a major issue, creating challenges for long-term planning and policy continuity, and uncertainty for investors and the business climate. Independent institutions such as the Fiscal Council, and regulatory or specialized agencies are often unable to fully fulfill their roles because of a lack of resources, and often because of political interference. Fighting corruption has been a major target for consecutive governments, but the perception of corruption remains high and weaknesses in the judiciary have slowed progress.

9. **Private sector potential still constrained.** The private sector constitutes about 80% of GDP and 75% of employment. More than 99% of businesses are classified as small and medium-sized enterprises (SMEs). In general, Mongolia has one of the least restrictive trade and capital control regimes in Asia.⁴ It exhibits little direct state intervention in the goods markets and has few state-owned enterprises, although the government has a share in all strategically important mines. Despite these features, the absence of a comprehensive private sector development road map causes confusion and results in conflicting ministerial policies. Further constraining factors are past macroeconomic volatility, protracted banking instability, limited access to finance for SMEs, weak capacity in government agencies, a weak judiciary, and poor infrastructure. Weaknesses in the public–private partnership (PPP) framework and a poor track record of implementation also limit private investment in infrastructure.

B. Poverty and Inequality, Gender, and Labor Market Dynamics

10. **Many poor people despite progress in poverty reduction** (footnote 3). Mongolia's poverty headcount was 35%–36% during 1995–2008. The rate declined steadily from 38.8% in 2010 to 27.4% in 2012, to 21.6% in 2014. Poverty rose in 2016 to 29.6% before falling to 28.4% in 2018. Today, almost one in three Mongolians lives in poverty. Rural poverty (30.8%) is higher than urban poverty (27.2%), though this gap has narrowed considerably since 2010. Despite this, 63.5% of the poor live in urban areas (41.8% of them in the capital, Ulaanbaatar). Rural populations have less access to services such as health, education, and housing; and rural youths are particularly disadvantaged when it comes to quality education and employment opportunities. Children of all ages, and younger adults (aged 30–39) with multiple children at home are more likely to be poor than older people. People with disabilities are typically part of households that are more likely to be poor; more than 40% of them are in the poorest quintile.⁵

11. **More to do on women's economic empowerment and gender-based violence.** Non-income inequality, including gender inequality, remains a persistent constraint to inclusive growth. Mongolia ranks 71st on the Gender Inequality Index (2018), dropping by 8 places since 2014 because of increased adolescent fertility and a decline in women's labor force participation. Women are unable to fully participate in the labor force and are much less likely to be in better-paid jobs, particularly in industries such as mining—consequently, a more diverse economy could be an important facilitator of more inclusive development. Women perform well in literacy and enrollment in secondary and tertiary education. However, the country ranks only 120th of 153 countries on women's political empowerment.⁶ Although women account for 43.7% of public servants, they occupy only 23.5% of political positions. Gender-based violence, especially

⁴ International Monetary Fund. 2018. [Annual Report on Exchange Arrangements and Exchange Restrictions](#) (accessed on 2 November 2020).

⁵ ADB. 2019. *Living with Disability in Mongolia: Progress toward Inclusion*. Manila.

⁶ World Economic Forum. 2020. *The Global Gender Gap Report 2020*. Geneva.

domestic violence, and sexual harassment in the workplace remain key concerns; 57.9% of ever-partnered women have experienced some form of violence.⁷

12. Labor market characterized by low productivity and skill mismatches. Mongolia's labor productivity lags that of its peers in all areas, but particularly in agriculture and services. One-third of the economically active population are in agriculture, where productivity and wages are very low and employment is highly seasonal. Graduates are overrepresented in low-employment industries, suggesting a mismatch between skills and labor market demand. Mongolia's capacity to attract and retain talent is weaker than that of peers, and those emigrating to member countries of the Organisation for Economic Co-operation and Development (OECD) made up 1.5% of the labor force in 2017 alone.⁸ Despite higher educational attainment, women are underrepresented in the labor market because of the heavy burden of unpaid care and domestic work, and an earlier retirement age for women. Women's labor force participation has fallen from 64.3% in 2006 to 53.4% in 2019 (compared with 68.3% for men). Since COVID-19, women's labor force participation has dropped by another 1.6 percentage points (compared with 1.2 for men). Youth unemployment is 24.2%, which is two times higher than the national average.⁹

13. Progress made in education access, but quality remains a challenge. Expected years of schooling, after dipping initially in the late 1990s, rose steadily to 14.2 years in 2018. Mean years of schooling also increased since 1990, to 10.2 years in 2018, comfortably above the average for Asia and the Pacific (7.9 years).¹⁰ Education quality remains a major issue: school readiness, and primary and secondary attainment stagnated or declined since 2015.¹¹ There is also a clear need to strengthen quality assurance mechanisms—weaknesses in technical and vocational education and training (TVET) contribute to the skills mismatches described in para. 12.

