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May 28, 1993

To: Members of the Executive Board

From: The Secretary

Subject: Mongolia - Enhanced Structural Adjustment Facility -
Policy Framework Paper, 1993-96

Attached for consideration by the Executive Directors is the policy framework paper under the enhanced structural adjustment facility for Mongolia.

This subject, together with the staff report for the 1993 Article IV consultation with Mongolia and its request for arrangements under the enhanced structural adjustment facility (EBS/93/79, 5/28/93), is proposed to be scheduled for discussion on Friday, June 25, 1993.

Mr. Leimone (ext. 37315) or Mr. I. Kim (ext. 37327) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Unless the Documents Preparation Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the Asian Development Bank (AsDB), following its consideration by the Executive Board.

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INTERNATIONAL MONETARY FUND

MONGOLIA

Enhanced Structural Adjustment Facility

Policy Framework Paper, 1993-96

Prepared by the Mongolian authorities in collaboration with the
staffs of the Fund and the World Bank

May 28, 1993

I. Introduction

1. Mongolia's economic development until 1990 was based on the centrally-planned model adopted following independence in 1921. This model stressed the development of mineral resources and an industrial base with emphasis on processing agricultural products, although nomadic herding remained a significant economic activity. In recent decades, exports consisted mostly of animal byproducts and minerals (since the mid-1980s mainly copper concentrate) and imports mostly of petroleum products, capital goods, and some consumer goods. Reflecting both Mongolia's landlocked location and political orientation, external trade took place almost exclusively with other planned economies, principally the former U.S.S.R. with which Mongolia's economy was highly integrated. Mongolia also relied heavily upon the former U.S.S.R. for technical and financial assistance.

2. As in some other planned economies, high rates of growth in investment and output were achieved for a time but serious economic problems emerged by the second half of the 1980s. Increasing distortions in resource allocation and rising domestic and external imbalances became evident. Some steps were taken in the late 1980s to improve economic management and reduce central control, but socioeconomic tensions and macroeconomic difficulties nevertheless intensified.

3. Following political reforms in early 1990, an elected coalition Government embarked on a program of economic transformation to a market economy. The principal goals of the program were to shift from centrally-planned to market-oriented economic institutions, to reduce the role of the Government in the economy while promoting the private sector, and to expand and diversify external economic relations. Broad-ranging reforms were initiated in the legal and institutional framework, and efforts were initiated to expand Mongolia's economic relations with market economies and to seek membership in international economic and financial organizations.

4. Mongolia's efforts to transform its economy were accompanied by severe external shocks during 1990-91. These shocks included the virtual cessation of new financial assistance from the former U.S.S.R., a sharp contraction of trade with the former U.S.S.R. and other members of the former Council for Mutual Economic Assistance (CMEA), and declining export prices. Moreover, Mongolia's capacity to respond to these shocks was hampered by the breakdown of the old planning system before new market-oriented institutions and policy instruments were fully in place. Real GDP declined by 12 percent during 1990-91 as shortages of key imported inputs, particularly petroleum products and spare parts, intensified; inflation (previously nonexistent) picked up sharply and the balance of payments weakened significantly.

5. In late 1991, Mongolia entered into a one-year stand-by arrangement with the Fund to support its program of stabilization and reform. It also successfully requested concessional financial assistance from other multilateral and bilateral sources. These financial resources were complemented by the initiation of a large program of technical assistance contributed by multilateral agencies and bilateral donors.

6. Elections under a new democratic constitution were held in June 1992, and the new Government has reaffirmed its intention to continue and accelerate the transition to a market economy. The present policy framework paper follows a Memorandum on Economic Reform and Medium-Term Policies (EBD/91/269, 9/16/91) prepared in conjunction with the stand-by arrangement with the Fund. The paper describes recent economic developments and progress in policy implementation, sets forth medium-term objectives and policies, discusses efforts to address the social impact of adjustment, and examines external financing requirements.

II. Recent Economic Developments

7. Since 1991, progress in stabilizing Mongolia's economy has been hampered by external shocks (notably the breakup of the CMEA trading system and of the former U.S.S.R.), difficulties in transforming domestic institutions, and some domestic policy slippages. Real GDP declined by an estimated 8 percent in 1992 (Table 1); notwithstanding a pickup in activity in the emerging private sector, industrial and agricultural production were constrained by shortages of intermediate goods and spare parts and, in the case of agriculture, also by adverse weather. Domestic investment has fallen sharply since 1990, partly reflecting a curtailment of projects financed by the former U.S.S.R., resulting in a large decline in activity in the construction, transportation, and communication sectors. The national savings rate has also declined because of a fall in real income, accentuated by a deterioration in the terms of trade that reflected a weakening of world prices of copper and cashmere. Inflation accelerated to over 300 percent (12-month change) by end-1992, reflecting deregulation of official prices and monetary and credit policies that were accommodative during the first part of the year.

8. The overall fiscal deficit (including off-budget operations) registered about 10 percent of GDP in 1992, and was mainly financed by external resources. The underlying budgetary position remained weak, as revenue continued to rely heavily on the supplementary taxation of state enterprises (including taxes--partly financed by bank borrowing--on accrued windfall gains associated with price adjustments). The revenue effect of new tax measures introduced during 1991-92 (including customs duties and additional excise taxes) was less than expected as a result of the decline in economic activity and foreign trade, weaknesses in administration, excessive exemptions, and delays in implementation. Despite continued heavy outlays for energy use, food, and social benefits, current expenditures were sharply reduced in real terms, primarily through the elimination of most direct budgetary subsidies to state enterprises and through restraint over salary increases. Although budgetary capital expenditures were constrained, substantial outlays were incurred on a number of large off-budget projects initiated in prior years and financed partly through external commercial borrowing.

9. Monetary aggregates expanded rapidly in the first half of 1992, reflecting difficulties in shifting from direct to indirect methods of monetary control and in completing the transition to a two-tiered banking system. Through midyear, some measures were taken to slow monetary expansion (increases in the Bank of Mongolia's lending rate to 30 percent per annum and the introduction of reserve requirements and of limits on commercial bank borrowing from the Bank of Mongolia). However, the effects of these measures were limited by continued indirect access to central bank credit that reflected delays in the establishment of a clearing mechanism and the lack of an effective institutional framework to enforce monetary policy. Following the introduction of the clearing mechanism in mid-1992, monetary policy was tightened significantly in the fourth quarter. The Bank of Mongolia's lending rates were raised to 10-20 percent per month (positive in real terms), reserve requirements were doubled to an average of 17 percent, a minimum deposit interest rate of 4 percent per month was established, and credit ceilings were set on each bank's lending to nonbanks. Reflecting these measures, seasonal factors and increased holdings of foreign currency banknotes, measured monetary aggregates declined in the fourth quarter; for 1992 as a whole, however, domestic credit expanded by 52 percent and broad money by 34 percent. Notwithstanding the introduction of central bank supervision and prudential controls, the financial condition of some banks continued to weaken as a result of weak loan portfolios (related to loans inherited from the old monobanking system as well as directed credits) and deteriorating liquidity positions, partly reflecting sluggishness in raising interest rates to attract deposits. The resulting deterioration of confidence was aggravated by a poorly functioning international payments system and by the publicity surrounding the disclosure in late 1991 of substantial foreign currency dealing losses.

