FOR AGENDA

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September 16, 1991

To: Members of the Executive Board

From: The Secretary

Subject: Mongolia - Memorandum on Economic Reform and Medium-Term Policies

There is attached a memorandum on economic reform and medium-term policies prepared by the Mongolian authorities in collaboration with the staffs of the Fund and World Bank. This is a companion document to the staff report for the 1991 Article IV consultation with Mongolia and Mongolia's request for a one-year stand-by arrangement (EBS/91/156, 9/11/91), which is scheduled for discussion on Friday, October 4, 1991.

Mr. Leimone (ext. 7315) or Ms. Milne (ext. 7328) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

MONGOLIAN PEOPLE'S REPUBLIC

Memorandum on Economic Reform and Medium-Term Policies

Prepared by the Mongolian Authorities, in Collaboration with the Staffs of the Fund and the World Bank 1/

September 10, 1991

I. Introduction

1. Because of its status as a large, landlocked country bordered exclusively by the U.S.S.R. and China, the Mongolian People's Republic 2/ has been largely isolated from most of the outside world. In addition to its external isolation, Mongolia's economic development has been hampered by high infrastructural costs that reflect a small, widely dispersed population (2.1 million), large expanses of mountainous or arid territory, and extreme climatic conditions.

2. Mongolia has limited experience with private markets, having moved from a feudalistic economy based almost exclusively on nomadic animal husbandry to a centrally planned economy, which stressed the development of mineral resources and the establishment of an industrial base. External trade has been conducted largely with other centrally planned economies, principally the U.S.S.R. Exports consist mostly of animal by-products and minerals; imports consist mostly of petroleum products, capital goods, and some consumer goods. Mongolia has also relied heavily upon the U.S.S.R. for technical expertise and financing to support its development.

3. Following high rates of growth in investment and output and rapid structural changes during the 1970s and early 1980s, serious economic problems became apparent by the second half of the 1980s. Increasing resource distortions, rising domestic and external imbalances, inadequate jobs for new entrants into the labor force, and a rapid accumulation of external debt, mainly to the U.S.S.R., became increasingly evident. In response, the Government took modest steps to improve economic management and reduce central control as a means of improving the efficiency of the

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1/ The staff of the Asian Development Bank (AsDB) assisted in the preparation of this paper on sections relating to sectoral policies and programs where AsDB staff has been concentrating their work and the AsDB is expected to play a major role in providing financial and technical assistance.

2/ Referred to hereafter as Mongolia.

command economy. Although reforms focused primarily on reduction and consolidation of the bureaucracy, the scope for market activity was increased moderately, and efforts were made to expand external trade with the convertible currency area. Notwithstanding these reforms, socioeconomic tensions intensified, the budgetary position weakened further, and foreign debt continued to mount.

4. These factors contributed importantly to the political turmoil that led to the establishment of a reformist government in March 1990 followed by Mongolia's first multiparty elections in July of the same year. Together with introducing new political and religious freedoms, the newly elected government embarked on a comprehensive program of economic transformation aimed at moving toward a market-oriented economy. The three-year program seeks to expand the role of the private sector, diversify the economic base, promote trade with and encourage foreign investment and technology transfer from the convertible currency area, and move toward a system dependent upon indirect tools of economic management. Reforms have been initiated in the areas of prices, banking, and the budget, and various legal and institutional changes aimed at increasing the scope of market transactions and encouraging private economic activities have been taken. To strengthen the external position, the tugrik was devalued against the U.S. dollar in July 1990 followed by further large devaluations in April and June 1991, and negotiations were concluded with Japan, the United States, and Korea for most-favored-nation status. Negotiations were also initiated with the U.S.S.R. to resolve the external debt overhang and are continuing. Agreement has been reached on the principle that debt service requirements would not be damaging to the Mongolian economy.

II. The Current Economic Crisis and Problems of Transition

5. The reform process has begun under adverse circumstances. Growth in most sectors of output turned negative in 1990, reflecting disruptions during the period leading up to elections, and a decline in Mongolian exports by over 40 percent during the year, in part because of deteriorating terms of trade and in part because of economic difficulties within the U.S.S.R. and other (former) CMEA trading partners, and weakness in demand for Mongolian products in the convertible currency area. The impact on growth has been exacerbated further by disruptions stemming from the shift to a new system of international pricing and payment in convertible currencies between the former CMEA members, resulting in severe shortages in many critical imported supplies and production bottlenecks, especially in the electricity and mining sectors, and in reduced demand for Mongolian exports. In 1991, these disruptions, combined with a halt in new financing from the U.S.S.R., have led to a sharp decline in Mongolia's total external trade. Trade reverted to de facto barter in which copper and other mineral exports to the U.S.S.R. are exchanged for imports of petroleum products and some consumer goods. By July, this arrangement had been formalized under a new bilateral agreement covering the remainder of 1991. The continued sharp

decline in economic activity, combined with cutbacks in government employment, has also contributed to an increase in unemployment.

6. Beginning in 1990, credit began to expand rapidly. In the wake of the abrupt reduction in the level of external financing, most of which went to finance public enterprises and the fiscal deficit, net domestic bank credit increased by 11 percent in 1990, compared with 2 percent in 1989, to cover the financing shortfall, and accelerated to over 175 percent at an annualized rate in the first half of 1991. In the face of rapidly increasing credit demand, monetary policy retained its traditional passive stance, pending the completion of reforms aimed at creating a two-tier banking system and establishing a strong central bank with adequate instruments of monetary and prudential control. As prices remained controlled throughout 1990, inflationary pressures created by the accelerating credit expansion were reflected in mounting shortages. Despite price adjustments to eliminate many subsidies and the doubling of some prices in early 1991, together with the liberalization of others, shortages of goods have continued.

III. Policy Framework for 1991-94

Medium-term economic strategy

7. The Government's current economic strategy is based on three main principles: (a) stabilization of the economy; (b) implementation of a broad range of structural reforms aimed at improving market signals, strengthening their effectiveness and providing the basis for a strong increase in the share of the private sector in economic activity to place Mongolia on a new market-oriented development path; and (c) opening of the economy and diversification of external economic relations to reinforce the shift to a market orientation. In the implementation of this strategy, due regard will be given to critical social and environmental concerns.

8. The main objectives of the three-year program are to arrest the current economic decline while setting the stage for sustained recovery, to contain inflation, and to make progress toward balance of payments viability. By the end of 1994, the program aims at restoring modest economic growth and establishing the stable economic environment necessary for stronger output increases and improved living standards over the medium term.

9. As the restoration of economic and financial stability is considered to be a necessary condition for sustained economic transformation, the program will give priority to checking demand pressures while seeking to increase supply over the medium term through maintaining the momentum of reforms. Demand management policies will focus on containing the fiscal deficit and on implementing tight monetary and credit policies. To strengthen demand management, reforms will be introduced to replace instruments of direct control with indirect instruments of macroeconomic management suitable for a market-oriented economy. The key to improving supply is the implementation

of a broad range of structural reforms of production and distribution designed to create a market-based economy, stimulate the growth of private sector activity, and foster competition. The principal features of the reform of production and distribution are privatization of state assets and liberalization of the external trade and payments system, with price liberalization and elimination of the state order system to be completed by the beginning of 1993. In addition, public enterprise operations are to be strengthened through granting broad operating autonomy and improving managerial efficiency until these enterprises can be privatized. The efficiency of investment is to be improved by establishing a system of priorities for public investment, placing reliance on the private sector for new investment in productive sectors, and encouraging foreign direct investment as a means of acquiring access to more modern technology.

