

# USAID/Mongolia

## Strategic Plan, 2004-2008



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This Strategic Plan for Mongolia was assembled by USAID/Mongolia. This Strategic Plan is a 'pre-decisional' USAID document and does not reflect results of USG budgetary review.

Additional information on the attached can be obtained from Jonathan Addleton, USAID/Mongolia, or Calista Downey, Office of East Asia Affairs, USAID Asia and Near East Bureau.

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# LIST OF ACRONYMS

ADB	Asian Development Bank
ANE	Asia and Near East Bureau
DAI	Development Alternatives, Inc.
DCHA	Bureau for Democracy, Conflict, and Humanitarian Affairs
DG	Democracy and Governance
EG	Economic Growth
EGAT	Bureau for Economic Growth, Agriculture, and Trade
EBRD	European Bank for Reconstruction and Development
EPSP	Economic Policy Support Program
ERA	Energy Regulatory Authority
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Service
GDA	Global Development Alliance
GDP	Gross Domestic Product
GER	Growing Entrepreneurship Rapidly Project
GOM	Government of Mongolia
GTZ	German Technical Cooperation
IR	Intermediate Result
IRI	International Republican Institute
IT	Information Technology
MAPS	Manual for Action in the Private Sector (MAPS) Survey
MCA	Millennium Challenge Account
MPP	Mission Performance Plan
MPRP	Mongolian People's Revolutionary Party
MTA	Mongolian Tourism Association
MVC	Most Valued Company
NCSC	National Center for State Courts
NGO	Non-Governmental Organization
OE	Operating Expenses
RFP	Request for Proposal
SO	Strategic Objective
SOAG	Strategic Objective Agreement
SOE	State Owned Enterprise
SPC	State Property Committee
TDB	Trade and Development Bank
UNDP	United Nations Development Program
USAID	U.S. Agency for International Development
USDH	U.S. Direct Hire Employee
USG	U.S. Government
WTO	World Trade Organization

## EXECUTIVE SUMMARY

This document presents the USAID strategy for Mongolia during the period FY 2004 through FY 2008. It is the product of a participatory process, one that included significant input from both the Asia and Near East (ANE) Bureau and the EGAT and DCHA Bureaus in Washington. It also involved a series of discussions within the Embassy country team; with Mongolian counterparts; with other donors; and with a broad range of stakeholders and partners in Mongolia. As a result, the strategy helps advance issues that are central to A.I.D.'s mandate; vital to the Embassy's Mission Performance Plan (MPP); and strongly supportive of Mongolian development objectives.

As described in this document, USAID/Mongolia will work with Mongolian counterparts over the next five years to promote good governance as well as sustainable, broad-based economic growth. The intent is to promote Mongolia as a *dynamic, growing economy, one that is marked by freedom, openness and accountability in economics as well as politics*. Success in one area will reinforce progress in the other. Thus, all USAID-funded activity will be organized around a strategic vision that focuses on two central Strategic Objectives (SOs):

-- First, USAID/Mongolia will work to *accelerate and broaden sustainable, private sector-led economic growth*;

-- Second, USAID/Mongolia will work to achieve *more effective and accountable governance*.

The formulation of these SOs is broadly similar to those developed for the 1998 – 2003 strategy period. However, the Intermediate Results (IRs) have been more substantially revised. In the case of economic growth, the program emphasizes an improved enabling environment for private sector growth; more competitive industries and sectors and expanded economic opportunity for marginalized Mongolians. In the case of good governance, the program focuses on comprehensive legal reform and more competitive, effective, and transparent political processes.

Mongolia achieved commendable progress over the last decade. Its progress in simultaneously introducing a broad range of economic and political reforms is especially notable. More than 75 percent of the economy is now in private hands, up from almost nothing in 1990. In addition, Mongolians have participated in a series of free and fair elections and enjoy a degree of political openness that sets the country apart, not only from its Central Asian neighbors but also from many other developing and transition countries. Not surprisingly, this progress also sets Mongolia apart as a potential candidate for Millennium Challenge Account (MCA) funds.

USAID, though representing less than five percent of total donor resources provided to Mongolia in a typical year, has made vital contributions to this transformation. Perhaps nowhere is this more evident than in privatization and banking. Over the past six months,

USAID was directly involved in Mongolia's two largest privatizations to date, that of the Trade and Development Bank (TDB) and Agricultural Bank. Together, these two transactions provided nearly \$20 million to the Mongolian treasury. In addition, they hold out the promise of another \$40 million in foreign investment over the next two to three years. USAID programs are also vitally involved in judicial reform; in making Mongolia's tourism and cashmere sectors more competitive; and in expanding economic opportunity to Mongolians living in both rural and "peri urban" Mongolia.

Yet much work still remains to be done. It is no exaggeration to say that the next five years will determine whether Mongolia is content to simply remain at "the head of a class" of struggling and marginal post Soviet countries or is prepared to ratchet itself up to a much higher level. In a "worst case" scenario, Mongolia could even backtrack rather than move forward. International investment in Mongolia's mining sector is growing and could become significant over the next five years. Such a development carries with it certain dangers. These dangers include the development of a one dimensional economy that stifles other kinds of economic activity; the concentration of wealth in a few hands; and the growing threat of corruption, a threat that could have a corrosive impact on the political, economic and social fabric of the country.

The proposed USAID/Mongolia strategic plan directly addresses issues that are central for Mongolia's future. The combination of "good governance" and "good economic policy" is vital. Beyond that, the identification of transparency, accountability and expanded information flows as important cross cutting concerns that affect every aspect of our program needs to be emphasized.

The strategy intends to provide both a vision and a framework for USAID programming in Mongolia over the next half decade. However, it also envisages an important degree of flexibility, especially at the IR level. In addition, it explicitly acknowledges that elegant or well-written studies are meaningless unless they are accompanied by the "acid test" of any program—effective implementation.

Finally, it is important to emphasize that the program will be heavily targeted in terms of areas of activity as well as number of management units. This high degree of "focus and concentration" is needed, not only to achieve results but also because of the extremely small size of USAID/Mongolia. Throughout the next five years, we will remain one of the smallest Missions in both the ANE Bureau and the Agency. The OE budget for Mongolia has never exceeded \$400,000 annually. The staffing pattern consists of a single USDH Mission Director supported by three FSN professional staff, two FSN administrative staff and a driver. Modest changes are possible—already, a program-funded US PSC is scheduled to join the Mission shortly. However, throughout the next five years USAID/Mongolia intends to maintain its position as one of the most pragmatic, cost-effective and results-oriented Missions in the Agency.

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# I. BACKGROUND

## A. Overview

Just over twelve years ago, Mongolia shook off its remaining ties with the Soviet Union and embarked on a far-reaching set of political and economic reforms. On the political front, it conducted a series of free and fair elections involving peaceful changes of government; avoided the “great leader” syndrome that has stymied democracy in other parts of the world; and accepted differing views among its citizenry, a characteristic that is largely absent elsewhere in Central Asia. Simultaneously, Mongolia made significant steps toward establishing a market economy. The private sector now accounts for more than 75 percent of GDP, an impressive turn-around given that it accounted for virtually nothing at the beginning of the 1990s. The challenge over the next five years is to consolidate these still fragile changes and then move them to the next highest level. Among other things, this challenge involves ensuring an effective response to enduring issues related to accountability, transparency and good governance.

*"Mongolia's strategic importance is primarily due to its geographic location between two nuclear powers"*

Though isolated for many centuries, Mongolia's strategic importance is primarily due to its geographic location between two nuclear-armed superpowers (Russia and China) and its close proximity to a much smaller nuclear armed “rogue state” (North Korea). Mongolia's southern border with China extends for 2,800 miles, China's single longest border with any country. Mongolia's northern border with Russia extends for another 1,900 miles. North Korea is 500 miles to the east, Kazakhstan 25 miles to the west. From a political and economic standpoint, a stable Mongolia contributes greatly to stability in both Central Asia and North East Asia.

Mongolia's vast territory, small population and distance from world markets represent perhaps its greatest development challenge. The country is larger than Britain, France, Italy and Germany combined. Yet these countries together have a population of approximately 250 million people, exceeding Mongolia's population of 2.5 million by a hundred fold. Air travel to Mongolia is costly and domestic air links are sporadic. A single north-south rail line runs through the middle of the country. With less than 1,000 miles of paved road, travel in Mongolia usually involves long journeys by jeep on dirt tracks that run across the country's formidable network of deserts, steppes and mountains. The fact that most international trade must be routed through ports in China and Russia adds to the cost. These factors also make it difficult for Mongolia to compete in the global marketplace.

*"Mongolia's vast territory, small population and distance from world markets represent perhaps its greatest development challenge."*

Officials estimate per capita income at around \$450 a year. This figure does not fully capture the important contributions made by Mongolia's vibrant “underground” economy, fueled in part by the large numbers of Mongolians who live and work in Korea, Japan and elsewhere. External debt is approaching \$1 billion, equivalent to the country's annual GDP. Almost all

debt is on concessionary terms from foreign donors, primarily the Asian Development Bank (ADB) and Japan. These loans will start coming due during the next five-year strategy period. The resulting debt burden will be substantial unless economic growth, stagnant in recent years, begins to increase. Growth in the mineral sector in particular could help fuel this much needed growth.

Health and education indicators remain impressive. This is partly a legacy of the positive steps taken in these areas during the Soviet era. It also reflects the relatively high proportion of government spending devoted to these two sectors (4.8 percent of GDP for health, 4.2 percent of GDP for education). Despite a drop in school enrollment during the mid 1990s, the literacy rate remains well above 90 percent. In contrast to most developing countries, Mongolian females are more likely than their male counterparts to graduate from high school. At a university level, more than two-thirds of all students are women. More than 95 percent of all Mongolian children are vaccinated. Life expectancy has been placed at 67. Infant mortality rates are estimated at around 30 per 1,000. In these and other areas, Mongolia out-performs most other countries at a comparable stage of development.

A continued commitment to economic and political reform, an educated population, an abundance of natural resources—all combine to provide this generation of Mongolians with a unique opportunity to reemerge after centuries of isolation and once again participate on the world stage. China's recent accession to the World Trade Organization (WTO) and Russia's increasing involvement in the world economy should strengthen Mongolia's prospects still further.

Yet much work remains to be done. In particular, the series of reform-oriented laws passed by parliament not only need to be effectively implemented; they also must become part of a "living culture" that builds on the strengths of a market economy while adhering to the norms and practices of a real democracy. In addition, Mongolia must move aggressively to expand transparency, root out corruption, reform the court system and streamline commercial rules and regulations if it wants to encourage local entrepreneurs, attract much needed foreign investment, and ensure a more just and democratic society for its citizens. In this context, a more competitive political system would also go a long way toward building and sustaining democracy over the long term. Finally, protection of Mongolia's fragile environment poses an important but critical challenge to sustainable development, a challenge that will grow more acute in the years ahead.

*"Mongolia must move to implement the series of reform-oriented laws passed by parliament and aggressively expand transparency, root out corruption, reform the court system and streamline regulations to attract private investment."*

## **B. U.S. Strategic Interests**

A vibrant and effective USAID program in Mongolia helps address two main U.S. strategic concerns:

- First, a strong and prosperous Mongolia promotes stability in a potentially volatile part of the world. Geographically, a land-locked Mongolia anchors one end of Central Asia, even as a land-locked Afghanistan anchors the other. Proximity to Russia, China, Korea and Kazakhstan further underscores its strategic importance. Viewed from this perspective, a stable, independent and democratic Mongolia can play a supportive role, both in the global war on terrorism and in promoting a peaceful and prosperous Asia.
- Second, a successful Mongolia provides a potent example to other countries on how to launch effective political and economic reform simultaneously. In particular, the unusual relationship that Mongolia maintains with both North and South Korea positions Mongolia to make a positive and constructive contribution as a potential “role model” for North Korea when that country eventually emerges from the isolation that it has maintained for the past many decades.

The two USAID Strategic Objectives (SOs) for Mongolia set forth in this strategy—building a market-based economy and strengthening a stable democracy—mutually re-enforce and build on each other. Successful attainment of each SO will go a long way toward ensuring stability within Mongolia and beyond. Specific activities will focus on economic restructuring, judicial reform, increased competitiveness, business development and expanded economic opportunity for those living in rural and “peri urban” Mongolia. USAID will also support a concerted effort to promote transparency, disseminate information, strengthen policy dialogue and inform a broad spectrum of Mongolians about issues that are vital to the country’s future.

### **C. Mission Performance Plan**

The USAID program in Mongolia is closely aligned with the Mission Performance Plan (MPP) prepared by the country team and approved by the State Department on an annual basis. This strategic planning document, which encompasses the full range of U.S. objectives in Mongolia, is built around three main goals. USAID activity is central to achieving two of these goals and plays an important role in helping to advance the third one:

- **Regional Stability:** *“Mongolia remains a stable, independent, democratic country that actively supports and participates in our campaign against global terrorism and increases its participation in East Asia security organizations”.* The Political Section and the Military Assistance Program play central roles in addressing this goal. The Economic Section and USAID assist, in part by promoting the economic and political foundations that underpin Mongolia’s stability and independence.
- **Democracy and Human Rights:** *“Mongolia is a democracy characterized by transparency, accountability, rule of law and respect for human rights.”* USAID plays a central role with other Embassy sections in advancing this goal. In particular, USAID focuses on judicial reform, parliamentary support and political party development as it relates to democracy and human rights. Concerns over transparency, corruption and public access and dialogue are also addressed.

- ***Economic Growth and Development:*** “*Mongolia is a private sector led, open market economy that enjoys significant and sustainable economic growth.*” Here again, USAID programs are central toward achieving this goal. Competitiveness is increasingly emerging as an organizational principle for achieving both the policy and sectoral changes needed to assure Mongolia’s success.

Lasting stability in Mongolia hinges on success in both the economic and political arena. All elements of the country team—including the Ambassador and the Economic, Political and Public Affairs Sections—share common goals as well as a common understanding of what we can do to support those goals. This shared vision goes a long way toward explaining the exemplary relationship maintained between the Embassy and USAID in Mongolia.