10. Pressures on the balance of payments have remained acute, reflecting the continuing impact of the external shocks, the maintenance of an over-valued exchange rate, administrative intervention in foreign trade, the

foreign currency dealing losses, and rising debt service obligations on commercial debts in convertible currencies. Exports rose modestly in 1992 while imports (including turnkey projects) fell by a further 20 percent as the virtual cessation of official medium- and long-term assistance from the former U.S.S.R. was only partly offset by new assistance from nontraditional sources. Concomitantly, the deficit on the external current account (including grants) declined to \$31 million in 1992. Net official reserves fell from \$49 million (3 weeks of imports) at end-1990 to \$14.4 million (1.9 weeks of imports) at end-1992. In addition, external payments arrears emerged during 1990-91 but were reduced by \$11 million to \$52 million during 1992. Mongolia's medium- and long-term external debt in convertible currencies rose rapidly to about \$342 million (87 percent of gross current account receipts) at end-1992, reflecting new commercial borrowing as well as new aid inflows; medium- and long-term debt to the former CMEA denominated in transferable rubles amounted to TR 10.6 billion. The exchange rate used to value barter transactions was devalued from Tug 7.1 per U.S. dollar to Tug 15 per U.S. dollar in November 1991 and was unified with the official rate of Tug 40 per U.S. dollar in March 1992. The differential between the official exchange rate and the rate in the free market widened sharply to more than Tug 250 per U.S. dollar by early 1993, exacerbating distortions and hampering the competitiveness of public sector enterprises subject to export surrender requirements at the official rate (private enterprises operate in the free market and are not subject to surrender requirements).

11. Over the last two years, important strides were made in structural reform. Price reforms have entailed the freeing of almost all retail and wholesale prices from administrative control and substantial increases in remaining administered prices, mainly for basic food, energy, rents, and public utilities and services. A banking law was enacted, under which the central bank was established and a two-tier banking system was formed, and steps were taken to establish the legal basis for a modern tax system. Most small- and medium-sized public enterprises and shops in the services sector were transferred to the private sector under the voucher system, and privatization of large public enterprises under this system was initiated. By end-1992, 90 percent of small enterprises, over 300 large enterprises, and almost all of the herds were privatized; a sizable portion of employment in the industrial and service sectors is now private. The Privatization and Company Laws enacted in 1991 legalized private sector activity in domestic and foreign trade and distribution, and by early 1993 more than 6,000 private sector activities had been identified. Actions were also taken to eliminate mandatory state orders, which had constituted a major vehicle for administrative intervention in the economy.

III. Medium-Term Objectives and Adjustment Strategy

Overview

12. Notwithstanding recent progress in structural reform, Mongolia continues to face severe economic difficulties that reflect deep-rooted structural

weaknesses, inexperience with new indirect methods of macroeconomic management, and the magnitude of the external shocks since 1990. Adjustment to these shocks has been hampered by the persistence of regulatory and administrative barriers to economic activity and governmental intervention in production and distribution, the limited development of financial and other markets, weak corporate governance in the state enterprise sector, the lack of a modern accounting system, and limited transportation and communication facilities. To address these difficulties, the Government has adopted an intensified program of medium-term structural adjustment. The program focuses on: (a) strengthening macroeconomic management through enhancing the use of indirect instruments; (b) deepening structural reforms to improve allocative efficiency and foster growth; (c) developing an efficient export sector; and (d) generating additional domestic savings to permit a recovery of investment. Particular emphasis will be placed on fostering private sector development--including through completion of the privatization program--and foreign direct investment as the likeliest sources of export growth.

Macroeconomic objectives and strategy

13. The medium-term (1993-96) macroeconomic objectives are to reverse the decline in output, restore financial stability, and make progress toward external viability. The program aims to limit the contraction of economic activity to less than 2 percent in 1993 and restore real GDP growth thereafter. The rate of inflation is targeted to be reduced from about 320 percent at end-1992 to single digits by 1995. The external current account deficit is to be contained to 17 percent of GDP over the medium term; gross international reserves are to be rebuilt to a level equivalent to 2 1/2 months of imports and external payments arrears will be eliminated. These are recognized as ambitious targets, the realization of which will require favorable external conditions and full implementation of stabilization measures and structural changes outlined in this paper.

14. Restoration of economic growth will depend on recovery in the agricultural, industrial, and services sectors, especially in export-related activities. Priority is also being given to reversing the decline in food supplies in recent years. A positive supply response in agriculture is expected from the establishment of market-determined producer prices and an appropriate exchange rate, the elimination of existing and the avoidance of new barriers--including mandatory state orders and export licensing--to agricultural exports, and exchange system liberalization. The services sector offers potential for gains in private employment in areas such as tourism, external and internal trade, business and professional services, and distribution. Some industrial subsectors, such as small, import-substituting consumer goods industries initiated with private capital, should also begin contributing to growth. However, output of many traditional industries is expected to remain stagnant or decline as a more rational price structure and hard budget constraints force nonviable

entities to close and other entities to undergo rehabilitation and restructuring.

15. Investment, which has declined sharply since 1990, is projected to recover substantially during 1994-96. Public investment will focus on the maintenance and development of infrastructure, especially in the areas of transportation, communications, and energy. The program also envisages an expansion in private sector investment in the agricultural, industrial, and export sectors. Steps will also be taken to improve the climate for foreign investment through appropriate macroeconomic policies, the adoption of a more liberal trade and payments system, and the enactment in 1993 of a revised foreign investment law that aims at reducing existing impediments to investment, clarifying legal ambiguities, and streamlining approval procedures.

16. The increase in investment will require a substantial expansion in domestic savings. Higher budgetary savings are to be generated through a combination of revenue-enhancing tax reforms and measures to restrain current expenditures, as described in paragraph 22 below. Efforts will be made to improve the financial position of state enterprises and increase their operating surpluses. Private sector savings are expected to rise in response to an increase in business profits and to financial policies that provide sufficient incentives to save.

17. The achievement of the targeted reduction in inflation will depend on the pursuit of appropriate financial policies. A key element of this effort will be control of the fiscal deficit and avoidance of its financing from the domestic banking system. The budgetary current balance should continue to improve with the surplus rising by 1 percent of GDP each year. Meanwhile, reflecting the effects of exchange rate changes on foreign currency-denominated transactions and the expected trajectory of disbursements for donor-financed investments, the overall fiscal deficit is expected to be over 20 percent in 1993 and 1994, before being reduced to 15 percent of GDP by 1996. This fiscal outlook envisions the continuation of reforms to broaden the tax base and to increase elasticity of revenues, to reduce exemptions and distortions, and to strengthen tax administration. Also, tight control will be maintained on current expenditure through wage and salary restraint, increased cost recovery for education and health, and further cuts in subsidies and transfers. To support the stabilization effort and provide scope for adequate expansion of credit to the productive sectors, the Government will aim to build up deposits in the banking system while financing the deficit from external sources. If external financing should exceed the amounts envisioned, the Government will nevertheless maintain expenditures within program levels.

18. Expansion in domestic credit will be restrained to a level consistent with inflation and external objectives. To this end, the Bank of Mongolia will take steps, detailed further in Section 3, to improve the monitoring of monetary developments and the supervision of commercial banks. Interest

rate policy will aim at keeping lending and deposit rates positive in real terms.

19. The targeted improvement in the balance of payments will depend on the development of an efficient and more diversified export sector. While prospects for expanding the volume of Mongolia's main export (copper) are modest (see paragraph 49 below), the establishment of an appropriate exchange rate, the removal of restrictions on private trading, and increased investment in infrastructure are expected to facilitate recovery in non-copper exports, including those of cashmere, textiles, leather products, and meat and meat products. The services account will offer potential for increased foreign exchange earnings, as the expansion in the tourism industry gains momentum. At the same time, import volume is projected to grow at an average annual rate of about 4 percent, primarily reflecting an increase in the demand for spare parts, intermediate inputs, and capital goods.

Structural reforms

a. Reforms for strengthening economic management

(i) Budgetary reforms

20. In line with the objectives of increasing domestic savings and expanding the role of the private sector, the economic role of the Government is being redefined. The medium-term goal is to limit the Government's role to provision of basic public services, economic infrastructure, defense, and protection of the lowest income groups and the environment, while permitting the private sector to take the leading role in productive activities. Budgetary reforms will focus on continuing the process of modernizing the tax system and broadening the tax base, strengthening the monitoring and control of budgetary revenue and expenditure, and rationalizing budgetary expenditure, while improving the cost effectiveness of the delivery of government services.

