

**Country Assistance Program
for
Mongolia**

Government of Japan

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Mongolia has proceeded with democratization and transition to a market economy since 1990, but the process has been full of difficulties. As a country with friendly ties to Mongolia, Japan led other donors in providing assistance through ODA to it for meeting, at an early stage, emergency needs for transition to a market economy and recently medium- and long-term development needs. This assistance has paid off, bringing about economic recovery that brought economic standards back to the pre-democratization level. However, there are many hurdles to overcome until Mongolia's economic growth is back on track and the country achieves poverty reduction. The country thus still requires assistance in a wide range of areas. To formulate Japan's country assistance program¹ for Mongolia for approximately the next five years, it is important to carry out a comprehensive analysis on Mongolia's political, economic and social situations. Therefore, the analysis on Mongolia's current development status, its development strategies and assistance by other donors are described in detail in Sections 1 and 2, respectively.

While the amount of Japan's ODA is on a downward trend, it is not possible for Japan on its own to meet all the development needs of Mongolia. The basic policy on assistance to Mongolia described in Section 3 tries to give a description of important areas and issues of development to make its focus clear as much as possible on the premise that this Country assistance program is for the next five years. Since Mongolia still requires assistance in a wide range of areas, there is a limit to narrowing them down. Nevertheless, based on this Country Assistance Program, Japan will utilize its limited ODA budget in an efficient and effective manner to provide assistance to Mongolia.

1. Mongolia's current development status

Mongolia achieved a transition from socialism to democracy in 1990. Development efforts have been made along with the transition to a market economy. It is necessary for Japan to consider the following initial conditions in order to assist Mongolia to achieve sustainable growth.

¹ This Country Assistance Program has been formulated upon a consensus. In March 2003, task forces on the Program in Tokyo as well as in Mongolia were set up. The task forces gathered a wide range of views from the people of Mongolia by discussions and interviews with the government of Mongolia, Mongolian NGOs, and key figures in Mongolia, as well as site visits in Mongolia. In addition, the task forces gathered opinions of Japanese NGOs. Upon the entire information gathering, a consensus was made. It is the first time that so many stakeholders from different quarters engaged in earnest discussions on Japan's development assistance to Mongolia and formulated a comprehensive assistance program.

(1) Development characteristics

a. Geographical characteristics

Mongolia has a land area of 1.56 million square kilometers, which is four times as large as Japan, and is endowed with rich underground mineral and livestock resources. However, as a landlocked country, Mongolia is economically disadvantaged in comparison to oceanfront countries due to unstable transportation and high transportation costs as accessible seaports are limited to those of Russia and China, and these seaports are at a great distance.

On the other hand, the bordering regions of North Eastern China and Far Eastern Russia have a population of 130 million. The population of Japan and the Korean Peninsula is approximately 197 million. If market access to neighboring countries is improved, Mongolia stands a greater chance of achieving stable and sustainable economic growth.

b. Demographic characteristics

Mongolia is an underpopulated country with only 2.504 million people in 2003, 40% of whom are scattered over its vast land. This is a highly restrictive factor on rural development.

However, Mongolia's average annual population growth rate remains relatively high at approximately 1.2% although it is somewhat lower than in the socialist era. Mongolia is a "young" country where 72% of the population is at the age of below 35. The literacy rate is 99%, the highest among the developing countries in Asia². In short, Mongolia has great potential for development in terms of human resources.

c. Natural environmental characteristics

Mongolia is located between the north latitude of 41 and 52 degrees and in a cold region where the annual average temperature is about 0 degree Celsius. The average annual rainfall is 251 mm, and the arable land is less than 1% of the total land area. This harsh natural environment has greatly affected the development of industries including agriculture and construction as well as social life.

² The adult literacy rates for selected Asian countries are as follows (male/female: %): 99.1/98.8 for Mongolia; 91.7/76.3 for China; 95.5/91.4 for Vietnam; 94.4/89.0 for Sri Lanka (Asia/Pacific Cultural Centre for UNESCO: 2000).

On the other hand, Mongolia's internationally-recognized impressive natural landscape allows the possibility of tourism development. Moreover, the country is endowed with underground mineral resources such as copper, gold, molybdenum and petroleum which have potential for further development.

(2) Political situation

In Mongolia, there have been frequent changes of power in 15 years since the transition to democracy in 1990. However, the policy geared toward democratization and a market economy has been consistent. In addition, absence of use of force for political control indicates relative stability in the country's political situation.

In March 1990, as the Mongolian People's Revolutionary Party (hereinafter referred to as MPRP), the socialist party that had been running Mongolia's single-party autocratic regime, faced a heated democratization movement, as a result of which the Party abandoned autocracy and introduced a multi-party system for itself. The country thus marked its first step on the road to democratization without bloodshed. In July 1990, a general election was held for the first time under a multi-party system. Although MPRP secured a majority of the seats in this election, it preferred coalition government with the Mongolian People's Progressive Party (hereinafter referred to as MPPP) which had been promoting the democratization movement³ and, as a result, the coalition government came into existence with Mr. Byambasuren, the party leader of MPRP, as Prime Minister.

After this, Mongolia's economy suffered at an annual average growth rate of minus 9.3% amid the turbulent political transition period. Against a background of the economic depression, in the general election of the State Great Hural in June 1992, the first general election under a new democratic constitution adopted in January 1992, public criticism was centered on MPPP which had been responsible for economic policy and had also abruptly introduced a market economy. As a result, MPRP won an overwhelming majority of the seats in the election and the single-party government of MPRP was founded with Mr. Jasrai of MPRP as Prime Minister.

However, in 1993, in the first presidential election under the new constitution, the

³ President Ochirbat was nominated by the opposition and not a MPRP member. The multi-party system was legislated in May 1990.

electorate voted differently. As the voters wished to strike a balance in the Parliament where MPRP had an absolute advantage, Mr. Ochirbat, nominated by the opposition parties, was elected to the presidency. At the second general election in June 1996, the Democratic Union Coalition, formed by the opposition parties, the Mongolian National Democratic Party and the Mongolian Social Democratic Party, won overwhelmingly and the coalition government came to power with Enkhsaikhan, Cabinet Minister of the Ochirbat administration, as Prime Minister.

However, there was a backlash against the radical reforms by the Democratic Union Coalition in the second presidential election in May 1997, where Bagabandi, the candidate nominated by MPRP, was elected to the presidency. A political struggle within the Democratic Union Coalition resulted in the en bloc resignation of the Enkhsaikhan Cabinet and formation of the coalition government in April 1998 with Mr. Elbegdorj, President of the Mongolian National Democratic Party as Prime Minister, based on the fact that the Cabinet possesses no right to dissolve the parliament under the new constitution. However, the Elbegdorj Cabinet too resigned en bloc three months after its formation due to a conflict within the ruling party triggered by a dispute in the Parliament over the privatization of state-owned banks.

The consensus building between President Bagabandi and ruling party on nomination of the incoming Prime Minister had a rough passage. Finally, in December 1998, the coalition government came into existence with Narantsatsralt, President of the Mongolian National Democratic Party, as Prime Minister⁴. However, the Parliament was again thrown into confusion over the sale of equities held by the Russian side of the Erdenet Copper Mine, an important Mongolian-Russian joint enterprise. In July 1999 the cabinet ended up resigning en bloc yet once again. Afterwards, Amarjargal (Mongolian National Democratic Party), a former foreign minister, was appointed as Prime Minister.

In the July 2000 General Elections, Mongolian voters opposed to the politically unstable Democratic Union Coalition government and voted for MPRP (the Mongolian People's Revolutionary Party secured 72 seats out of 76). The newly-formed Enkhbayar (President of MPRP) government (single-party government) continued to actively pursue basic policies of the previous governments such as the establishment of democratic system and the transition to a market economy. However, in the

⁴ The new constitution stipulates that the President has the authority to propose a candidate for Prime Minister nominated by the ruling party to the parliament within five days and that the Cabinet has no authority to dissolve the parliament.

parliamentary election of June 2004, MPRP came far short of the results of the previous election, failing to win a majority of the seats. The opposition Motherland-Democratic Union Coalition did not secure a majority in the parliament either. In the end, MPRP and Motherland-Democratic Union Coalition formed a grand coalition. Former Prime Minister Enkhbayar (MPRP) became president of the People's Great Hural, and the Motherland-Democratic Union Coalition's Mr. Elbegdorj was appointed Prime Minister.

In short, democracy is steadily taking root in Mongolia through several changes of power.

(3) Economic situation

a. Economic policy and the trend in economic growth

Since 1990, Mongolia has actively pursued the policy of introducing a market economy while trying to achieve macroeconomic stability. Privatization of national assets began with the distribution of vouchers to all Mongolians between July and October 1990. In January 1991, the country abolished regulations on pricing, production, export and import. In February 1991, Mongolia was approved to be a member of the IMF, the World Bank and the ADB. In May 1991, the new Banking Law went into effect and the Bank of Mongolia became an independent central bank. A new financial system with the central bank and commercial banks was thus established. Mongolia was further approved to be a member of WTO in 1997 and the European Bank for Reconstruction and Development (EBRD) in October 2000. (To render Mongolia eligible for assistance, the EBRD amended its charter in January 2004. Japan accepted the amendment in June 2004.)