Finally, both the MPP and the planned new USAID/Mongolia strategy reflect strong support for joint Department of State/USAID *Strategic Planning Framework*. The Mission statement put forth in that draft document is to “*create a more secure, democratic and prosperous world for the benefit of the American people and the international community.*” Within that framework, USAID is charged with contributing to “*global peace, prosperity and security by promoting political, economic and social progress in developing and transition countries.*” Specific items addressed within that plank include strategic objectives related to democracy (“*advance the growth of democracy and good governance*”) and economic prosperity (“*enhance economic prosperity . . . by promoting global economic growth*”).

#### ***D. Prior USAID Programs and Strategies***

The first bilateral USAID program in Mongolia was launched in November 1991 following a firm decision on the part of the country’s political leadership to embark on a brave new path toward political and economic reform. Assistance provided in FY 1992 focused on short-term emergency relief. Among other things, the program involved a \$10 million cash transfer to help buy critically needed raw materials, equipment and supplies to survive the difficult first winter following a withdrawal of virtually all Soviet support. Other elements included a monetized butter program, 30,000 metric tons in emergency wheat supplies and \$2 million in technical support and training. The next year’s program continued this heavy emphasis on the emergency response needed to shore up Mongolia’s rapidly decaying energy infrastructure.

*USAID Assistance Strategy for Mongolia, FY 1994 – FY 1998 (November 1993):* The first USAID strategy entailed a tentative first step toward more long-term development concerns. The ongoing energy crisis played a key role, as did the economic collapse that marked the first years of Mongolia’s shift away from Soviet ways of thinking toward a market economy. Inflation rates at the time surpassed 300 percent. In addition, the downward economic spiral included an unprecedented ten percent decline in GDP in 1991 and an eight percent decline in 1992. Despite its seemingly bleak economic prospects, Mongolia was also making its first decisive step toward democracy. Important early steps included the adoption of a new constitution in February 1992 and the election of an opposition candidate (Ochirbat) to the presidency in June 1993.

The first USAID strategy for Mongolia identified a series of “significant issues” facing the country. A number of these concerns have largely been addressed, including “achieving macroeconomic stabilization;” “shoring up the energy sector;” “reducing state involvement in foreign trade;” and “reducing the size and scope of government.” Other issues mentioned in the strategy remain very much a part of the ongoing policy discussion, though substantial progress has been made in a number of areas, including “creating a legal regulatory authority;” “developing a modern financial sector;” “promoting competition;” and “completing privatization.”

At an operational level, the strategy set in motion programs in three main areas: democratization (including early work related to parliament, rule of law, political party development and civic participation); economic growth (including training, policy advice and financial sector development); and energy. Though references were made to long-term development, its repeated mention of a possible looming disaster in energy suggest just how far Mongolia has come in the last ten years: “A system breakdown in winter, even for a relatively short period of time, could be disastrous, perhaps forcing the evacuation of an estimated 50 percent of the urban population and threatening the lives of thousands of individuals.” Given the circumstances, it is not surprising that the lion’s share of USAID assistance during these early years was emergency and short-term in nature.

*Country Strategic Plan for Mongolia, FY 1999 – FY 2003 (October 1998):* The second USAID strategy provided a much more decisive break from the past. It marked an important shift *away* from short-term emergency relief concerns and *toward* long-term sustainable development. It also explicitly linked the two main themes of the program, promoting democracy and strengthening private sector led economic growth. Significant investment in energy infrastructure, a core concern of USAID through the mid 1990s, was finally brought to a close. Instead, the program was sharply focused on technical assistance and training aimed at achieving the twin goals of consolidating Mongolia’s transition to democracy and accelerating the level of private sector growth.

With respect to democracy, the emphasis was on “consolidation” and “transition.” Planned activities focused on parliament, judicial reform and a more effective civil society in rural areas. This latter effort subsequently evolved into the more business-oriented Gobi Initiative that quickly emerged as one of the first serious, systematic efforts to address both economic and democracy concerns in rural Mongolia. With respect to economic reform, the emphasis was on “environmentally sound private sector growth.” Areas of activity included privatization, financial markets, the business environment, and a more effective use of Mongolia’s natural resource base. While USAID/Mongolia’s involvement in natural resource issues remained relatively modest, strategy implementation witnessed significant success related to privatization and financial markets, especially in the banking sector.

A recent (January 2003) internal assessment concluded that the October 1998 strategy “proved to be well conceived and durable.” In particular, the strategy “provided cohesion and focus” to the Mission program; ensured that USAID was deeply involved in some of the most significant issues facing the country; and set in motion a series of activities that are

proving effective and achieving results.” On a less positive note, “the failure of Mongolia to enter into a period of sustained economic growth casts a shadow over the strategy as well as the country’s long-term development prospects. Anticipated annual growth rates of five percent simply have not materialized.”

### ***E. New Strategy Development***

The decision to launch a new country strategy was made in May 2002 as part of the Washington review of the Internal Assessment of the FY 1998 – FY 2003 Strategy and the Mission’s Annual Report (02 State 117253 provided in Annex K). Several options were considered, ranging from simply extending the existing strategy by two or three years to preparing an entirely new strategy from scratch. In the end, a “middle ground” was adopted, one that involves preparation of a new strategy document that keeps the basic Strategic Objective (SO) structure largely intact while undertaking more extensive modifications at the Intermediate Result (IR) level.

The final wrap-up meeting in Washington established several parameters aimed at shaping a new USAID strategy for Mongolia. These parameters included:

- Preparation of a new five-year sustainable development strategy covering the period 2004 through 2008
- Maintenance of the twin emphasis of economic growth and democracy
- Notional annual funding levels of \$12 million in ESF and \$3 million in DA annually, combined with the development of alternative scenarios in the event of unexpected funding increases or decreases

Finally, the Washington review established a timeline for completing a new strategy. This was to ensure that there would be no “gap” or “hiatus” between the conclusion of the current strategy and the adoption of a new one.

Subsequent events have largely followed the basic parameters and time frame set during the May 2002 Washington review. However, some new developments have since occurred that do affect the final version of this document. For example, current budget scenarios are much less optimistic. At this point, the planning figure for FY 2004 is \$10 million in ESF, one third less than the combined \$12 million in ESF and \$3 million in DA that was previously anticipated. At the same time, the ESF figure for FY 2003 declined, from an anticipated \$12 million to only \$10 million. Finally, the anticipated Washington review date for the new strategy was advanced by several months. It is now set for May 2003 rather than fall 2003.

In developing this new strategy, the Mission drew heavily on the extensive array of studies and assessments commissioned by the government as well as numerous foreign donors. The most important source material is listed in the bibliography. In addition, the Mission commissioned five background papers, including three mandatory assessments (covering gender, environmental concerns and potential sources of conflict) and two optional papers

(covering various aspects of other donor assistance). The fact that Japan, the World Bank, ADB, the Ministry of Finance and the Prime Minister's office have all been undertaking strategy development at the same time as USAID/Mongolia is fortuitous, providing useful opportunities to share information and perspectives.

Other strategy development process events in late 2002 and early 2003 further underscore the collaborative nature of the work in Washington and the field. Specific items include a four-person strategy team visit arranged by Washington to Mongolia (October 2002); coordination with the Embassy MPP through an off-site retreat (January 2003); additional consultation with USAID/Washington involving the Mission Director (January 2003); Washington assistance in preparing an initial draft of the strategy document (March 2003), and distribution of the draft strategy among counterparts and donors to solicit additional input prior to submission (April 2003) in anticipation of the final Washington strategy review (May 2003).

Taken together, these inputs from many sources have significantly shaped a final document aimed at providing effective strategic direction for the Mission over the next five years. This input amply reflects the diverse interests and concerns of other parties that are committed to a successful and prosperous Mongolia, including USAID/Washington, the Embassy, other donors and Mongolian colleagues and counterparts both inside and outside government.

## II. COUNTRY OVERVIEW

### A. Political Context

Mongolia's transition to democracy is a remarkable achievement with ramifications that go well beyond its frontiers. Over the last decade, the country has had nine elections, three each at the local, parliamentary and presidential level. Governments have been elected to power in free and fair elections—and then peacefully relinquished that power in response to subsequent elections. Mongolia's admirable record in this area stands in stark contrast to its five Central Asian neighbors, each of which is still governed by the same former Communist ruler who assumed power when these countries were granted independence more than ten years ago. Indeed, it compares favorably with virtually *every* independent country that rose out of the ruins of a Soviet past.

In the last set of parliamentary elections in 2000, the Mongolian People's Revolutionary Party (MPRP) swept back into power to replace the Democratic Coalition's brief and at times erratic rule (1996-2000). While the MPRP publicly embraced a policy of wide-ranging reform, the overwhelming dominance of a single party in any political system inevitably prompts public discussion about political competition, electoral reform, and the need for strengthened transparency, accountability, and public participation. Meanwhile, opposition parties remain weak, unorganized, and lack a cohesive voice. National elections scheduled for summer 2004 will provide a useful opportunity to assess the extent to which multi-party democracy has taken hold in Mongolia.

*"Overwhelming dominance by a single party in any political system inevitably prompts public discussion about political competition."*

Issues related to governance are a recurring theme in almost any conversation about development in Mongolia. While parliament has passed a series of laws aimed at advancing the reform process, implementation and enforcement are emerging as key issues. In many cases, laws have been passed quickly and with little or no public debate. More extensive open hearings and outreach with the private sector could improve public trust and shape a more informed commercial environment. Recently (December 2002), parliament held its first open committee hearings on judicial budgets and foreign aid. Further progress in this area is needed and mechanisms for holding open committee hearings and providing public comment on draft laws should become more formalized, regularized, and systematic.

Mongolia's judicial and legal sector is well positioned for reform. The *Ikh Hural* (Mongolian parliament) adopted a strategic plan for the justice sector in May 2000. Comprehensive new civil and criminal codes came into effect in September 2002. Despite these positive steps, opinion polls suggest that the judiciary ranks as the "least effective" of Mongolia's government institutions in the eyes of the Mongolian public. Further judicial reform is certainly needed. Private investors are wary of a court system that appears weak and arbitrary. Judges who lack training can hardly be expected to understand modern business practices. Viewed from the perspective of a potential investor, whether foreign or local,

Mongolia offers few guarantees that business contracts or private property rights will be effectively upheld or enforced.

Corruption also represents an area of growing concern. While probably low compared to its Central Asian neighbors as well as many other developing and transition countries, the public perception is that corruption is problematic at all levels, ranging from petty corruption to higher level scandals and pay offs.

*"Judicial reform is needed for improving the commercial climate in Mongolia."*

Continued corruption can only foster public mistrust. It also raises the cost of business transactions in ways that undermine economic efficiency. Mongolia's private sector simply cannot absorb these extra costs. Left unaddressed, corruption will damage Mongolia's reputation as well as its competitiveness in the international marketplace.

Two international indices score Mongolia on governance and private sector issues. Transparency International assigned Mongolia a score of 4.3 in the 1999 Corruption Perceptions Index by Transparency International (10 is highly clean and 0 is highly corrupt).<sup>1</sup> More recently, the Heritage Foundation gave Mongolia a score of only 3 in its 2003 Index of Economic Freedom (1 is free and 5 repressed), citing enforcement of private property laws, rule of law, the need for reform within the legal and judicial sectors, the vast number of regulations passed in recent years, continuing restructuring of the government, and corruption in the bureaucracy as some of the major governance problems affecting business development. At the same time, it should be recognized that Mongolia's adoption of new civil and criminal codes in September 2002 constitute an important step forward in the governance arena.

Mongolia thus continues to face significant challenges in completing its political and economic transformation. Key issues revolve around ensuring effective governance, implementing laws passed, strengthening the court system, rooting out corruption, improving transparency, sharing information, introducing accountability and engaging in sustained dialogue with the public about matters that are vital for Mongolia's economic and political future. If these issues are not effectively addressed, Mongolia could well move backward rather than forward during the next five years.

## **B. Economic Profile**

Mongolia is a large, land-locked country with a small population. With an annual per capita income of around \$450, Mongolia falls squarely in the ranks of low income countries.<sup>2</sup> However, remittances from workers abroad and the large informal sector may make this figure an underestimate. Major areas of economic activity include agriculture (between one fifth and one third of GDP), services (more than half), and industry (approximately 17 percent). Roughly 40 percent of the labor force is engaged in agriculture/livestock herding.

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<sup>1</sup> Score is the most recent score from 1999.

<sup>2</sup> Population, GDP, and economic composition data from World Bank, "Mongolia at a Glance," 9/20/02

Major buyers of Mongolia's exports include China (41 percent), the United States (32 percent), and Russia (9 percent).<sup>3</sup>

While relatively open and market-oriented, Mongolia has a small production base, is poorly diversified, and is reliant on a few volatile commodity exports, such as copper, gold, and

*"Mongolia's economy is poorly diversified and reliant on minerals and raw materials, which puts pressure on the fragile environment."*

cashmere. Increased production puts pressure on the environment as people try to sustain themselves--often in illegal and damaging ways--by extracting or producing raw, semi-processed, and low value products from the relatively unspoiled yet increasingly fragile natural resource base.<sup>4</sup>

In 1990, Mongolia broke with the Soviet Union and began a dramatic transition *away* from a centrally planned economy *toward* a modern market economy. Economic restructuring and the sudden collapse of Soviet aid and trade support caused an economic shock of enormous magnitude. Short term results included a deep recession, hyperinflation estimated at more than 300 percent, a sharp deterioration in the of payments accounts, and a decrease in real income by one-third. However, by the mid-1990s, bold new market-oriented economic policies established macro economic stability and were beginning to have a positive impact on other areas of the economy.

Subsequent progress includes eight consecutive years of slow but positive growth, single digit inflation and exchange rate stability. Other major economic developments include a sharp increase in private sector credit, privatization of many state-owned enterprises, privatization of livestock and housing, and the establishment of numerous new companies. In 1997, Mongolia took an important step by joining the World Trade Organization (WTO). It also maintains a relatively low tariff structure, despite the ever-present temptation to adopt unproductive approaches aimed at protecting local industries.<sup>5</sup> Although overall economic growth remains too slow to translate into significantly higher living standards or reduce poverty, the performance in some non-agricultural sectors—including manufacturing, construction, mining and services—has been quite strong in recent years. According to some estimates, Mongolia's large informal sector accounts for as much as 30 percent of GDP.