21. On the revenue side, a comprehensive tax package was implemented in early 1993. A 10 percent sales tax on domestic production and imports was introduced (replacing the temporary surcharge on imports adopted in late 1991) and the scope of customs duty exemptions was reduced. Measures to strengthen administration of these taxes will be adopted--based on technical assistance recommendations that have been provided by the Fund--including the introduction of a customs valuation code in 1993 and the establishment of individual taxpayer identification numbers by mid-1994. Also in early 1993, the number of corporate income tax rates was reduced from six to four, and the definition of taxable income was modified to allow deductibility of wages and depreciation. A revised personal income tax was introduced under which income of unincorporated businesses is now taxed as personal rather than corporate income and existing limits on allowable deductions were removed. Income tax administration will be further improved with technical assistance to be provided by the Fund. Over the medium term, consideration

will be given to further simplification of the rate schedules of personal and corporate income tax and addressing the issue of adequate revaluation of assets to permit economically appropriate levels of depreciation. All specific excise tax rates have been converted to ad valorem, and the coverage of the tax on transport facilities and motor vehicles has been expanded to include diesel-powered vehicles.

22. Expenditures will be constrained to a level consistent with the revised role of government and objectives for the fiscal deficit. Measures to rationalize expenditure will be concentrated in the areas of health, education, and the social security system, while ensuring an adequate safety net for the truly needy. The social security system will be modified by end-1993 through the phased introduction of employee contributions to the pension system (which is expected to result by 1996 in a system fully financed by employee and employer contributions), standardization of minimum retirement ages, and reduction of pensions paid before the minimum age. Nonpension social security benefits will be curtailed and restructured to provide resources to targeted beneficiaries at the poverty level through two new funds for meeting subsistence needs and promoting employment. In conjunction with the announcement of a doubling of average civil service wage rates in late 1992, the Government established incentives to budgetary units for reductions in force; future increases in the wage bill will be strictly limited in line with available resources and inflation objectives. All direct producer subsidies were eliminated in 1992, and subsidies for urban transport and fodder transport are to be phased out. The management and control of government expenditure by the Ministry of Finance will be enhanced through the implementation of recent IMF technical assistance recommendations; these cover improvements in budget classification, fiscal forecasting, treasury management, and fiscal reporting and auditing.

(ii) Public investment program

23. A comprehensive investment review was initiated in 1991 and budgetary support has subsequently been terminated for projects that did not meet efficiency and rate of return criteria and priority requirements. Decisions to continue existing projects or approve new ones will be based on resource availability, sectoral priorities, and rates of return. These criteria are being applied to a minimetallurgical project and a hotel project that is slated for privatization. Beginning in 1993, a rolling three-year public sector investment program is being prepared with IDA-financed technical assistance. This is being preceded by the preparation of an inventory and audit of present and planned public sector investment projects.

24. An investment coordinating mechanism will be established to assure consistency between annual and medium-term investment priorities and the availability of domestic and external resources. This mechanism will involve overall coordination among the Ministries of Finance and Trade and Industry, the National Development Board, and the Bank of Mongolia, and consultation with line ministries responsible for the execution of specific projects. To improve the process of monitoring and evaluating public sector

investment outlays, all projects not undertaken by ongoing enterprises will be fully reflected in the budget beginning in 1994. To avoid pressure on the use of domestic resources, investment expenditures to be financed through external resources will not be undertaken until the relevant external financing becomes available. The Government will refrain from participating in or financing projects engaged in directly productive activities that fall within the domain of the private sector, except joint-venture projects with large foreign equity participation and projects cofinanced with donor assistance meeting restrictively defined criteria of profitability and critical need. In such cases, efforts will be made to fully privatize such projects as quickly as possible. The Government will also shift to public enterprises full responsibility for meeting debt service obligations on their external and domestic borrowing.

(iii) Banking sector reforms

25. Financial sector reforms will focus on steps to increase the effectiveness of monetary management by the Bank of Mongolia and development of the commercial banking system. Annual and quarterly financial programs will be established, and a "flash" reporting system for key monetary data will be developed in 1993. To reinforce the effectiveness of monetary policy in controlling inflation, domestic intrapublic sector arrears will be cleared by September 1993, and additional steps--primarily improvement in the payments system and the introduction of a realistic possibility of seizure of assets or bankruptcy--and enforceable payments regulations for public sector entities have been taken to reduce arrears and prevent their recurrence. To improve the efficiency of the payments system, the central bank is introducing discountable commercial bills and will work with commercial banks to establish a National Payments Council to advise on payments issues. With IMF technical assistance, steps will be taken to develop open-market operations by 1995. The system of commercial bank credit ceilings introduced in 1992 to bolster credit control will be phased out in favor of indirect methods of credit control, as will existing practices for direction of credit to selected sectors; in the meantime, any new directed credits will be explicitly guaranteed by the Government.

26. To restore confidence in and develop further the commercial banking system, the Bank of Mongolia's supervisory capabilities are being augmented significantly. During 1993, the authority to conduct on-site supervision will be confirmed through passage of a permanent Central Bank Statute. The department of banking regulation and supervision is developing guidelines, requirements, and limits for capital adequacy (using risk-based assessment), prudential liquidity, large loans, connected lending, and management of foreign exchange operations. To enforce these prudential regulations, the supervisory audit and review functions will be fortified, including through the development of a manual on banking supervision. Banks will be required to draw up statements of lending policy with a view to improving the overall quality of their loan portfolios. A review of commercial bank portfolios is being undertaken that will identify nonperforming and substandard loans. Procedures have recently been established to deal with problem loans,

including loan-loss provisioning, and the financial position of the foreign trade bank will be resolved.

27. Further steps to reinforce and support a market-based banking system will include the establishment of a banking institute--jointly supported by the central bank and commercial banks--to train commercial bank staff in credit appraisal and analysis. To facilitate appraisal of credit risk, a system of national accounting standards will be developed with World Bank technical assistance; these standards will be applied to selected public enterprises by mid-1994 and extended to all public enterprises by 1995. Summary financial statements for enterprises having adopted the standards will be published every six months beginning no more than six months after adoption. Commercial banks will be required to publish balance sheet and income accounts by end-1994 and steps will be taken to reduce lags in booking transactions and in reporting to the Bank of Mongolia.

(iv) External sector reforms

28. Improvements in the balance of payments will require a diversification of external trade. The Government recognizes that, in order to obtain new markets and sources of supply and to expand trade, participation in foreign trade by the private sector must be promoted actively in a market-oriented environment.

29. The Government has initiated a policy of decentralizing foreign trade activities and has abolished general export licensing except for a limited number of commodities. Government-imposed barriers to trade, including quotas, export bans (except for bona fide, e.g., environmental and cultural purposes), and minimum export prices have been eliminated. Conditions attached to engaging in domestic procurement of exportable goods and marketing of imported goods, including requirements to seek permission to engage in such activities, have also been eliminated. On May 27, 1993, revised foreign trade guidelines (including items under licensing and administrative procedures) were published that reflect these changes in the trade system introduced in early 1993.

30. The Government will not introduce export taxes other than royalty-type taxes on nonrenewable natural resources and will not impose other restrictions or conditions on external trade, including barter trade (e.g., specifications regarding types or quantities of goods to be traded), other than those noted above. The current export licensing requirements for live animals, meat, and wheat will be reviewed by end-December 1993 with a view toward their elimination. The system of mandatory procurement of goods under state orders, whether for domestic sale or exports, has been abolished with effect in 1993. To ensure competition in the procurement of domestically produced agricultural commodities and industrial goods, private agents will have uninhibited access to their purchase either directly or through established commodity markets, without regard to whether state orders have been filled. The previous monopoly position of the foreign trade corporations has been abolished, and the corporations are in the process of being

privatized. The centralized distribution of imports, including food and consumer goods, will also be phased out by end-1993, except for government-procured petroleum and some grant-financed emergency imports. In conjunction with a prospective World Bank credit, a mechanism will be established to ensure that the private sector receives unconditional access to imported inputs for productive purposes. Firms and individuals in the private sector will be encouraged to export and to develop new export and import-substituting industries with minimum governmental interference. With the abolition of general export licensing, registration of export transactions for statistical purposes will be done through the Customs Administration, and registration of trade contracts has been eliminated.