However, due to the collapse of the USSR and Soviet bloc, Mongolia lost markets it had had for decades and was found it difficult to find alternate markets. This was the main cause of negative economic growth from 1990 to 1993. Consequently, the real GDP in 1993 was 80 % of that in 1990. Hyperinflation at the rate of over 300% occurred in 1992 due to such factors as turmoil triggered by the transition to a market economy, increase in import prices as a result of the transition to a floating foreign exchange rate system, as well as a fiscal deficit and increase in the money supply. Amid such backdrop, Mongolia accepted structural adjustment loans from the IMF in May 1992 and started to take measures which included administrative reforms aiming at a "small government", substantial reduction in government expenditure, and the tightening of the money market. These measures helped bring about a gradual economic recovery in Mongolia.

The rate of increase of GDP deflator in 2002 compared to the previous year was 9.2%, which indicated higher macroeconomic stability compared to the early 1990s with triple-digit inflation. Mongolia's economy grew at an average annual rate of 2.7 % between 1995 and 2002. In 2000 and 2001, the economy grew by about 1.1 %; in 2002, 4.0 %. In 2003, the real GDP growth rate was 5.5 % partly because no major natural disasters such as heavy snow occurred.

The exchange rate rapidly depreciated from 14 tugrik per US dollar at the end of 1990 to 1,168 tugrik per US dollar in 2003. Mongolia deserves credit, however, for adjusting the exchange rate properly in the face of severe inflation. As a result of the proper adjustment of the exchange rate, Mongolia's nominal GDP in 2002 was 1.09 billion US dollars and the GDP per capita was approximately 442 US dollars⁵; in 2003, the figures were 1.17 billion US dollars and 466 US dollars, respectively. In 2003, the rate of increase in the consumer price index from the previous year was 4.7% and that of the GDP deflator was 4.0 %, which indicates, as previously mentioned, that the economy is now relatively stable compared to the past.

The production of the following commodities in 2003 increased as follows compared to the previous year: grain, by 31.1 %; wheat, 30.0 %; potatoes, 51.6 %; and vegetables, 50.1 %. In addition, the nominal value of the sum of wholesale and retail trade as of October 2003 recorded a 24.7 % increase compared to the same period in the previous year. The real values of production output as of December 2003 were as follows compared to the same period in the previous year: manufacturing, an increase by 6.7 %; mining, a decrease by 1.0 %; supply of electricity, hot water, and water, an increase by 1.0 %. In addition, calculated on the basis of the US dollar in 2003, Mongolia's export grew by 17.5 %, import by 16.0 %, fiscal revenue by 12.3 %, and fiscal expenditure by 12.4 %. Factors such as recovery in livestock breeding and agriculture due to relatively minor damage from snow as previously mentioned, manufacturing in such fields as textile, and revitalization of commerce and other sectors seem to have contributed to the annual GDP growth of 5.5 %.

b. Privatization

As a result of the privatization in the last 15 years, in 2002, the private sector comprised 75 % of Mongolia's GDP.

⁵ The World Bank computes Mongolia's per capita income in 2000 at 390 US dollars on an exchange rate basis and at 1,750 US dollars on a purchasing power parity (PPP) basis. See the World Bank, *World Development Indicators 2002*.

The privatization of state-owned assets began with the distribution of a voucher worth 10,000 tugrik to all Mongolians between July and October 1990, a total worth 44% of the total of state-owned assets. Many of these vouchers were converted to equities by March 1994. In the same year, the Securities Law was enacted and the Securities and Exchange Commission was established. In August 1995, the government launched a primitive securities exchange market and declared that the first phase of privatization was completed.

However, this hasty privatization produced thousands to tens of thousands of so-called paper shareholders for each corporation and resulted only in a change of ownership registration, with very little positive impact on corporate management, technologies and capital. In addition, the newly privatized entities inherited the corporate debt incurred prior to the privatization. Finally, the large-scale production facilities built for exports to the COMECON member countries under the divided production system of the former socialist economic organization became obsolete and a burden to the country.

c. Financial sector

As a result of the liberalization of the financial sector, Mongolia came to have 14 commercial banks in 1996. Many of them, however, did not have the sufficient capability and know-how for bank management. Furthermore, the high interest rates policy of the government turned a substantial proportion of these banks' outstanding loans into bad debts by burdening many of the privatized enterprises with heavier debts. The World Bank took the initiative in reforming the financial sector. In consequence, the banking sector has been recovering, with balance of money loans starting to increase. However, the average annual lending rate, weighted with the amount of outstanding loans of each bank, is as high as 35%. In this connection, the M2-GDP ratio was 53.8% in 1990, decreased to 18.5% in 1995, and then recovered to 37.9% in 2002 and 51.6% in 2003. However, in addition to banks, there are many non-bank institutions in the indirect financing sector, saturating the small financial market. The Mongolian financial sector has greatly lagged behind the real economic sector.

Moreover, the ratio of the total value of marketable securities at current prices to GDP was only 2.9% in 2002 and 3.6% in 2003, respectively, indicating that the securities market was playing hardly any role in direct financing. This was influenced by the fact that, among the privatized enterprises, as many as 470 enterprises were listed on the

securities market without clear standards in 1995. At the end of 2003, 402 enterprises were still listed, 80 % of which were fully privatized and 20 % were semi-private. The performance of most of these enterprises was poor. Among the listed enterprises, only some 15 were able to pay dividends at a minimal amount. Another cause of the lackluster Securities Exchange was that some 1,500 shareholders eventually dominated the equities that had initially been distributed to all Mongolians. 97% of transactions at the Securities Exchange were on government and corporate bonds, whereas equities accounted for only 3% of total transactions. The monthly interest rate for short-term government bonds was 0.5% to 0.7%, long-term government bonds, with maturity of 3 months or longer, was between 1.2% and 1.76%, and that of corporate bonds between 1.6% and 1.65%. The annual interest rates of these bonds were between 9% and 22%, which were perhaps more attractive to investors than the savings interest rates which were between 6% and 10%. However, these high interest rates are a major burden for poorly performing enterprises and hard to maintain.

As described above, the banking sector is finally undergoing a series of reforms. However, it has not contributed to the development of the private sector as the bank interest rates on loans in 2002 and 2003 remain quite high at 30% or more, and the stock market is in its infancy.

d. Demand side GDP structure, challenges and the role of ODA

The collapse of socialism led to the disintegration of the trade market. As it was difficult to find an alternative market, negative growth continued from 1990 to 1993. Real GDP in 1993 declined to as low as 80% of the 1990 level. Although the trend turned upwards later on, the growth rate has remained low with the annual average from 1995 to 2002 at 2.7% and the single-year rates ranging between 1% and 4%: that is, 1.1%, 1.0% and 4.0% in 2000, 2001 and 2002, respectively. Slow growth in 2000 and 2001 was attributed to *dzud* or snow disaster.

It is not yet certain whether the GDP growth rate of 5.5% in 2003 is a demonstration of the growth potential of the Mongolian economy or just as a result of minimal *dzud* damage.

In 2003, the demand structure of GDP was as follows: 91.0% for consumption, and 28.9% for investment. The high rate of consumption is brought about by excessive imports. The net export ratio is -19.9% with commodity exports accounting for 52.8%

and commodity imports accounting for 69.6%. Thus a trend of adverse balance of trade continues⁶. As for public finance, the budget deficit at 11.9% of GDP in 1999 was reduced to 5.9 % in 2003 after a series of fiscal reforms including the strengthening of taxation capacity, the tightening of public expenditure control, and the reduction of domestic and foreign debts. On the other hand, the chronic state of deficit has not changed and requires improvement although the deficit in 2003 was below the IMF recommendation of 6.0%⁷.

In 2002, 66.3% of investment was financed through foreign aid, which helped maintain positive growth. Mongolia receives ODA equivalent to approximately 20% of its GDP, a higher ratio of dependency on foreign aid than other Asian countries. Japan's ODA accounts for over 40% of the total of past multilateral and bilateral ODA to Mongolia and for approximately 70% of ODA provided by major bilateral donors.

Although Mongolia's public foreign debts accounted for approximately 94.0 % of GDP in 2002, the debt service ratio was 6.7%, indicating a relatively stable level. Multilateral development banks conclude that Mongolia's foreign debt is in a sustainable state. Japan is closely observing the status of Mongolia's debt management as the repayment to the principals and interests of Japan's yen loans will reach the peak in the next few years.

As for the debt owed to Russia, a pending problem for a long time, the governments of Russia and Mongolia announced on December 31, 2003, that they had agreed to forgive 97.8% of Mongolia's debts incurred during the Soviet era, and the remaining debt of 250 million US dollars had been repaid on December 26. While the steady progress of debt relief negotiations with Russia has had an effect on building greater confidence of the international community in Mongolia's solvency, it is necessary to watch over the impacts of transferring much of the 250-million-dollar debt to domestic debt on Mongolia's fiscal management and capacity to borrow foreign funds in the future.