*"Economic growth remains too slow to translate into significantly higher living standards."*

The fiscal deficit deteriorated to 6.0 percent of GDP in 2002, up from a respectable 3.9 percent in 2001.<sup>6</sup> While revenue collection increased by 10 percent in 2002, expenditures increased even more rapidly by 14 percent. Meanwhile, fiscal deterioration and promised

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<sup>3</sup> Economic figures here and elsewhere are based on data provided by EPSP/DAI, which is in turn based on information provided by the Government of Mongolia.

<sup>4</sup> See Mongolia Environmental Analysis by Christopher Finch (January 2003)

<sup>5</sup> The Heritage Foundation *2003 Index of Economic Freedom* reports an "across the board tariff of 5 percent," up from the average rate of 1.1 percent reported in the *2002 Index*. In addition, Mongolia charges a 5% export tax on cashmere .

<sup>6</sup> Here again, data is based on information provided by DAI/EPSP through its "Monthly Economic Review: Review of the Year 2002 + December 2002" and assorted other reports.

civil service pay raises jeopardized IMF support via the \$37 million Poverty Reduction and Growth Facility.

The external debt is significant at around \$885 million and continues to grow. With external debt nearly equivalent to GDP, claims about old debt owed to Russia as well as the approaching end of grace periods for loans from Japan and the ADB means that future debt servicing capacity will have to be carefully managed. Mongolia's major exports are subject to price volatility. This complicates economic management and makes economic forecasting much more difficult. In 2002, exports decreased by 3.9 percent and imports increased by 3.3 percent, expanding the already large trade deficit to 14 percent of GDP.<sup>7</sup>

Domestic and foreign investment remains relatively low. In 2000, net Foreign Direct Investment (FDI) was estimated at only \$22 million by one source<sup>8</sup>. Microeconomic and institutional factors serve as significant barriers to business growth. Entrepreneurs complain about a host of problems, including a high corporate tax rate of 40 percent, high annual interest rates exceeding 30 percent, lack of access to long-term finance, and a host of problems related to licensing, inspectors, customs, and tax administration. Exporters must contend with the high cost of transport to regional and international markets. In addition, corruption, lack of transparency and a weak judiciary stand in the way as stumbling blocks to private sector growth.

Finally, Mongolia must delicately manage private sector transition and acceleration without compromising socioeconomic achievements and without significantly worsening the gap

*"In recent years, harsh weather conditions and economic decline in the countryside have resulted in a growing urban-rural divide"*

between the "haves" and the "have-nots." In recent years, harsh weather conditions and economic decline in the countryside have resulted in a growing rural-urban divide. This in turn fuels migration to the peri-urban *ger* districts on the fringes of the major cities of Ulaanbaatar, Darkhan, and Erdenet. An estimated 36 percent of the total population in Mongolia currently lives below the poverty line.<sup>9</sup>

Looking ahead, the Government of Mongolia faces some significant challenges in advancing its ongoing economic reform agenda. These challenges include creating a business friendly environment through streamlining commercial regulations; completing privatization of "most valued companies" (MVCs);<sup>10</sup> advancing energy sector reform; expanding and diversifying the banking sector; land use reform; maintaining fiscal discipline; and ensuring effective management of the high debt burden. In addition, governance issues deeply affect the commercial climate. Indeed, problems related to corruption, transparency, information sharing, weak implementation of commercial laws, legal reform and limited consultation

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<sup>7</sup> Ibid.

<sup>8</sup> Heritage Foundation 2003 Index of Economic Freedom; in contrast, possibly optimistic Government of Mongolia data suggests the figure could be as high as 45 million in 2001 and \$78 million in 2002.

<sup>9</sup> World Bank "Mongolia at a Glance," 9/20/02

<sup>10</sup> Most small and medium sized state-owned enterprises have been privatized under the sealed bid auction process. The only MVCs that have been privatized are the Agricultural Bank and Trade and Development Bank. Other MVCs to be privatized include: Gobi Cashmere, Mongol Daatgal (insurance), NIC (oil and gas), and MIAT (airline).

between the public and private sectors are increasingly viewed as important and as yet unresolved concerns.

### **C. Summary of Critical Issues**

Twelve years ago, Mongolia embarked on a far-reaching economic and political transformation. Few outside observers in the early 1990s could have predicted the important steps that Mongolia would take over the next decade. Its performance is even more remarkable when set against the limited progress achieved by other seemingly more economically endowed post Soviet economies in Central Asia and elsewhere. These changes resulted in an impressive degree of political openness. They also brought about economic stability while dramatically expanding the role of the private sector.

Despite these impressive gains, GDP growth has been stubbornly slow over at least the past three years. External factors—including a series of harsh winters, low commodity prices and global recession—have certainly been a source of concern. Yet Mongolia can and should make changes in those areas that it can control. In the global economy, small economies set themselves apart if they are more nimble and flexible on policy and administrative matters than their neighbors. In a country the size of Mongolia, government bureaucracies and the administrative environment that they control should be organized around principles that promote rather than stifle growth. The fact that interventions and policy changes that might seem modest in large countries can have national impact in an economy the size of Mongolia's makes this approach all the more promising.

*"Mongolia should aspire to set the global standard for positive political and economic change."*

Over the past decade, Mongolia may have been encouraged when comparing its progress to that of its post-Soviet Central Asian neighbors or even a number of other countries that were once part of the Soviet bloc. But, over the next five years, Mongolia should no longer be content to be the "best of a dubious lot." Rather, it should aspire to attain global standards of positive political and economic change. The main goal should be for Mongolia to ratchet its reform and transformation process up to a much higher level.

Reaching a higher level requires honest dialogue and effective implementation in several key areas:

- *Open acknowledgement of important governance concerns that must be addressed, including those related to corruption, transparency, accountability, information flows, public participation, and strengthened rule of law.*
- *Heightened focus on effective implementation as a key issue. A new law can serve as an important landmark but real progress lies in effective implementation.*

- *Demonstrated commitment to a more streamlined commercial environment*, one that fosters competition, builds on Mongolia’s competitive advantages and encourages rather than undermines economic growth.
- *Expanded interest in the “micro” economy*, both as it relates to economic competitiveness and in ensuring that previously marginalized Mongolians—including those living in the countryside and in rapidly expanding *ger* districts— participate much more actively in the economic life of the country.
- *Increased understanding of the important interplay between a market economy and a strong civil society*.
- *Pragmatic emphasis on sustainable economic growth* as a key element in Mongolia’s quest for prosperity.

From a USAID/Mongolia perspective, these themes are central to the country’s long-term development prospects. They will also figure prominently in the USAID program in Mongolia over the next five years.

### III. Rationale for Choice of Strategic Approach and Strategic Objectives (SOs)

Mongolia's performance over the last decade has been impressive, especially given the severe handicaps the country faces in terms of its small population, limited infrastructure and significant distance from world markets. As far as transition economies and political systems are concerned, it has out-performed many countries within the former Soviet Union that would seem to have had far greater early advantages.

Given this past performance, Mongolia needs to move beyond the rhetoric of "transition" or even "consolidation." It must no longer be content to compare itself with the lower tier of post Soviet countries. Rather, its main challenge over the next five years should be to combine the twin, mutually re-enforcing themes of good governance and economic competitiveness into a single strategic vision. From a USAID/Mongolia perspective, this vision is best organized around Mongolia as a dynamic, growing economy, one that is marked by freedom, openness and accountability in economics as well as politics. This over-arching in goal is in turn closely linked to our two central Strategic Objectives for the new strategy period, objectives that re-enforce each other and lie at the heart of what USAID/Mongolia will be about:

*"This vision should be organized around Mongolia as a dynamic, growing economy, one that is marked by freedom, openness, and accountability in economics as well as politics."*

- First, *USAID/Mongolia will work to accelerate and broaden sustainable, private sector-led economic growth;*
- Second, *USAID/Mongolia will work to achieve more effective and accountable governance.*

This strategic construct is rooted in an understanding of several factors, including Agency priorities; country team priorities; USAID's past history in Mongolia; other donor contributions; and the development path to which Mongolia has committed itself.

*First, with regard to Agency priorities:* A twin focus on economic growth and democratic governance lies at the heart of the A.I.D. strategic vision world-wide. Given the limited size of the program as well as our management capacity, we cannot be "all things to all people." For example, in view of Mongolia's relatively high social indicators we do not envisage a health program. Similarly, in view of the conflict assessment drafted as part of the strategy preparation process, we do not envisage that conflict mitigation or humanitarian relief will figure anywhere in the USAID portfolio over the next five years. However, significant issues related to both economic growth and democracy will certainly be addressed. Progress here will contribute to A.I.D. success as an effective international development institution.

*Second, with regard to U.S. strategic interests in Mongolia:* As discussed earlier, USAID/Mongolia makes a vital contribution to the three areas of strategic interest highlighted in the Mission Performance Plan (MPP). That document presents regional stability as a key concern, underpinned by a strong interest in democracy and economic growth. Thus the USAID/Mongolia strategic construct ensures that we make a significant contribution in two areas, while also strengthening the foundations necessary to support the third. Here again, the USAID/Mongolia strategic construct aligns closely with wider USG priorities.

*Third, with regard to USAID's past history in Mongolia:* This past history was analyzed in detail in preparing this strategy. There is little doubt but that the current strategy (1998-2003) was well formulated. Perhaps most importantly, it provided effective yet flexible strategic guidance during a vital period in Mongolia's development. Indeed, the emphasis on sustainable economic growth that was front-and-center in that strategy document remains largely unchanged at the SO level. However, at an IR level, there will be more emphasis on implementation, on sustainability and on addressing a "second generation" of issues now that the basic building blocks for a market economy are firmly in place. With regard to democracy, planned activities build very much on foundations set during the 1990s. Here again, though, the emphasis at an IR level has changed, in this case to reflect a more explicit recognition of the importance of good governance, transparency and accountability in maintaining the progress that Mongolia has made in recent years.

*Fourth, with regard to other donors:* Two papers commissioned prior to the preparation of this strategy speak directly to this concern. As one observer commented, "the problem in Mongolia isn't *too little* assistance; rather, it is not enough of the *right kind* of assistance." This point underscores the very real issue of absorptive capacity, one that will come into play if Mongolia accesses Millennium Challenge Account (MCA) funds.

By some estimates, per capita aid levels in Mongolia are around \$100-\$120 a year. USAID accounts for \$4 of that total. This \$4 has proved catalytic in achieving significant changes in the financial sector and in privatization. It plays an important part in shaping legal reform. It also funds pioneering business development programs aimed at both rural and peri-urban Mongolia, home for many Mongolians who have yet to benefit from the economic changes underway.

When set against other donor activity, USAID/Mongolia probably most stands out for its flexibility, pragmatism, direct engagement with the private sector and willingness to take on tough civil society issues, including corruption. The proposed new USAID/Mongolia strategic construct poises the Mission to remain deeply engaged in these issues, both at the Strategic Objective (SO) and Intermediate Result (IR) level. The fact that much of the USAID program takes place outside government channels to some extent also helps address the absorptive capacity concern.

*Fifth, with regard to Mongolian priorities:* Twelve years ago, Mongolia made an irrevocable commitment to far-ranging economic and political reform. The pace of change may have varied over time, but few Mongolians have expressed any desire to return to the

era of central control over all aspects of one's life. In stark contrast to a number of other post-Soviet economies, nine out of ten Mongolians living in both the city and the countryside indicate continued support for the political and economic changes that have taken place. This sense is reflected in successive and freely elected governments that have maintained a commitment to change, despite both external and self-inflicted obstacles encountered along the way.

As far as economic policy is concerned, opposition parties as well as the Prime Minister's office have expressed interest in "competitiveness" as useful organizing principal for dialogue on policy issues. This is reassuring for a strategic construct designed to last at least five years. It also underscores the importance of agreeing to a new strategic framework that provides direction while also ensuring the flexibility required to maintain program effectiveness and direction, even if political personalities change.

Finally, as this strategy was being finalized, the Director of the Department for Economic Cooperation within the Ministry of Finance and Economy confirmed Government of Mongolia support for this strategy with this comment: "The two Strategic Objectives are in line with the policy priorities set for in the Economic Growth Support and Poverty Reduction Paper (EPSRSP), which is being finalized by the Government" (Amarsaikhn-Addleton letter dated April 25, 2003).

*In sum*, the strategic choices made in this document will provide the filter for making decisions on program activity for the next five years. Within that strategic framework, flexibility will be paramount. Some of the Mission's biggest successes during the last five years— restructuring AgBank, establishing XacBank and publishing *Rural Business News*, to name three of them—were neither mentioned nor anticipated in the last strategy. So too, we anticipate that there will be significant achievements over the next five years that cannot be properly anticipated beforehand.

Against this backdrop, USAID/Mongolia is convinced that the two Strategic Objectives (SOs) proposed are on-target and reflect the precise areas where attention should be focused. The five underlying Intermediate Results (IRs) articulate in more specific terms expected results as well as key areas of anticipated USAID activity during the next five years.

## **IV. STRATEGIC OBJECTIVE ONE: “Accelerate and Broaden Sustainable, Private Sector-Led Economic Growth”**

### ***A. Statement of Strategic Objective***

USAID/Mongolia’s Strategic Objective (SO) and associated Intermediate Results (IRs) for economic growth for the five year period FY 2004 – FY 2008 are as follows:

#### **SO 1: “Accelerate and Broaden Sustainable, Private Sector-Led Economic Growth”**

- *IR 1.1 Improved Enabling Environment for Private Sector Growth*
- *IR 1.2 More Competitive Industries and Sectors*
- *IR 1.3 Expanded Economic Opportunity for Marginalized Mongolians*

**Link to State/USAID Strategic Plan:** “Enhance Economic Prosperity and Security,” including performance goals such as “institutions, laws, and policies foster private sector-led growth,” “secure and stable financial and energy markets” and “enhanced... agricultural development.”