10. The reforms are based on the premise that a major increase in private participation in economic activity is essential to improving economic growth and efficiency over the long run. Thus, new private activity is to be fostered through the creation of a basic legal and regulatory framework establishing property rights, a bankruptcy process, antimonopoly controls, and the introduction of other requisite institutions. Meanwhile, based on the privatization law passed in June 1991, public assets will be shifted to private ownership and/or control through sales, leasing, and free distribution through auction in conjunction with the voucher (coupon) system. Barriers to entry and constraints on the operation of private enterprises and individual private economic activity will be eliminated.

11. While maintaining economic relationships with Mongolia's neighbors and traditional trading partners, the Government intends to open up the economy and diversify its external economic relations. The main objectives are to find new markets for exports as a means of stimulating domestic growth and improving the quality and choice of imports for investment and consumption, to obtain new sources of external financing and technical assistance, and to encourage foreign direct investment in Mongolia.

12. In recognition of the short-run difficulties of the transition to a market-oriented economy, programs will be put in place to protect low-income population and to alleviate the impact of unemployment. Such efforts will concentrate on improving the social security and welfare system, providing cash transfers to vulnerable groups, and creating special programs for promoting employment. Efforts will also be made to improve health care and disease prevention while giving special priority to modernizing and reforming the educational system to provide job skills required by a market-oriented economy.

Macroeconomic objectives

13. The program would aim at halting the deterioration in economic growth and checking the acceleration of inflation in 1992, and restoring modest economic growth of 3-4 percent by 1994. The rate of inflation would be reduced significantly during 1992-93 and, by 1994, would be brought in line

with inflation levels in trading partners. The sharp compression in imports will result in a shrinkage of the current account deficit in the balance of payments in 1991, and the deficit is expected to continue declining through 1994. Moderate increases in international reserves are envisaged from 1992 onward, and by 1994, net international reserves are expected to be at a level equivalent to two months of imports.

14. Economic recovery over the 1991-94 period is expected to be led by strong growth in the agricultural sector, as producer prices, distribution, and ownership of productive factors in this sector are liberalized. The services sector offers potential for significant gains in employment as new private activities develop. Output of traditional industries is expected to remain below capacity because of shortages of spare parts and raw materials and the closure of some noneconomic entities. Construction activities are not expected to rebound until the end of the program period, reflecting constraints on government spending and imports of key building materials.

15. In view of the sharp reduction in foreign savings envisioned during the program period, compared with earlier years, successful implementation of the program relies on a substantial improvement in domestic savings. Because of the very young population (over 50 percent aged below 20 years) and the low level (less than $500 per capita) and egalitarian distribution of personal income, the general government budget and state enterprises will initially have to be the primary source of increased domestic savings. In this connection, savings should be enhanced through reforms aimed at improving the operating efficiency of state enterprises and reducing their operating losses. Moreover, the new owners of privatized state enterprises will have greater incentives to save in order to raise their level of investment. Financial sector reform leading to the development of a modern two-tiered banking system and market-determined interest rates should also broaden and deepen financial savings.

16. As a major share of investment has traditionally been financed from external resources, the sharp drop in such financing and government efforts to restrain expenditure are expected to lead to a fall in investment in real terms in 1991 and 1992. Based on subsequent increases in domestic savings and some expansion in new sources of external financing, investment should pick up in 1993 and 1994. Government investment will be refocused from expanding productive capacity to the maintenance and development of infrastructure, leaving new investment in plant and equipment to be undertaken mainly by the private sector and revitalized state enterprises.

Key stabilization and structural policies

17. A major focus of the stabilization effort will be tight fiscal policies. The annual budget deficit, projected at about 14 percent of GDP in 1991, will be reduced substantially over the next two years to reach a level no higher than 9 percent by 1994. Recourse to domestic financing of the deficit will be minimized and, in any case, will be consistent with inflation, growth, and balance of payments targets. Budgetary investment

outlays will be refocused and closely linked with available external financing on concessional terms. Efforts on the revenue side will focus on establishing a market-oriented tax system and broadening the tax base.

18. Another focus of the stabilization effort will be tight control over credit growth to reduce inflationary pressure. Within overall credit targets, however, efforts will be made to provide an adequate share of credit available to newly emerging private sector activities. To reinforce credit policy and promote a more efficient allocation of investment resources, the central bank will seek, through its rate for bank advances, to achieve and maintain interest rates that are positive in real terms.

19. The reform effort will address all key areas--putting in place basic instruments of macroeconomic management, accelerating structural reforms designed to improve market signals and promote competition, and providing the basic framework for private sector activities. Among the highest priorities for reforms affecting macroeconomic management are prompt establishment of a fully functioning central bank and provision of tools adequate for conducting an active monetary and credit policy. Measures will be taken to restructure budgetary expenditures and to strengthen the monitoring and control of budgetary revenues and expenditures. The process of modernizing and broadening the tax base through the introduction of income, customs, and sales taxes will continue. The exchange and trade system will be improved to meet the needs of the economy. In the initial phase, the exchange rate will be used to provide a nominal anchor to help contain inflation. Structural measures include a phased deregulation of prices, to be completed by end-1992, and the removal of impediments to private sector participation in external trade and internal distribution. Initially, privatization measures will be focused on agriculture and associated transportation and distribution activities and small-scale enterprises largely in the services sector since these areas are considered to have the greatest potential for quick response in terms of expanding output and generating employment. The principal components of the basic legal framework for underpinning private markets will be enacted. Measures to assure a social safety net and to target income supplements will also be taken. Finally, steps are being taken to improve policy coordination.

Reforms for strengthening management of economic policy

Budgetary reforms

20. Budgetary reforms will have two principal aims: to modernize the tax system and to restrain expenditures.

21. Efforts to modernize the tax system and establish a broad and stable tax base will continue. The introduction of modern corporate and individual income taxes and a customs tariff in early 1991 will be followed by a sales tax in the 1992 budget and technical assistance will be sought for its full implementation by July 1992. The level of selective excise taxes will also be increased from October 1, 1991. The current system of automatic

deduction of income taxes on wages and tax registration of public and private enterprises will be maintained while a new system of individual taxpayers' identification numbers is established. Technical assistance will be sought with a view to completing this process by 1993. A number of improvements will also be made in the newly introduced income taxes and customs duties. A comprehensive set of regulations and procedures and a harmonized customs system will be drafted for consideration by parliament with a view to implementation in 1992. Customs inspectors will begin monitoring foreign trade organizations (FTOs) warehouses, and the Custom Affairs Department will be reincorporated into the Ministry of Finance. Additional technical assistance will be sought to sustain the momentum of tax reform.

22. The Government will introduce measures aimed at controlling the budget deficit, taking into account any external financing that may be channeled through the budget. Budgetary control will be strengthened and technical assistance will be sought to identify and implement measures toward this end. Restraint in expenditures will be focused initially on constraining investment and wages. Any increases in selected expenditure categories required to improve the existing social safety net for the poor will be financed by additional expenditure cuts in other categories or additional revenue measures. Consideration will be given to assigning user fees and charges for public services, starting in the 1992 budget. Budgetary outlays on education will be contained and new sources of financing of educational costs will be considered. Technical assistance is being sought for a World Bank educational sector study to identify means of employing educational resources more efficiently. The introduction, by 1993, of a national health program financed by employer and employee contributions will permit reductions in budgetary outlays for health services. The schedule of user fees on health services provided by the Government will be expanded, and the cost of medicine provided by hospitals and doctors will be equalized for population in urban areas, except for children. To mitigate the impact of the government wage bill on expenditure, administrative expenditure will be cut through the rationalization of government agencies and wage increases to government employees will be held below the rate of inflation. During the remainder of 1991, no additional wage or pension increases will be granted. Government wage levels will not be allowed to exceed levels for similar types of work in the private sector. As the functions of government are changing, some reallocation of employees will be required as some functions and agencies are abolished and new ones related to the management of a market-oriented economy are established.