⁶ In 1990, the exports to and the imports from Russia accounted for 78.3% and 77.5% of the total, respectively. However, the structure of the trade market drastically changed afterwards. In 2003, 47.2% of the total exports were to China, 32.3% to the United States, 6.3% to Russia, 4.7% to South Korea, and 1.2% to Japan. As for the share of imports in 2002, Russia accounted for 34.7%, China for 20.5%, South Korea for 11.8%, and Japan for 4.8%. Unless otherwise noted, the sources of statistical data in this document are the National Statistical Office of Mongolia, *Mongolian Statistical Yearbook, 2000, 2001, 2002, 2003* and *Monthly Bulletin of Statistics* (October, November, December 2003, January through June 2004), and Asian Development Bank (ADB) – *Key Indicators 2004*.

⁷ The Mongolian government has come up with fiscal reform policies aimed at strengthening budgetary planning, implementation and monitoring, improving transparency through a transition from the single-year budget to a medium-term budget, linking policy priority with the budget, improving the comprehensiveness of the budget, introducing an integrated fiscal account system, and strengthening the reporting system.

In addition, foreign direct investment (FDI) in Mongolia is increasing gradually. This is due to the improvement in infrastructure such as coal mining, electric power, communications and railroads, as well as in software infrastructure like foreign investment law etc. This improvement was made possible largely by assistance from Japan and other countries. In 2002, the total amount of FDI contracts reached nearly 7% of GDP. Mining development and light industries accounted for 23.5% and 19.4%, respectively, of the accumulated FDI from 1990 to 2000. In 2001, China, South Korea and Japan respectively had a 36.0%, 16.5% and 1.1% share in the FDI contracts with Mongolia.

Mongolia's macro-economy has thus been steadily growing in recent years. However, there are problems including weak growth recoverability, prolonged trade and budget deficits and shortfall in tax revenue, although there has been an effort to redress the causes, i.e., the underdeveloped private sector and tax collection system, and as a result, tax revenue is increasing. There are many tasks for bringing about macroeconomic stability.

e. Supply side GDP structure, challenges and the role of ODA

(a) Structure of industry

Due to the poor performance of the mining and manufacturing sectors, the share in GDP of agriculture and livestock breeding --- Mongolia's basic industry --- increased from 15.2 % in 1990 to 38.0 % in 1995. However, the share in 2002 dropped to 20.7 % because of the droughts and *dzud*, or snow disasters, in 2000 and 2001⁸. In 2003, the share is 20.0 %. In addition, the country has been facing the new challenge, increase of livestock diseases such as the foot-and-mouth disease since 2000.

The mining and manufacturing sectors constitute another key component of the Mongolian economy. The combined share of these sectors in GDP was 19.1% in 2003 and those of the mining sector and manufacturing sector were 9.5 % and 6.0%, respectively. Mining products accounted for 34.8% of all the exports and textile products for 26.8%. The Mongolian economy still relies on the export of mineral resources such as copper and molybdenum, as well as the production and export of

⁸ The population of the five major livestock species increased from 25.86 million in 1990 to 33.57 million in 1999. As a result of *dzud*, however, the number fell to 23.90 million in 2002 and 25.428 million in 2003. The breakdown is as follows: 1) horse (1,968,900 head); 2) cattle (2,567,000 head); 3) sheep (10,756,400 head); 4) goat (10,652,900 head); 5) camel (256,700 head). Wheat production was 596,000 tons in 1990 but dropped to 160,400 tons in 2003. Land productivity in 2003 was approximately 0.8 tons per hectare, which is extremely low.

cashmere products⁹.

The growth in exports of mineral products per se is good for Mongolia's economic growth. For instance, exports of copper concentrate to China are growing rapidly. However, a mineral resource-dependent export structure is inefficient because of its low added value. In addition, the prices of copper and gold on the international market have been decreasing since 1995. These exports are vulnerable to instability despite expectations for an upward trend of the gold price in recent years.

Mongolia's cashmere industry, which is another source of exports, also faces a challenge. It was originally created with Japan's economic cooperation and earned the large part of the country's foreign exchange in the 1980s. The industry played even in 2003 a large part in exports and has contributed to the improvement of incomes for the nomadic population. Nevertheless, the industry has not only difficulties in procuring a sufficient amount of raw materials for domestic processing factories as raw wool is exported to China, but also problems of the degradation of grasslands due to an increase in the goat population. Drain of raw materials to other countries is a serious problem for Mongolia's export-oriented industries, including the cashmere one, that constitute the main means of earning Mongolia's foreign exchange. From now on, important tasks for Mongolia's industry include resolving international trade issues on exporting raw materials and importing finished goods, and how best to raise the quality of raw materials, add values, and export finished products as competitive goods.

In 2003, the GDP share of the tertiary or service industry was 58.5%¹⁰, which is a result of the development of a distribution network and thus increased goods in the market. Other reasons for the high service industry share include a slump of the primary industry and a minimal growth of the secondary industry. Accordingly, this phenomenon cannot be viewed simply as a result of a more sophisticated industrial structure due to economic development. Tourism, for instance, has not helped increase Mongolia's GDP. The number of foreign visitors remains an anemic 50,000 per year although tourism utilizing the country's vast and diverse natural scenery is a prospective sector for earning foreign exchange.

(b) Structure of employment

⁹ In 2003, the production of copper concentrate was 372,000 tons and that of gold was 11.1 tons. The copper content of copper concentrate used to be about 32% but has declined to about 25% in recent years.

¹⁰ The breakdown is as follows: 28.8% for marketing distribution; 1.2% for hotel and food services; 15.1% for transport and communications.

The total number of working population was approximately 927,000 in 2003, of which some 42% or 390,000 persons were engaged in the agriculture and livestock breeding sectors, the key industries of Mongolia. However, these sectors accounted for approximately 32% of total employment or 244,000 persons in 1989, on the eve of the country's transition to a market economy. In 1999, the share of the number of working persons in the agriculture and livestock breeding sectors was 45% of the total number of working persons. This increase was partly due to an influx of the unemployed labor force, numbered nearly 146,000, from a dwindling manufacturing sector to the livestock breeding sector as part of emergency means to earn a living.

On the other hand, the employment share of the mining and industrial sectors was 11.7% in 2003, including 3.4% for the mining sector and 5.9% for the manufacturing sector. Although mining development is important, it is not expected to create many jobs. The tertiary sector accounted for 42.6% of total employment, which may include a number of individual merchants with no regular business¹.

Currently, the accumulation of surplus labor is contributing to the formation of an informal sector in Mongolia's primary and tertiary industries. Poverty reduction can not be achieved without tackling this problem. In other words, the most important challenge for the future of Mongolia's economy may be how surplus labor in the livestock breeding sector is absorbed in other sectors through job creation.

Regarding the issue of overgrazing, the sudden decrease of livestock (camels, horses, cattle, sheep, and goats) has temporarily reduced pressure on the grasslands. The number of livestock increased at one time due to the rapid growth of livestock sector employment, but then declined in a short period due to severe degradation of grasslands caused by overgrazing, the harsh natural conditions including *dzud* and communicable livestock diseases. In 2002, the estimated number of livestock was 23.898 million, a decrease of nearly 9.76 million from the peak year of 1999¹².

f. Situation of economic infrastructure

t and communications.

¹ In 2002, the unemployment rate based on registered cases was 3.4% (number of registered unemployment persons: 30,877) which is somewhat better than 4.6% of the previous year. The number for 2003 is 33,335, an increase of 8% from the previous year.

¹² The number of livestock increased to 25,428 million in 2003, as previously mentioned.

Mongolia is characterized by its vast and sparsely-populated land with a small population, as well as the fact that a substantial proportion of the population is engaged in nomadic activities as opposed to settled businesses. These characteristics cause many difficulties in supporting rural areas and thus constraints resulting from them should be taken into consideration when planning economic infrastructure development. In addition, since Mongolia is landlocked, it is essential to ensure land conservation and national security by providing social services for nomadic people spreading throughout the country.

To alleviate the restrictive conditions on economic development due to Mongolia's landlocked character, Japan has helped the country strengthen its railway transport capacity by such means as developing the railway tracks for safe and regular operations, improving a transshipping facility at Zamyn-Uud near the border with China, purchasing freight trains¹². Moreover, with assistance from the ADB and Japan among others, Mongolia has been developing its road infrastructure within the city of Ulaanbaatar and vicinity, from the capital to the northern border with Russia, as well as between Darkhan and Erdenet. In the long term, a trunk road extending from east to west is seen to be a part of the Northeast Asia and Eurasia corridor. This section has been named the "Millennium Road" by the Mongolian government and has been partially under rehabilitation and construction.