14. Health and human development have improved steadily but challenges remain. Mongolia ranks 92nd of 189 countries on the Human Development Index (2019). Life expectancy at birth has climbed steadily since 1990, from 60.3 years to above 70 in 2018 (footnote 9). The maternal mortality and under-5 mortality ratios have fallen substantially, already beyond the SDG target. The first national review of the SDG attainments in 2019 highlighted several issues, such as non-inclusive growth, limited access to basic services in urban areas, public health issues caused by air pollution, and disparities in the quality of life of different population groups.¹²

C. Environment, Natural Resources, and Climate Change

15. Threats to natural resources, environment, and resilience. Mongolia's natural resources are being threatened by environmental degradation; desertification; unsustainable water extraction; air, water, and soil pollution; and habitat loss—largely because of mining, overgrazing, urbanization, and climate change. The country's scarce supply of fresh water is becoming increasingly polluted by the discharge of effluent from industries such as mining and

⁷ National Statistics Office of Mongolia and United Nations Population Fund. 2018. *Breaking the Silence for Equality: 2017 National Study on Gender-based Violence in Mongolia*. Ulaanbaatar.

⁸ World Bank. 2020. *Mines and Minds: Leveraging Natural Wealth to Invest in People and Institutions*. Washington, DC.

⁹ National Statistics Office. 2020. *Mongolia Statistical Yearbook 2019*. Ulaanbaatar.

¹⁰ United Nations Development Programme. 2020. *Human Development Report 2019: Beyond income, beyond average, beyond today: Inequalities in human development in the 21st century*. New York.

¹¹ Ministry of Education, Culture, Sciences and Sport; and ADB. 2019. *Primary and Secondary Education Sector Report*. Ulaanbaatar.

¹² Government of Mongolia. 2019. *Mongolia Voluntary National Review Report – 2019: Implementation of Sustainable Development Goals*. Ulaanbaatar.

tanneries, inadequate sanitation and solid waste collection systems, and uncontrolled access of livestock to rivers and lakes. In 2020, about 66% of the urban population and 41% of the rural population did not have access to good sanitation.¹³ Ulaanbaatar ranks among the worst cities in the world on air pollution as a result of coal-based heating and a continuing influx of poor rural migrants to urban *ger* (tent) areas. Seasonal concentration levels of pollutants in winter frequently exceed national and global air quality standards and cause about 1,400 deaths annually.¹⁴ Air pollution is also increasing in secondary cities and *aimag* (provincial) centers. As for solid waste management, inadequate disposal measures and facilities are contributing to water and soil pollution, greenhouse gas (GHG) emissions, and health risks.

16. Mongolia's natural ecosystems and biodiversity under threat. Between 2005 and 2015, an estimated 1.4 million-plus hectares of forest land were logged, or degraded by unregulated timber collection, fire, and inadequate management.¹⁵ Efforts to support forest management are constrained by an inadequate institutional framework and limited investment and capacity. Virtually all ecosystems are used as rangelands, and high livestock numbers led to severe rangeland degradation, exacerbated by drought, fire, and other climate change impacts. The government has established a large national network of protected areas (about 20% of Mongolia's area) and plans to expand this to about 30% by 2030, yet most existing sites do not receive adequate management support. Challenges to biodiversity conservation include habitat loss, overgrazing by livestock, mining, timber collection, fire, infrastructure development, hunting, and climate change. Most local agencies lack sufficient capacity, funding, and resources to tackle these issues.

17. Natural hazards and climate change are a major threat to resilience. The country's natural environment includes seasonal cycles of extreme temperature fluctuations, storms, drought, forest fires, and *dzuds*.¹⁶ As a result of anthropogenic climate change, Mongolia is experiencing some of the fastest rates of warming in the world (more than 2°C between 1940 and 2015) and increasing frequency and intensity of climatic events. In 2014, Mongolia's GHG emissions totaled about 34.5 million tons of carbon dioxide equivalent—low overall but high on a per capita basis. GHG emissions come from energy (50.1%), in particular coal; and agriculture (48.5%), in particular livestock.¹⁷ In 2020, Mongolia submitted its updated nationally determined contributions to the United Nations Framework Convention on Climate Change (UNFCCC).¹⁸ These include mitigation measures for energy, industrial processes, agriculture, and waste. The cumulative impact of the measures is meant to reduce GHG emissions by 22.7% by 2030, compared with business as usual for 2010. This excludes land use, land use change, and forestry. *Dzuds* have caused the mass starvation and deaths of livestock. Reduced pasture productivity and extreme cold temperatures lowered livestock production and increased mortality rates. Climate change impacts may disproportionately affect herders and rural communities, which have fewer forms of income diversification than urban communities.

¹³ Ministry of Environment and Tourism. 2019. *State of Environment Report 2017–2018*. Ulaanbaatar.

¹⁴ L. Hill et al. 2017. *Health assessment of future PM_{2.5} exposures from indoor, outdoor, and secondhand tobacco smoke concentrations under alternative policy pathways in Ulaanbaatar, Mongolia*. <https://pubmed.ncbi.nlm.nih.gov/29088256/> (accessed on 2 November 2020).

¹⁵ UN-REDD Mongolia National Programme. 2018. *Mongolia's Forest Reference Level submission to the UNFCCC*. Ulaanbaatar.

¹⁶ *Dzuds* consist of a summer drought, resulting in insufficient production of hay, followed by very heavy winter snowfall (10–350 centimeters), winds, and lower than normal temperatures (–40°C to –50°C).

¹⁷ Ministry of Environment and Tourism. 2018. *Mongolia Third National Communication*. Ulaanbaatar.