23. New budgetary outlays for investment in production and distribution activities will be strictly limited and investment will be concentrated in social and economic infrastructure. A process has already begun to set priorities for public investments and steps will be taken to improve project management, control, and execution and to strengthen design capabilities. The Ministries of Finance and National Development will coordinate to set up an investment monitoring group to implement a system of investment procedures for this purpose, and technical assistance has been requested

toward this end. The overall level of government investment will be linked to the level of government savings and the availability of external and domestic financing, taking into account overall requirements for macroeconomic stability and balance of payments viability. The Government will also shift to public enterprises full responsibility for meeting debt service obligations on all their new external and domestic borrowing even if such funds are channelled through the budget.

Banking and financial sector reforms

24. To contain demand pressures and generate domestic financial savings, an active monetary policy will be implemented through the establishment of annual and quarterly financial targets consistent with the Government's inflation and growth objectives. The financial program will be implemented indirectly by setting quarterly targets on currency issue. These targets will be achieved through limits on central bank credit to commercial banks and branches of the (former) State Bank still under Mongolbank control, and to the central government, and by adjusting the central bank loan rate. In addition, cash reserve requirements, initially set at an average rate of 8.5 percent, will be assessed on nonbank deposit liabilities of commercial banks and remaining branches from September 1, 1991. The required reserves will be remunerated, and the reserve requirement will also serve prudential as well as monetary policy goals and should help strengthen confidence in the banking system. Branches of the (former) State Bank remaining with Mongolbank will be subject to the same treatment as commercial banks. Because of institutional considerations, however, a limit will be placed on the maximum size of loans made by these branches to a single borrower without head office approval. Steps will be taken to develop new instruments of monetary control and technical assistance is being sought from the Fund for this purpose.

25. The interest rate on the central bank overdraft facility was raised to 15 percent per annum on September 1, 1991, and this rate will be adjusted as needed to ensure real rates of interest by mid-1992. Under the banking law, commercial banks are free to set interest rates, but lack of experience and easy access to central bank credit has slowed banks' response. Thus, while maintaining a tight bank credit policy, Mongolbank will encourage banks to make rate adjustments. To measure inflation, selected retail prices have been collected since June 1991 and, with Fund assistance, efforts are being intensified to develop retail and wholesale price indices.

26. The program of base money control will need to be supplemented by administrative actions of the monetary authorities because of the instability of macroeconomic relationships, the lack of experience with financial programming, and interest-rate insensitivity of monopolistic state enterprises. The central bank will also introduce better statistical measures and accounting procedures in order to monitor the growth of money and credit. The central bank intends to establish a research department and has requested Fund assistance to train staff in macroeconomic principles and

monetary and financial programming. The AsDB will also provide technical support, particularly in training central bank staff.

27. During the program period, the financial sector reforms initiated in late 1990 will be deepened. Together with establishing a system of money and credit control, priority will be given to establishing a fully functioning central bank and creating a two-tier banking system, as provided by the new banking law effective May 1, 1991 and by statute of Mongolbank adopted by parliament in June 1991. Branches of the (former) State Bank will curtail new commercial lending operations, and by March 1992 most of their loan portfolios and personnel are expected to have passed to commercial banks. A program to deal with nonperforming and doubtful debts, as well as low fixed-interest loans still on the books of Mongolbank or unilaterally allocated to the commercial banks separated from the (former) State Bank, will be developed with technical assistance from the Fund for implementation in 1992. In the transition period and because of communications problems, some (former) State Bank branches in aimak centers 1/ will be maintained to assist local branch banks and to perform some supervisory functions. Mongolbank will also seek technical assistance to rationalize and simplify interbank clearing and payments arrangements.

28. The development of commercial banking also requires a significant strengthening of Mongolbank's supervisory capabilities. To this end, a new department of banking regulation and supervision was recently created and monthly reporting by commercial banks was instituted. Banks established before May 1 are being relicensed according to the new banking legislation. Any bank not having met the capital adequacy requirement will be combined with another bank. By end-1991, Mongolbank will have established key ratios and requirements related to capital adequacy, liquidity, loan size, sectoral concentration of credit, and internal control and supervisory activities. The authorities have requested long-term technical assistance from the Fund and other multilateral and bilateral donors to train staff and further develop the supervisory role of Mongolbank.

29. The authorities intend to enact companion legislation as required to support a market-based banking system. Company, privatization, and bankruptcy laws have already been implemented. During 1992 additional legislation will be considered by the parliament, including amendments to the criminal code to strengthen penalties to enforce the banking law; new laws on debt recovery, security to cover commercial lending, financial leasing, bills of exchange, truth-in-lending, and consumer protection; and the introduction of national accounting standards and establishment of a legal and regulatory basis for enforcing such standards.

1/ Administrative centers in the provinces.

External sector reforms

30. In light of fundamental changes in the trade relationships within the former CMEA area and, in particular, in Mongolia's trade relationship with the U.S.S.R., improvements in the balance of payments position will require a substantial diversification of external trade. The Government recognizes that, in order to expand trade through obtaining new markets and sources of supply, the participation in foreign trade by the private sector must be promoted actively in a market-oriented environment. An unencumbered trade and payments system and an active and realistic exchange rate policy will be crucial to achieving these objectives.

31. The Government has initiated a policy of decentralizing foreign trade activities by issuing trade licenses to private and public enterprises other than state FTOs engaged in direct production activities, although some public enterprises have been denied licenses to conserve foreign exchange access. Requirements to seek permission for individual trade transactions and for engaging in domestic procurement of exportable goods and marketing of imported goods will be eliminated. The system of mandatory state orders for exports will be phased out and state procurement agencies will be competing with other private and public agents to purchase goods to fulfill export contracts, including those associated with barter trade. The current foreign exchange allocation system will be replaced with an indicative import plan. The centralized distribution of imported inputs through FTOs, except for barter trade and emergency imports, will also be phased out, by permitting public and private economic agents to purchase goods directly. 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.

32. The Government recognizes that, in addition to an open foreign trade system, a basic element for encouraging foreign trade is a realistic exchange rate policy. Toward this end, the Government aims at managing the external position through appropriate stabilizacion policies rather than through administrative mechanisms. The Government will pursue the medium-term objective of letting market forces determine the level of the exchange rate. During the initial period of transition to a market-oriented economy, however, the Government will pursue a pragmatic approach by simplifying and improving the existing exchange rate system. Toward this end, the exchange rate applicable to transactions other than those for barter trade will be reviewed continually. A more appreciated exchange rate is applied in barter transactions. However, it is the intention of the Government to abolish this rate as soon as the trade relationship with the U.S.S.R. is normalized, and to the extent that transactions with the U.S.S.R. take place in cash, these will be effected at the official rate.