As for energy and electric power, the level of annual power production was maintained at, although lower than 3,576 million kwh in 1990, 3,010 million kwh in 1995 and 3,310 million kwh in 2003 with assistance from Japan. It is worth noting that electric power and steam heating have secured the social infrastructure for health care and communications as well as household purposes, which has led to establishment of both domestic and foreign-owned enterprises. However, electric power is still in short supply for future economic development. Moreover, as the major power plants in the capital are seriously aging, construction of new plants rather than rehabilitation will soon be on the agenda. The settlement of unpaid bills and further improvement in the efficiency of the power company management are also necessary. As for rural electrification, solar power facilities have been widely installed with Japanese assistance. Diesel generators have also been set up at *Sum*, or districts, off the grid. Here the problem lies in how to secure a diesel oil supply and how to collect charges for system maintenance. Another problem

¹² Mongolia used to utilize a large number of freight trains leased from Russia. Japan's assistance of providing freight trains greatly contributed to reducing freight lease related costs and saving foreign exchange.

is the disparity between regions that have successfully utilized diesel generators and those incapable of maintaining installed diesel generators.

As part of risk management such as emergency response to patients in urgent need of care and to rough weather, the government of Japan assisted Mongolia in developing short-wave radio communication infrastructure, covering 1671 villages in 340 districts. This assistance is highly appreciated in Mongolia. Japan also provided yen loans to install optical fiber with a capacity of one million lines, with the north-south lines currently being connected to the rest of the world. With the assistance from South Korea, Mongolia has installed eastward lines from Ulaanbaatar, aiming at establishing links with Northeast Asia. In the capital as well as major locations in *aimag*, the Internet is widely accessible. In 1990, Mongolia was like a remote island in the ocean where even international telephone connections could not be made easily. However, with Japanese assistance, Mongolia's communications sector has rapidly improved in recent years.

It is fair to say that infrastructure development has made a certain amount of progress in the past 15 years. However, the remaining challenge throughout the infrastructure is how to develop institutional and organizational frameworks for its maintenance, rehabilitation, and improving its economic efficiency.

(4) Social and living situation

a. Widening gap between the rich and the poor and among regions

In Mongolia, a serious social problem in recent years is the emergence and increase in the gap between the rich and the poor and growing poverty. There are a number of causes for it. The disintegration of socialist countries has led to the collapse of the export market for Mongolia. Hasty privatization of state-owned enterprises devastated the manufacturing sector, leaving many people unemployed who turned themselves into herdsmen. Further poverty problems are emerging due to harsh natural conditions, including *dzud*, for the livestock breeding industry, as well as some new herdsmen's lack of experience.

Economic disparities between the capital and the rural areas have also sharply increased. In 2001, the GDP per capita of Ovorhangai was 182 US dollars, the lowest of all *aimag* or provinces in Mongolia. There were 8 *aimag* with the GDP per capita between 200 and 299 US dollars and 10 *aimag* between 300 and 399 US dollars. Govi-Sumber had 437 US dollars, a little below the average of 442 US dollars. Regions with above

average GDP per capita were Orhon, at 551 US dollars, and the capital city of Ulaanbaatar, at 709 US dollars. Disparities among regions are not just economic but also social. Rural areas are witnessing the beginning of a disintegration of social infrastructure. Land privatization, which was partially started in 2003, and its socio-economic impact, should also be closely observed.

In addition, poverty in the urban areas is on the increase. At the beginning of the transition to a market economy, surplus labor moved from the cities to the rural areas. However, in recent years, poor people who find themselves helpless in the rural areas flow into the urban areas including Ulaanbaatar. As the urban areas provide few employment opportunities, however, these impoverished people form informal settlements or slums, which have grown year by year.

It is obvious that poverty in Mongolia is mainly attributable to the stagnation of the industrial, agricultural and livestock breeding sectors. Among the major causes of poverty are unemployment due to depressed economic activities and loss of livestock caused by natural disasters such as *dzud* after the introduction of the livestock privatization policy. Other causes of poverty include those related to women¹⁴ such as divorces, large families, and an increasing number of fatherless families, particularly in urban areas, as well as the breakup of families due to alcoholism. In this connection, there were 4,712 orphans, 43,569 children with single parents, and 57,556 households with four or more children, which is more than 10% of all 568,625 Mongolian households in 2002¹³.

The Mongolian government defines the poverty group using the minimum living standard. Although the standard varies more or less with each region, the poverty line is generally between a monthly income of 19,500 tugrik (about 2,000 yen) and 25,300 tugrik (about 2,600 yen). By this standard, it was found that in 1998, 35.6% of the total population and 39.4% of the urban population was below the poverty line.

b. Need for expansion of education to develop necessary human resources for promoting a market economy

Mongolia's literacy rate is as high as 99%. The former socialist government deserves main credit for this accomplishment. However, the country faces a serious lack of

¹⁴ Families with the female head of household are more susceptible to poverty than those with the male head.

¹³ In 2002, the number of houses was 311,965 in the urban areas and 256,660 in the rural areas.

human resources to promote the market economy. Many problems are also found in primary and secondary education including the triple-shift schooling using the same schoolhouse in the morning, afternoon and evening due to the lack of facilities, dropouts, urban-rural disparity in educational standards, an education system — currently, Grade 10 graduates can enter a college — incompatible with the international standard, teacher training, and the procurement of learning materials.

Higher education also faces challenges. Although the number of colleges has rapidly increased in recent years, they do not offer courses of the expected quality and only a limited number of institutions can provide education and training with advanced professional knowledge, skills and expertise. As a result, many wish to go overseas for higher education. It is therefore crucial to substantially improve basic education, higher education and occupational training in order to develop the necessary human resources for the promotion of the market economy.

c. Need for improvement in health and medical services, especially in rural areas

In Mongolia, the life expectancy is 64 years for males and 67 years for females. Problems in the health and medical sector include a high maternal mortality rate¹⁴ and a low level of medical services in rural areas.

The infant mortality rates and the maternal mortality rate have declined in recent years but are still at a high level. Given the fact that almost all child deliveries are attended by skilled professionals in Mongolia, it may be essential to analyze reasons for the still high mortality rates and to improve medical services based on this analysis¹⁵. At the same time, measures are required against infectious diseases such as tuberculosis, viral hepatitis, brucellosis, and sexually transmitted diseases¹⁶.

Regarding medical services in rural areas, the Mongolian government is aiming to improve the organizational efficiency of regional health institutions and the quality of medical services, as well as to implement such measures as a policy of relieving

¹⁴ The maternal mortality rate was between 120 and 175 persons per 100,000 live births from 1985 to 1990 but reached 240 persons in 1993. Although the rate has been declining in recent years, it is approximately 160 persons and still higher than that of many other developing countries.

¹⁵ In 2002, the crude birth rate was 1.91%, the crude death rate was 0.64%, and the infant mortality rate was 2.96%. 46,922 persons were born and 15,857 persons died during the year, which resulted in a net increase of 31,065 persons. The actual number of women who died during pregnancy or childbirth was 82 in 2001 and 57 in 2002.

¹⁶ Brucellosis is a zoonotic infection transmitted from animals to humans by ingestion of infected food products, and direct contact with an infected animal. Symptoms include fever, fatigue, and depression. The disease infects all organs.

vulnerable groups and the poor from the burden of medical expenses through an amendment to the Health Insurance Law. However, among the remaining problems are a lack of financial and human resources as well as underemployment of medical practitioners. Further work is required to establish a medical scheme under the market economy system¹⁷.

To address the issues mentioned above, Mongolia's Ministry of Health is currently taking the lead in developing a strategy for the health sector.

d. Need for dealing with Mongolia's specific natural environmental problems such as degradation of grasslands

Livestock breeding based on natural grasslands is itself closely related to conservation of the ecosystems in Mongolia. In recent years, however, the people have been unable to manage the wells maintained under the former socialist regime, causing herds of livestock closing about a few remaining water points. Consequently, livestock end up ruining the grasslands around the water points. Grassland degradation has also been triggered by the fact that nomads gather in the vicinity of urban centers wishing to live near the consumers of livestock products due to the insufficient distribution system. As a result of overgrazing, grassland degradation and desertification have accelerated and insufficient stock of hay has caused serious loss of livestock with each *dzud* or drought.

e. Need for rural development

Since 1990, state-owned enterprises have been drastically privatized and the trade market of the former USSR and Eastern Europe, which was the export destination of livestock products of the then socialist Mongolia, has disintegrated. As a result, the industrial infrastructure not only in urban areas but also in rural ones collapsed and a large number of facilities which had been under construction were left as they were due to bankruptcy of enterprises. In addition, rural areas faced degradation of grasslands and desertification as well as depression in the livestock industry and cultivation-based agriculture due to *dzud* and drought. Moreover, social infrastructure such as electric

¹⁷ In 2002, there were 18,616 beds in the hospitals, 33,273 persons including 27,384 women employed in health-related sectors, and 6,823 doctors including 5,296 women. In the capital city, there were 3,971 doctors and 587 pharmacists. Mongolia has on average a doctor for every 360 persons. Shortage of medical doctors in countryside is a problem of underemployment, i.e. a high rate of medical license holders who have no employment opportunities as doctors. In 1990, the government budget had a 70.3% share and the health insurance had a 29.7% share in the funding sources of the Mongolian health sector. In 2002, however, the government budget accounted for 53.9%, the health insurance for 41.8%, and paid services for 4.3%.

power, heating, water supply, and medical services in the rural areas has seriously deteriorated. Confusion during the transition period negatively affected the quality of these services, which is worse than under the former socialist regime. As a result, migration from rural to urban areas can not be stemmed. The Mongolian government has therefore prioritized regional development and is currently formulating a policy for the development of regional centers.

f. Excessive concentration in Ulaanbaatar and occurrence of urban problems

Ulaanbaatar's population was 580,000 in 1992. However, due to the flow of population from the rural to urban areas, especially Ulaanbaatar, the capital had now reportedly a population of approximately 1.1 million whereas Mongolia's total population was 2.504 million in 2003¹⁸. The population increase, on top of the problem of dilapidated infrastructure in the capital, has exacerbated the problems of garbage disposal, water supply and sewerage, air pollution from burning coal for heating, and inadequate heating capacity for the expanding urban areas.

g. Issues concerning gender equality

Under the former socialist regime, both men and women were supposed, in principle, to participate in economic activities. The democratized government has basically followed the same principle. The employment rate is almost the same for males and females between the ages of 25 and 50. Percentages of women who attend college, work in NGOs, the private sector and government institutions may even exceed those of Japan.