¹⁸ Ministry of Environment and Tourism. 2020. *Mongolia's Nationally Determined Contributions to the UNFCCC*. Ulaanbaatar.

D. Development Prospects

18. **Promising medium-term outlook.** Mongolia shares a 4,630-kilometer border with the PRC and its large market. It also enjoys enormous mineral wealth yet has a relatively small population of just over 3 million people. It enjoys natural opportunities that, coupled with the right policies, will spell out a positive future. Capitalizing on this will require strong macroeconomic policies, building on the high-quality fiscal performance during 2017–2019 and lending this policy success to structural reforms in other areas, most notably the finance sector. It will also require stronger policy implementation to ensure that long-term plans and visions are better reflected in medium-term government plans and short-term budget planning, complemented by clear sector planning with a focus on inclusion to address poverty reduction and job creation. Mongolia has a young and well-educated population, and the growth in its working-age population will continue to 2030. Championing policies that allow the Mongolian people to fulfill their potential, such as investing in human capital development, improving infrastructure, and strengthening the business enabling environment, will bear fruit. The country must invest in disaster and climate resilience to protect itself against natural hazards and climate change, but also in social protection to shield people from its volatile economy.

II. KEY IMPEDIMENTS TO INCLUSIVE AND SUSTAINABLE GROWTH

19. **Investments needed in inclusion, infrastructure, and resilience to unleash the country's potential.** Mongolia has numerous successes to build on. But obstacles remain, although many reflect the reality that development challenges do not have quick fixes and often require decades of continuous effort and reform. COVID-19 has deepened many problems and has made the lives of vulnerable Mongolians harder, particularly herder families and those engaged in microbusinesses and SMEs. Mongolia needs to enable its most important resource, its people, to recover from the impact of COVID-19, improve resilience to external shocks and fulfill their potential. It can do this by focusing on four areas: broadening the economic base; improving governance and policymaking; investing in people; and managing risks related to the environment, climate change, and disasters.

A. Narrow Economic Base

20. **Mongolia is landlocked with a narrow economic base.** Mongolia's dependence on low value-added mining exports makes growth volatile and non-inclusive, genuflecting to the cyclicity in commodity prices. The economy relies heavily on the PRC as an export destination. While mining dominates contributions to growth from the supply side, FDI dominates growth on the demand side—mining is the target of 69%–78% (73.1% on average) of total FDI.¹⁹ While much was done to boost other industries, opportunities remain nascent and/or limited. The continued development of agriculture, manufacturing, energy, and tourism, for instance, can lead to more value addition, create jobs, and provide opportunities in rural and urban areas. Increased geographic diversification where more parts of the country can drive growth would be an important part of this, but it is held back by weak infrastructure in energy, transport, and trade. The western *aimags* of Bayan-ulgii, Khovd, and Uvs offer a good initial focus for diversification. The area has strong transport links to the PRC and the Russian Federation thanks to the ADB supported Western Regional Road, and animal husbandry provides 38%–51% of employment. The area also represents some of the environmental challenges facing Mongolia with an overgrazing rate of 27.4%—5 percentage points higher than the national average.

¹⁹ Between the first quarter of 2011 and the second quarter of 2020. Source: Bank of Mongolia. 2020. External Sector Statistics Manual. Ulaanbaatar.

21. **Urban areas need investment to be growth catalysts.** Mongolia has undergone rapid urbanization since the late 1990s, but despite efforts, investment in urban areas has not kept pace. Only 40% of Ulaanbaatar households and less than 30% in *aimag* centers live in apartments and serviced houses. The rest are in *ger* areas suffering from air pollution (despite recent progress)²⁰ and a poor living environment with inadequate infrastructure and limited urban services. Weak infrastructure increases the cost of doing business, discourages investment, inhibits urban redevelopment, and reduces the quality of life. It is necessary to decentralize Ulaanbaatar and open new areas for residential development through the growth of subcenters and the expansion of satellite cities. Besides Darkhan and Erdenet (each with about 107,000 people), most *aimag* capitals have populations below 30,000. The deficiency of urban services in these *aimag* and *soum* (district) centers is one of the major impediments for agribusiness development. The lack of access to urban and economic services to support microbusinesses and SMEs hampers local business development and thereby prevents job creation and contributes to the territorial imbalance and persistent migration to Ulaanbaatar, which in turn puts pressure on Ulaanbaatar's infrastructure.

22. **Rural economy needs investment to fulfil export potential.** The development of rural areas is constrained by climate change, low investment efficiency, infrastructure development, job creation, business promotion, and the deficiency of urban services (para. 21). Agriculture has potential but faces major challenges: livestock numbers are unsustainably high, pastureland and water management is inadequate, livestock mortality is high during extreme winters, transboundary disease is frequent, veterinary services and forage supply are minimal, and Mongolia finds it difficult to demonstrate standards for international trade. Crop production is susceptible to low yields and low quality because of weather conditions, inadequate and outdated irrigation infrastructure and technology, soil degradation, weak management of crop lands and fertilization, and low quality seed materials. Improving agricultural production and adding value will require the development of competitive industries and value chains for goods and services by boosting productivity, technology and know-how, compliance with international standards, and public-private partnerships (PPPs). It will be imperative to give microbusinesses and SMEs better access to finance, and increase the information exchange between producers and suppliers. Tourism could make progress with a focus on key locations for nature-based tourism, combined with a comprehensive national tourism master plan to identify and drive medium-term priorities and create jobs for youths and women, in particular.