33. To encourage market development, the Government will implement a simplified foreign exchange surrender requirement, consisting of a uniform surrender requirement on traditional exports and tourism services, and zero on all other exports, to rebuild Mongolia's international reserves to an

appropriate level. Foreign exchange may be traded through the commercial banking system, and this will provide the basis for the development of a market for foreign exchange. Licensed commercial banks will be granted the right to operate in the foreign exchange market. Management of the country's international reserves will pass back to the central bank.

34. Virtually all of Mongolia's external debt obligations are owed to former CMEA members, primarily the U.S.S.R., and are 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. The modalities for servicing outstanding obligations, including the appropriate exchange rate for the transferable ruble, are presently under negotiation. Agreement has been reached, in principle, with the U.S.S.R. that future debt service will not impede Mongolia's economic development. It is the intention of the Government to seek restructuring of remaining debt-servicing obligations to minimize their impact on the balance of payments; however, resolution remains a mainly political rather than economic issue.

35. At present, Mongolia has only limited debt denominated in convertible currencies, and current debt service obligations are not excessive. As trade relations expand and are diversified, and in order to support the transformation process, it will be necessary to obtain external assistance from multilateral institutions, foreign governments, and private creditors. However, the debt service burden of such financing will be kept within manageable levels. Toward this end, external borrowing of the public sector (budgetary units, Mongolbank, state enterprises and cooperatives, including commercial banks) and private sector enterprises (including financial intermediaries) will be monitored closely by a debt monitoring committee established for this purpose. This committee will be supported by technical units located in Mongolbank and in the Ministry of Finance for separately monitoring short-term and medium- and long-term debt, respectively. Until such time as Mongolia's external financial position is more firmly established, the Government will refrain from short-term borrowing (credits with original maturity of one year or less) and/or guaranteeing of such loans, excluding normal trade credits. The contracting of public and publicly guaranteed loans in the medium-term maturity range on nonconcessional terms will be strictly controlled.

36. Recognizing that foreign direct investment is a source of non-debt-creating financing and can introduce beneficial effects through enhancing competition in the domestic market and contributing much needed technology, the Government enacted a foreign investment law in 1990. Efforts will be undertaken to rapidly develop the regulations and institutional framework for implementing the law and expediting procedures for prospective investors. In this connection, a foreign investment unit will be established to process applications for foreign investment in an efficient and expeditious manner and to serve as a channel for facilitating negotiations in connection with such applications. Repatriation of capital and remittances of profits/dividends will be unrestricted.

Reforms for improving production and distribution

Reform of prices, wages, and pensions

37. The Government has reduced controls on prices. The process of price liberalization started at the beginning of 1991, when a large number of prices were liberalized and prices of the 35 farm, industrial, and consumer product groups that remained subject to control were doubled. In July 1991 prices on agricultural produce were decontrolled; however, as a substantial number of contracts for procurement of agricultural goods were signed earlier in the year, the effect of this measure will be felt as new contracts are signed. Beginning October 1, 1991, at least one half of remaining controlled prices will be liberalized with a view to freeing all prices by the end of 1992, except for housing rents, public utility tariffs, and selected medicines. This list of controlled prices will be reviewed continually in light of the adequacy of supplies. The level and structure of tariffs and rates applied to public services will be reviewed and adjusted regularly, in line with price developments.

38. State procurement agencies will be required to compete with other private and public agencies for the purchase of goods and must pay freely negotiated prices. Other than the areas remaining subject to price controls, the Government will refrain from intervening in the price-setting process and will focus instead on fostering competition through divestiture of public enterprises and promoting private activities in trade, distribution, and commerce to mitigate elements of monopolistic pricing. In addition, legislation has been enacted to restrict monopolistic practices and limit trust activities.

39. The wage determination process will be decentralized and subjected to market forces. Except for setting a minimum wage, the Government will not interfere in the wage determination process in the private sector and will confine its control over wages to its own employees and employees of enterprises receiving budgetary transfers. Public enterprises, other than those receiving budgetary transfers, will be free to set wage rates of employees in line with market conditions and their own financial position, although the salaries for enterprise managers will be set by the Government. A tripartite commission, consisting of representatives of the Government, the state enterprises, and labor will be established to guide 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 civil service wages 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 at minimum retirement age will be raised to the poverty line. The wage scale of government workers will be restructured so that differentials are introduced reflecting conditions and responsibilities. The Government will set wages for its own workers in such a fashion as not to place upward pressure on wages for similar workers in the enterprise and private sectors. In order to promote a more efficient allocation of the work force, the

Government will review labor laws and restrictions with a view to removing barriers to labor mobility.

Privatization and reform of public enterprises

40. The promotion of private sector activities is a major pillar of the Government's economic strategy to move toward a market economy. Privatization has two basic components. The first involves the promotion of new private sector activities by providing the basic legal and institutional framework and eliminating barriers to entry and other impediments to the free functioning of private markets. The second involves restructuring and reforming public enterprises and converting them to private management and ownership.

41. The recent adoption by parliament of a company law and bankruptcy law, a consumer protection law, and an anti-monopoly law will be followed by the implementation of basic legislation covering contract law, a commercial code, and accounting standards. This legislation will assure parallel treatment for public and private enterprises so as to maintain a level playing field for conducting economic activity. Additional legislation conducive to the operation of free markets, including laws on land ownership, protection of intellectual property, standard measurements, and immigration will also be implemented. Licensing requirements or authorization for operating businesses or engaging in domestic or external trade in goods or services will be abolished, except for a simple registration procedure to monitor growth and facilitate taxation of new enterprises. Other barriers to private sector entry into specific areas of economic activity, or conducting private activity, except for health, safety, or environmental reasons will also be eliminated, excluding the production or trade in narcotics and other activities considered harmful to the public interest and activities associated with national security. Initially, special emphasis will be placed on eliminating barriers to private activity in the area of transport, distribution, and marketing. For this purpose, a review will be undertaken before the end of 1991 with World Bank collaboration to identify regulatory and other barriers to private sector activities and to develop an action program by mid-1992 to remove such barriers and to further develop appropriate incentives and the appropriate institutional framework for private sector development.

42. Existing enterprises in certain sectors of economic activity, namely in the energy sector, rail and air transportation, communications, the water supply, and the meteorological service will remain fully or majority-owned state property. In principle, the private sector would be permitted to start new enterprises in these areas. Other state-owned enterprises and property are being privatized through sale, leasing, or auction of property and ownership shares in conjunction with the privatization law passed in June 1991. Under this law, all existing enterprises have been required to reregister and the Government's ownership and control clearly established in order to forestall legal challenges to the privatization process. To facilitate the privatization process and to reduce the scope of monopolistic

control over specific sectors of the economy, the Government intends to break up a number of large enterprises into smaller operating units prior to privatization. However, some enterprises may require financial rehabilitation to make them more attractive to private owners. New enterprises and other property will be auctioned or sold for cash, but the principal vehicle for privatization will be auction through the use of vouchers distributed to each Mongolian citizen. These vouchers can be freely traded but their use is restricted to the purchase of state-owned property or shares of state enterprises. A portion of the shares of some public enterprises will be awarded to their workers, and in rural areas, leasing of state-owned property may be continued and leasing periods extended. Under the privatization law, agricultural cooperatives are free to determine their own methods for privatization or continued mutual association.