31. The Government aims at managing the external position through appropriate macroeconomic policies, including a realistic exchange rate policy, rather than through administrative mechanisms. To this end, the exchange rate was adjusted from Tug 40 per U.S. dollar to Tug 150 per U.S. dollar at the beginning of 1993 as part of a phased approach to the establishment of a unified floating exchange rate system. Under this system now in effect, the official exchange rate for the tugrik is determined on the basis of developments in the free market. Surrender requirements not exceeding 60 percent of export proceeds for public enterprises producing the country's main exports (copper, cashmere and other wool products, live animals, meat and meat by-products, and wood and wood products) will be retained on a transitional basis to provide foreign exchange for official purposes, including debt service, reserve accumulation and certain government imports, and all surrendered export proceeds will be channeled through the banking system. Importers with bona fide documentation will have unrestricted access to the foreign exchange market. Exchange rate policy for the medium term will focus on maintenance of a market-oriented exchange rate system; by the end of the ESAF program remaining restrictions on payments and transfers for current international transactions will be eliminated.

32. Management of international reserves has been transferred from the State Bank (International) to the Bank of Mongolia, and reserves will be rebuilt in line with program targets. Consonant with the transfer of reserves, the central bank has established operational guidelines, including requirements covering record keeping and limits on exchange risk exposure for its foreign currency dealers. To assist the development of the foreign exchange market, banks holding a license to engage in foreign exchange operations have been required to establish internal rules covering dealing, risk exposure, portfolio management, and back office operations, and review of these procedures is being established as an integral part of the Central Bank supervisory process. Proposals to address the uncovered foreign currency deposit liabilities of selected commercial banks will be developed and implemented by end-1993. Under its permanent statute, the Bank of Mongolia will be granted the necessary authority and effective powers to enforce rules and regulations governing foreign exchange operations.

33. The major share of Mongolia's external debt obligations is owed to former CMEA members, primarily Russia, and is denominated in transferable

rubles. From January 1, 1991, all outstanding debt payments, as well as payments and clearing mechanisms through the IBEC, were suspended by mutual agreement. Agreement was reached, in principle, with the former U.S.S.R. and reconfirmed by Russia that future debt service will not be such as to impede Mongolia's economic development. Negotiations are continuing with Russia on postponing debt service on medium- and long-term debt falling due through 1995 until at least the year 2000. Proposals on modalities for valuation and future settlement of these obligations are under negotiation, and the Government is seeking to renegotiate outstanding IBEC balances owed to Russia. The Government has also undertaken discussions with other former CMEA members to settle outstanding IBEC balances.

34. Mongolia's debt denominated in convertible currencies has risen rapidly (from a low base) since 1990. A significant amount of this debt was contracted on relatively unfavorable terms, and the Government is seeking to renegotiate its major commercial debt obligations. To enhance debt management, all external borrowing of the public and private sector enterprises will be monitored by the Ministry of Finance and the Bank of Mongolia. Procedures for coordinated review and approval of all public and publicly guaranteed external borrowing will be developed and implemented and the authorization of the Minister of Finance will be required for such borrowing. Until Mongolia's external financial position has become more firmly established, the Government and the Bank of Mongolia will refrain from short-term borrowing (credits with original maturity of one year or less) and/or guaranteeing of such loans, excluding normal import-related credits. The contracting of public and publicly guaranteed loans in the medium-term maturity range on nonconcessional terms will also be strictly controlled.

35. To promote foreign direct investment as a source of non-debt-creating financing, greater competition, and much-needed technology, the Government enacted a foreign investment law in 1990. Experience to date has indicated the need to enhance further the climate for foreign investment, and to this end a new law is being considered by Parliament. The Government will issue, in consultation with the World Bank, comprehensive and transparent regulations for implementing the new law. In this connection, an interagency unit will be established during 1993 to streamline procedures for processing applications for foreign investment in an efficient and expeditious manner. Repatriation of capital and remittances of profits/dividends will be unrestricted.

(v) Improvements in economic data

36. The Government recognizes that existing statistical information must be upgraded, expanded, and reported on a more frequent basis as a guide to economic policy, and that the transition to a market economy requires the publication of timely and reliable economic statistics to guide decisions by businesses and households. In this connection, priority is being given to key data on the national accounts, monetary accounts, fiscal operations and public sector debt, and public sector enterprise operations, wages, and prices. The monetary accounts reporting system was revised in 1992 to

improve coverage and incorporate international accounting standards, especially for international transactions. By mid-1994, a detailed manual of accounts for commercial banks will be published. By end-1993, the budgetary reporting system for central and local governments will be revised and expanded to provide quarterly reports with detailed information on expenditures by type and by function. With Asian Development Bank (AsDB) and World Bank assistance, a program will be initiated in 1993 to begin compiling income and output data according to the UN System of National Accounts (SNA) and, in 1995, national accounts data will be completely shifted from the old system of net material balances to the SNA concept. During 1994, new price index weights will be computed to take into account the impact of price liberalization and other structural changes on spending patterns. These new weights will be used to calculate the consumer price index beginning January 1995. The Government will encourage the regular publication of international commodity prices relevant to Mongolia and the exchange rates of major currencies. The World Bank will also assist in compiling indicators on social-related issues to monitor poverty.

b. Reform of prices, wages, and pensions

37. Following a series of price liberalization measures taken since early 1991, only the prices of public utilities, rents, and urban bus transportation remain subject to government control. Since September 1991, local regulatory bodies have monitored prices set by monopoly producers and importers but cost increases are being passed through to retail prices. Only meat, flour, and bread are now supplied under the ration system, and it is expected that with further improvements in supplies this system will be phased out during 1993. By mid-1994, regulatory commissions, including both public and private sector representatives, will be established to approve tariffs for public utilities and services.

38. To promote a more efficient allocation of resources, steps have been taken to increase competition and remove restrictions on economic agents from freely buying or selling goods or services at market-determined prices. State procurement agencies will be either abolished or required to compete with other private and public agencies for the purchase of goods and pay freely negotiated prices. Except for the remaining goods and services still subject to price controls, the Government will refrain from intervening in the price-setting process, but will instead foster competition through divestiture of public enterprises and the promotion of private activities in trade, distribution, and commerce to mitigate elements of monopolistic pricing.

39. Regarding wage determination, the Government establishes a minimum wage and regulates wages of its own employees and employees of enterprises receiving budgetary transfers. The tripartite commission, consisting of representatives of the Government, the state enterprises, and labor will continue to guide the general level of wage increases in the state enterprise sector. Future increases in the minimum wage will be held below the rate of inflation to minimize the adverse impact on employment of marginally

productive workers. Increases in the civil service wage bill (including the value of goods and services provided to employees at below-market prices) and in pension benefits will also be held below the rate of inflation, except that the base pension for those who have never worked or for those retiring at the standard retirement age or through disability will not fall below the poverty line. In light of the need to retain key skilled personnel in the civil service, the Government will review and restructure wage scales and benefits, including the conversion of some benefits to cash wages. To reduce impediments to labor mobility, the Government will, with external assistance, examine methods to delink access to housing from employment with a view to implementing measures during 1994-95.

c. Privatization and reform of public enterprises

40. The Government's strategy of promoting private sector activity involves providing a basic legal and institutional framework, eliminating barriers to entry and other impediments to the functioning of markets, and converting state assets to private ownership and control. While substantial progress has been made in establishing the legal framework, further legislation conducive to the operation of free markets is necessary; in this respect, draft amendments to the company law--providing protection for shareholders and defining the scope of activities of enterprise management and boards--are being submitted to Parliament, together with an anti-monopoly law and a land law. In the longer term, a new company law will be needed. Barriers to private sector entry into specific areas of economic activity, except for health, safety, environmental, or national security reasons, are being eliminated. The Government will monitor progress to ensure that private sector activities are not hindered by regulations or more informal barriers.