23. **Urgent need to invest in renewable energy.** Coal-fired combined heat and power plants account for 90% of total installed capacity for power and heat demand. Delayed investment in new capacity means that the country imports about 20% of the power it needs to meet demand. The high dependency on coal use makes Mongolia a highly carbon intensive economy for its income level. The Central Energy System grid accounts for 87% of total installed capacity and electricity demand. Despite aging power facilities, the grid system has been well managed. However, growing demand increasingly pressures the existing power plants, and additional generation capacity of 230 megawatts is needed by 2023 (and a further 891 megawatts by 2030). Central heating systems in most major cities are unable to meet growing demand, so coal is burned in individual stoves, which leads to high pollution and negative health impacts. Mongolia is yet to fully exploit its huge potential in renewable energy, especially wind, solar, and geothermal, which could fully meet the power demand in the country and form the basis of an important export industry.

²⁰ Recorded levels of particulate matter less than 2.5 micrometers in diameter (PM_{2.5}) fell by 41% between the winter of 2018 and the winter of 2019. The primary factor in this reduction was a ban on raw coal.

24. Transport services key to export prospects. Mongolia made some progress in the development of key transport corridors, but the absence of periodic road maintenance and insufficient funding for road maintenance in general led to the deterioration of many paved roads. While road traffic is generally low, Mongolia's road safety record remains a problem and traffic congestion in Ulaanbaatar is a major issue. Urban transport services have not kept pace with the rising population, and more needs to be done to make public transport accessible and safe, especially for women and girls, and people with disabilities. The railway network is essential to the export of Mongolia's bulk commodities, but connectivity is a challenge—no physical connection exists between the main north–south and the eastern lines, and a different rail gauge in the PRC increases the time and cost of transport between the two countries. The main north–south railway line runs through the center of Ulaanbaatar, contributing to traffic congestion and presenting a risk to public safety. Civil aviation could play a significant role in connecting widely scattered population centers and in providing international connectivity, but its development has been slow. Inefficient logistics (Mongolia ranks 130th of 160 countries in the Logistics Performance Index²¹) is a constraint to all trade, and limited cold-chain infrastructure greatly restricts agribusiness exports.

25. Trade and connectivity potential ready to be exploited. While mining will continue to dominate exports in the foreseeable future, there is potential to increase exports in other industries and gradually broaden Mongolia's economic base. But this has been undermined by the lack of an institutional framework for trade, which creates uncertainty with trading partners and erodes the confidence of foreign investors. Support and planning in trade are not reflective of the reality and requirements, and lack private sector-led industries with targeted government support for the provision of public goods. Moreover, the roles of Mongolian agencies involved in trade are uncoordinated and often overlap. This hampers Mongolia's ability to market itself effectively and develop business links with its trading partners. To boost trade and regional integration, and enhance the competitiveness of non-mining exports will require investment in infrastructure, sanitary and phytosanitary standards, and veterinary and animal quarantine services. A 10% reduction of import time at the border would expand trade and raise its share in Mongolia's GDP by 0.65 percentage points.²² ADB is working closely with the government to support the development of trade infrastructure. Investments to improve the efficacy of cross-border trade as well as linked transport, logistics, and cold-chain infrastructure need to continue.

B. Need for Stronger Policies and Governance.

26. Consistent policies essential to solve country's challenges. Mongolia has undergone huge policy changes since 1991. Its commodity-dependent structure made policymaking difficult as governments grappled with wildly fluctuating business and financial cycles. While the country made good progress in some areas and shows pockets of good practice, the creation and consistent application of strong policies were often undermined by government changes and strong political influence in decision-making. The current government has a great opportunity to capitalize on relative political stability and formulate a lasting policy legacy.

27. Strong commitment needed to consistent macroeconomic framework. Mongolia's macroeconomic policy has often been pro-cyclical and volatile. This resulted in balance-of-

²¹ World Bank. 2018. The Logistics Performance index and its indicators. Washington, DC.

²² K. Kim and P. Mariano. 2020. Trade Impact of Reducing Time and Costs at Borders in the Central Asia Regional Economic Cooperation (CAREC) Region. *ADB Working Paper Series*. No. 1106. Tokyo: Asian Development Bank Institute. ADB. 2019. *2018 CAREC Corridor Performance Measurement and Monitoring Report*. Manila.

payment and fiscal deficits (so-called "twin deficits"), high inflation, lack of investment and savings, and a debt buildup, which in turn weakened competitiveness and led to macroeconomic imbalance and instability. Mongolia needs fiscal and monetary policies that insulate it from commodity price volatility, such as a credible regime for managing natural resource revenues and safeguarding the economy during downturns, and a continuous commitment to structural reform to strengthen competitiveness and resilience. The 2010 Law on Fiscal Stability already contains the necessary limits on debt, structural balance, and expenditure growth to maintain fiscal stability. Mongolia should build on the solid fiscal policy of recent years and implement this legislation. Monetary policy needs to be used proactively alongside coherent fiscal policy to mitigate shocks by keeping prices stable, ensuring finance sector stability, and maintaining a macroeconomic balance while committing to exchange rate flexibility and building up foreign exchange buffers to absorb shocks.