**Strategic Objective Duration and Life of Project Funding:** Under the new strategy, the duration of this SO will be extended until September 30, 2009. The authorized additional life of funding for this SO is \$40 million, or \$8 million per year for the five-year period covered by the strategy. This brings the total authorized funding level for this SO from \$50 million when the strategy was presented to \$90 million.

### ***B. Problem Analysis and Program Approach***

#### **Problem Analysis**

At a macro level, Mongolia’s economic transition has so far been largely successful. More than 75 percent of the economy is now in private hands, up from only 4 percent in 1990. Small and medium sized state assets have mostly been sold off. Many new companies have been established, especially in the trading sector. The informal sector is flourishing. Housing and livestock is almost entirely in private hands.

However, overall economic growth over the past three years has been sporadic, growing from 1.1 percent in 2000 to 1.0 percent in 2001, and 3.9 percent in 2002. These less than impressive figures (especially for 2000 and 2001) are partly blamed on harsh weather conditions, low prices for certain commodities and the global economic down-turn. The fact that agriculture, including herding, accounts for almost one-third of the economy means that any problems in that sector have reverberations throughout the country. Yet, even in these circumstances, Mongolia has witnessed respectable growth in manufacturing, mining, construction and services in recent years.

Mongolia's economy faces three main problems: (1) growth is too slow to significantly increase living standards and may cause difficulties with future debt servicing obligations; (2) the economy is relatively undiversified, relies on low value products and is vulnerable to external shocks due to its dependence on herding and a few volatile export commodities such as cashmere, copper, and gold; and (3) significant sections of the population have been left out of the development process, especially those living in rural areas, a process that in turn fuels growing migration from the countryside into the peri-urban *ger* districts of Ulaanbaatar and elsewhere.

Few doubt that the private sector must serve as Mongolia's "engine of growth" for the future. Reform-minded governments have passed numerous laws aimed at liberalizing the economy and establishing a more favorable legal and regulatory framework. Yet effective implementation remains as a central concern. At this point, the issue is not so much in making the case for reform. Rather, it is moving beyond the rhetoric to effectively implement public policy pronouncements. In particular, the dynamics of competition tends to be poorly understood. In addition, entrenched bureaucracies all too often fail to realize that their job is to facilitate economic activity, not stymie it.

New opportunities appear to be emerging for using "competitiveness" as an organizing principal in establishing Mongolia's position in the global marketplace. Certainly, this approach lays bare some of the most important issues facing Mongolia's private sector. These include continued legal and regulatory barriers to doing business; lack of access to either affordable or long-term credit; only a rudimentary mix of financial products; the frustrating "hassle" factor that faces entrepreneurs in areas such as licensing, registration, and tax collection; and high transport costs when attempting to access world markets.

Other issues include a weak court system that is only just becoming familiar with the importance of enforcing contracts, maintaining private property and protecting intellectual property rights. Reducing microeconomic, institutional, and administrative barriers to growth will help reduce transaction costs. This in turn should make Mongolia a more attractive destination for private investment while also making Mongolian products more competitive internationally.

Cutting across these problems is weak participation in administrative decisions that involve the private sector. Lack of adequate public participation and debate impedes the consensus building needed to accelerate reform and ensure effective implementation. In a similar vein, information on important reform issues is often poorly shared within government departments and among the broader public. All too often, civil servants operate under the assumption that public administration is something done *to* people rather than *with* or *for* them.

Anticipated work in this area tracks closely with the "new thinking on the microeconomic foundations of competitiveness" that is highlighted in the economic growth chapter of *Foreign Aid in the National Interest* (2002). As that document notes, "Wealth is created

through an economy's microeconomic foundations, rooted in company operations and strategies as well as in the inputs, infrastructure, institutions, regulations and policies that constitute the business environment in which a nation's firms compete. To fully succeed, political, legal fiscal and monetary reforms must be accompanied by microeconomic improvements." It is for this reason that the second, stand-alone IR is being presented as a complement to the first IR, one focused entirely on more competitive industries and sectors. Effective work here will not only help inform policy discussions; it will also enhance USAID credibility on a broad range of policy issues that are vital to Mongolia's future.

## **Program Approach**

Under the new FY 2004 – 2008 strategy, USAID/Mongolia will seek to accelerate and broaden private sector growth in an inclusive and environmentally sustainable fashion. Specific areas of involvement include: (1) improving the enabling environment for private sector growth; (2) supporting more competitive industries and sectors, and (3) expanding economic opportunity for marginalized Mongolians.

The emphasis is purposefully on economic growth rather than welfare. In a real sense, the "business" of USAID in Mongolia over the next five years is "business"—dynamic, effective, private sector driven business. Rather than viewing economic issues in isolation, USAID/Mongolia will take a coordinated approach in ways that promote economic activity, advance private sector development and include a much wider spectrum of Mongolians in the economic transformation process.

Work will take place at three main levels. First, IR 1.1 will focus on improving the enabling environment required for private sector growth. Second, IR 1.2 will emphasize specific sectors and industries in which Mongolia appears to have a competitive advantage. Third, IR 1.3 will provide economic opportunities for previously marginalized Mongolians, helping to bring them into the economic mainstream.

Each IR is closely linked to the others. For example, policy work undertaken under IR 1.1 will be informed by and contribute to interventions focuses on industries and sectors that are supported under IR 1.2. Similarly, business development activities undertaken under IR 1.3 have obvious implications for Mongolian competitiveness, even as wide participation in the economy is essential to promote the type of policy reform needed to sustain an effective market economy.

The economic growth Strategic Objective is explicitly linked to the other element of the USAID program that focuses on good governance. In particular, there are important links between judicial reform and the emergence of an effective commercial regime that is capable of resolving commercial disputes and enforcing contracts. In addition, an interest in accountability, transparency and information dissemination is a significant recurring theme, cutting across the entire Mission program.

Finally, the economic growth Strategic Objectives reinforces and builds on other donor activity. At the highest level, IMF conditionality is directed toward ensuring a stable

macroeconomic environment. This is further supported by ADB and World Bank program loans that include specific conditionality, on occasion conditionality that directly supports USAID programs (such as the privatization of the Agricultural Bank). Within these broad areas, USAID has been most notably involved (and experienced its biggest success) in the financial sector and, more recently, in privatization. The flexibility and willingness to pursue “targets of opportunity” that was prevalent during the last strategy period will also be a hallmark of the program during the next one.

### **C. Key Intermediate Results**

#### **IR 1.1 Improved Enabling Environment for Private Sector Growth**

USAID will work to strengthen Mongolia’s commercial business environment and make it more conducive to private sector growth. Although more than three-fourths of GDP is now in private hands, further growth is held back by public sector constraints. At a macro level, USAID will identify policy constraints and, where appropriate, work directly to reduce them. At a micro level, USAID will work to streamline commercial rules and regulations. At both levels, a sustained public-private dialogue will help build broad-based consensus among national decision-makers, the business community, and private sector stakeholders.

Any policy advice provided by USAID to Mongolian counterparts will focus on key impediments to economic growth and core concerns related to Mongolia’s competitiveness in the global economy. On occasion, USAID will provide “hands on” assistance to implement specific programs, as was the case in restructuring Agricultural Bank, establishing the Energy Regulatory Authority (ERA) and supporting the State Property Committee (SPC) during the recent past.

Given the wide potential menu of policy interventions and a limited USAID budget, technical assistance will be flexible. Much of the response will be demand-driven, ensuring quick interventions in areas in which other donors are either unwilling or unable to become involved. At the same time, USAID technical advice will provide significant support in terms of formulating and then driving a wider policy agenda, one that reflects the twin concerns of economic growth and international competitiveness. Key counterparts will almost certainly include the Prime Minister’s Office, the Ministry of Finance and Economy, the Ministry of Infrastructure and the Central Bank.

#### **Relation to Cross-Cutting Themes**

**Conflict:** Corruption and land distribution are two potential areas of conflict. USAID efforts to improve transparency and streamline regulations reduce opportunities for conflict over *rent-seeking and corruption*. Policy activities related to land tenure and use can also help mitigate the potential for conflict over *land distribution*.

**Environment:** USAID programs to improve *energy policy and pricing* could reduce pollution, especially in urban areas. Efforts to ensure natural resource use in ways that reflects their true value could have a similar effect.

At a policy level, USAID will address economic constraints and inefficiencies that restrain private sector competitiveness. Potential areas of involvement include macroeconomic policy, tax reform, mining, trade policy (including WTO issues such as trade standards), intellectual property rights, enterprise privatization and restructuring, energy sector commercialization, land use constraints, banking reform and financial sector expansion and diversification (e.g., mortgages, insurance, leasing). Given past successes in the banking sector and USAID credibility in this area, USAID will put a special emphasis on deepening its involvement in financial sector reform to expand access to credit, particularly for small and medium enterprises (SMEs), rural and peri-urban businesses, and other individuals. A focus on access to commercial credit will reinforce proposed activities under IR 1.2 “More Competitive Industries and Sectors” by addressing the investment issue that SMEs and entrepreneurs will face should USAID decide to promote the expansion of tourism and cashmere sectors.

USAID’s current privatization program is ending on a highly positive note with the completion of the two largest privatization transactions in Mongolian history—the sale of Trade and Development Bank to a US-European consortium for \$12 million and the sale of the Agricultural Bank to a Japanese investor for \$6.8 million. Together with earlier privatizations in which USAID was also involved, these sales have brought \$35 million into government coffers while holding out the promise of an additional \$40 million in foreign investment over the next two or three years.

USAID programs have also strengthened the ability of the State Property Committee (SPC) to carry out privatizations that are both transparent and successful. Greater SPC capacity to undertake privatizations, combined with a diminishing number of “Most Valued Companies” (MVCs) available for privatization, means that USAID’s activities in this area will necessarily be scaled back. Some of the so-called “crown jewels”—including the telecommunications sector and the national airline—are in any case better left to the multilateral donors, given the size of these transactions; the political sensitivities involved; the length of time that will probably be needed; and the significant funding levels that will almost certainly be required. However, USAID will be well positioned to offer advice on broad privatization issues, work with other donors to “cover” pending privatizations and, where appropriate, offer limited assistance to specific transactions where government commitment to privatize is clear and unequivocal.

Progress has been made in energy sector reform, starting with the passage of a new energy law, establishment of the Energy Regulatory Authority (ERA), and the unbundling of the national power utility into 18 separate entities. However, the pace of change in recent months has been more difficult as the “hard slog” toward real commercialization begins. There is a growing sense that the Ministry of Infrastructure is reluctant to loosen its ties on a sector that involves significant funding and in which it has long been intimately involved. Even as the ERA attempts to exert its independence, there are also indications that at least some segments of government want to reassert a worrisome measure of direct political control. The energy sector, which now accounts for almost half of Mongolia’s external debt, is too important for USAID *not* to be involved. Here, the emphasis will reflect a combination of policy advice

and “hands on” involvement aimed at strengthening the independence of the ERA and possibly strengthening the capacity of some of the most viable commercial power utilities.

The financial sector has witnessed significant change in recent years, especially in the banking arena in which USAID/Mongolia has been intimately involved, partly through privatizations (TDB and Agricultural Bank), partly through management restructuring (Agricultural Bank) and partly through the establishment of an entirely new private bank with a significant emphasis on micro credit in rural Mongolia (XasBank). In effect, USAID played a vital role in reshaping two of the country’s largest four commercial banks while also helping to establish a creative and innovative third bank

Despite a dramatic increase in the availability of credit, interest rates—now estimated at around 3-4 percent per month—remain much too high. Access to long term credit is a concern. As the banking sector expands and becomes more competitive, some consolidation is likely over the next several years. In this environment, issues related to banking supervision will undoubtedly arise. Over the next five years, USAID/Mongolia anticipates deepening its engagement in the financial sector, not only in banking but possibly in other financial institutions as well. In particular, we anticipate providing advice, training and useful models focused on new financial mechanisms, including mortgages, leasing, long-term credit and insurance.

While maintaining macro economic stability, Mongolia needs to identify and implement changes at the micro level aimed at improving the commercial environment and unleashing the dynamism of its growing private sector. “Red tape” is a problem in any country. In the case of Mongolia, the relatively small size of the economy should make it easier to identify bottle necks and overcome constraints. Efforts to limit competition is one area of concern. Here and elsewhere, initiatives undertaken under IR 2.1 will work hand-in-hand with activities funded under IR 2.2 to streamline Mongolia’s commercial regime and make it more transparent.

Finally, the sustainability of any policy transformation hinges on the active involvement and understanding of a larger general public. One approach will be to develop and nurture associations of like-mind private businesses, along the lines of our recent attempts to transform the moribund Mongolian Tourist Association (MTA) and make it viable. The promotion of public-private sector partnerships is another dimension of this work. There will also be much greater emphasis on packaging information and ensuring that it is distributed among a wide spectrum of the informed Mongolian public. Some pilot efforts in this area have already been funded. Under the new strategy, public involvement and information transfer will be elevated to an even higher level.

### ***Illustrative activities***

While retaining a high degree of flexibility, the mix of illustrative USAID-funded includes the following:

- A continued strong relationship with the Prime Minister’s office and associated line ministries, providing an important platform and forum for advice and training on key areas of macroeconomic concern, especially related to energy, trade and investment, privatization and the financial sector.
- Active involvement in streamlining commercial rules and regulations, confronting corruption and removing “red tape”.
- Identification of impediments to international trade and investment combined with follow-up action actions to remove them.
- Direct assistance in implementing specific policies or programs, along the lines of what USAID has already undertaken with respect to restructuring Agricultural Bank, establishing the Energy Regulatory Authority and supporting the State Property Committee’s privatization program.
- Strong support for a more transparent and informed policy discussion on economic matters vital to Mongolia’s future, in part through public-private sector partnerships that involve dialogue, transparency and information transfer to a wider segment of the Mongolian public.
- Improved capacity within Mongolian institutions to undertake policy analysis, in part through training, internships and related interventions.