41. The conversion of state assets to private ownership was launched in conjunction with the privatization law passed in June 1991. Existing enterprises in certain sectors of economic activity, namely in the energy sector, rail and air transportation, water supply, and the meteorological service will remain fully or majority-owned state property. Other state-owned enterprises and property (including buildings) are being privatized through sale, leasing, or auction of property and shares and this will continue. The process of privatization of state enterprises through the voucher system is expected to be completed by end-1993; by then, about 45 percent of the assets of state enterprises as of 1990 will have been privatized. While continuing to provide support for education, public health, culture and arts, and basic science, the Government will refrain from starting or investing in new publicly-owned enterprises in the productive sector except in selected cases of joint ventures with foreign equity investors. In these cases, the guiding principle will be state ownership solely as a transitional mechanism until domestic private investors can be identified. The privatization process will be broadened to include urban land and possibly housing.

42. The stock market has been a key element in the privatization of state enterprises through the sale of shares in medium and large enterprises in

exchange for vouchers. A securities law will be passed by March 1994 as a basis for secondary market trading of shares. Within the framework of this law, stock market regulations that will provide transparency of operations and prevent fraud, manipulation, and insider abuses will be promulgated. (AsDB technical assistance is being provided to the stock market).

Sectoral policies and programs

43. In the agriculture/livestock sector, more than two thirds of all animals are now privately owned and most cooperatives have been privatized. Most state farms dedicated to cultivation have been divided into smaller private plots through leasing of land, pending the passage of the land law, which will determine the modalities for ownership and transfer of land. Legislation will be introduced to establish long-term leasing of agricultural land. In keeping with nomadic tradition, pasture land will remain under state ownership but consideration will be given to a system of usage fees; technical assistance will be sought for setting grazing fees based on economic land value. As part of the first phase of privatization, equipment and buildings have been made available to the private sector through leasing or purchase. Only research farms will remain under public ownership.

44. Procurement prices for agricultural products, held at inadequate levels for some time, were raised at the beginning of 1991 and liberalized in 1992. To encourage a significant supply response and to stimulate producers and traders of agricultural products to search for new and expanded export markets, all bans on private exports of agricultural products have been lifted, concomitant with giving private sector agents full access to the purchase of such commodities either directly from producers or through intermediaries. In this connection, the powers of agricultural commodity exchanges established during 1992 have been redefined to provide conditions for increased competition in agricultural distribution, including through formation of marketing cooperatives. Over the medium term, improvement in agricultural incomes through these measures will permit the phased elimination of fodder transportation subsidies and an increase in the price of veterinary service charges to recover costs. Privatization of the veterinary service will be undertaken at a later stage when the development of private sector distribution channels and adequate private access to foreign exchange can ensure that imported medicine can be acquired and distributed.

45. The industrial sector, consisting of manufacturing, mining, and energy production, accounts for somewhat more than one fourth of net material product. However, most enterprises possess an inefficient and obsolete capital stock and, because of deficient accounting practices, do not fully cover their cost of capital. Although most direct budgetary subsidies were eliminated in 1992, a number of enterprises continued to receive government assistance in the form of directed credit through the banking system, and cross subsidization of imports through official exchange rates.

46. The Government's strategy in this sector is to create more rational economic incentives for all enterprises and to improve managerial capability

and efficiency of enterprises remaining in the public sector. Efforts will be concentrated on establishing hard budget constraints on state enterprises through the removal of remaining indirect subsidies, the phased elimination of directed bank credit, and a requirement that enterprises pay market-determined prices for imported inputs. Management contracts will be tied to enterprise financial performance. The Government will begin this year to identify and close down state enterprises that cannot be restructured into viable units in the new market environment. Budgetary oversight of the financial position of public enterprises excluded from full privatization is being initiated with the 1993 budget, even as subsidies and remaining centralized controls over prices, employment, and other operating decisions are eliminated. In addition, efforts are being made to decentralize industrial concentration through encouraging the establishment of smaller-scale processing firms at the local level. Efforts will also be undertaken to upgrade technology in enterprises judged to be viable in the new market environment, mostly through encouraging foreign direct investment. A program loan to support reforms in the industrial sector is currently being processed by the AsDB.

47. The energy sector, which will remain mainly under state ownership in the near term, will continue to receive special emphasis. For the mainly coal-based power plants, short-run priority has been given to facilitating coal production through donor-financed imports of new equipment needed for mining and coal transport. The import costs for electricity procured from the Russian grid will be passed through to energy tariffs. A system of energy audits of major enterprises to identify additional methods of conserving energy will be developed, with assistance from the AsDB, for introduction in 1994. As more urgent sectoral problems are overcome, the Government intends to produce, with donor assistance, a comprehensive energy assessment to identify longer-term investments and policies in the sector. Among possible investment projects, the Government is conducting a feasibility study of the Egiin Gol hydropower project with technical assistance from the AsDB. In this connection, the development of an integrated tariff structure, which would be set so as to cover fully both operating and capital costs, will be required. A study of power tariffs being undertaken by the AsDB and related efforts will provide a basis for meeting this requirement. In planning policies and investments, environmental considerations will play a crucial role.

48. Mongolia's complete dependence on imports to meet its needs for petroleum products places a heavy burden on the balance of payments and has made the economy especially vulnerable to supply interruptions and shortages. Accordingly, the Government is reviewing its petroleum supply and distribution system with a view to rationalizing the use of petroleum products and improving procurement, transport, and storage to limit supply interruptions. Prices of petroleum products will be adjusted to fully cover costs, including full and immediate pass-through from exchange rate depreciation, in order to promote conservation and to provide resources for improving transport and storage facilities. Consideration will also be

given to the imposition of an excise tax on petroleum products to further encourage conservation and provide additional revenues to the budget.

49. Mongolia is endowed with mineral deposits such as copper, molybdenum, fluorspar, silver, gold, and coal. There is potential for exploiting additional mine sites and for processing ore to higher-value products, but given the scarcity of domestic financial resources and Mongolia's limited external debt-servicing capacity, realization of this potential will depend heavily upon the ability to attract foreign investment. A study of the mining sector is being carried out in collaboration with the World Bank with a view to developing a long-term plan for the sector and proposals for immediate action.

50. Erdenet mining company, which produces copper and molybdenum concentrates, was the source of about half of Mongolia's exports in 1992. In 1991, production declined sharply as a result of difficulties in electricity supply and shortages of spare parts. This decline was partially reversed in 1992, and production is expected to reach 90 percent of capacity in 1993. Given the high transportation costs to remote smelters and final consumers and the declining copper ore quality, significant growth of exports from Erdenet beyond current capacity is unlikely in the medium term. The Government is formulating a plan to address long-term problems in the copper sector based on the study completed by the World Bank under its Technical Assistance Credit. In this regard, specific measures to offset the decline in copper ore grades will be implemented. Particular importance is given to research at company level and more effective management.