28. Weak governance and institutional quality constitute major obstacles. Recent progress includes the Public Procurement Law, the establishment of the General Procurement Agency, better use of the government's e-procurement system, and the creation of an independent anticorruption authority. However, the ambiguity in legislation, vulnerability to elite capture, and capacity constraints in key responsible agencies undermine the efficacy of these reforms. Indices covering corruption show an increased perception of corruption.²³ The anti-money laundering and counter-terrorism financing (AML/CTF) greylisting in October 2019, the SME fund scandal in 2018, and the payment-for-posts scandal during the 2016 election all increased this perception. Despite progress in strengthening budget cycle management, weaknesses remain in budget planning and implementation, public investment efficiency, and domestic resource mobilization, including digitization of tax administration. The government has an opportunity to capitalize on changes to civil service legislation (which aim to reduce civil servant turnover) to build capacity and strengthen policy continuity. Digital transformation offers the potential for progress given the important role it plays in the Government Action Plan. The recently launched E-Mongolia platform of integrated public services and other e-governance initiatives offer the chance to increase efficiency and improve transparency, among other aspects.

29. Business enabling environment must be strengthened. The disadvantages of the country's geographical position (landlocked) currently outweigh the advantages (proximity to the PRC) because of inadequate infrastructure and logistics. This inadequacy stems from the lack of investment in infrastructure as well as poor funding for the operation and maintenance of existing assets. A weak PPP framework and frequent institutional changes mean that few PPPs are implemented. More work is needed to ensure that it is possible to structure transactions based on widely accepted PPP norms. Further, the government needs to improve the investment climate. Stronger leadership in driving trade and reforms to the investment climate are essential to coordinate the multiple agencies involved in this space, so as to reduce red tape, increase transparency, and enable business to flourish. There are opportunities to ease taxation, customs compliance, and trading across borders, while more public sector leadership could help budding businesses link with prospective investors or markets abroad. The rapid development in technologies will create both opportunities and hurdles. It could bring unprecedented benefits (e.g., more productivity, new wealth, new ways to connect citizens to public services, transformed agriculture, empowered SMEs) but also challenges (including job displacement).

30. Future growth contingent on decisive finance sector reform. Despite improvements in increasing households' access to financial services, Mongolia continues to face huge

²³ For example, Transparency International's Corruption Perception Index and the Asia Foundation's Survey on Perceptions and Knowledge of Corruption.

challenges in the finance sector. Access to credit remains a major constraint for businesses in the non-mining space. The governance of banks, which dominate the finance sector, has been weak because of a high concentration of ownership and continued regulatory forbearance. The banks' performance is hindered by the high and rising level of impaired loans, low profitability, and uncertainty around capital adequacy. The nonbank financial system covers mainly individuals, households, and microbusinesses and cannot cover for deficiencies in banking. Despite recent growth, nonbank financial institutions remain weak and risky, and the capital market remains shallow with virtually no long-term debt finance in local currency. Notwithstanding the commendable achievement in getting delisted from the AML/CFT grey list,²⁴ restoring the finance sector's position in the dollar and euro money markets will take time. Finance sector supervision may benefit from a more integrated institutional setup that is better able to tackle coordination challenges. More efficient and effective macroprudential policy and money markets are key to managing the exposure to commodity cycles. Coherent, sustained, and well-coordinated reforms will be vital to stabilize the finance sector and enable it to adequately perform financial intermediation and serve the needs of microbusinesses and SMEs, the future drivers of diversified and resilient growth. Bank of Mongolia's Banking Sector Strengthening Program, 2020-2023 and recent amendments to the Law on Banking set out an ambitious agenda and will need to be implemented diligently.

C. Human Development Continues to Lag in Several Areas

31. **People should be primary focus of any development strategy.** As highlighted in para. 10, many Mongolian people are poor, and many remain excluded from economic growth and social services. People aged 15–34 make up 31.7% of the population, and many young people will enter the labor market before 2030.²⁵ The extent to which Mongolia ensures that they are able to contribute to the country's future will play a key role in determining its development trajectory. Important progress has been made in education, health, and social protection, but more needs to be done to ensure that these investments adequately equip Mongolians to participate fully in the economy, including hitherto excluded groups such as women, people with disabilities, and youths. However, as noted in section I, low productivity, skills mismatches, geographical disparities, and educational disparities between men and women are fundamental constraints that need to be overcome.

32. **Education sector needs strengthening in equity and quality.** ADB has been working in education since 1992 and has helped Mongolia make important progress, including in gross enrollment rates. Despite this, the urban poor, children with disabilities, and ethnic minorities have low enrollment rates. School readiness is only 63.1% for socioeconomically disadvantaged children, compared with the national average of 85%, and 90.3% for the wealthiest. Only 45.2% of children from herder households enroll in kindergartens, compared with 90.2% of children living in *aimag* centers. The performance trend in core subjects of primary and secondary education is stagnant or declining. Given the large size of the country and relatively low population base, internet connectivity has the potential to help boost skills development, lifelong learning opportunities, and cross-sector collaboration. The disruptions from COVID-19 have amplified this need. The quality of higher education varies among public and private institutions; and academic, research, and professional performance generally lags international levels. More needs to be done to regulate the quality of higher education institutions, particularly where they benefit from government subsidies. Enrollment in TVET fell by 13% during 2015–2018. Investment in research

²⁴ Mongolia was greylisted in October 2019 but then exited the grey list in October 2020, a record time for entering and exiting the grey list.