## IR 1.2 More Competitive Industries and Sectors

Mongolia remains heavily reliant on a few low value products (such as meat and raw cashmere) and small number of volatile export commodities (such as cashmere, copper and gold). The challenge is to ensure broader, higher-value added private sector growth. This is especially important during a period when international mining investments will emerge as perhaps *the* driving forces of the Mongolian economy. This represents a significant opportunity—but only if Mongolia avoids the one dimensional, resource extraction approach that has brought social unrest and hampered economic development in other parts of the world. In reality, the financial resources required to develop Mongolia’s mining sector will almost certainly come from private investors in Toronto, Sydney, New York, London and elsewhere. Over time, such investment should lower Mongolia’s dependence on donor assistance and also reduce its debt burden.

Newly emerging Mongolian businesses lack access and understanding of international markets. Instead, they tend to focus purely on their own particular circumstances, viewing other companies as “threats”. In reality, the effective development of a sector or industry in which Mongolia enjoys a comparative advantage brings with it opportunities for individual firms as well as the country as a whole. Indeed, given the small size of the Mongolian economy, the country is still at the stage when success in a particular industry or sector can have a strongly positive national impact.

### Relation to the Environment:

USAID efforts to produce higher value added products (i.e., quality rather than quantity) reduce pressures on the environment. Eco-tourism and the ethic of “leave no trace” offers an opportunity for local communities to economically benefit from the environment. It should also help increase national and local commitment to conserving these resources.

Over the next five years, USAID will help facilitate the growth of more competitive industries and sectors in ways that “thicken” and “deepen” the economy. New markets need to be established, even as old markets (such as Siberia) are reestablished. Part of the rationale is to ensure private sector led growth in a range of sectors, not just mining. There is little doubt that Mongolia’s future hinges on the effective and sustainable use of its impressive natural resource endowment. Mining is an important part of that endowment. However, most other promising industries—including tourism and cashmere now, perhaps including meat, food processing and a more diversified set of fiber products in the future—are based on the efficient use of the country’s natural resources in ways that add value and increase incomes. One of Mongolia’s main challenges over the next five years will be to ensure success on several economic fronts, not just one of them.

Under IR 1.2, the chief USAID aim is to play a catalytic role in shaping the development of a small number of sectors and industries in which Mongolia appears to be internationally competitive and offer export or foreign exchange earning potential. Based on past USAID activity, two possible areas of involvement include:

- The tourism sector, which is now experiencing significant growth, represents one such area. Some barriers are formidable, including the short tourist season, remote location, limited infrastructure, high travel costs and, most recently, the SARS epidemic in neighboring China. Yet Mongolia’s vast land area offers unique natural and cultural treasures, especially for the adventurous who seek something truly different in an increasingly homogenized world. The fact that adventure travel is the most rapidly growing segment of the international tourist market is significant. USAID involvement in this emerging sector now can help shape the country’s tourism industry for years to come.
- Cashmere represents another area with considerable potential. At this point, China controls 80 percent of the world cashmere market, Mongolia the remaining 20 percent (Afghanistan and Iran could possibly emerge as small players at some future point). The next five years will almost certainly determine whether China exerts a stranglehold on cashmere, or Mongolia emerges as a credible international competitor with a significant niche of its own. The adoption of a “collective mark” that sets Mongolian cashmere apart will be an important step forward. Beyond that, USAID is poised to work with the industry to promote “Mongolian cashmere” as a premium product that is as readily identifiable and widely appreciated as “Scotch whiskey” or “New Zealand lamb.”

All USAID interventions under IR 1.2 will be centered on competitiveness issues that contribute to value added, foreign exchange or greater export earnings. The links with IR 1.1 on policy issues will be vital. Beyond that, involvement in specific industries may entail involvement in the entire cluster (the term “broad” in Mongolia is relative; unlike in much larger countries, the number of players involved in any particular industry is more manageable). Activities would include associational development, product improvements, new technologies, improved international marketing and strengthened management, all

aimed at improving the efficiency and competitiveness of the particular industry cluster involved.

IR 1.2 will also address public-private sector dialogue concerns. Since the private sector is most intimately aware of issues that impede competitiveness, USAID will push hard to encourage dialogue with the government to identify legal and regulatory barriers to business expansion. It will engage with the wider public on why these sectors offer much economic promise for the future. The focus should be on promoting productive partnerships and building consensus with government and within industry. Given the unique characteristic of these particular sectors, there may be opportunities for global linkages and international partnerships as well.

Possible USAID involvement in other sectors or industries will depend partly on funding, partly on unexpected opportunities that may present themselves and partly on the “facts on the ground,” as determined by competitiveness analysis undertaken by the new USAID-funded policy and competitiveness program scheduled to be launched later in 2003.

In most instances, it is inappropriate for USAID to pick “winners” beforehand. Rather, it should be positioned to help motivated self-selected industry groups to organize, form “clusters” that are representative of all industry actors along the supply chain, and take ownership over developing a cluster strategy. USAID will help facilitate the formation, strengthening, and capacity building of industry groups and associations and provide advice in strategy development, improving product quality and marketing, and linking to domestic, regional, and international markets.

Possible areas of future interest could involve support for marketing and business plan development related to the down-stream and service side of Mongolia’s growing mining industry. Alternatively, it could involve more sustained efforts related to herding and livestock, perhaps involving skins, leather, food processing or non-traditional but niche products such as camel or yak wool. Expansion into these types of areas will be possible if funding levels increase. As noted earlier, USAID private sector activities will be supported by the range of broader policy reform efforts undertaken under IR 1.1. In some instances, it should be possible to develop significant linkages with IR 1.3 as well.

Finally, it bears emphasizing that the credibility of USAID in Mongolia hinges to some extent on our ability to effect change at the sector, industry or institutional level, in part through a direct, hands-on engagement. Perhaps nothing illustrates this better than the Agricultural Bank experience cited elsewhere in this strategy. Ostensibly a “firm specific” effort, in reality this program had far-reaching and positive consequences in privatization, in banking, in the financial sector, in rural development—and in setting the tone for an effective, results-oriented USAID presence in Mongolia.

### *Illustrative activities*

- Support for competitiveness and formation and capacity building in industry clusters and associations, such as adventure travel and eco-tourism as well as cashmere and other animal-related products.
- Provision of business training and expertise in strategy development, management, improved product quality, productivity, and marketing.
- Support for “brand identification” related to Mongolia, building on past efforts aimed at “destination marketing” (in tourism) as well as in developing a collective mark for Mongolian cashmere.
- Support for export and investment competitiveness, in part through work on “best practices” related to quality control, international standards, trade agreements, import/export procedures and related areas.
- Collect and analyze comparative statistics on Mongolia’s relative competitiveness in key areas.
- Introduction of innovative incentive schemes to work with and reward trend-setting Mongolian firms for their competitiveness as well as their involvement in the international marketplace.
- Support for public-private coalitions to ensure that the government and the private sector pursue a common vision aimed at promoting competitiveness and identifying impediments to business expansion.

### **IR 1.3 Expanded Economic Opportunity for Marginalized Mongolians**

In Mongolia as well as in other USAID Missions, “sustainability” is often used when formulating an SO to emphasize the importance of taking environmental considerations into account. Certainly, this SO has been developed with full recognition of this concern. Mongolia has a natural resourced based economy and its future depends on the wise, sustainable use of its natural resource endowment.

However, “sustainable” can also be used in a different context, this time referring to the sustainability of particular political, economic and social orders. Used in this sense, the sustainability of Mongolia’s reform process hinges on the extent to which its citizens are actively engaged in it and benefit from it. The growing urban-rural divide is emerging as an important issue within the country. This is reflected in a large scale movement of populations from rural *soum* (district) centers to *aimag* (provincial) capitals, and from *aimag* capitals to Ulaanbaatar and a handful of other urban centers.

At this point, perhaps one million people live in Ulaanbaatar, representing around 40 percent of the country’s population. The two next largest urban centers—Darkhan and Erdenet—have populations of around 80,000 each. According to the 2000 census, 57 percent of Mongolia’s population is now “urbanized.” The census also indicated that one in five Mongolians live in an *aimag* other than the one in which they were born in; one in eleven Mongolians moved *aimags* in the previous five years; and as many as 30 percent of the population in some more remote *aimags* wish to move elsewhere.

International experience suggests that these migration patterns are neither unique nor unexpected. Indeed, a decade from now the proportion of Mongolians living in the

countryside is almost certain to decrease still further. The point isn't to "halt" this migration or pursue unsustainable investments in areas of the country that offer little or no economic opportunity. Rather, it is to take advantage of the economic dynamism that the widespread movement of peoples typically unleashes, using this movement to expand economic opportunity and ensure that a wider number of people benefit from the economic transformation that is taking place

Poverty estimates depend largely on the particular methodologies employed. Seemingly contradictory figures sometimes arise because of a failure to recognize this point. However, in as recently as 2000 the World Bank's Participatory Living Standards Assessment (PLSA) suggested that the percentage of Mongolia's population in the mid-income levels is decreasing as more people fall into poverty than escape from it.<sup>11</sup> Other estimates suggest that perhaps 36 percent of the population live in poverty, a proportion not atypical for a country at Mongolia's level of development. Whatever the percent, poverty is visible not only in the countryside but also in the growing *ger* districts surrounding Ulaanbaatar and elsewhere, some migrants having moved recently and others over the last several years. According to some accounts, as much as 60 percent of all Mongolians live in *ger* settlements in one part of the country or another.<sup>12</sup>

From a USAID/Mongolia perspective, the issues of economic growth in rural Mongolia and rural-to-urban migration are closely related and best addressed together. The carrying capacity of some Mongolian rangelands has at one time or another been exceeded. While the issue of rangeland conservation is highly complex, it is clear that over the long term Mongolia needs to develop a smarter and more sustainable livestock industry. In fact, historically much of the statistical data base for portraying Mongolia has been skewed because of the emphasis on the numbers of livestock rather than the productivity of herds. Herding in Mongolia is often considered a "way of life" (as it happens, during the 1990s large numbers of people began to herd who had never managed livestock before). Yet it is also a business. It must be economically viable in order to survive, both as a business and as a way of life.

#### Relation to Cross-Cutting Themes

##### **Conflict and the Environment:**

IR 1.3 addresses concerns about conflict over natural resources and socioeconomic disparities. On the *natural resource* side, USAID efforts to create higher quality livestock and alternative business opportunities will hopefully reduce pressure for resources in the countryside. On the *socioeconomic side*, USAID efforts to create income-generating opportunities in rural and peri-urban areas aim partly at reducing socioeconomic inequalities and possible social tensions.

**Information:** USAID rural development programs include an emphasis on information, in part through supporting radio and print media that provides information on market and weather conditions to isolated herders.

**Gender:** USAID business and credit development programs involve large numbers of women, thereby ensuring their active participation in the economic life of the country.

<sup>11</sup> See Mongolia Conflict Vulnerability Analysis by Christopher Finch, p. 9

<sup>12</sup> Ibid.

As any visitor to the countryside can attest, the central problem in rural Mongolia is not lack of investment during past decades. On the contrary, derelict factories, housing complexes, schools, theatres and government buildings are a relatively common sight in most provincial capitals. Rather, it is the lack of *sustainable* investment that constitutes the real concern.

The survival of rural Mongolia depends on the growth of economic activity, activity that will in large part rely on the country's natural resources, whether related to minerals, livestock or tourism. It also depends on strengthening rather than reducing the links between rural areas and urban areas of the country. Here too, a twin emphasis on business development that involves both viable commercial activity in the countryside and newly emerging commercial opportunities in urban Mongolia offers the best combination to truly involve large numbers of Mongolians in the economic transformation of the country. The central challenge is to accelerate economic growth so that otherwise "marginalized" populations living in both the countryside and peri-urban Mongolia are not left far behind.<sup>13</sup>

Over the next five years, USAID will continue its dual emphasis on economic development in rural Mongolia (initiated in 1999 as the "Gobi Initiative") as well as its new peri-urban program (launched in early 2003 as the "GER" program). Both activities build on the notion that the shift to a market economy should be accompanied by greater economic opportunity; that the tools needed to benefit from economic growth should be spread as far and wide as possible; and that the changes now underway carry with them the prospect for considerable further economic expansion. The focus is thus on business development, not welfare. Major themes include providing credit, expanding access to business services, disseminating information, identifying and overcoming business development constraints and improving the commercial environment that confronts new entrepreneurs. To the extent that USAID/Mongolia can address Agency disability concerns over the next five years, it will likely be through business development and related programs supported under this IR.

In the absence of significant additional funding, USAID will continue to focus its herder, business development and rangeland management activities solely on the large Gobi region covering south central Mongolia (credit programs through XacBank and other mechanisms will remain national in scope). However, activities related to information dissemination will be national in scope, as will initiatives designed to project the "lessons learned" from our on-ground experience to a large donor and government audience. In contrast, the smaller peri-urban program can aspire to be national scope from the start, given its immediate focus on expanding small businesses in the three largest peri-urban centers of Mongolia—Ulaanbatar, Darkhan and Erdenet.

Programs funded under IR 1.3 will provide an important "reality check" on the policy and sector programs envisaged elsewhere within this Strategic Objective. At a policy level (IR 1.1), experience gained will help inform and shape broader policy discussions and

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<sup>13</sup> Ibid. Socioeconomic and/or rural/urban inequality could be a risk to conflict in Mongolia, albeit in limited form. Over the last decade, Mongolians have typically taken to the polls to settle differences. Major political swings in the previous two sets of parliamentary elections are largely attributed to discontent over lack of economic opportunity.

interventions aimed at promoting economic growth. At a sector and industry level (IR 1.2), there is even more room for interaction. For example, the countryside provides the base for two industries that can contribute much more to the Mongolian economy, namely cashmere and tourism. Indeed, it is difficult to work at developing a competitive “industry cluster” in either tourism or cashmere without taking rural Mongolia into account. Similarly, various activities under the Good Governance Strategic Objective have direct relevancy to what happens in both rural and peri-urban Mongolia. More broadly, USAID expects that activity under IR 1.3 will demonstrate to government as well as the donor community what happens when serious, practical and pragmatic approaches are applied in a sustainable, results-oriented way.