Since democratization, however, the burden on women has increased as day-care centers and nurseries are no longer free of charge while the number of fatherless families continues to increase¹⁹. The privatization of state-owned enterprises and the introduction of private ownership have benefited mostly men. Traditional customs have limited women's ownership of property and restricted women's economic activities to the informal sectors.

¹⁸ In 2003, the official population of the capital was 893,000. Nationally, in 2002, population density was 1.58 persons per square kilometer but the capital city was 180 persons per square kilometer. In 2003, 35.7% of the population and 57.8% of GDP are concentrated in the capital.

¹⁹ In 2002, the number of female-headed households was 61,765, which was 11% of the total. 46,298 women were single mothers with a child under age 16. 13,514 couples got married and 688 got divorced in 2002.

2. Trends in Mongolia's development strategies and assistance to Mongolia

(1) Current development challenges

Once Mongolia moved to a market-based economy, it was able to leave the process of contracting equilibrium in the early 1990s, and recently turned in economic growth. This process was smoother than that of the Central Asian economies which faced conditions similar to Mongolia²⁰.

However, the economy of Mongolia in 2003 barely exceeded the size of that in 1990. Meanwhile, there were substantial changes in the structure of both the economy and employment, causing the widening gap between the rich and the poor as well as among the regions.

An important issue to be addressed is the decline of the agriculture and livestock industries. To revive the livestock breeding and agricultural industries, it is particularly important to raise efficiency and have the surplus labor in these sectors move on to other sectors in a proper fashion. Given an expected increase in the labor force in the future and the fact that the impoverished have been left behind in the development process, it will be necessary to create 200,000 to 300,000 new jobs in the next 10 years.

Accordingly, looking at the prospects for the next decade, Mongolia is at the crossroads as to whether it can be on the path to sustainable development. The important development challenges that Mongolia faces can be summarized as follows:

- How jobs will be created through the promotion of the market economy (and in particular SMEs and the private sector) the financial system reform, improvements of investment environment, infrastructure building and whether employment through these measures will absorb surplus labor from the livestock industry.
- How poverty, regional differences, environmental degradation and other living and social problems can be solved.
- How human resource development, management capacity, policy making and implementation capacity of both the private sector and the government can be improved.
- How economic activity will be boosted by overcoming the handicap of limited

²⁰ Mongolia's real GDP index, with the base set at 100 in 1990, was 104.7 in 2002 while that of Kazakhstan was 77.9 and that of Kyrgyzstan was 69.8. See *ADB-KEY INDICATORS OF DEVELOPING ASIAN AND PACIFIC COUNTRIES 2003*.

market access due to its geopolitical situation and by linking with the Northeast Asian market.

Mongolia is rapidly implementing economic liberalization measures such as privatization of state-owned enterprises and private ownership of land and its government is formulating policies and laws accordingly. Development assistance to Mongolia must take these trends into account.

(2) The Government's development programmes

The Mongolian government's main mid-term development strategies are the Government Programme of Action for 2000-2004, "the Good Governance for Human Security Programme", and "Economic Growth Support and Poverty Reduction Strategy (EGSPRS)²¹" which is aiming at implementing the Government Programme of Action. The EGSPRS was drafted under the Mongolian government ownership in consultation with donors, institutions and numerous NGOs. All donors are now required to align with the EGSPRS in providing assistance.

a. The Government Programme of Action

The MPRP's Enkhbayar administration came to power in 2000 and formulated the "Government Programme of Action" for 2000-2004. The Programme shows the following principles and policies in each sector with the basic goal of poverty reduction through sustainable economic growth:

(a) Principles:

- Drastic economic reform and economic growth through exports
- Respect for and preservation of education and culture
- Improvement of living standards by promoting efficiency of income distribution, and amplification of social welfare by developing an effective system
- Implementation of the regional development concept and reduction of the gap between rural and urban areas;

(b) Sector-specific policies:

A. Social policy: provision of basic education and vocational training, health

²¹ Economic Growth Support and Poverty Reduction Strategy Paper (Mongolia's PRSP)

promotion through top-quality medical and preventive care, art and culture based on unique Oriental characteristics and its global worthiness, promotion of science and technology, improvement of wealth and income distribution mechanism and reduction of the gap between the rich and poor.

B. Economic policy: macroeconomic stabilization, development of sound fiscal and banking system, pursuance and promotion of efficiency of privatization, revitalization of domestic industries and promotion of exports, strengthening the mining sector, stemming the decline of the livestock industry, tourism development, and development of rural infrastructure.

C. Regional and rural development policy: rural-oriented taxation, investment and credit policies, and rural development of respective five blocks of the country.²²

D. Environmental policy: eco-friendly economic growth, precisely defined civil rights and responsibilities related to the utilization and protection of local natural resources.

E. External policy: crime prevention in border areas, development of good neighborly relations with Russia and China, strengthening and extension of the comprehensive partnership with Japan, strengthening of relations with the Asia-Pacific countries.

F. Strengthening of governance, public order and discipline: efficient implementation of policies, effective public services for citizens, strengthening of governance including development of law and order, improvement of public service accountability and eradication of corruption, bribery and crime through drastic legal reform and improvement in law enforcement.

Although the Government Action Programme is somewhat all-embracing and has no quantitative data or targets, it is a step in the right direction because the Mongolian government has spelled out policy directions under its ownership. If the socio-economic policy in the Programme is implemented as planned, it is expected that in 2004, the final year of the Programme, annual economic growth will reach 6%, budget deficit will be 5.7% of GDP, current revenue will be 4% of GDP, and macroeconomic stability will be achieved.

²² In 2003, the State Great Hural, or parliament, adopted development plans for the below-mentioned five regions and eight cities, that is, two cities from each of the four regions excluding the capital. The target regions and center cities are as follows: (1) Western region (Khovd, Uliastay); (2) Khangay region (Kharkhorin, Erdenet); (3) Central region (Zuunmod, Darkhan); (4) Eastern region (Choibalsan, Ondorkhaan); and (5) Capital. Detailed development plans are currently being formulated. After the parliamentary election of 2004, whether to keep the division of the five regions is being negotiated. As of September 2004, the Democratic Union is advocating a policy concentrating on the Central region including the capital, as opposed to the MPRP's five regions as stated above.

b. Good Governance for Human Security Programme

The Good Governance for Human Security Programme was announced in 2001, elaborating on priority socio-economic issues of the Government Programme of Action as the following eleven priorities:

1. To stabilize the macro-economy, and intensify the process of economic recovery.
2. To develop a sound fiscal and banking system.
3. To facilitate economic growth by developing domestic industry and supporting export-oriented industry.
4. To promote regional and rural development as well as infrastructure development.
5. To enhance human resource development and social sector services.
6. To reduce the number of unemployed persons, and to improve living standards.
7. To protect the environment.
8. To promote land reform.
9. To reduce pollution and to improve waste processing.
10. To promote good governance for human security.
11. To develop a democratic civil society respecting basic human rights.

c. Economic Growth Support and Poverty Reduction Strategy (EGSPRS)

Since 1999, the Mongolian government has undertaken the drafting of a Poverty Reduction Strategy Paper (PRSP) with the support of the World Bank through an inter-ministerial committee convened by the Ministry of Finance and Economy. In the process of drafting the full PRSP, the title of this document was changed from “Poverty Reduction Strategy Paper (PRSP)” to “Economic Growth Support and Poverty Reduction Strategy (EGSPRS)”. The EGSPRS is the government’s development strategy centered on the policy of poverty reduction through economic development, balancing economic and social development through the following five pillars:

- Ensuring macroeconomic stability and public sector effectiveness.
- Supporting production and exports and improving the environment for private-sector-led development.
- Enhancing regional and rural development and environmentally sustainable development.
- Fostering sustainable human development.
- Promoting good governance, and implementing and monitoring the strategy.