²⁵ National Statistics Office. 2020. www.1212.mn

and development is also low, which is a worry given the low levels of innovation and adoption of technology by Mongolian firms. Priorities include improving the quality of tests and curricula as part of the overall school quality enhancement, and better equipping youths to match the skills required in the labor market.

33. Health sector challenges amplified by COVID-19. Despite early and decisive action to prevent the arrival and spread of COVID-19, community transmission of the virus was eventually detected in November 2020. The hard-won gains in the health sector, including the achievement of the Millennium Development Goal targets for child and maternal mortality, are under threat. The spread of COVID-19 has led to rising hospitalizations, tests, and quarantine protocols, drawing precious health resources away from the treatment of other serious illnesses such as heart disease, stroke, diabetes, and cancer, which are the leading causes of death in Mongolia. Now that Mongolia has achieved full vaccination of 85.3% of its targeted population, it is important to help the sector complete the recovery and pursue some of the efficiency reforms that will strengthen resource allocation and boost outcomes. Primary health care is underfunded, receiving only 17% of state expenditure, compared with the 66.7% received by hospitals. Greater budgetary autonomy of hospitals, combined with centralized bulk procurement, has great potential to realize savings. Moving to a single purchaser model for health services would also result in efficiencies from the current two-source finance model, as well as providing a basis for improving the quality of health services. Medicine safety is another issue, and the introduction of a single pharmaceutical regulator would help increase medicine quality and lead to better outcomes.

34. Implementation of legal and policy framework on gender equality inadequate. The implementation of gender equality measures is hindered by (i) limited accountability and capacity of government institutions in the areas of gender analysis, mainstreaming, and gender-responsive budgeting; (ii) poor cross-sector coordination, including with civil society organizations; (iii) lack of sex-disaggregated data in some sectors; and (iv) social norms and gender stereotypes. Gender issues are complex in Mongolia and the country faces a reverse gender gap in certain spaces with lower life expectancy, higher morbidity, and mortality for men. Women, households headed by women, people with disabilities, and youths are at higher risk of poverty and unemployment than other population segments, since they face more difficulties in accessing finance and assets such as land. Women's businesses are typically smaller and have fewer employees. Many gender-based inequalities were amplified during the COVID-19 crisis because of the increased burden of unpaid care work, the dominant role of women in the health sector (82% women), and the fact that most micro, family, and sole-entrepreneur businesses are owned by women.

35. Social protection needs to be more effective at supporting vulnerable people. The inherent commodity-related volatility of the economy and its vulnerability to exogenous shocks means that social protection is an essential part of the policy mix. Local shocks have also exacerbated poverty and vulnerability, including *dzuds*. The experience of past crises shows that negative coping strategies result in the sale of productive assets; reduced consumption; or decisions against investments in education, health, and/or livelihoods—all of which impair people's longer-term well-being. Mongolia has a long-established social welfare system, and evidence confirms that social transfers were the main driver of poverty reduction from 2016 to 2018. This system has been the government's primary instrument to manage the impact of COVID-19 on vulnerable households. While this helped reduce the impact of COVID-19, it exposed the inefficiency of the system and the need to better link social protection to skills development and the labor market. The reforms required involve better targeting of beneficiaries and consolidating the number of programs to avoid the duplication of benefits. Further, social workers have limited capacity to deliver effective social welfare benefits and services, and need

support. Although social insurance coverage is good, the system is not fiscally sustainable and reforms are urgently needed, while the private pension system is not fully developed.

D. Environmental degradation and exposure to disasters and climate change risks

36. Mongolia's natural resource base needs protection. Environmental degradation; desertification; unsustainable water extraction; air, water, and soil pollution; and habitat loss are key threats to Mongolia's natural resources. The degradation in rangelands (para. 16) requires decisive action. Strict quotas on livestock numbers, the monitoring of rangeland conditions, and policies to strengthen management are needed to overcome these issues. National and local agencies responsible for protecting Mongolia's ecosystems and biodiversity need to be supported with capacity building and financing, to ensure that protected areas are managed effectively. Biodiversity conservation in Mongolia will increasingly be linked to nature-based tourism, which presents new opportunities for livelihoods and for the sustainable financing of protected areas.

37. Reducing water, air and soil pollution key policy priorities. The country needs to do an updated assessment of soil and groundwater pollution in Ulaanbaatar, and then mainstream water resource management, river basin management, and institutional capacity building for the responsible agencies into its environment planning. The ban on the burning of raw coal improved air quality in Ulaanbaatar, and reduced particulate matter less than 2.5 micrometers in diameter (PM_{2.5}) by 41% from winter 2018 to winter 2019. But the capital's air remains polluted, as is the case in secondary cities. Those that are worst hit are the poor, women, children, and elderly, so efforts need to continue.²⁶ Awareness of the need to reduce indoor air pollution remains low, especially in communities, which has important gender implications. It is therefore imperative to prioritize awareness raising in tandem with decarbonizing the economy. About 2.9 million tons of solid waste are generated annually in Mongolia, of which about 1.2 million tons originate in Ulaanbaatar.²⁷ Most solid waste is disposed in formal disposal sites or recycled, but about 7% is illegally dumped, which deteriorates the environment and raises health risks, especially in *ger* areas.²⁸