***Illustrative activities:***

- Direct business support to herder cooperatives and other herder groups, including advice and training on enterprise development, product improvement, quality control, rangeland management and marketing.
- Direct business support to new and emerging rural businesses on similar themes
- Direct business training and related support to new and emerging businesses in peri-urban Mongolia.
- Identification, discussion and action on impediments within the regulatory and administrative environment on business development in rural and peri-urban Mongolia.
- Assessment of the dynamics of Mongolia’s informal sector, coupled with promotion of an effective enabling environment for expanding both its growth and its integration into the broader economy.
- Promotion of new products, programs and other initiatives aimed at delivering efficient credit services to economically active but heretofore marginalized Mongolians.
- Support for emerging NGOs and associations that engaged in practical, commercially-oriented support aimed at expanding economic opportunity in rural and peri urban Mongolia.
- Strengthened linkages between small and micro businesses in rural and peri-ban Mongolia with larger and more mainstream private enterprises.
- Integrated approaches aimed at linking herder groups and other small businesses with the international marketplace.
- Active dissemination of relevant information on various media (including radio and print media) on issues vital to the development of rural and peri-urban Mongolia.

***D. Critical Assumptions***

As in any strategy, the presentation of a specific objective along with its associated intermediate results is based on certain underlying assumptions. With regard to accelerating and broadening sustainable private sector led economic growth in Mongolia, the critical assumptions include the following:

- Economic stability and growth is maintained through *proper fiscal and monetary management* (e.g., civil service reform and salary restraint, reasonable fiscal deficits, effective financial sector regulation). Foreign debt servicing obligations stay manageable.

Mongolia has come a long way towards macro economic stability over the past five years. The assumption here is that that sound economic management will continue.

- Following the 2004 elections, the Government of Mongolia remains *politically committed* to broad-based economic reforms. In addition, any government will be sincerely interested in effectively addressing issues related to Mongolia's international competitiveness, including streamlined commercial laws and regulations and other microeconomic barriers to business growth. Survey research suggests that nearly nine out of ten Mongolians continue to support the economic and political path that the country embarked on twelve years ago. This commitment has survived changes in political power and appears to have broad public support both inside and outside government.
  
- Overall growth is not dramatically affected by *worsening weather and worldwide economic conditions*. Mongolian policy makers must work within the context of a small economy that is highly dependent on volatile commodity exports as well as international economic factors that are beyond their direct control. The Mongolian countryside will always be cold and copper, gold and cashmere prices will always fluctuate wildly. However, a rapid unraveling of the global economy due to war, recession, SARS or a series of unexpectedly ferocious winters would necessarily require a major rethink of what USAID expects to accomplish under its economic growth objective.

## **V. STRATEGIC OBJECTIVE TWO: More Effective and Accountable Governance**

### ***A. Statement of Strategic Objective***

USAID/Mongolia's Strategic Objective (SO) and associated Intermediate Results for democracy and governance during the five year period FY 2004 through FY 2008 are as follows:

#### **SO 2: More Effective and Accountable Governance**

*IR 2.1 Comprehensive Legal Reforms Implemented*

*IR 2.2 Political Processes Made More Competitive, Effective, and Transparent*

**Link to State/USAID Strategic Plan:** Strategic Objective 2 supports the joint State/USAID strategic goal of "Democracy and Human Rights," which aims to "advance the growth of democracy and good governance, including civil society, the rule of law, respect for human rights, and religious freedom." In particular, this SO supports the performance goal: "Measures adopted to develop transparent and accountable democratic institutions, laws, and economic and political processes and practices."

**Strategy Duration and Life of SO Funding:** Under the new strategy, the duration of this SO would be extended until September 30, 2009. The authorized additional life of funding for this SO is \$20 million, or \$4 million per year for the five-year period covered by the strategy. This brings the total authorized funding level for this SO from the \$17 million when the strategy was presented to \$37 million.

### ***B. Problem Analysis and Program Approach***

#### **Problem Analysis**

Mongolia has made significant progress over the past twelve years in establishing the basic framework for a democratic society. An impressive constitution is in place, along with a plethora of laws and regulations that provide the foundation for even further progress in the years ahead. If one true test of democracy is the ability to change governments through regular free and fair elections, then Mongolia has passed that test with admirable results. Its record here stands in marked contrast to that of its five Central Asian neighbors, each of which is still ruled by the same leader who inherited power following the break-up of the Soviet Union.

Yet Mongolia's continued progress is by no means guaranteed and difficulties will almost certainly be encountered in the days ahead. As economic prospects improve, competition over the country's productive resources is likely to increase. The stakes will become higher and the issues will become more complex. Given that environment, it is all the more important to build on the relatively high degree of openness, media freedom and tolerance for

dissenting views that Mongolians already enjoy in ways that not only maintain gains made thus far but also expand them further into the future.

As in the economic arena, *implementation* is a central concern. New civil and criminal codes adopted in September 2002 place Mongolia at the forefront of former Soviet states in terms of its adoption of a legal framework that is in keeping with its ambitions to transform itself into a democratic, market-based society. In here and other areas, the challenge is to move beyond the law as it is reflected in legal tomes and make it part of the widely understood and accepted legal norms, practices and expectations of Mongolian society.

As the Washington strategy team that visited Mongolia in October 2002 pointed out, considerable USAID activity in Mongolia and elsewhere focuses on the “supply” side of the democracy equation. There has been a strong and understandable interest in building an effective democratic framework for the future, one that includes a judiciary that is efficient, a parliament that is accountable and political parties that are open and transparent. The more difficult long-term challenge is to strengthen, sustain and further transform these institutions through strengthened *demand* on the part of the public for more effective political institutions. The greater emphasis placed on dialogue, transparency and the free flow of information as a cross-cutting theme is directly related to the renewed effort within the Mission to address this particular concern.

Finally, it should be noted that DCHA/DG defines the term “democratic governance” as the promotion of greater transparency, accountability, and participation in government institutions and in public policy reform processes at all levels. USAID/Mongolia endorses this definition, recognizing that other organizations such as the World Bank define the term somewhat differently.

In sum, USAID/Mongolia has chosen to focus on two areas – legal reform and political processes – that are key to strengthening the existing trend toward better governance in Mongolia. In the context of the DCHA/DG conceptual framework, broad-based legal reforms will improve government transparency and accountability, and better political processes will improve government accountability and participation. Specific indicators for these two intermediate results will be developed in late FY 2003 during preparation of the Mission’s new performance monitoring plan.

### **Program Approach**

Under the new FY 2004 – FY 2008 strategy, USAID will help achieve more effective and accountable governance in Mongolia. Specific areas of involvement include (1) a comprehensive engagement with a broad range of legal reform issues, with a special emphasis on implementation; and (2) more limited engagement with parliament and political parties, with possible adjustments made in programming priorities following the summer 2004 elections.

“Good governance” and “accountability” are not only useful organizing themes; they should also serve as the touchstone for much of what the Mission undertakes within the democracy

as well as the economic arena over the next five years. In particular, the greater emphasis on transparency and open access to information, combined with a willingness to address corruption explicitly, reflects a growing awareness within some elements of both the government and the donor community that these are critical issues that will play an important role in shaping Mongolia's future.

One of the most important results of the Washington strategy team visit during fall 2002 was the recommendation for the Mission to stay the course on legal reform. Viewed from one perspective, USAID could assess its impact in the judicial sector thus far, "declare victory" and go home. As noted, commentaries and training were provided related to new civil and criminal codes. By the end of this year, the lion's share of the country's court case load will have been automated. New approaches to dealing with case load management will have been introduced. Most judges and prosecutors and a significant proportion of the country's private attorneys will have benefited from a series of training sessions organized in conjunction with GTZ. Yet international experience suggests that durable legal reform is a long term proposition, one that requires not only a new legal framework but also years of effective training and implementation.

Washington strategy team recommendations for a more expansive democracy portfolio were made within the context of what in retrospect appears to have been an overly optimistic budget scenario. Indeed, the proposed framework initially involved four separate IRs covering legal reform, political party development, parliamentary strengthening and "increased citizen demand for responsive, transparent and accountable government."

Given the probable budget realities, the Mission is instead electing to focus on legal reform (under IR 2.1) and political processes (under IR 2.2). This formulation will provide more flexibility in dealing with both shifting budgets and changing circumstances in Mongolia. Any future programs related specifically to parliament and to political parties will depend on assessments following the results of the summer 2004 elections. In addition, the term "political processes" is broad enough to embrace other possible areas, including civic education, acceptance of dissenting political views and further engagement with Mongolia's NGO community. Here again, budgets and election results will very much determine what form this activity will take during the post 2004 period.

Rather than "stove piping" sectors, USAID will take a complementary approach to its development programs. In particular, the focus on judicial reform has clear implications for Mongolia's economic growth objectives. The efficient resolution of commercial disputes is one obvious area of concern, respect for property rights another. More effective and transparent political processes are vital; not only in terms of periodic elections but also in ensuring broad and inclusive discussion on key issues that affect Mongolia's future. Here too, the possibility of using initiatives organized within one Strategic Objectives to re-enforce and build on programs undertaken in the other should be readily apparent.

## C. Key Intermediate Results

### IR 2.1 Comprehensive Legal Reforms Implemented

All too often, the initial response to any issue in Mongolia is to draft a law or administrative procedure about it. While there is certainly a place for USAID input into new laws and procedures, the strong emphasis over the next five years will be on *implementation*.

The importance of this approach is amply demonstrated in the series of targets and indicators used to track improvements in the judicial sector over time. Indicators cover many areas, including judicial discipline, budgeting, selection, transparency, policy and decision-making. Significant achievements are being recorded in FY 2003, almost all on account of new laws and procedures that were put into place with the establishment of new civil and criminal codes in September 2002. However, the daunting task of effectively implementing these changes still largely lies ahead.

As the October 2002 strategy team recommended, this approach will involve deeper engagement in the “bigger picture” of legal reform. As the new strategy period begins, USAID will already have played a key role in shaping the new civil and criminal codes; in establishing a new anti-corruption unit within the prosecutor’s office; in automating the lion’s share of the country’s caseload; in introducing new ideas related to transparency, such as a public access computer terminal in every automated courtroom; in improved court room procedures and caseload management; and in setting up a framework for continuing legal education, the mechanism by which many of the changes made in Mongolia’s legal profession over the last several years will be deepened and sustained.

Most of what has been accomplished thus far was based on the *Strategic Plan for the Justice System of Mongolia*, developed during the late 1990s with USAID/Mongolia support and endorsed by both the former Democratic government and the current MPRP one. Over the next five years, the challenge for USAID will be to move beyond the “introduction” of these new approaches and ensure that they are actually “embedded” and “institutionalized” within the legal profession.

#### Relation to Cross-Cutting Themes

**Environment:** The legal framework for protecting Mongolia’s environment is fairly impressive. However, laws and regulations that do exist all too often are not implemented. A more efficient and effective judiciary would go a long way toward ensuring that already existing laws are effectively implemented.

**Gender:** Most Mongolian judges are women, though senior levels of the judiciary remain predominantly a male reserve. The USAID emphasis on strengthening the professionalism of Mongolia’s judicial staff should also increase the skills and professional standing of women living across Mongolia.

**Conflict:** Corruption if left unchecked could become a source of conflict and instability. USAID support for a new anti-corruption office will help ensure that this concern is directly addressed, not just theoretically but also in a practical way.

The fact that Mongolia is a relatively small country increases the prospects of success. In fact, Mongolia's entire population of practicing judges (less than 400) can fit into a single conference room. Close involvement and coordination with other donors, especially GTZ, also increases the likelihood of success. This engagement in a broader range of judicial issues will not result in a frittering away of scarce management time and attention into dozens of areas at once. Rather, it will poise the Mission to take advantage of the synergies and opportunities that exist within a small judiciary to implement one of the more far-reaching efforts at judicial reform yet attempted within the former Soviet bloc.

The efficient and effective delivery of justice is an important governance issue. It also deeply affects the commercial environment as well as Mongolia's prospects for sustained economic growth. Synergies between legal reform and the private sector can partly be achieved by training judges to better understand modern business practices and better enforce contract law, property rights, intellectual property rights, and commercial dispute settlement. These efforts to strengthen links between the "economic" and "democracy" side of the Mission portfolio are important and are in keeping with the guidance provided during the May 2000 program review. At the same time, it also needs to be emphasized that our involvement in legal reform is not predicated solely on ensuring that local and foreign investors "feel secure" about their investments. Rather, it is to ensure all Mongolians that they live within a state in which the rule of law is respected and followed.

Finally, USAID will help improve citizen awareness about changes in the legal and judicial sector framework, in part through public information outreach programs that help inform citizens about their rights and responsibilities under Mongolia's new and dramatically changed legal framework. The fact that public information access points are already available at virtually every court in Ulaanbaatar and in several model courts outside the capital city means that such campaigns are not rooted in "theory." On the contrary, tools are already in place that, if used effectively, can provide the transparency that Mongolia's legal system so desperately needs.

### ***Illustrative Activities***

- Practical advice on new laws, legislation and administrative procedures related to legal reform in Mongolia.
- Hands-on training in implementing specific legal reforms.
- Detailed review of current *Strategic Plan for the Justice System of Mongolia*, possibly followed by a new, updated version that takes into account the dramatic changes over the past couple of years.
- Completion of courtroom automation (including installation of public access computers) in virtually every courtroom in Mongolia.
- Direct assistance related to prosecutorial reform, including support to new anti-corruption office.
- Commercial law development and application, including training of judges and prosecutors so that they better understand business practices related to contract law, laws on private property rights, intellectual property, and commercial dispute settlement.

- Introduction of effective approaches to continuing legal education that deepen and sustain the legal reform progress for the long term.
- Active engagement with wider public on judicial reform issues, including information campaigns designed to broaden understanding of the rights and responsibilities of citizens under the country's new legal regime.