43. The privatization of small and medium-sized firms, which began in July 1991, will initially be emphasized as capital and/or vouchers necessary to acquire such firms are easier to amass and skills to manage them easier to acquire. By end-September 1991, the privatization of shares of large enterprises will begin. The privatization committee intends to announce lists of properties, enterprises, and shares to be privatized on a weekly basis. The process of privatizing enterprises and goods permitted under current law is expected to take three years to complete. 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 except in the case of joint ventures with foreign investors. Even in these cases, the guiding principle will be state ownership solely as a transitional mechanism until domestic private investors can be identified. Support to the private sector is also being given through technical support for the establishment of medium-sized and small industries, especially outside of large urban areas. During 1993 the privatization process will be reviewed with the aim of broadening its scope.

44. Efforts will be made to improve the efficiency of state-owned enterprises to enhance the prospects for their privatization. As the privatization process will require time and the state enterprise sector will retain an important share of output in the interim, improvements in their operational efficiency will also be crucial to mitigating the short-run adverse impact on output and inflation from the transition to a market-oriented economy. A basic element of these efforts will be the establishment of hard budget constraints on state enterprises through the phaseout of remaining subsidies and the elimination of automatic access to credit from the state-owned banking sector. Over the past several years, enterprises have been granted increased autonomy for deciding prices and composition of output, use of retained earnings, hiring and firing employees, and other operating decisions, but a significant portion of their investment has been provided from government resources. Beginning in 1991, state-owned enterprises are being made responsible for funding their own investment and assuming full obligation for servicing debt acquired from domestic or external sources. A mechanism will also be set up for closing down state enterprises that cannot be restructured into viable units in the new market

environment. The Government will also establish internationally acceptable accounting standards and require their application by public enterprises in producing financial statements that accurately reflect their operations. A pilot project for applying these standards will be started for three state enterprises by December 1991 and extended to a further nine enterprises by December 1992, based on the availability of technical assistance. Publications of summary financial statements for enterprises having adopted the standards will be made every six months beginning no more than six months after adoption.

45. A stock market, to begin operations in September 1991, is expected to facilitate the privatization of state enterprises through the sale and trading of shares. More importantly, over the longer term, the stock market should foster the accumulation of savings for investment in newly established and expanding private enterprises. An institutional framework and stock market regulations to provide transparency of operations and prevent fraud, manipulation, and insider abuses will be established. Technical assistance from the AsDB has been approved for this purpose.

46. After the process of privatization of public enterprises and goods has been firmly established, consideration will be given to privatizing the housing stock, which is virtually all owned by the public sector, principally the Government. In the interim, individuals may acquire property at no cost for constructing housing under homesteading rights up to 0.03 hectare and additional property may be acquired at a cost, including for commercial or productive purposes. A land law to accelerate the process of making available more land for private use and to clarify what types of land will be restricted to communal usage is being considered and is expected to be passed by end-1991.

Sectoral policies and programs

47. Agriculture provides a major portion of goods for domestic consumption and export and is an important source of raw material inputs used in domestic processing industries. Following the elimination of limits on private ownership and composition of livestock herds in 1990, the number of animals increased significantly, and is projected to reach 27 million at end 1991. Some leasing and de facto privatization has already taken place in this subsector, and further privatization will be encouraged through leasing and the distribution of animals in conjunction with the privatization law passed in June 1991. However, a significant portion of the livestock sector may remain organized on a cooperative basis as the law gives to the members of each state farm and cooperative the right to decide the particular form of organization to pursue. State farms dedicated to cultivation will be divided into smaller private plots through leasing of land pending the passage of a land law, which will determine the modalities for ownership and transfer of land. Equipment and buildings will be made available through leasing or purchase through coupons or cash. A small percentage of state farms, mainly those engaged in agricultural research and certain cereal reserve farms, will remain in the public sector. A program will be prepared

with World Bank technical assistance by mid-1992 aimed at completing the privatization of herds and crop farming by the end of 1992. This program will consider the modalities for establishing private ownership or control of agricultural land by end-1994.

48. To encourage a significant supply response from this sector, which has been affected adversely by inadequate prices for its output for some time, procurement prices for agricultural products were raised at the beginning of 1991 and freed in July 1991; the full effect of this will be felt as new contracts are signed. This measure will be reinforced through privatization of local marketing and transportation activities, which in addition to privatization of agricultural resources, will receive priority emphasis under the new privatization law. The privatization of shops and transportation equipment and motor vehicles has already begun; all regulations prohibiting private trading and transportation of agricultural products will be eliminated. Technical assistance is also being sought from the AsDB for the rehabilitation of irrigation projects in 1993.

49. The industrial sector, consisting of manufacturing, mining and energy production, accounts for somewhat more than one fourth of net material product (NMP). However, most enterprises, which are largely state owned, possess an inefficient and obsolete capital stock. Through 1990, selected industries (milk, bread, meat, glass products, felt footwear, children's clothing, timber, and coal mining) received budgetary subsidies to offset losses on retail sales at low fixed prices, although most other industries showed an accounting profit and paid profit taxes to central or local governments. Profits should improve for many enterprises as prices are decontrolled. However, output of this sector has been hit increasingly hard by shortages of spare parts, petroleum products, and other critical imported inputs, reflecting reduced external financing from, and disruptions in trade with, the U.S.S.R. and other former CMEA trading partners. In the short run, efforts will be made to obtain new sources of external financing for critical spare parts to alleviate the most serious bottlenecks.

50. The Government's strategy in this sector is to create a more rational set of economic incentives and to strengthen managerial capability of existing public enterprises in preparation for wide-scale privatization. In addition, new laws seek to encourage private domestic and foreign investment in new enterprises. Efforts to decentralize industrial concentration will be made 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. Technical assistance for restructuring the industrial sector has been requested from the AsDB for 1991; this assistance would set the basis for seeking a program loan to analyze such efforts in 1992-93. A review of enterprises remaining under majority state ownership will be undertaken, in collaboration with the World Bank, during June-December 1992 and agreed recommendations for streamlining the operations of these enterprises, strengthening their financial autonomy,

and determining the modalities of managing residual government participation will be implemented during 1993-94.

51. Special emphasis will be given to the energy sector, which will continue to remain under state ownership. For the mainly coal-based power plants, priority in the short run will be given to increasing critically low coal stocks, through new equipment needed for the transport of coal. Efforts will also be devoted to the rehabilitation, including obtaining critical spare parts, of the Ulaanbaatar power plants. By mid-1992, an integrated tariff structure for different sources of energy will be developed with World Bank assistance to achieve cost-recovery, taking into account Mongolian resource endowments and foreign exchange availability. A system of energy audits of major enterprises to identify additional methods of conserving energy will also be introduced. As external financial constraints become less binding, the sector will require investment in more modern and efficient technology. To address this issue, a review of Mongolia's energy requirements will be carried out by mid-1992, with the assistance of the World Bank, to develop a long-term master plan for the sector. The Government is also cooperating with private foreign companies in exploring for domestic sources of petroleum. Success in these efforts is expected in the medium term to lead to self-sufficiency in petroleum products and allow exports. Efforts will be made to use coal-based generation of electricity instead of diesel-based generation where feasible, subject to environmental considerations. Furthermore, in rural areas solar power is being introduced on an experimental basis. Hydropower will also be developed over the longer run; technical assistance and financing is being sought from the AsDB for an initial hydropower project.