38. Need to boost disaster and climate change resilience. Disasters and climate change pose major threats to the country's sustainable development, hitting the poorest hardest, and disproportionately affecting herders and rural communities. Measures to increase resilience are required to support economic growth and protect livelihoods, enterprises, and infrastructure. The continuing expansion of *ger* areas in locations prone to floods and earthquakes, as well as a high risk of fires in *ger* areas remain major concerns and should be dealt with immediately. For rural populations, measures to build resilience to disaster risks should include community-based disaster risk reduction and preparedness measures, tailored insurance schemes, and enhanced enabling legislation. Also, the national disaster risk management action plans need to take a more holistic approach. The sharp focus on disasters and emergencies triggered by the COVID-19 pandemic provides a unique opportunity to upgrade these systems to ensure that they are fit for the purpose in the future.

²⁶ L. Hill et al. 2017. Health assessment of future PM_{2.5} exposures from indoor, outdoor, and secondhand tobacco smoke concentrations under alternative policy pathways in Ulaanbaatar, Mongolia. *PLoS ONE* 12(10): e0186834.

²⁷ B. Delgerbayar. 2016. *Current Status of Solid Waste Management in Mongolia and Business Opportunities*. <http://www.unido.or.jp/files/Mongolia-updated.pdf>

²⁸ National Recycling Association. 2018. *Manual for Management on Production of Recycling*. Ulaanbaatar.

III. IMPLICATIONS FOR ADB COUNTRY ENGAGEMENT

39. **Mongolia joined ADB 30 years ago and this partnership has been a consistent feature of Mongolia's development over this period.** The country partnership strategy (CPS) for 2017–2020 was the deepest and most significant so far. It represented the growing importance of the relationship between ADB and the Mongolian people and formed the backdrop for the new CPS period (2021–2024), which will further strengthen the engagement. ADB supported a wide array of major projects, including pioneering infrastructure investments such as the current airport in Ulaanbaatar, road and energy infrastructure across the country, and assistance in responding to and preparing for disasters such as *dzuds*. ADB's partnership has evolved with the gradual opening and market orientation of Mongolia's economy, covering almost every sector and region of the country. Mongolia made remarkable progress in this period. It reduced poverty from 38.8% in 2010 to 28.4% in 2018. More Mongolian children go to school than ever before, and the primary enrollment rate reached 97.9% in 2017. Mongolians are healthier and their life expectancy has risen significantly. Despite this, more work is needed to ensure that Mongolians can fulfill their potential, that the country can better cope with economic fluctuations, and that economic progress is inclusive and does not come at the cost of environmental degradation. These challenges are amplified by the deep impacts of COVID-19, and Mongolia will need to support its people to recover from this crisis, while laying the groundwork for long-term development and inclusive growth.

40. **Mongolia's planning and strategy documents provide firm basis for engagement.** Mongolia has two major planning documents that reflect its objectives. The Government Action Plan (2020–2024)²⁹ prioritizes the socioeconomic recovery from COVID-19; human development; economic policy; governance; green development; and municipal, regional, and rural development. Mongolia's Vision–2050 highlights the long-term development policy in nine focus areas: shared values of the nation; human development; quality of life and the middle class; the economy; good governance; green development; peaceful and safe society; regional development; and Ulaanbaatar city and satellite cities.³⁰ Both plans focus on the importance of ordinary Mongolians benefiting from the country's development through a rising middle class and increased economic opportunities. These plans are implemented with an annual calendar-year budget approved by Parliament.

41. **Multidimensional approach to development issues.** ADB has gradually strengthened its leadership role in Mongolia's continuously evolving development finance landscape by progressively scaling up its assistance, including in periods when other development partners were retreating. This was achieved by increasingly focusing financial and knowledge support on high-priority and complex operations where government capacity was lacking. ADB supported such major projects as family health centers and core education initiatives, and is pioneering work in key areas such as sustainable tourism and value-added agriculture. Applying the One ADB approach, ADB will draw on its full suite of instruments—sovereign and nonsovereign lending, grants, technical assistance (TA), and knowledge products—to provide comprehensive support to the government and leverage cofinancing from development partners and the private sector to help deliver development objectives. Given Mongolia's limited access to international financial markets, remaining poverty, and lack of capacity, ADB should continue to provide concessional assistance throughout the CPS 2021–2024 period.

²⁹ State Great Khural. 2020. *Government Action Plan, 2020-2024*. Ulaanbaatar.

³⁰ State Great Khural. 2020. *Mongolia's Vision–2050*. Ulaanbaatar.

42. **Leveraging experience.** ADB needs to build on the lessons of the previous CPS period to strengthen its engagement. Central to this is the need to improve project administration by strengthening project readiness, streamlining lending and TA operations, and allocating staff resources accordingly. ADB should capitalize on the potential for nonsovereign operations, building on progress made. It should retain flexibility in-country programming and be ready to respond if required. Finally, it is incumbent on ADB to build on its successful country knowledge plan by doing more to disseminate lessons from its operations and from the comprehensive analytical work done for the CPS 2021–2024, including the country diagnostic study (footnote 1).