## IR 2.2 Political Processes Made More Competitive, Effective, and Transparent

Access, competition and transparency are the hallmarks of an effective democracy. The term “political processes” embraces a range of institutions, including political parties, parliament and civil society. There is scope for USAID involvement in all three areas, though the nature and shape of that support will depend in large part on the outcome of the summer 2004 elections.

*With regard to political parties*, Mongolia is currently characterized by a single dominant grouping, the Mongolian People's Revolutionary Party (MPRP). This party ruled throughout the Soviet period and then acquired a new reformist face to lead the country through the early stages of transition away from Communism and toward a more open and democratic society. It relinquished power to a fragmented and sometimes ill-organized democratic coalition following the 1996 elections. Four years later, it dramatically returned to power, winning 72 out of 76 parliamentary seats despite garnering only 51 percent of the popular vote. Today, the MPRP is unquestionably the dominant political force in Mongolia.

Ongoing USAID support for political party development in Mongolia through the International Republican Institute (IRI) is designed to respond to the aftermath of that election. The Mission does not “take sides” on political issues. It does not promote any particular party or political grouping. Rather, its only interest and goal is to promote democracy within a competitive political system that is open and transparent.

IRI programs support both the MPRP and the Democratic opposition. However, specific activities are designed to respond to very different circumstances. For the MPRP, the “message” is to promote transparency and citizen involvement. The party enjoys overwhelming political power. But, as the government in power, it must also represent all Mongolians, hopefully in ways that are inclusive and reflect a high degree of openness. For

### Relation to Cross-Cutting Themes

#### Information and transparency:

Work initiated by USAID to help organize open parliamentary hearings represents an important contribution to parliamentary transparency. This innovation needs to be continued and improved over the long term.

**Gender:** Women, often the most dynamic party members at a local level, need to be incorporated more into the political mainstream. Political party training can contribute to strengthening and expanding this involvement.

**Sustainability:** National elections scheduled for summer 2004 elections will be an important test of how firmly democracy is rooted in Mongolia. A post election analysis will determine the nature and shape of USAID support for political parties, if any, during the post 2004 period.

the democratic opposition, the “message” is to unite and focus. Experience in power during the period 1996–2000 demonstrated the difficulties inherent in unstable coalitions. Unless it unifies, the opposition is unlikely to contribute much toward political competition in Mongolia for the foreseeable future.

*With regard to parliament*, the dominant position of the MPRP helps reinforce the strong USAID message of transparency and openness. Most recently, IRI worked with parliament to help establish a system of open hearings. Initial hearings have focused on the judicial budget and on foreign loans. Hopefully, these early, well-attended public hearings are only the precursor to a much more ambitious schedule of hearings that will provide opportunities for the informed public to comment on major political and economic issues facing the country.

Elections are the periodic political process by which governments and heads of state are selected. Parliament is the day-to-day working out of a political process among those elected to power. Beneath these two formal structures lies a network of other individuals, institutions and organizations that are vital to the smooth functioning of democracy. Among other groups, this network includes NGOs, media and civil society writ large. Such networks are important not only in ensuring effective political processes; they are also vital in establishing the foundation that is needed for a vibrant free-market based society to prosper and thrive.

During the lead-up to national and presidential elections in summer 2004, the USAID-funded IRI program will maintain its focus on parliamentary and political party development. On the party side, the intent will be to provide the tools needed to understand an electoral process, develop a platform, cultivate grassroots support and run a competitive political campaign. On the parliamentary side, the effort will be directed toward establishing transparent and open procedures that the next parliament can build on, regardless of who comes to power.

Specific USAID interventions during the remainder of the strategy period will depend very much on the outcome of the 2004 elections and the assessment that follows. Certainly, it should be possible at that time to gain a new understanding for the relative strength of various political parties as well as the key issues affecting the new parliament.

Ideally, after the election results, the emphasis will be on strengthening the political system to give systematic space for a regular “loyal” opposition to take root, and the ability of the overall system of checks and balances to govern well in the national interest. In this environment, the focus could be less on elections and more on expanding the effectiveness of the parliament and other institutions.

Realistically, a continued measure of political party support may be needed, especially if the overall political landscape remains unchanged or serious political competition becomes even more limited. New opportunities to work with parliament might also emerge. Beyond these two areas, the results might also point to a broader and more in-depth look at other factors that go into sustaining a transparent and effective political process, including NGOs, the

media and the promotion of a culture of political openness in ways that tolerate dissent. Already, increased public dialogue and expanded access to information have been identified as important cross-cutting issues throughout the upcoming strategy period. If further work in these areas is needed to build more competitive, effective, and transparent political processes, USAID/Mongolia will certainly consider them.

### ***Illustrative Activities***

- Technical assistance and training prior to the summer 2004 elections to make political parties more professional and effective. Training message and content will vary, depending on the circumstances involved. However, a concerted effort will be made throughout to help parties develop the tools, approaches, understandings and grassroots support needed to promote competition and run an effective political campaign.
- Continued advice to parliament aimed at increasing transparency, accountability and professionalism, in part through a system of open public hearings that draw members of the general public into broader policy debates.
- As appropriate, elections support including monitoring, and voter education aimed at strengthening an indigenous elections monitoring capacity.
- Outreach programs to other civil society actors aimed at improving their capacity to monitor and report on issues related to transparency and accountability in Mongolia.
- Detailed post election analysis to determine the continued scope of Mission activity involving political parties, parliament and possibly other civil society actors. The latter would be assessed in relationship to other ongoing programs focused on transparency, information dissemination and corruption.

### ***D. Critical Assumptions***

As with the economic growth Strategic Objective, USAID/Mongolia programs related to democracy and governance reflect a number of inherent assumptions. These include:

- *National elections scheduled for summer 2004 are fair, peaceful and democratic.* The conduct of these elections, the fourth since the end of the Soviet era, will provide an important test of the extent to which electoral democracy has been rooted in Mongolia. At this point, there is every indication that they will be as free and fair as the earlier ones.
- Regardless of the results of the 2004 elections, the Mongolian government *remains politically committed to the path of democracy and reform*, including in the judicial sector.
- Throughout the next five years, the Mongolian political climate is *broadly open in ways that support democratic principles and tolerate dissent*.

## **VI. CROSS-CUTTING THEMES**

Over the next five years, the USAID program in Mongolia will be heavily focused on two mutually reinforcing goals. First, *it will accelerate private sector led economic growth on a sustainable basis*. Second, *it will help achieve more effective and accountable governance*. While each activity will be organized around at least one of these two organizing principles, specific activities will be developed in ways that also address a number of important cross-cutting concerns.

### **A. Transparency and Access to Information**

Transparency and access to information will be a dominant cross-cutting theme throughout the new strategy period. USAID programs will increasingly turn toward transparency and information dissemination as a way to advance good governance, promote public involvement and reduce corruption. Each SO, each IR and each contractor/grantee will have at least some activities that address this paramount concern. Examples include the various media programs pioneered by the Gobi Initiative; public information programs related to legal reform and energy; public hearings in parliament; the open government website within the Prime Minister's office; and new public access terminals in courtrooms cross the country. From a Mission perspective, transparency and access to information should be viewed as a "core" concern, one that *every* USAID-funded activity should address.

### **B. Information and Communications Technology**

Information technology (IT) is a cross-cutting theme as well as a useful tool for achieving higher level strategic results. Few in USAID/Washington would view USAID/Mongolia as having a "strong focus on IT." However, a portfolio review indicates a myriad of IT-related activities, all employed as part of a broader effort to ensure program success in a country that lends itself to modern communication technologies.

At a basic level, a variety of USAID-developed web pages suggest the ways in which IT can be used to help market Mongolia ([www.travelmongolia.org](http://www.travelmongolia.org)); disseminate information on rural issues ([www.gbn.mn](http://www.gbn.mn)); engage the wider public ([www.open-government.mn](http://www.open-government.mn)); and contribute to transparency in the privatization process ([www.spc.gov.mn](http://www.spc.gov.mn)). Beyond that, one of the most high profile USAID-funded IT initiatives involves the installation of computers in courtrooms across the country. Virtually every courtroom in Ulaanbaatar and some pilot courtrooms outside the capital are now automated, each having its own public access terminal. Here and elsewhere, IT can also help address broader concerns related to transparency and accountability.

Mongolia's small population, vast empty spaces and long distance from international markets all lend themselves to employing IT tools in the most efficient, cost-effective way possible. For example, web technology is increasingly emerging as an important marketing tool for Mongolian tour companies. Within Mongolia, IT can play an important role in delivering needed information to the countryside. Wider IT issues are not at this point addressed within

the Mission's policy program. However, such concerns could certainly be included within the mandate of that program if they emerge and if other donors show a reluctance to become involved.

### **C. Sustainability**

The first five years of USAID activity in Mongolia included a heavy emphasis on emergency relief and rehabilitation. By the later part of the 1990s, attention shifted to a more development-oriented approach, one that emphasized results and responded quickly to Mongolia's rapidly changing development landscape. During the next five years, issues of sustainability will emerge as a paramount concern and will need to be addressed in virtually every area in which USAID is involved.

Approaches will vary, depending on the circumstances. USAID has already made an impressive contribution in some areas. For example, Mongolia's banking sector three years ago verged on bankruptcy. The situation today, though still fragile, is vastly different. The privatization of the Trade and Development Bank as well as Agricultural Bank, both actions in which USAID was directly involved, provided \$20 million to government and hold out the promise of a further \$40 million in additional investment over the next two to three years. USAID/Mongolia support for XacBank, once significant, is rapidly declining and may fall to as little as \$50,000 this fiscal year. In these and other areas, USAID was catalytic in providing initial support for institutions that should continue long after a USAID program in Mongolia concludes.

Work in the economic policy arena is more difficult and long term. While depending to some extent on the scope and shape of USAID's new policy and competitiveness initiative that should be launched later this year, there is clearly an interest in providing more direct support for capacity building within local institutions. The possible internship program included in the RFP partly addresses this concern, as does USAID support for some two dozen long term scholarships over the past ten years, most of them in the financial sector. Other elements of the program, including competitiveness work related to clusters, reflect a similar sustainability concern. In broad terms, the intent is to shift the focus from USAID "delivering products" to empowering local associations and other groups to help themselves.

Judicial programs reflect some of these same concerns. Certainly, an important driving force behind the judicial training program is the desire to place this function wholly within a Mongolian institutional setting. Agreements tied to courtroom computerization reflect a similar interest in sustainability. An important task over at least the short and medium term is to ensure that the courtroom automation "works" in the way that was intended, resolving any unforeseen problems as and when they occur.

Finally, there are important issues of sustainability associated with USAID's ongoing business development programs aimed at broadening the involvement of rural and peri-urban Mongolians in the economic transformation process now underway. These issues are much more difficult than they might appear at a first, superficial level. Even with user fees, can the delivery of business services to relatively poor Mongolians ever be self-sustaining? Does the

measurement of sustainability for USAID lie in the creation of institutions to deliver such services into the foreseeable future, or does it rest with the dozens if not hundreds of new businesses that are created as the direct result of our business development efforts?

Such issues are at the heart of our dialogue with the implementers of both our rural and peri urban business development programs. In reality, there will likely be a combination of responses, not just one. For example, the media and information programs sponsored by Gobi should certainly become sustainable during the next five years. However, certain kinds of business support services may be useful for the duration of USAID support and then disappear. In these circumstances, the USAID legacy would not lie in the bureaucratic institutions that it leaves behind. Rather, it would rest with the change in attitudes and the myriad of small enterprises that it brought about as part of its broader support for the economic and political transformation of Mongolia.

#### ***D. Global Development Alliances***

USAID/Mongolia lacks the size and management capacity to aggressively seek out major new Global Development Alliances (GDA). However, there are certainly opportunities to actively cultivate such alliances within our portfolio. A couple of recent examples help illustrate the point. During September 2002, USAID teamed up with Boeing and Mongolia's Civil Aviation Authority to conduct a management assessment of the national airline, one that will hopefully result in a management contract funded by the European Bank for Reconstruction and Development (EBRD). At another level, the Gobi Initiative organized a fall 2002 tour of Mongolia for its home office supporters that resulted in a useful cash donation that was channeled toward media development in the Gobi.

Some small but intriguing partnerships have also been worked out in other ways. For example, our tourism program involves music entertainers and media groups, among others. Similarly, the cashmere activity recently secured international advertising for the new collective mark for Mongolian cashmere, with private companies providing \$5 for every \$1 contributed by USAID. Though not yet finalized, the total private sector contribution in support of this effort is expected to reach \$200,000.

In addition, USAID strongly supports recent efforts made by XacBank management to attract other investment, not only from the International Finance Corporation (IFC) but also from such groups as ShoreBank (US) and Triados (Netherlands). GDA themes were also highlighted in the Request for Proposals (RFP) issued earlier this year for our most significant procurement in recent years, the new policy/competitiveness support program. Hopefully, that process will result in viable partnerships involving the public, private and NGO sectors. As these examples suggest, USAID/Mongolia does expect to contribute to the Agency's GDA goals over the next five years.

#### ***E. Potential Other Sources of Funding***

During a time of considerable budget uncertainty, the Mission is increasingly turning its attention toward other potential sources of funding. From our perspective, such funding is

welcome as long as it is closely intertwined with ongoing project activity and advances broader strategic concerns.

Here again, recent examples are instructive. At the end of FY 2002, XacBank received \$1.2 million from the EGAT Bureau in Washington to support its microfinance lending objectives in Mongolia. XacBank, which grew out of the Gobi Initiative, apparently ranked first out of the nearly four dozen proposals submitted to Washington. The grant is completely on-target as far as the USAID strategy in Mongolia is concerned. Even more recently, the Mission was informed that the Wildlife Conservation Society (WCS) proposal for a “living landscapes” project on the eastern steppes of Mongolia had been approved, again for more than \$1 million.

In addition, the two USAID programs designed to promote business development in rural and per-urban Mongolia have either received or are likely to receive substantial local currency resources under the Embassy-managed 416b wheat programs. The total amount this year could be as much as \$5 million. In such cases, the USAID-funded programs can become a “platform” for additional activity that goes far beyond what could have been funded under the initial USAID grant.