52. Mongolia is generously endowed with mineral deposits such as copper, molybdenum, silver, gold, and coal. It has several coal mines producing for domestic power plants, though as in the case of industries, production of some mines is being hampered by a lack of spare parts. In turn, these mines are unable to supply the required inputs to the power plants. Production of the Erdenet copper mining and refining plant, the main user of electricity in the country, is also hampered by the domestic shortages and, until recently, the cutoff of electricity previously imported from the Soviet grid. The potential for exploiting additional mine sites and for processing the ore to higher-value products is considerable and is likely to attract foreign investors. By mid-1992, a study of the mining sector will be carried out in collaboration with the World Bank with a view to developing a long-term master plan for the sector and project proposals for immediate action.

53. The limited development of transportation facilities in Mongolia constitutes a major obstacle to the expansion of domestic and external markets. The bulk of foreign trade is transported over the rail network, with trade through the U.S.S.R. being increasingly switched through China, although 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. Efforts will be concentrated on negotiating

with Mongolia's neighbors, especially China, to improve the efficiency of the rail and port facilities used by Mongolia to facilitate transportation of externally traded goods. Toward this end, an agreement was reached in August assuring Mongolia's access to the Chinese Port of Tianjin. New technology that can ease the difficulties caused by the differences in rail gauges between the two countries will also be sought. Mongolia has air links only with the U.S.S.R. and China, but the number of flights are insufficient to meet the current demand for passenger travel. Negotiations will be undertaken with airlines of other nations to initiate new charter or scheduled routes to Mongolia. The AsDB is expected to assist in improving airport facilities to attract a larger number of flights. A loan for this purpose has been requested for 1992. Nearly three fourths of domestic freight is carried over the road network and most of the remainder by rail. Although the road network is extensive, its condition is poor with only 3 percent of the total paved. Constraints on the domestic transportation system in the short run will be eased by promoting private participation in local transportation and distribution activities, thereby reducing the demands on the network created by the centralized distribution network. Particularly important in this regard will be the privatization of transport corporations and motor vehicles, in line with the privatization law. Assistance is being sought from the AsDB for a Road Master Plan feasibility study and a road and rail rehabilitation project. A study of road user charges and railway tariffs will be undertaken by mid-1992 with a view to adopting an action program by end-1992 that would implement the recommendations of the study by mid-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 external financial assistance. In the interim, overall responsibility for coordination and oversight of transport policy will be assigned to a single coordinating authority within the Government at an appropriate level by end-1992. In addition, a Transport Policy Unit, reporting to the coordinating authority, will be set up to focus on strategic planning and institutional reform, including privatization of the transport sector, and to support the formulation of an integrated transport policy.

54. Both internal and external communications links are extremely limited, also hampering Mongolia's efforts to expand commercial and other contacts with the outside world and delaying the transmission of official, commercial, and personal information domestically. The Government is actively negotiating contracts with other Asian nations for the development of a modern telecommunications network. In this connection, Japan signed a $7 million telecommunications project grant in August 1991. A medium-term strategy for the further development of the communications sector will also be drawn up as a basis for seeking external financial assistance. Technical assistance for this purpose is being sought from the AsDB.

<u>Investment program</u>

55. As part of the 1991 budget process, a number of steps were taken to improve the process of investment planning and investment efficiency. A

comprehensive investment review was undertaken and budgetary support was terminated for projects that did not meet efficiency and rate of return criteria. All projects under construction that did not meet the tests will be sold at auction. Investment criteria were set up, based on minimum projected rates of return and break-even points of three-five years, as a basis for continuing existing projects or approving new ones. These criteria are applied differently for projects depending upon classification as socially oriented (especially for health and education), public enterprises, or public services. Within an overall framework of meeting the medium-term structural needs of the economy and upgrading the general level of technology, investment financed from budgetary resources over the medium term will be focused mainly on basic socioeconomic infrastructure. A core investment program for this purpose is under preparation and is expected to be completed by early 1992 for presentation to interested donors. In addition, as part of the 1991 budget, Tug 100 million was committed toward a new program for promoting small enterprises, both public and private, as a means of creating employment and decentralizing industrial activity. Beginning with the 1993 budget, a rolling three-year public sector investment program will be prepared in collaboration with the World Bank.

56. An investment coordinating mechanism will be established to assure consistency between annual and medium-term investment priorities, the availability of domestic budgetary resources, and the availability of external financing and foreign exchange. This mechanism will involve overall coordination among the Ministries of Finance, National Development, Trade and Industry and the central bank and consultation with line ministries responsible for the execution of specific projects.

IV. Social Safety Net and Human Resource Development

57. The abrupt reduction in external financing and the transitional difficulties associated with the transformation to a market-oriented economy have resulted in a significant decline in living standards for the entire population and are contributing to rising unemployment, concentrated in construction and, to some extent, in government employment. A segment of the urban population with limited access to food through family ties in the rural sector is most likely to bear the brunt of the impact on living standards and the rising level of unemployment. Although rural sector incomes, at least in monetary terms, are lower than in the urban areas, the rural population has better access to food and is expected to benefit from improvements in agricultural procurement prices.

58. 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 March 1991, instituted a system of severance pay financed by employers to provide unemployment insurance and other assistance to unemployed workers. Following modifications in July 1991, all employers are required to transfer the equivalent of three months' salary of dismissed workers to employment centers, who use

these funds to pay modest unemployment benefits and to provide job information, job training, and job creation services. A liberalization of benefits under the existing social security system will provide additional protection to persons at risk. The 1991 budget also includes an allocation for a social safety net program that includes cash grants to the needy through local governments and funds for the promotion of job creation through fostering new small businesses. Existing targeted programs will be continued, and the Government intends to improve and extend targeting in order to eliminate remaining generalized price subsidies. Crucial to this effort will be the identification of vulnerable groups. To this end, the Statistical Office has developed a measure of minimum living standards and established an objective measure of poverty. The Government recognizes that the adjustment measures will compound the difficulties of homeless children in urban areas in the coming winter, and intends to establish shelters in Ulaanbaatar and aimak centers. The Government welcomes an expanded role for nongovernmental organizations in providing assistance to vulnerable elements of the population and, to facilitate their work, will establish a national registry of these agencies.

59. In addition to strengthening the social safety net, the Government plans to create a national health insurance fund financed by employer and employee contributions that will gradually permit coverage for the entire population. A pilot program, started in 1991, for establishing a limited number of user fees for health services for employed persons will be expanded, and private medical practice encouraged to ensure a more efficient use of health and medical services. A strategic review of the finance and delivery of health services will be undertaken with the collaboration of the World Bank by end-1992. Donor assistance will be sought to seek methods of improving cost effectiveness. High priority in the provision of health services will be given to maternal and child health protection, elimination of malnutrition, a reduction in mother and infant mortality rates, and the reduction of illness from communicable diseases.

60. Educational policy is to be refocused to emphasize training for enhancing job-specific skills within the context of the move to a market-oriented economy and to provide greater basic educational and training opportunities for youth in rural areas. Starting in 1991, children in rural areas are required to be enrolled in school before age eight. Private schools are now permitted and will be further encouraged. Efforts will be made to establish vocational, production, and professional training centers, including professional schools attached to enterprises. The curricula of technical schools and institutes will be reorganized and upgraded and greater emphasis will be placed on providing more opportunities for university level training within Mongolia and upgrading such training to international standards. A strategic review will be conducted in collaboration with the World Bank to assist in carrying out these reforms and to reorient human resource development. Concomitant with curriculum reform, teachers will receive in-service retraining. As the availability of foreign scholarships has fallen dramatically, Mongolia will seek donor support for new scholarships from market-oriented economies.