The Poverty Research Group in the Ministry of Finance and Economy is to coordinate the EGSPRS implementation, monitoring and reporting. Under the coordination, sector ministries will, within a certain period of time, implement various programs designed to contribute to the achievement of policy goals. In addition, the related ministries, institutions and NGOs will be responsible for the implementation and monitoring of certain projects and programs within the EGSPRS. The Poverty Research Group will analyze and assess the numerous activities and report on their progress to the government, parliamentarians, the World Bank and other related institutions.

Currently the Mongolian government is trying to ensure consistency among the Government Programme of Action, EGSPRS and the Millennium Development Goals (MDGs) in drafting the annual implementation policy called the “Socio-Economic Basic Policy”. The government will monitor the progress of the above mentioned three plans when drafting this implementation policy and has shown its intention to improve the policy-making process. Details of the new government’s economic and development policies are not yet known, but it seems certain that it will proceed with development in accordance with the EGSPRS formulated under the Enkhbayar administration²³.

(3) Japan’s ODA to Mongolia so far

Ever since the establishment of diplomatic relations with Mongolia in 1972, Japan has made steady diplomatic efforts and has provided assistance of approximately 6 billion yen by 1990. This assistance included the construction of a cashmere factory (5 billion yen) for the promotion of processing and indigenous industry, which played a major role for then socialist Mongolia in earning foreign exchange.

In 1991, Japan provided emergency assistance to help ease the confusion caused by the political and economic transition. Since then, Japan has actively supported Mongolia as the top donor, taking the following points into consideration: mid- to long-term development needs of Mongolia centered on economic infrastructure such as energy, communication and transport (railways, roads), human resource development and institutional building necessary for smooth transition to a market economy, promotion of agriculture and livestock industry, basic needs for living such as education, healthcare,

²³ The Motherland-Democratic Union Coalition has pledged to continue the foreign policy of the previous administration.

water supply and food aid. Meanwhile, Japan has actively supported Mongolia's entry into the international arena not only through economic cooperation but also through the membership application process to the ADB, World Bank and IMF among other international institutions. From FY 1991 to FY 2003, Japan has provided 36.126 billion yen in loans, 68.810 billion yen in grant aid, and 23.342 billion yen in technical cooperation, or a total of 128.278 billion yen which amounts to approximately 70% of all bilateral aid to Mongolia²⁴.

With support to basic human needs for living such as food, water supply, healthcare and education, then industrial infrastructure including energy, communication and transportation (railways, roads) as well as promotion of livestock industries, Japan's assistance as the top donor to Mongolia has played a key role in the country's transition from a socialist economy to a market economy.

Mongolia gives high praise and gratitude to Japan's assistance. An analogy goes as follows: "Japan saved Mongolia from drowning and cured Mongolia as the primary physician at the hospital. From now on, Mongolia, just discharged from the hospital, would appreciate having the support of Japan as the caretaker."

The following are a few examples of assistance which are very highly regarded within Mongolia. For infrastructure, among the popular projects are establishment of the earth station for satellite communications, construction of cargo reshipping base at the China-Mongolia border, road construction, refurbishment of the 4th thermal power station, provision of urban buses, extension of school buildings, and provision of diesel generators to the rural areas. For emergency aid, food aid, food production aid, and provision of shortwave radio through an emergency grant are highly appreciated. School refurbishment projects are popular under the grant assistance for grassroots projects scheme. Human resource training in the infrastructure sector, specifically for staffs of the 4th thermal power plant, the bus company and the Darkhan Steel Company received high marks.

On the other hand, there are some projects that could not be fully utilized as the management system for the assisted facilities collapsed due to the hasty transition to a market economy. There were other projects for which the results took extra time to materialize, due to financial difficulties and lack of maintenance costs on the Mongolian

²⁴ In FY 2003 alone, Japan provided 3.085 billion yen of grant aid and 1.526 billion yen of technical cooperation or a total of 4.611 billion yen.

side. In selecting future projects, based on the lessons learned from past projects, it is increasingly vital to consider Mongolia's political, economic and social framework and trends in addition to the needs for the projects and expected outcomes.

(4) Trends in assistance by other donors and NGOs to Mongolia

The major donors to Mongolia in the last decade have been Japan, the ADB and the World Bank. Recognizing that Mongolia is at a crossroads, all of the three entities are currently drafting a medium-term 3-5 year assistance plan from 2004.

a. The Asian Development Bank (ADB) is the second largest donor after Japan, providing 54 million US dollars in technical assistance and 570 million US dollars in loans since 1991. The ADB has supported, and will continue to support, Mongolia in the following six priority sectors: agriculture, finance, revitalization of the public sector, the social sector, urban development, and roads.

b. The World Bank is Mongolia's third largest donor and has provided a total of 300 million US dollars assistance from 1991 to date. 51% of this assistance has been directed toward infrastructure, 23% to the financial sector, 12% to poverty issues and 8% respectively to deal with private sector and governance issues. The Bank is likely to focus its assistance on the Economic Growth Support and Poverty Reduction Strategy (EGSPRS), the Mongolian government's top priority goal. To achieve this goal, the Bank is anticipated to support public sector reform, private sector and social sector development and has announced that it will also devote efforts to infrastructure (roads and rural electrification) and rural development.

c. Assistance by the United States to date has been limited mostly to food aid (flour) and technical cooperation. However in September 2003, the U.S. unveiled its Mongolia Assistance Plan covering 2004 to 2008 which placed an emphasis on assistance for private sector-led sustainable development and enhancement of governance. The U.S. also made public 63 target countries for the Millennium Challenge Account (MCA), a new assistance plan. Mongolia is the only MCA target country in Northeast Asia, and the future direction of MCA bears watching.

d. China is currently not a major donor to Mongolia, but it is becoming Mongolia's largest trade and direct investment partner. China has provided loans and grants for construction projects and the mining industry. When Chinese President Hu Jintao visited

Mongolia in June 2003, he promised to provide 300 million US dollars in loans. However, at the Consultative Group (CG) meeting held in November 2003, the Mongolian government declared that it had no intention of borrowing non-concessional loans in the future. Accordingly, the two countries are negotiating the terms of the promised loans in the direction of making them concessional, and what happens to the loans is of interest to the donor community.

e. Although Russia is not a major donor, new possibilities are emerging for development in economic cooperation between Mongolia and Russia as Mongolia's external debt problem with Russia was resolved in December 2003. Mongolia is constructing the Altanbulag Free Economic and Trade Area on the Mongolian side of the Russian border along the North South Railways. This is an effort to facilitate trade relations with Russia, reflecting Mongolia's high interest in the Siberia market.

f. NGO activities: In post-democratization Mongolia, international, local and Japanese NGOs have been active in socio-economic development projects. International NGO activities, in particular the health and education activities of "World Vision", "ADRA" and "Save the Children" are notable. Many Japanese NGOs are active in Mongolia, providing assistance to urban street children and to nomads who have lost their livestock because of *dzud* and drought since 1999.

(5) Proceedings of the 10th Consultative Group Meeting

Japan hosted the 10th Consultative Group (CG) meeting on Mongolia in Tokyo, with the World Bank and the Government of Mongolia as co-chairs from 19th to 21st November 2003. This was the last time that the CG would be held outside of Mongolia. At the meeting, a review of the last ten years of assistance along with an analysis of Mongolia's current economy and issues were done, with a discussion on how donors could support the EGSPRS and commitment of assistance by donors.

More specifically, the need to support broader based growth for longer term development and to create more job opportunities was affirmed. At the same time, the need for increasing private sector-led investment and creating new jobs to achieve sustainable economic growth was stressed. Furthermore, in connection with this, the importance of improving the climate for private sector investment and the management environment, creating a legal environment which facilitates private sector-led

development, improving public sector productivity and efficiency, streamlining the size of the government, increasing transparency and accountability in budget execution, and improving governance were all emphasized. In addition, for Mongolia to achieve poverty reduction and the MDGs, the importance of improving service provision and rural development as well as the need to tackle rapid urbanization and the urban poverty problems were acknowledged.

A total of 335 million US dollars was committed at this CG. Japan declared that it would provide 4.611 billion yen of assistance in FY 2003. The World Bank represented other donors in recognizing that Japan has provided a large amount of assistance to Mongolia over a long period of time and played an important role in charting and contributing to Mongolia's development.

3. Basic policy on assistance to Mongolia

(1) The significance of assistance to Mongolia

a. Mongolia is landlocked between two large countries, China and Russia, and has an important geopolitical position in Northeast Asia. Mongolia's commitment to democracy is expected to contribute to the achievement of stability and peace in this region. Northeast Asia is closely linked to Japan's security and economic prosperity, and its importance for Japan has increased considerably in recent years.

b. Bilateral relations between Japan and Mongolia have been exceptionally intimate from a diplomatic perspective. The deep and friendly relations between the two countries which existed when Mongolia was under the socialist regime have further strengthened since 1990. The two countries have confirmed the "Comprehensive Partnership"²⁵ which advocates the building of two-way relations in broad areas as well as the strengthening and promotion of mutually advantageous relations in not only bilateral but also international arenas.