51. The limited development of transportation facilities in Mongolia constitutes a major obstacle to the expansion of domestic and external markets over the medium term. The bulk of foreign trade is transported over the rail network through Russia and China. Agreement has been reached to secure Mongolia's access to the port of Tianjin in China but differences in gauges between Mongolia and China create bottlenecks at the border and the intensive use of Chinese railways leaves little spare capacity for transit traffic. Investment to ease the difficulties caused by the differences in rail gauges is being sought, and railway rehabilitation will be financed by a concessional project loan from Japan. Mongolia has air links only with Russia and China, but has initiated intensive negotiations to establish air links with other countries in the region. The AsDB is expected to provide project assistance to improve airport facilities. Nearly three fourths of domestic freight is carried over the extensive road network; however, the condition of the network is poor with only 3 percent of the total paved. The rapid increase in private motor vehicles and the prospective privatization of some transport corporations should ease some of the constraints on the domestic transportation system. Assistance is being provided by the AsDB for a Road Master Plan feasibility study and the AsDB's project pipeline includes projects for road development. In addition, a prospective project financed by the World Bank, including assistance for workshops, would also help Mongolia to remove bottlenecks in road and rail transport. An action program to implement the recommendations of a study conducted with

World Bank technical assistance on road user charges and railway tariffs will be adopted by end-1993. In addition to addressing critical bottlenecks, the Government intends to draw up a medium-term strategy for the development of the sector, which can serve as a basis for seeking additional external financial assistance.

52. Extremely limited internal and external communication links also hamper Mongolia's efforts to expand commercial and other contacts with the outside world and delay the transmission of official, commercial, and personal information. To improve the institutional capacity of the Mongolian Telecommunication Authority (MTA), postal, telecommunication, and broadcasting transmission services have been separated, leaving the MTA as a policy making body. The Government is also actively negotiating contracts with other Asian nations and France for the development of a modern telecommunications network. A medium-term strategy for the further development of the communication sector is being drawn up with AsDB technical assistance as a basis for seeking further external financial assistance.

IV. Social Safety Net and Human Resource Development

53. The abrupt reduction in external financing, the disruption in external trade, and the transitional difficulties associated with the transformation to a market economy have resulted in a significant decline in living standards for the Mongolian population and are contributing to rising unemployment. To help mitigate the effects of unemployment, the Government in 1990 instituted grants for civil service workers losing employment as a result of rationalization of government agencies, and in 1991, instituted a system of severance pay financed by employers. All employers are required to transfer the equivalent of five months' salary of dismissed workers to employment centers, which use these funds to pay modest unemployment benefits and to provide job information, job training, and job creation services. The Government intends to restructure its current system of social benefits to improve targeting and to provide support for self-employment, job creation, and expanded job training while eliminating remaining generalized price subsidies. In order to identify vulnerable groups--a crucial part of this effort--the Statistical Office has developed a measure of minimum living standards and established an objective measure of poverty. Assistance will be sought from international organizations such as the International Labor Organization, the World Bank, and the AsDB to improve the statistical base for measuring poverty. The Government welcomes an expanded role for nongovernmental organizations in providing assistance to vulnerable groups of the population and, to facilitate their work, plans to establish a national registry of these agencies by mid-1993. The AsDB is preparing a livelihood project targeted to provide small-scale financial support for economic activities undertaken by the poorest groups.

54. A strategic review of the delivery and finance of health services is being undertaken with the collaboration of the World Health Organization. High priority in the provision of health services will be given to maternal

and child health protection, elimination of malnutrition, reduction in mother and infant mortality rates, and reduction of illness from communicable diseases. Intensive family planning campaigns are being programmed to reduce the high rate of abortions and the associated maternal mortality. Donor assistance is being sought to finance the introduction of new methods of improving cost effectiveness and cost recovery. A training program will be initiated in 1993 to improve medical diagnosis and drug prescription practices as a means of improving the efficiency of treatment and reducing overuse of drugs and injections. Some cost recovery for hospital food and medicines will be introduced for patients with incomes above the poverty line. The Government plans to replace the present system for financing health expenditure by a national health insurance fund financed by employer and employee contributions that will gradually permit coverage for the entire population, while continuing to finance preventive health care and maternity services directly from the budget. Private medical practice is now permitted and efforts will be made to privatize auxiliary services of health facilities to improve their efficiency.

55. Educational policy is being refocused to emphasize training for enhancing job-specific skills within the context of the move to a market economy and to provide greater basic educational and training opportunities for youth in rural areas. Private schools are now permitted. Efforts are being made to establish vocational, production, and professional training centers, including professional schools attached to enterprises. The curricula of technical schools and institutes are being reorganized and upgraded. Greater emphasis will be placed on providing more opportunities for university level training within Mongolia and upgrading such training to international standards while simultaneously seeking donor support for new scholarships. The concept of assigning user fees and charges for public services, which began in the 1992 budget, will be expanded. Several measures are being taken to contain budgetary outlays on education, including the planned introduction in 1993 of a student loan program in place of stipends for post-secondary students while retaining a limited program of merit-based scholarships. Efforts to reduce administrative costs, including through restructuring of schools, are also being undertaken. To ensure that the poorest segments of society are protected, budgetary priority will be given to primary education.

V. Environmental Considerations

56. The Government is committed to limiting adverse environmental effects associated with economic activities. An environmental action plan is being prepared and is expected to be completed in early 1994. The action plan will focus mainly on measures to protect the environment from negative aspects of mining exploration, to stop soil erosion, and to reduce air and water pollution in urban areas. To maintain and protect pasturelands, the Government intends to restore exhausted areas through encouraging fertilization and the growth of protective vegetation, and reintroducing more traditional forms of livestock breeding while restricting the expansion of

crop cultivation on fragile pastureland. The phasing out of subsidies on fodder transport is expected to result in the relocation of livestock to areas best suited as pastureland. A rangeland management study will be initiated during 1993 and will address environmental issues. Greater attention will be given to protecting and conserving the supply of fresh water, recycling industrial and household wastewater, and introducing water meters in urban areas to conserve household use of water. Urban planning will also focus on improving sanitation facilities for sewage collection and disposal. Better methods for valuing and pricing the use of water will be instituted, and some inefficient irrigation systems will be closed down. Efforts will also be made to foster improved use of forestry resources through the promotion of reforestation, better forestry management, and other measures, and to preserve natural balance in the Gobi area through afforestation and encouraging protective vegetation along river valleys. In this connection, AsDB assistance will be provided for afforestation. To reduce air pollution, the use of "scrubbers" will be reinstated in electricity plants by end-1993. As sound environmental management in Mongolia is hampered by an inadequate natural resource data base and limited data analysis capacity, technical assistance has been extended by the AsDB to strengthen environmental assessment procedures, by DANIDA on soil erosion, and by JICA on urban water pollution.

VI. External Financing Requirements

57. Mongolia will continue to require substantial inflows of foreign assistance in the form of grants or highly concessional credits to support economic recovery. In 1993, the external current account deficit (excluding official transfers) is expected to be about \$110 million, and total financing requirements (including the settlement of short-term debt obligations and external arrears) are estimated to total about \$225 million (Table 2). Disbursements from existing and prospective commitments of bilateral donors amounting to about \$155 million and disbursements from multilateral institutions other than the Fund, totaling \$40 million, would meet the bulk of these requirements, with the remainder covered by debt rescheduling and a small amount of foreign investment. During the period 1994-96, the current account deficit excluding official transfers is expected to widen to about \$130 million a year. On this basis, gross external financing requirements through 1996, including planned increases in international reserves, are anticipated to amount to some \$530 million. Based on donors' current plans and commitments, about \$190 million of the financing requirement is expected from disbursements of resources from multilateral institutions other than the Fund, \$165 million in assistance from bilateral donors, and \$20 million from inflows of foreign direct investment. The International Development Association (IDA) and the AsDB have each committed \$30 million of quick-disbursing assistance for 1993-94. At the May 1992 meeting of the Mongolia Assistance Group, indications also made by the IDA and AsDB to help meet Mongolia's large infrastructural requirements are projected to result in disbursements of some \$30 million and \$70 million of project financing, respectively, during 1994-96. In addition, disbursements under prospective

new project commitments from multilateral donors are projected at \$60 million during 1995-96. Fund support will be provided in the form of a three-year ESAF arrangement, the resources from which would be used for the replenishment of Mongolia's external reserves.