43. **The focus of ADB’s CPS 2021–2024 will be to help Mongolia recover from the COVID-19 crisis and lay resilient foundations for inclusive and sustainable growth.** This is crucial in the context of the economic downturn, rapid urbanization, and proneness to 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 crosscutting nature of these development challenges, ADB’s strategy and operations must shift from the current sector-by-sector approach to one more specifically focused on removing the key impediments to inclusive and sustainable growth (paras. 19–38). The new CPS will focus on the following strategic priorities:

44. **Strategic priority 1: Foster inclusive social development and economic opportunity.** ADB will help the government support the Mongolian people affected by the COVID-19 crisis to recover and to fulfill their potential by making health, skills development, and social protection systems more efficient. Firms will create more jobs as they benefit from a stronger business environment and better access to finance, including trade finance. ADB will also work with microbusinesses and SMEs, particularly those owned by women, to boost their competitiveness, and to promote innovation and entrepreneurship. ADB will use knowledge work to strengthen planning and financing in health, education, and social protection; enhance finance sector supervision; build small-business capacity through business advisory support; and support the business environment reform, which will help unlock opportunities for nonsovereign operations. Sovereign and nonsovereign collaboration will focus on access to health and education, access to finance, small-business capacity development, and business enabling reform.

45. **Strategic priority 2: Climate-resilient infrastructure to drive competitiveness and diversification.** ADB will expand hard and soft infrastructure investments in urban and rural areas to catalyze inclusive growth and broaden livelihood opportunities. Infrastructure for regional cooperation and integration such as road, rail, information and communication technology, and border-crossing points will be complemented by efforts to strengthen trade administration and by export-enabling policies. ADB will work with the government on strengthening the PPP framework to boost private investment. It will use knowledge work to promote road safety, infrastructure maintenance, and logistics; increase value addition and remove supply chain constraints around mining; enhance FDI; boost urban planning; and strengthen trade policy. Sovereign and nonsovereign collaboration will focus on access to urban services, digital connectivity, logistics and cold-chain distribution, and value addition in the mining supply chain.

46. **Strategic priority 3: Resilience for sustainable, green, and climate-conscious development.** ADB will work closely with the government to ensure sustainable use of resources, establish early warning systems for disasters, and reduce pollutant emissions. It will use health interventions to strengthen Mongolia’s resilience to future disease outbreaks by building on lessons from COVID-19. ADB will use sovereign and nonsovereign operations to boost value chain development in climate-smart agriculture and eco-tourism. It will promote macroeconomic stability and resilience through sovereign operations and knowledge support. It will use knowledge

support to help the government develop and implement a long-term strategy on green and low-carbon goals consistent with the Paris Agreement, to mainstream climate change into development plans, and to tap available resources to support green development. ADB will also use knowledge work to assess the impacts of climate change and identify innovative solutions that strengthen resilience, particularly of rural livelihoods. It will use sovereign and nonsovereign support as well as PPPs to boost renewable energy and energy efficiency, make energy less carbon intensive, and ensure a better supply of energy to support Mongolia's economic potential. Sovereign and nonsovereign collaboration will focus on sustainable agriculture value chains.

47. **Thematic priorities.** ADB will build on past success to further accelerate progress in gender equality through more stand-alone programs and through knowledge and policy dialogue. It will step up efforts to facilitate private sector participation across the country program. Strengthening institutional capacity and governance will ensure that ADB support is complemented by more robust project implementation and policymaking capacity. Digitization is a priority theme, and ADB will continue to apply digital solutions to improve the efficiency of government services and foster innovation in areas such as fintech. It will seek even greater engagement with civil society organizations to strengthen project design and implementation, improve beneficiary feedback and citizen engagement, and enhance the approach to social and environmental safeguards.

48. **Close coordination and flexible programming.** ADB will coordinate closely with development partners, the private sector, civil society, and other stakeholders to enhance the ability to deliver results. It will also encourage the government to strengthen its leadership in this area. ADB will deepen its work with civil society organizations through the Civil Society Advisory Committee established in 2019, and will explore the need for similar structures with the private sector. ADB will retain a broad strategic focus but with prioritization within sectors and a more programmatic approach with fewer, larger operations. ADB will seek to prioritize within sectors based on what constitutes best value for money. ADB will also seek to group its interventions geographically, with an initial focus on western Mongolia, to ensure maximum development impact by aligning rural and urban operations and ensuring coordination with development partners.

49. **Strategy 2030 provides ADB with a framework to respond effectively to the needs of the Mongolian people and the challenges of the SDGs.** The strategy's operational priorities 1 (addressing remaining poverty and reducing inequalities) and 2 (accelerating progress in gender equality) will form the centerpiece of ADB's engagement given their strong people focus. All other operational priorities are strongly featured in this CPS, underlining the comprehensive and ambitious approach being taken to support Mongolia's development over the next 4 years. This is the first CPS in Mongolia since the approval of Strategy 2030, and ADB will therefore sharpen its focus on collaboration and partnerships, strengthen knowledge provision, enhance nonsovereign operations, expand its in-country presence, and draw on the full range of its in-house expertise by using the One ADB approach to deliver the best results for the people of Mongolia.