²⁵ This was confirmed by the then Mongolian Prime Minister Enkhsaikhan, on a visit to Japan in February 1997, and the then Japanese Prime Minister Hashimoto. When President Bagabandi officially visited Japan in May 1998 for the first time as a Mongolian chief of state, the two countries reconfirmed that they would pursue the "Comprehensive Partnership" and issued a "Joint Statement on Friendship and Cooperation". In December 2003, the "Mongolia-Japan Joint Statement", was issued during President Bagabandi's official visit to Japan, and confirmed the steady progress of the Partnership and the intention to further develop bilateral relations and partnership in the regional and international community.

c. Mongolia was one of the first countries to declare, in 1990, its transition from a socialist regime to a democracy and to establish a democratic political system through free elections. Japan, as a democracy, highly commends Mongolia's efforts in economic and social development under the shared political concept of democracy. Japan is convinced that assistance to promote Mongolia's economic and social development will promote the development of democracy in other developing countries which have made the same efforts as Mongolia.

d. Mongolia has made various efforts to liberalize and open its economy, bringing about certain progress in privatization and institution building. From now on, based on such achievements, Mongolia will accelerate efforts toward a market economy by, among others strengthening private sectors under its ownership. Active support toward such self-improvement is in line with Japan's ODA Charter and is worthy in itself.

e. Mongolia's natural environment has global and anthropological uniqueness and value. Mongolia's nomadic culture and unique heritage, including its traditional music, nurtured by this vast nature, has intrigued the world. However, the sad reality is that this nature is being degraded as a result of the rapid transition to a market economy and valuable, traditional culture is slowly fading away. The government of Mongolia has taken steps to protect the natural environment and preserve traditional culture and has requested assistance from the international community to support these efforts. It is important for Japan to assist Mongolia in these efforts from the viewpoint of global environmental protection and traditional culture preservation.

(2) Direction in assistance to Mongolia

The Mongolian government's development strategies mentioned in Section 2 (2) "The Government's development programmes are steps" is a step in the right direction as they aim to achieve poverty reduction through sustainable economic growth and reflect the government's efforts for self-improvement.

Japan is not going to try to respond to all of Mongolia's development challenges. Rather, with aid coordination among the major donors in mind, it will assist in a selective and concentrated manner Mongolia's policies to implement its own development strategies. Japan's main objective in assistance to Mongolia for the next five years is to support the

implementation of linked policies in which Mongolia promotes economic activities, reduces budget deficit by stabilizing macro-economy and streamlining the public sector, improves aid absorption capacity, and devotes increased revenue to poverty alleviation and environmental protection. In view of facilitating smooth implementation of such linked policies, the overall goal of Japan's assistance to Mongolia is to support Mongolia's self-improvement efforts toward poverty reduction through sustainable economic growth, and in order to achieve this goal, the intermediate goal is to bring about a general economic uplift in the rural areas and absorb surplus labor of the livestock industry in newly created jobs in other sectors.

To achieve the goals mentioned above, Japan will support institutional and human resource development in both the public and private sectors for sound macroeconomic management, and assist rural development to bridge the gap between the rural and urban areas. It will also support environmental protection for eco-friendly sustainable economic growth. Furthermore, it will support infrastructure development conducive to promoting economic activity including foreign exchange-earning industries and policy formulation related to such development.

Japan set such direction based on the basic recognition that the fundamental solution to poverty can be achieved through economic growth, and it has selected and concentrated on specific goals with the objective of carrying out poverty reduction effectively. With regard to assistance directly targeting the poor and socially vulnerable, Japan is going to aid, for example, activities of NGOs through such schemes as "Grant Assistance for Grassroots Human Security Projects" and also "Grant Assistance for Japanese NGO Projects".

(3) Priority areas in assistance to Mongolia

Based on the direction mentioned above, Japan's assistance to Mongolia for the next five years will have the following four priority areas:

1. Support for institution building and human resource development necessary for promoting a market economy.
2. Support for rural development (support for certain model development areas centered on regional development hubs, revitalization of pasture, livestock breeding and farming.)
3. Support for environmental protection (preservation of the natural environment as well as appropriate utilization of natural resources, and measures against environmental

problems in Ulaanbaatar).

4. Support for development of infrastructure to promote economic activity.

The priority areas for Japan's assistance match those of the EGSPRS laid down by the government of Mongolia. The Government of Mongolia plans to create a mid-term budgetary framework to implement the various policies stipulated in the EGSPRS and to use Millennium Development Goals (MDGs) indicators (localized for Mongolia's situation) as a tool for monitoring social development activities in particular. It may be a good idea, therefore, to refer to the indicators used by the Mongolian government in order to evaluate the effectiveness of Japan's assistance.

a. Support for institution building and human resource development necessary for promoting a market economy

Human resources development through strengthening basic education and vocational training is very important for sustainable economic growth. In basic education, there are many issues to address such as triple-shift schooling due to lack of school buildings, improvement in the quality of education, school administration problems due to scheduled change of the 10-year school system to an 11-year one in 2005, poor educational environment in rural schools, and retraining of teachers. Vocational training in a practical manner is also important for expanding employment opportunities for the poor.

In the public sector, establishment of a tax collection system, enhancement of administrative and financial management capacity including development of a legal and regulatory framework, and improvement of policy planning capacity and specialized skills in both economic and social sectors are urgently needed. In the private sector, strengthening of the financial system, enhancement of system supporting development of business enterprises including improvement of management capacity in small and medium enterprises and of know-how in commercial transactions, and development of trade and investment environment are critical issues which need to be tackled. For that purpose, institution building and human resource development are urgently required. In particular, the financial system has many problems such as high interest rates and troubled monetary circulation which adversely affect economic activity. It is one of the bottlenecks of private sector-led economic growth. Institution strengthening and human resource development are thus urgently required in this field.

Support to institutional strengthening and human resource development is an important prescription for escaping from poverty through private sector-led growth in both Ulaanbaatar that produces nearly 60% of Mongolia's GDP and the rural areas. Japan will address the issues mentioned above by utilizing among others the Mongolia-Japan Center that was established in Ulaanbaatar in 2002. On the other hand, it is vital for Mongolia to nurture an environment in which trained human resources will stay in Mongolia and contribute to the country's economic growth, and not be induced to move abroad for other opportunities.

b. Support for rural development

1. Support for certain model development areas centered on regional development hubs

To fundamentally solve the poverty problems in Ulaanbaatar and the rural areas, rural development is absolutely necessary.

For rural development, the most important task is to stimulate the regional economy through development of industries in hub cities of the region. Support to regional development in this line would be revitalization of the agricultural and livestock breeding sector – the driving force behind the regional economy – through development of economic infrastructure like irrigation, assistance to the private sector and industry including distributive trade, and provision of low-interest loans. To implement grazing of a traditional nature as well as agriculture with higher productivity in each region, it is important to address each specific issue under a comprehensive policy. Measures to facilitate development through rich tourism and underground resources in countryside are also needed.

Improvement of social services such as health- and medical-care is also important. For this purpose, it is necessary to train medical practitioners and nurses who can provide better services.

In a country like Mongolia that has a vast territory and a small population, it is hard to provide the types of support mentioned above in all regions as it would be expensive and may not be cost effective. Accordingly, it would increase aid effectiveness to select certain areas among the regional development hubs that the Mongolian government designated, and to provide development support to the areas, which is expected to be a model case for other areas.

2. Support for revitalization of pasture, livestock breeding and farming

Major causes of poverty in Mongolia include such agriculture-related factors as desertification due to overgrazing, *dzud*, and drought. Accordingly, for the certain areas mentioned above, it is necessary to support, among the livestock breeding and farming sectors, particular ones, the support to which not only has high economic efficiency but also makes meaningful contributions to poverty reduction. This is to be done from the perspective of aiming for sustainable growth while paying attention to environmental protection. It is important to take action under a comprehensive policy to revitalize pasture, livestock breeding and farming. Based on the lessons learned from its assistance to Mongolia so far, Japan will select issues from previous ones such as measures against desertification, drought and *dzud*, as well as improvement of production of cashmere, wool, milk, grain and vegetable, and provide support to projects for dealing with the selected issues. It is also important to develop an institutional framework and to disseminate related technology, which contributes to the effective implementation of the projects mentioned above

c. Support for environmental protection

1. Preservation of the natural environment and appropriate utilization of natural resources

Mongolia's ecosystem is varied, home to internationally rare and valuable wild animals, and is a genuine portrait of biodiversity. Previously, this environment was preserved through the traditional nomadic life. However, rampant development in the 1990s has increased pressure to exploit wild plant and animal resources. Although Mongolia is signatory to the 1992 Convention on Biodiversity, the 1994 Convention to Combat Desertification, and other international natural environment conservation frameworks, it lacks sufficient domestic capacity to monitor compliance with the principles of these frameworks. This seems to be due to the lack of laws on environment protection, weakness in managing their implementation, lack of appropriate technology for utilizing natural resources, lack of conservation technology for protecting rare wild animal and plant species, and lack of scientific data on animal and plant populations. These problems, however, can be surmounted through appropriate assistance.