V. Environmental Considerations

61. The Government is committed to limiting the adverse environmental effects caused by economic activities. In particular, it intends to focus programs on protecting and restoring pasturelands, reducing rural and urban pollution, protecting the water supply, and promoting a balanced use of natural resources. To maintain and protect pasturelands, it intends to restore exhausted areas through encouraging the growth of protective vegetation, fertilization, and reintroducing more traditional forms of livestock breeding while restricting the expansion of crop cultivation on fragile pastureland. Efforts will also be made to restrict overgrazing, and to limit activities that contribute to land erosion. Programs will be instituted to reduce the use of chemicals and poisonous substances in the rural environment and to contain and reduce industrial pollution of water and air in urban areas. 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. Better methods for valuing and pricing use of water resources 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, improved 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 technical assistance will be sought for afforestation. In the immediate future, priority will be given to the introduction of environmental assessment and monitoring procedures. As sound environmental management in Mongolia is hampered by an inadequate natural resource data base and limited data analysis capacity, technical assistance has been requested from the AsDB to develop information and expertise in this area.

VI. Technical Assistance

62. The broad scope of the economic transformation being carried out in Mongolia and the limited experience with market institutions requires support in the form of technical assistance from sources outside Mongolia in virtually all areas of reform being attempted. Given the size and range of these requirements, the Government will continue to seek such assistance from a variety of multilateral and bilateral sources. In so doing, the Government will endeavor to give priority to seeking assistance that matches and supports the sequence of reforms being carried out.

63. Initial emphasis has been given to support reforms designed to carry out macroeconomic policy in a market environment. For this purpose, the International Monetary Fund has provided technical assistance in the areas of tax reform; development of an appropriate statistical framework, including the development of a system of monetary accounts and reporting designed for carrying out monetary policy; and transformation of the

monobanking system into a modern two-tier banking system and advice on adoption of an adequate bank supervisory system and foreign exchange operations. Further assistance in developing an adequate framework for macroeconomic policy is envisioned in the areas of tax reform, tax administration and budgetary control, designing indirect instruments of monetary policy, implementing a proficient system of bank supervision and training in financial programming, evaluation of credit applications, and compilation and analysis of economic statistics, especially the development of a consumer price index. The central bank has begun to establish a research department and is seeking assistance in strengthening this function. The World Bank is developing a wide-ranging program aimed at institution building. The AsDB's technical assistance will also support macroeconomic institutions with emphasis on staff training, as well as preparatory work required for future project support. Foreign governments have also begun to provide advice in financial and technical areas, and to develop local training capabilities.

64. Advice and assistance are also critically needed in: (a) drafting the basic legal framework for delineating property rights and underpinning market activities; (b) designing modern, market-oriented accounting standards; (c) developing a system of management accountability for public enterprise managers and providing training in management, marketing, and accounting; (d) developing a system for setting public sector investment priorities, project evaluation, and project monitoring; and (e) training of central bank staff.

VII. External Financing Requirements

65. As the expansion of exports to new markets during the program period is not expected to generate sufficient foreign exchange to finance minimum import requirements needed for economic recovery, Mongolia must depend on substantial inflows of foreign assistance in the form of grants or highly concessional and flexible credits to finance part of its import needs. In order to finance a level of imports consistent with development needs, the current account deficit, excluding official transfers, is expected to average about 14 percent of GDP a year during the program period. On this basis, gross external financing requirements through 1994, including planned increases in international reserves, are anticipated to average about $130 million a year. The requirement covering the 18-month period July 1991-December 1992 is projected at about $165 million at an annual rate, reflecting a recovery from severe import compression in the first half of 1991. Based on donors' current plans and commitments, about $140 million of the financing requirement over the 18-month period through December 1992 is expected from disbursements of resources from multilateral institutions, and assistance from a few large bilateral donors. Additional unidentified disbursements of about $110 million will need to be raised to meet the remaining unfilled requirement. Initially, Fund support will be largely in the form of a one-year stand-by arrangement, the resources from which would be used for the replenishment of Mongolia's external reserves. Balance of

payments projections for the program period do not take into account the servicing of outstanding debt owed to the U.S.S.R. and other former CMEA members, which is still under negotiation.

66. During the program period, Mongolia is expected to continue to experience balance of payments difficulties arising from external factors. As the terms of trade are expected to deteriorate, further financial support will have to be mobilized in order to maintain the level of imports required to sustain the pace of structural reforms. In addition, a pipeline of financing for future investment projects needs to be built up in view of Mongolia's large infrastructural requirement to support the growth of private economic activity and diversification of its productive structure.

Mongolia: Summary Description and Timetable of Macroeconomic and Structural Adjustment Measures, 1991-94

Sector	Objectives	Strategies and Measures	Timing
Budget	Design fiscal policies consistent with inflation, growth and balance of payments targets.	- Constrain government expenditure and raise revenue consistent with macroeconomic targets.	1991-94.
		- Establish mechanism for issuing government securities.	1991.
		- Restructure government outlays on social services and introduce user fees.	1992-93.
	Strengthen mechanisms for control of fiscal deficit.	- Introduce monthly monitoring of budgetary revenues and expenditures.	By October 1, 1991.
	Establish modern tax system and broaden revenue base.	- Introduce 10 percent surcharge on customs duties.	By October 1, 1991.
		- Increase excise tax rates and broaden the tax base.	By October 1, 1991.
		- Establish individual taxpayer identification numbers.	1993.
		- Introduce sales tax.	By July 1, 1992.
		- Introduce more uniform corporate income tax.	1992.
		- Establish comprehensive customs regulations and procedures.	1991-92.
		- Introduce harmonized customs system.	1992.
	Limit, restructure and prioritize capital outlays.	- Refocus budgetary capital outlays from productive sectors to social and economic infrastructure.	Ongoing.
		- Set up investment monitoring and management group.	By July 1992.
Banking	Design monetary policies consistent with inflation, growth and balance of payments targets.	- Raise central bank lending rate to banks to level of inflation.	Mid-1992.
		- Introduce reserve requirements on commercial bank deposits.	September 1, 1991.
	Develop a modern banking system.	- Finalize separation of commercial and central banking functions of Mongolbank.	By March 1992.
		- Rationalize and simplify interbank clearing and payments arrangements.	1991-92.
		- Develop additional instruments of indirect credit control.	1992-94.
	Establish system of prudential oversight of banking system.	- Adopt legislation and regulations covering, inter alia: civil penalties, debt recovery, consumer protection, bills of exchange.	1991-92.
		- Identify nonperforming and doubtful debts and establish a mechanism to deal with them.	1991-92.
		- Establish selected prudential ratios to ensure commercial bank viability.	1991.
		- Implement system of licensing and continual supervision of banks, including a reporting system and on-site audits.	Ongoing.