58. Additional unidentified resources of some \$110 million will need to be raised to meet the remaining unfilled requirement. It is expected that these gaps would be filled by a combination of donor assistance and rescheduling of external debt obligations. Approaches have been made to bilateral donors to mobilize additional concessional assistance and to a number of creditors on a bilateral basis to seek relief from forthcoming debt service obligations and a meeting of Mongolia's bilateral and multilateral donors is planned for September 1993, at which time additional commitments of support in the form of grants and loans to be disbursed during 1994-96 will be sought. The realization of this financial support will depend to a large extent on the Government's ability to build up a large pipeline of projects for which external assistance will be necessary. Based on recent bilateral indications, the Government is confident that additional resources to meet the remaining financing gap of \$25 million for the 1993/94 program year will be secured.

VII. Implementation

59. The implementation of the medium-term program will require close coordination between all agencies involved with economic and financial matters, and, in particular, the Ministry of Finance, the Bank of Mongolia, the Ministry of Trade and Industry, and the National Development Board, which is responsible for overall macroeconomic planning and public investment. To facilitate this coordination, an interagency committee will be established under the office of the Prime Minister. The implementation capacity of the economic agencies is being supported through the placement of long-term advisors from the IMF and the United Nations Development Program under an IDA technical assistance project.

Table 1. Mongolia: Summary Description and Timetable of Macroeconomic and Structural Adjustment Measures, 1993-96

Objectives	Strategies and Measures	Timing
<u>Budget</u>		
Strengthen framework for implementing fiscal policies	Contain overall fiscal deficit to 15 percent of GDP by 1996 while improving the current fiscal balance by 1 percent of GDP each year	1993-96
	Introduce quarterly reporting of budgetary expenditure by function and by type	1993
	Initiate legal and administrative preparations for independent external audit and streamline internal audit procedures	1993
	Incorporate cost and financing of public sector projects, except for those of fully operational public enterprises, into the budget	January 1994
Establish modern tax system and broaden revenue base	Introduce customs valuation code	1993
	Establish appropriate rules for depreciation and asset revaluation for corporate income tax purposes	1994
	Modify corporate income tax to achieve greater uniformity in rates	1995
	Modify personal income tax to incorporate uniform global schedule for all income sources	1995
Limit and restructure budget expenditures	Hold increases in the civil service wage bill and the minimum wage below rate of inflation	1993-96

Table 1. Mongolia: Summary Description and Timetable of Macroeconomic and Structural Adjustment Measures, 1993-96 (continued)

Objectives	Strategies and Measures	Timing
Limit and restructure budget expenditures	Phase out subsidies on urban transport and fodder transportation	1993-95
	Standardize pension retirement ages and limit early retirement benefits	1994-95
	Restructure nonpension social security benefits to improve targeting	1993
	Introduce insurance schemes with employer and employee financing for medical services, workers' compensation, unemployment, and pensions	1994-95
<u>Investment program</u>		
Improve process of establishing public sector investment priorities	Prepare rolling three-year public sector investment program in agreement with World Bank	1993-96
<u>Monetary system</u>		
Improve effectiveness of monetary policy	Phase out government direction of credit to state enterprises	1994
	Maintain interest rates positive in real terms	1993-96
	Establish National Payments Council, chaired by the Bank of Mongolia (BOM), to improve collaboration with banks in developing new banking instruments	By mid-1994
	Initiate open market operations	1995
Strengthen financial position and efficiency of banking system	Identify nonperforming and substandard loans on commercial bank books	1993

Table 1. Mongolia: Summary Description and Timetable of Macroeconomic and Structural Adjustment Measures, 1993-96 (continued)

Objectives	Strategies and Measures	Timing
Strengthen financial position and efficiency of banking system	Implement procedures to deal with problem loans, including through loan-loss provision and asset substitution (e.g., central government bonded debt)	1993-96
	Pass permanent central bank statute	1993
	Strengthen Mongolbank's supervisory audit and review functions, including on-site supervision of commercial banks	1993
	Establish and operate a training center, jointly supported by the central bank and commercial banks, to strengthen training of commercial bank staff in accounting, bank supervision, credit appraisal, and analysis	1993-96
	Develop and implement program for dealing with issue of uncovered resident foreign exchange claims on banking system	1993
<u>External</u>		
Maintain liberal trade and exchange system	Avoid recourse to export quotas, taxes, bans, and minimum export prices, and restrict the scope of export licensing to items for cultural and conservation purposes	1993-96
	Review export licensing of live animals, meat, and wheat	December 1993
	Avoid imposition of quantitative restrictions on imports, and further licensing of imports, except for drugs, explosives, chemicals	1993-96

Table 1. Mongolia: Summary Description and Timetable of Macroeconomic and Structural Adjustment Measures, 1993-96 (continued)

Objectives	Strategies and Measures	Timing
Maintain liberal trade and exchange system	Maintain relatively low, uniform rate of import duty	1993-96
	Reduce reliance on barter trade arrangements, and diversify trade toward convertible currency countries	1993-96
	Phase out centralized distribution of imports except for petroleum products and some grant-financed emergency imports	December 1993
	Transfer registration of exports for statistical purposes to Customs Administration	December 1993
Exchange rate policy	Maintain a unified exchange rate system, under which the exchange rate is determined on the basis of transactions in the foreign exchange market	1993-96
	Pass foreign exchange law, based on principles of market determination of the exchange rate and current account convertibility	December 1993
Other external policies	Eliminate external arrears	June 1994
Improve management of external debt and capital flows	Develop and implement procedures for coordinated review and approval of all new public external debt	1993
	Develop and maintain debt register for monitoring all existing and future external debt, both public and private, including information on terms and repayment schedules	1993-96

Table 1. Mongolia: Summary Description and Timetable of Macroeconomic and Structural Adjustment Measures, 1993-96 (continued)

Objectives	Strategies and Measures	Timing
Improve management of external debt and capital flows	Establish comprehensive and transparent regulations for implementation of new foreign investment law based on streamlined procedures	1993
<u>Economic data</u>		
Improve effectiveness of macroeconomic management	Establish flash reporting system for key macroeconomic and financial data	July 1993
<u>Accounting</u>		
	Develop national accounting standards and apply these standards initially to selected state enterprises; upgrade system of reporting key indicators of the operations of public enterprise, including commercial banks	Mid-1994
	Extend application of accounting standards to all PSEs	1995
	Require commercial banks to publish balance sheets and income statements	1994
<u>Prices and distribution</u>		
Liberalize prices and improve resource allocation	Replace consumer rationing with system of need-based support	End-1993
	Establish regulatory commissions, including representation from public and private sectors, to set tariffs for public utilities and services	Mid-1994
<u>Privatization</u>		
Promote privatization of state-owned assets	Initiate privatization of buildings and urban land	End-1993

Table 1. Mongolia: Summary Description and Timetable of Macroeconomic and Structural Adjustment Measures, 1993-96 (continued)

Objectives	Strategies and Measures	Timing
Promote privatization of state-owned assets	Complete voucher privatization of enterprises under current law	End-1993
	Enact securities law to provide basis for stock market regulations and secondary market trading in corporate shares	March 1994
<u>Agriculture</u>		
Improve supply response and rationalize use of inputs	Implement phased program for cost recovery of veterinary services	1993-95
<u>Industry</u>		
Restructure and rationalize operations of state enterprises	Set up mechanism for identifying and closing nonviable state enterprises	1993
	Implement mechanism for closing nonviable state enterprises	1993-96
	Establish budgetary oversight of finances of enterprises reserved for state ownership	1993
<u>Energy</u>		
Set priorities for energy development and rationalize energy prices	Implement integrated energy tariff structure	1994
	Develop and implement system of energy audits	1994
	Develop strategy for petroleum procurement, storage, and distribution	1994
<u>Mining</u>		
Set priorities for mining development	Complete review to develop sector master plan	1993