Mongolia faces a number of environmental challenges such as grassland degradation and desertification due to drought, *dzud*, and forest fires, and increasing frequency of yellow dust storms accompanying these phenomena. In addition, the country has seen

receding glaciers and depletion of lakes and rivers that global warming seems to cause. However, since the cause-and-effect relationships of these phenomena have not been scientifically resolved, it is important to grasp the state of the natural environment by monitoring climate and environment in a comprehensive manner and encourage preparation of early warning and disaster prevention systems.

Environmental considerations are thus very important to Mongolia's development. It is also vital to protect the indigenous nature of Mongolia as it is a source of a unique culture. In addition, natural resources are the foundation of tourism development that the Mongolian government is promoting. It has to be noted that local residents expect to utilize natural resources, animals and plants as a source of additional income. Accordingly, it is necessary to promote the protection of the natural environment and the appropriate use of natural resources in such a way that they contribute to poverty reduction and the preservation of indigenous, traditional culture. This undertaking also needs the participation of local residents.

2. Measures against environmental problems in Ulaanbaatar

As previously stated, the actual population of Ulaanbaatar is reportedly 1.1 million due to the inflow of nomads who could no longer make a living in countryside because of *dzud* and drought. Such concentration of population in cities is causing symptoms of urban environmental degradation such as air pollution due to use of coal for heating, disposal problems of household trash and industrial waste, and water pollution. Mongolia does have environmental regulations and the law on waste disposal but has little power to enforce them. From now on, it is worthwhile to consider support to such areas as improvement of coal as fuel, human resources development for urban environmental administration, establishment of a proper waste disposal system, and improvement of water quality.

d. Support for development of infrastructure to promote economic activity

Infrastructure is the foundation of Mongolia's economic development. It is more important than ever as most of the existing facilities built through aid from the Soviet Union are decrepit. In this Country Assistance Program for the next five years, Japan plans to help develop infrastructure, including that for information and communications, which will facilitate industrial development in Ulaanbaatar and regional cities and directly help improve the people's daily lives. In addition, while economic growth is to

be led by the private sector, Japan has in mind assistance to development of the transportation sector that promotes industries for acquisition of foreign currencies such as tourism and development of underground resources.

From now on, it is important in the medium and long term to provide assistance to infrastructure development which is a foundation of economic activities for promoting links to Northeast Asia such as development of underground resources, trade, and a common market projects being started at the Chinese and Russian borders while closely watching how infrastructure development in eastern Siberia and northeastern China will proceed.

(4) Matters to keep in mind in assistance to Mongolia

a. Policy dialogue

For assistance to be efficient and effective, Japan will hold close policy discussions with the government of Mongolia in project planning, approval and implementation. This policy dialogue will foster the Mongolian government's ownership. On the policy dialogue, appropriate aid schemes as well as continuity and relevance of schemes will be discussed.

b. Aid coordination and partnership with other donors and NGOs

Mongolia has received assistance from many countries and international organizations. However, as Japan has been the top donor to Mongolia, it is expected to take the lead in donor coordination and partnership. More importantly, for implementation of efficient partnership and coordination, the ownership of the government of Mongolia needs to be enhanced. In April 2004, a working group on improving efficiency of aid for education, healthcare and infrastructure was set up under the auspices of the Mongolian government. Japan, along with the ADB, became vice-chair of the working group on education. From now on, efforts must be made, not only by Japan but also by the donor community as a whole, to raise the impact and effectiveness of aid while respecting the ownership of the government of Mongolia. In this connection, institutional strengthening of the local task force is needed for closer policy coordination and partnership with other donors.

To provide effective and efficient assistance to Mongolia, the exchange at the citizen

level such as NGOs of the two countries should be taken into full consideration. Bilateral relations between Japan and Mongolia, especially the exchange at the citizen level, have been deepened rapidly since Mongolia turned to democracy and the market economy. In the economic cooperation arena, Japanese NGOs have provided grassroots assistance tailored to the developmental needs of their target areas. The Government of Japan feels it should not only support such initiatives but also aim for citizen-participating economic cooperation from the perspective of strengthening bilateral relations.

c. External debt issue and aid absorption capacity

Mongolia's public external debt is high at 94.0% of its GDP, causing the IMF to express its concern. However, the debt service ratio has improved to 6.7%, which is relatively low for a developing country, and the economy has taken a turn for the better in recent years. The views that Mongolia is in a position to borrow limited concessional loans mainly from international organizations are further strengthened. Mongolia's debt with the former USSR, which had been a matter of recent concern, was resolved in favor of Mongolia at the end of December 2003. Mongolia's efforts to resolve foreign debts could be appreciated although the debts' influence on the domestic economy is causing a concern. As mentioned earlier, Mongolia must accelerate its efforts to improve its economic infrastructure, which leads to a large demand for financial resources. The strengthening of institution for receiving and implementing aid and the enhancement of management capacity for public expenditure become more and more important. Finance institution building to facilitate inflows of various types of external funds and the expansion of Mongolia's financial system are also important issues. Japan is closely observing the status of Mongolia's debt management as the repayment to the principals and interests of Japan's yen loans will reach the peak in the next few years.

In relation to the capacity to absorb aid funds, the inter-ministerial coordination within the government of Mongolia needs improvement. Japan will emphasize the importance of the ownership of the Mongolian government and request efforts to redress the side effects of bureaucratic sectionalism in the government. The Mongolian government duly recognizes this problem and enacted the aid and loan coordination law in June 2003 to stipulate the duties and responsibilities of each ministry. It is expected that aid will be implemented smoothly in accordance with this law in the future. It may be also necessary to request the strengthening of governance.

d. Considerations for environmental and social aspects

To improve economic infrastructure and formulate projects in this field, it is necessary to pay close attention to environmental and social aspects, especially equal opportunities for men and women, as such undertaking can affect these aspects.

It is also necessary to be aware of the risks posed by Mongolia's harsh natural conditions such as extreme cold, dryness, and limited arable land. These are a significant obstacle to Mongolia's economic development. In providing assistance, the risk of these natural conditions should be recognized consistently and measures against them should be considered.

e. Evaluation for effective implementation

This Country Assistance Program is for the next five years. To implement assistance based on this program in an effective and efficient way, it is important to build a monitoring system. Every year, the ODA task force in Mongolia is to monitor the implementation of this program focusing on the situation of project formulation and implementation in each priority area and that of the above mentioned points to keep in mind. The results of this monitoring constitute an important input to the country evaluation, or third-party evaluation, which is to take place four years after the formulation of this program.

End

| | 2000 | 2001 | 2002 | 2003 |
|---|------|-------|-------|-------|
| Real GDP Growth Rate (%) | 1.1 | 1.0 | 4.0 | 5.5 |
| Rate of Increase in Consumer Prices (%) | 11.8 | 8.2 | 1.5 | 4.6 |
| GDP (million US dollars) | 945 | 1,016 | 1,100 | 1,189 |
| Population (million) | 2.41 | 2.44 | 2.47 | 2.50 |
| GDP per capita (US dollars) | 395 | 419 | 442 | 466 |
| Investment/GDP (%) | 36.2 | 35.8 | 32.2 | 31.1 |
| Savings/GDP (%) | 29.5 | 29.9 | 22.8 | 22.8 |
| Budget Deficit/GDP (%) | 7.7 | 4.5 | 5.8 | 5.9 |
| Trade Deficit/GDP (%) | 14.8 | 16.7 | 20.5 | 16.8 |
| Current Account Deficit/GDP (%) | 6.7 | 5.9 | 9.4 | 8.3 |
| Exports (million US dollars) | 536 | 523 | 524 | 627 |
| Imports (million US dollars) | 676 | 693 | 753 | 827 |
| Foreign Currency Reserves (million US dollars) | 202 | 257 | 399 | 243 |
| Official External Debt/GDP (%) | 96.5 | 87.4 | 94.0 | - |
| Debt Service Ratio (%) | 6.1 | 6.7 | 6.7 | - |

Note: Results between 2000 and 2003 (Source: ADB). The debt to Russia that was repaid in December 2003 is not reflected in this table.

The Government Programme of Action

1. Economic reform and economic growth led by the private sector
2. Respect for and preservation of education and culture
3. Improvement of living standards and development of an effective social welfare system
4. Correction of regional disparities

Economic Growth Support and Poverty Reduction Strategy (EGSPRS)

- (a) Ensuring macroeconomic stability and public sector effectiveness
- (b) Supporting production and exports as well as private-sector-led development
- (c) Enhancing regional and rural development and environmentally sustainable development
- (d) Fostering sustainable human development
- (e) Promoting good governance

Japan's ODA to Mongolia

- Strengthening basic education and professional training
- Capacity building of government officials
- Strengthening the financial system

- Revitalizing the regional economy
- Revitalizing pasture, live stock breeding and farming
- Improving social services such as healthcare and medical services

- Environmental protection

- Improvement of infrastructure

Institutional and human resource development for a market economy

General Economic uplift in the rural areas

Preservation and appropriate utilization of the natural environment

Promotion of economic activities

Poverty Reduction through Sustainable Growth