Mongolia: Summary Description and Timetable of
Macroeconomic and Structural Adjustment Measures, 1991-94

Sector	Objectives	Strategies and Measures	Timing
External	Liberalize and promote international trade.	- Issue foreign trade licenses on a nondiscriminatory basis.	Ongoing.
		- Eliminate mandatory state orders for exports.	End-1992.
	Liberalize exchange system and improve international competitiveness	- Adjust exchange rate as needed to achieve the program's objectives.	1991-94.
		- Allow private sector exporters to retain foreign exchange earnings.	1991-94.
		- Permit licensed commercial banks to conduct selected foreign exchange operations.	December 1991.
		- Permit the development of a foreign exchange market through the banking system.	1992.
		- Central bank to assume management of international reserves.	December 1991.
	Improve management of debt and capital flows.	- Establish agency for approving and monitoring of external public debt.	By mid-1992.
		- Establish unit for processing foreign investment applications.	December 1991.
Prices and Incentives	Liberalize prices.	- Deregulate prices at all levels except for public services, utility tariffs, rents on public housing, and selected medicines.	End-December 1992.
		- Abolish mandatory state orders for all goods.	End-December 1992.
		- Introduce retail and wholesale price indices.	September 1991.
Wages	Improve efficiency of labor use and restrain cost-push inflation.	- Establish tripartite commission for wage increases in state enterprise sector.	December 1991.
		- Hold increases in civil service and minimum wages and pensions, except base pensions for those who have never worked or those at minimum retirement age, below rate of inflation.	Ongoing.
		- Restructure wage scale of civil service.	1992-93.
		- Review laws and regulations restricting labor mobility.	1992-94.
Privatization	Promote privatization of state-owned enterprises and assets.	- Continue privatization of enterprises through stock sales, leasing, and direct sale.	1991-94.
	Promote efficiency and financial accountability of public enterprises	- Establish national accounting standards including a pilot project for applying such standards.	1992.
		- Require semiannual publication of financial statements.	From 1992.
		- Establish budgetary oversight of public enterprises receiving budgetary transfers or excluded from full privatization.	1991.
		- Establish mechanism for closing loss-making public enterprises.	1992.

Mongolia: Summary Description and Timetable of
Macroeconomic and Structural Adjustment Measures, 1991-94

Sector	Objectives	Strategies and Measures	Timing
	Promote growth of private economic activity.	- Establish stock market regulations.	September 1991.
		- Conduct review to identify regulatory and other barriers to private sector activities.	By end-1991.
		- Develop action program to remove barriers to private sector activity and to develop further appropriate incentives.	By mid-1992.
Agriculture	Privatize and improve supply response.	- Prepare program for privatization of herds and cropland.	By mid-1992.
		- Implement program for privatization of herds and cropland.	By end-1992.
Industry	Streamline process of state enterprise management.	- Review status of management of state-owned enterprises.	June-December 1992.
		- Implement recommendations of review of state enterprise management.	1993-94.
Mining	Set priorities for mining development.	- Undertake sectoral review to develop sectoral master plan and projects for immediate action.	Mid-1992.
Energy	Set priorities for energy development	- Develop master plan for meeting long-term energy requirements.	Mid-1992.
	Rationalize energy pricing to achieve efficient cost recovery.	- Develop integrated tariff structure for energy sources.	Mid-1992.
Transport	Improve coordination of transportation policies.	- Assign transportation policy to single coordinating authority and establish supporting transport policy unit.	By end-1992.
	Rationalize pricing of transportation services.	- Undertake study of road user charges and railway tariffs.	By mid-1992.
		- Adopt action program to implement recommendation of study of road user charges and railway tariffs.	By mid-1993.
		- Implement recommendation of study of road user charges and railway tariffs.	By mid-1993.
Investment program	Improve process of establishing public investment priorities	- Prepare rolling three-year public sector investment program.	By end-1992.
Social Policy	Mitigate short-run negative effects during transition to market economy.	- Review government policy on subsidies and transfers and improve targeted programs	1991-94.
	Improve health services.	- Establish a national health insurance system financed by employers and employees.	1992-93.
		- Undertake strategic review of finance and delivery of health services	By end-1992.
	Reorient education and training toward market requirements.	- Undertake strategic review of human resource development.	By end-1992.
Environment	Repair ecological damage and protect natural resources.	- Further develop environmental assessment and monitoring procedures.	Ongoing.

Mongolia: Main Economic Indicators, 1990-94

	1990	1991	1992	1993	1994
			(Changes in percent)		
Output and prices					
Gross domestic product					
Nominal	-2.5	44.5	37.7	25.0	18.5
Real	-2.1	-15.0	-5.0	--	3.0
Prices					
GDP deflator	-0.4	70.0	45.0	35.0	15.0
Consumer	--	130.0	50.0	30.0	20.0
Exports	-13.5	-1.0	2.0	2.0	2.5
Imports	-13.4	5.5	5.0	4.0	4.0
Terms of trade	0.7	-6.2	-2.9	-1.9	-1.4
			(Percent of GDP)		
Budget, credit, and money					
Revenue	51.0	62.7	48.5	48.5	48.5
Expenditure	64.4	76.9	60.4	58.5	57.0
Overall deficit	-13.5	-14.2	-11.9	-10.0	-8.5
Broad money	60.5	56.6	54.9	53.8	53.5
Of which:					
Currency in circulation	7.1	10.7	9.7	8.1	7.2
			(Changes in percent)		
Revenue	2.4	77.7	6.5	25.0	18.5
Expenditure	-3.8	72.3	8.2	20.6	11.3
Domestic credit	11.4	74.4	19.0	14.6	9.2
Broad money	25.1	34.4	33.6	22.5	17.9
Velocity of circulation	-22.1	7.0	3.0	2.0	0.5
			(In millions of U.S. dollars, 1/ unless otherwise specified)		
External accounts					
Balance of payments					
Exports, f.o.b.	444.8	437.0	485.0	550.0	630.0
Imports 2/	-1,023.6	-574.3	-595.0	-630.0	-690.0
Current account deficit	-644.0	-100.0	-103.0	-83.0	-63.0
Overall balance	-53.3	-70.9	-43.4	-53.4	-48.4
Net international reserves	49.2	9.6	45.8	72.7	106.2
(In weeks of imports)	(3.4)	(1.0)	(4.0)	(6.0)	(8.0)
External debt (bn. of transferable rubles)	10.5	10.5	10.5	10.5	10.5
Debt service ratio 3/	13.4	13.9	13.1	12.1	11.6

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

1/ Calculated using official exchange rates.

2/ Includes imports and payments associated with turnkey projects.

3/ In percent of exports of goods and services.

Mongolia: External Financing Requirements, 1991-94

(In millions of U.S. dollars)

	Jul.-Dec. 1991	1992	Total Jul.-Dec, 1991 + 1992	1993	1994
Current account deficit excluding grants	66.2	123.0	189.2	93.0	73.0
Amortization 1/	15.3	0.4	15.7	0.4	0.4
Change in net reserves	9.7	36.2	45.9	26.9	33.5
FINANCING REQUIREMENTS 2/	91.2	159.6	250.8	120.3	106.9
FINANCING 2/	91.2	159.6	250.8	120.3	106.9
Identified	59.9	80.0	139.9	30.0	25.0
Direct investment	--	5.0	5.0	10.0	15.0
Grants	39.9	20.0	59.9	10.0	10.0
Food, medicine, and other	(19.9)	(10.0)	(29.9)	(10.0)	(10.0)
Bilateral balance of payments support	(20.0)	(10.0)	(30.0)	(--)	(--)
Loans for balance of payments support	20.0	55.0	75.0	20.0	--
Multilateral sources	(20.0)	(55.0)	(75.0)	(20.0)	(--)
Bilateral sources	(...)	(...)	(...)	(...)	(...)
IMF	...	...	...	...	...
Unidentified	31.3	79.6	110.9	80.3	81.9

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

1/ Including repayments of short-term trade debt.

2/ Excludes Soviet turnkey projects and possible payments on short-term debt to the IBEC which are under negotiation.