Table 1. Mongolia: Summary Description and Timetable of Macroeconomic and Structural Adjustment Measures, 1993-96 (concluded)

Objectives	Strategies and Measures	Timing
<u>Transport</u>		
Improve the use of transport services	Implement a national tariff policy on transport services	1994-95
<u>Social policy and human resource development</u>		
Cushion negative effects of transition to market economy and provide ongoing social safety net	Restructure and improve targeting of social benefits	1993-95
	Provide training for improved medical diagnosis practices	1993-95
	Promote family planning	1993-95
Rationalize use of educational resources	Introduce university tuition, student loan program, and needs-based criteria for financial support to post-secondary students	1993-94
	Reduce ratio of administrators to teachers	1993-94

Table 2. Mongolia: Key Economic Indicators, 1990-96

(In percent, unless otherwise indicated)

	1990	1991 Est.	1992 Est.	1993 Prog.	1994 Prog.	1995 Prog.	1996 Prog.
Real GDP growth	-2.0	-9.9	-7.6	-1.3	2.5	3.5	4.5
GDP deflator	-0.5	100.6	195.7	330.9	51.5	13.3	7.2
Consumer prices (period average)	...	120.2	202.5	291.3	51.5	13.3	7.2
Consumer prices (end period)	...	208.6	321.0	195.5	20.4	9.5	6.3
Gross capital formation/GDP	42.3	28.9	14.5	22.1	26.8	27.8	28.7
Foreign savings/GDP	27.1	16.7	3.5	13.1	17.0	16.7	15.5
National savings/GDP	15.1	12.2	10.9	9.1	9.8	11.1	13.3
Fiscal revenue/GDP	50.6	47.4	22.8	23.4	23.8	24.7	25.4
Current expenditure/GDP	51.9	51.7	21.6	21.2	20.5	20.5	20.1
Current account/GDP (deficit -)	-1.3	-4.3	1.3	2.3	3.3	4.3	5.3
Overall balance/GDP (deficit -)	-13.5	-9.7	-10.0	-23.4	-24.4	-17.9	-15.0
Bank financing/GDP <u>1/</u>	5.7	-1.1	-1.7	0.6	-1.0	-0.8	-0.4
Broad money	10.8	76.0	31.6	168.2	38.8	27.3	19.0
Net domestic assets	18.9	74.3	36.5	80.5	21.0	12.6	6.7
Domestic credit	11.3	68.0	47.8	81.2	35.4	14.2	11.6
Credit to Government (net) <u>2/</u>	29.1	-14.6	-53.9	-58.8	-86.0	-41.6	-18.2
Credit to nonbanks	0.9	58.3	48.6	78.1	41.5	18.6	12.9
Income velocity	1.9	1.9	4.0	6.3	7.0	6.5	6.1
Export volume growth	-38.8	-13.0	11.0	2.6	3.1	4.4	5.3
Import volume growth	-41.6	-48.7	-17.3	8.0	3.5	3.5	3.5
Change in export prices (In terms of U.S. dollars)	-8.7	-10.5	-7.5	1.5	-3.7	0.9	1.5
Change in import prices (In terms of U.S. dollars)	-8.3	-4.5	-3.5	2.5	2.0	2.0	2.0
Terms of trade	-0.3	-6.2	-4.1	-1.0	-5.6	-1.1	-0.5
External current account (US\$ mn.) <u>3/</u>	-651.4	-160.5	-72.5	-110.7	-126.8	-131.4	-130.5
External current account/GDP	-29.1	-17.0	-5.6	-17.2	-19.6	-19.0	-17.6
Current account/current account receipts	-130.8	-43.0	-18.5	-27.3	-30.9	-30.3	-28.1
Gross international reserves (US\$ mn.) <u>4/</u>	177.4	126.2	53.9	65.9	96.3	113.0	121.2
(In weeks of imports)	9.0	13.1	7.0	8.2	10.7	11.9	12.1
Net international reserves (US\$ mn.) <u>4/</u>	49.3	20.5	14.4	16.6	26.6	36.6	46.6
(In weeks of imports)	2.5	2.1	1.9	2.0	3.0	3.9	4.7
Debt service (US\$ mn.) <u>5/</u>	...	15.8	44.6	90.9	28.4	31.9	33.9
Of which: Amortization	...	10.9	28.8	75.5	18.7	22.2	24.4
Debt service ratio <u>5/ 6/</u>	...	4.2	11.4	22.4	6.9	7.4	7.3
Of which: Amortization	...	2.9	7.4	18.6	4.6	5.1	5.3
External debt (US\$ mn.) <u>7/</u>	128.1	236.3	341.8	385.6	524.2	626.6	728.5
Medium-term	--	156.0	248.0	336.3	454.5	550.2	653.9
IMF	--	16.1	18.9	31.7	52.1	58.8	57.0
Short-term	128.1	64.2	74.9	17.6	17.6	17.6	17.6
External debt/GDP <u>3/</u>	5.7	25.0	26.5	60.0	81.0	90.8	98.0
External debt/current account receipts <u>7/</u>	25.7	63.3	87.4	94.9	127.9	144.6	157.1

Sources: Data provided by the Mongolian authorities; and staff estimates and projections.

1/ Includes bank financing for off-budget projects.

2/ Excludes bank financing for off-budget projects.

3/ Excludes official transfers.

4/ Figures after 1992 represent those held by the Bank of Mongolia only.

5/ Excludes servicing of medium- and long-term debt obligations in transferable rubles to former CMEA members.

6/ In relation to gross current account receipts.

7/ Excludes debt obligations to former CMEA members (see footnote 1).

Table 3. Mongolia: External Financing Requirements, 1990-96

(In millions of U.S. dollars)

	1990	1991 Est.	1992 Est.	1993 Prog.	1994 Prog.	1995 Prog.	1996 Prog.
Current account deficit, excluding official transfers ^{1/}	651	160	73	111	127	131	131
Amortization ^{1/}	21	9	26	25	26	18	7
Changes in gross international reserves	-102	-51	-72	25	30	17	8
IMF repurchases	--	--	--	--	--	9	9
Other reserve liabilities	48	38	69	--	--	--	--
Arrears (reduction -)	--	-63	12	36	16	--	--
Short-term capital, including errors and omissions	-73	101	69	29	5	-5	--
Total financing requirements	<u>545</u>	<u>194</u>	<u>177</u>	<u>226</u>	<u>204</u>	<u>170</u>	<u>155</u>
Financing sources	<u>545</u>	<u>194</u>	<u>177</u>	<u>226</u>	<u>153</u>	<u>145</u>	<u>120</u>
Disbursements from:							
Existing commitments	545	194	159	166	76	45	38
Loans and grants	545	179	153	166	76	45	38
Loans	537	135	112	106	74	45	38
Multilateral	0	10	42	41	65	35	28
Bilateral	537	125	70	65	9	10	10
Grants	7	44	41	60	2	--	--
Foreign direct investment	--	--	2	--	--	--	--
IMF (Stand-by arrangement)	--	15	4	--	--	--	--
Prospective new commitments	--	--	--	33	50	82	83
Loans and grants	--	--	--	30	45	75	75
Official loans	--	--	--	2	25	55	55
Multilateral	--	--	--	--	--	30	30
Bilateral	--	--	--	2	25	25	25
Grants	--	--	--	28	20	20	20
Foreign direct investment	--	--	--	3	5	7	8
Total disbursements	545	194	159	199	126	127	121
Rescheduling	--	--	18	14	7	3	-9 ^{2/}
Prospective ESAF	--	--	--	13	20	15	8
Remaining financing gap	--	--	--	--	<u>51</u>	<u>25</u>	<u>35</u>

Sources: Data provided by the Mongolian authorities; and staff estimates and projections.

^{1/} Excludes effects of debt relief from rescheduling.

^{2/} Increase in debt service due as a result of rescheduling in 1993.