It is uncertain whether or not we will receive additional funding of this order of magnitude in FY 2004 and beyond. However, we will continue to raise the profile of USAID programs as a potential implementer of Embassy local currency programs. We will also support potential EGAT or DCHA funding in areas that contribute to our broader strategic objectives. For example, we recently commented on two proposals that involve Mongolia as part of DCHA/PVC “strengthening the NGO sector” competitive grants program. If selected, one or both programs could help address our concern that bilateral funding may be insufficient to achieve our democracy and governance Strategic Objective.

#### ***F. Millennium Challenge Account***

Millennium Challenge Account (MCA) issues are discussed at greater length in an annex to this strategy document. However, it is useful to highlight here the fact that Mongolia is emerging in various press accounts as a potential candidate for MCA funding in FY 2004 or beyond. This recognition reflects the success that Mongolia has had in moving forward simultaneously on both the political and economic elements of its ongoing transformation toward a democratic, market-based society. Already, the Government of Mongolia has responded to the media discussion about its potential inclusion in the MCA by forming a working group to discuss MCA-related issues.

Clearly, Mongolia’s inclusion in MCA—if it were to happen—would have significant implications for the USAID program in Mongolia. At this point, it is useful to simply affirm that Mongolia’s competitiveness for MCA funding hinges on its continued commitment to both economic and political reform. It is also worth emphasizing that this strategy places issues related to MCA at the front-and-center of our program over the next five years. In particular, the USAID/Mongolia economic growth Strategic Objective will be heavily involved in the “promoting economic freedom” aspect of MCA, even as our good

governance Strategic Objective advances “just government” concerns. Our recent dialogue with counterparts and other donors on corruption—the one “make or break” aspect of the apparent MCA rating system—also addresses issues vital to the MCA process.

### **G. Donor Coordination**

On a per capita basis, Mongolia receives one of the highest levels of donor assistance in the world. During the decade 1991 through 2001, aid commitments averaged \$216 million per year and disbursements averaged \$214 per year. By the end of 2001, Mongolia’s external debt stood at more than \$850 million, or approximately 80 percent of GDP. Almost all of this debt—which excludes the as yet unresolved “Russian debt issue”—is on concessionary terms. Most of Mongolia’s external debt is owed to either Japan or the ADB.

Japan, the World Bank and the Asian Development have all been developing country strategies at the same time that USAID has been drafting its own, affording useful opportunities to coordinate. Annual Consultative Group (CG) meetings alternating between Paris, Tokyo and Ulaanbaatar provide a useful forum for broad policy level discussions. Sector level meetings covering such topics as energy, rural development, urban development and governance revolve around more technical discussions.

The range of activity undertaken by various donors is discussed at length in two background papers prepared as part of the strategy formulation process. It is also briefly summarized in an annex to this strategy. Amidst this mix of other donor activity, USAID/Mongolia seeks to stand out on account of its sharp focus in terms of areas of involvement; speed, flexibility and pragmatism in implementing programs; strong emphasis on economic growth; and willingness to work directly with the private sector expansion as the key driving force behind Mongolia’s future prosperity.

While donor coordination is improving over time, some feel that Mongolia is “over-donored;” that the government is stretched to the limit in managing the peculiarities of various donor strategies and their corresponding administrative requirements; and that individual programs all too often lack effective coordination at the level of both planning and implementation. There is also a sense in some quarters that a donor emphasis on dialogue and discussion can at times crowd out the much stronger emphasis that needs to be placed on implementation.

Despite the shortcomings, USAID/Mongolia will make a concerted effort to promote cooperation among various donors throughout the next strategy period. Already, we can point to several positive examples of what can happen when donors work hard at working together. For example, XacBank was formed following the unprecedented merger of two ongoing non-bank financial institutions, one initiated by the UNDP and the other by USAID. Similarly, coordination between GTZ and USAID has been highly effective in the area of judicial reform. The World Bank, Asian Development Bank (ADB) and International Monetary Fund (IMF) all strongly supported the AgBank restructuring and privatization process.

At a project level, the Gobi Initiative cooperated with the ADB last year in well drilling in western Mongolia; the Competitiveness Initiative cooperated with GTZ, Soros Foundation and the Governments of Thailand and the Netherlands in tourism development; IRI cooperated with Britain's Westminster Foundation in political party development; and the judicial reform program cooperated with UNDP on addressing corruption issues. While much of the *talk* about donor coordination takes place at a policy level, some of the most productive relationships are in fact forged at a field level when project implementers begin to actively work with each other.

As always, funding levels for the out years are uncertain. In such an environment, the need for close coordination can only increase. Given that the ADB is the largest multilateral donor and Japan is the largest bilateral donor, these relationships are especially important. In recent months, a special effort has been made to engage more closely with Japanese counterparts, first to better share program information and then, if possible, to work together, at least at an operational level. Much more than in the past, Japanese aid teams are beginning to engage with Mission as well as USAID-funded contractors on possible future program directions.

## **H. Gender Issues**

Gender issues are discussed at greater length in the annexes and in an accompanying background paper prepared as part of the strategy formulation process. In many ways, the realities in Mongolia stand in sharp contrast to most other countries at Mongolia's level of development. This is especially the case in education, where a significantly higher proportion of girls than boys finish primary and secondary school. By university, more than two out of every three students are female. Yet this high level of education does not translate into power or authority, especially at the highest levels of government. Some of Mongolia's most dynamic and influential mid level managers are women. If it is relatively easy for women to enter a particular profession, it is much more difficult for them to break into the upper echelons of leadership in both the public and private sector.

About 40 percent of the two dozen Mongolians awarded long-term scholarships in the US over the past decade have been women. With respect to the prestigious and highly competitive short-term Eisenhower Fellowships, two out of three participants were either former or present female Members of Parliament. There is significant female involvement in all USAID-supported financial programs, both in terms of clientele and senior management. Women also participate heavily in training sponsored by the judicial reform program, an involvement that over time should certainly increase professional opportunities. During the next five years, USAID/Mongolia will continue to monitor the program to ensure active participation across a wide spectrum of Mongolian society.

## **I. Environmental Concerns**

Environmental issues are summarized in the annexes. In addition, a detailed background paper was prepared as part of the strategy development process to ensure compliance with Section 119 of the Foreign Assistance Act. The anticipated arrival of a new PSC who served as a senior environmental advisor within the Bureau for Europe and Eurasia will strengthen

our capacity to understand and respond to environmental issues over the next five years immeasurably. Among other things, the new person will be charged with reviewing all aspects of our program to ensure that the Mission fully adheres to Agency policy and guidelines on environmental issues.

This strategy does not propose a stand-alone environmental project along the lines of the Lake Hovsgol conservation and development project that was implemented during part of the most recent strategy period. As that experience indicates, stand alone projects, while useful, can have limited impact if the broader policy initiatives needed to maintain and sustain them are not also put into place. Another “test case” of this proposition could well emerge in the coming years with the implementation of the five-year “living landscapes” project for the eastern steppes of Mongolia recently approved by the EGAT environmental office and implemented by the World Conservation Society (WCS). USAID/Mongolia looks forward to actively monitoring the implementation of this new WCS activity, the first of its “living landscape” programs to involve Asia.

Given past experience and current budget realities, USAID/Mongolia has purposefully adopted an integrated approach to environmental issues over the next five years. At a national level, this means supporting sustainable policy approaches that reflect the true cost of Mongolia’s natural resource endowment. Included within this approach is energy pricing that reflects the true cost of production as well as a strong emphasis on adding value to the commodities that Mongolia produces, rather than exporting them in a low cost, unfinished state. At a sector level, this means introducing new concepts such as eco-tourism “leave no trace” adventure travel. Finally, the Gobi Initiative includes an important rangeland management component aimed at identifying and testing new models for protecting Mongolia’s fragile yet important grasslands.

## **VII. Resource and Management Requirements**

### ***A. Funding Requirements and Scenarios***

#### ***Base Case Scenario***

This strategy is based on a “core” funding scenario of around \$10-\$12 million a year, or total program levels of approximately \$50-\$60 million over the next five years. This is somewhat less than what was envisaged at the May 2002 country review, but is more in keeping with current budget realities which at this point suggest ESF funding for Mongolia of \$10 million in FY 2003, \$10 million in FY 2004 and \$12 million in FY 2005. In reality, the Mission will almost certainly have to wrestle with considerable funding uncertainty during each of the next five years.

The strategy could accommodate some budget variation, especially if it is in an upward direction. The basic strategic framework is sound. Most importantly, it ensures that the Mission will be actively engaged in the central issues facing Mongolia over the next five years.

#### ***High Case Scenario***

If annual budgets are increased to an average of \$15 million—or \$75 million over the next planning period—we would significantly increase our engagement in the policy and competitiveness arena. Among other things, such an increase would allow for more direct, hands-on involvement in a broader range of policy issues as well as competitiveness clusters beyond the two or three now being contemplated. For example, USAID could extend its involvement beyond the financial sector and energy sectors to include other areas, such as customs or taxes. Similarly, it could extend its competitiveness work beyond two or three core areas such as cashmere and tourism to include other sectors such as information technology, light manufacturing, agro-industry or a broader range of animal products. We could consider much deeper engagement in the privatization of some of Mongolia’s large remaining government-owned enterprises, including in transport and telecommunications. Finally, additional funding would allow the Mission to deepen its involvement in governance issues, especially those related to “demand-driven” governance and civil society issues (e.g., citizen “watchdog” and monitoring, civic education, information transparency and media professionalism).

#### ***Low Case Scenario***

If annual budgets drift much below \$8 million annually, USAID will face a problematic situation that would seriously call into question its ability to implement this strategy. Program budgets in most cases reflect minimal levels to mount serious interventions into what are widely perceived as core areas that are vital to Mongolia’s future. Perhaps the political party and parliamentary development programs could be concluded shortly after the

summer 2004 elections. Perhaps the peri-urban and rural business development programs could be “consolidated” into a single new business initiative.

Under such circumstances, the USAID program would consist of as few as three remaining activities, each roughly equal in size. One would be focused on “big picture” policy and competitiveness issues. A second would take a business-oriented approach toward developing skills and changing mindsets among significant numbers of Mongolians who have been “left out” of the economic transition process. And a third would pursue a range of legal reform concerns. An abbreviated program of this sort would probably also necessitate a review of the strategy, resulting in a smaller and more streamlined document with more modest ambitions in terms of what can reasonably be accomplished over the next five years.

### ***B. Management Implications***

USAID/Mongolia ranks along with USAID/Lebanon as the smallest USAID Mission in the Asia Near East (ANE) Bureau. At this point, staffing consists of a single USDH Mission Director; three Mongolian professional staff; two Mongolian support staff; and a driver. Four of the six Mongolian staff are program-funded. In addition, the Mission will shortly receive additional management and operational support in the form of a much needed program-funded US PSC.

The OE costs of running a USAID Mission in Mongolia are the lowest in ANE. OE costs in recent years have been modest by any measure:

FY 1998	\$349,792 (actual)
FY 1999	\$304, 199 (actual)
FY 2000	\$201,371 (actual)
FY 2001	\$391,200 (actual)
FY 2002	\$329,193 (actual)
FY 2003	\$380,000 (budget)

As in past years, OE expenditures will fluctuate from year to year, sometimes markedly. Factors affecting the budget include family size, ICASS costs and occasional “exceptional” purchases, such as a new 4x4 vehicle that needs to be procured at least every three or four years. ICASS costs in particular have increased significantly in recent years, and this is putting increasing budget pressure on USAID/Mongolia. Given the reliance on support from both Manila and Washington, a significant travel budget is one of the key elements of the budget and must be maintained throughout the next strategy period.

USAID/Mongolia relies on backstopping from both USAID/Manila and USAID/Washington. Such support is essential in maintaining a small but effective Mission presence. In recent years, we have received exceptional administrative support from the regional legal, controller, executive and contracting officers, all based in Manila. A close relationship also exists between Ulaanbaatar and Manila FSN staff in these various offices. Indeed, these close relationships, cultivated over the years, are absolutely vital in maintaining an effective

USAID program in Mongolia. We literally could not run the USAID program in Mongolia without them.

In contrast, USAID/Washington support is focused primarily on technical areas and programmatic support, including in the area of strategy development. The arrangement is more “informal” and depends in part on the commitment and time demands of individual support groups in Washington. For example, our energy and our democracy programs have in recent years benefited from an important level of interest in Washington within both ANE and EGAT/DCHA. Competitiveness programs have also benefited, in part through the inclusion of Mongolia in a recent EGAT-funded evaluation of competitiveness programs world-wide.

The fact that Mongolia is successfully competing for EGAT funds in microfinance, environmental issues and other areas strengthens Washington interest still further. In addition, the preparation of this strategy itself reflects an important example of a successful partnership among the Mission, ANE, and EGAT/DCHA. Representatives from ANE, EGAT, and DCHA participated in the fall strategy mission to Mongolia. Subsequently, ANE provided three additional weeks of technical assistance to help draft the strategy.

The small size of the USAID Mission puts a premium on “focus and concentrate.” Yet, despite our small size, Mission staff remain deeply engaged with what happens on the ground, working directly with our contractors and grantees to shape effective programs that deliver results. We don’t adopt a “hands off” approach toward implementation. Rather, we seek to work together with our partners at every level to achieve lasting impact.

In terms of the number of management units, the current program consists of seven “large” activities, three implemented through contracts (DAI, BearingPoint and Nathan) and four implemented by cooperative agreements (CHF International, Mercy Corps International/PACT, National Center for State Courts and International Republic Institute). By December 2003, the number of “large” programs will likely be reduced to five, consisting of a single large new contract and four separate cooperative agreements.

In addition, the Mission manages a limited number of smaller activities, including a modest scholarship programs (Academy for International Development and Eisenhower Foundation) and occasional “one off” activities such as bench book project (International Law Development Institute) and a legal drafting initiative (Legislative Drafting Center in New Orleans). It also has on-ground oversight responsibility for several Washington-funded programs, including EGAT grants to XacBank (Mercy Corps International) and to a new program in the eastern steppes (World Conservation Society). While the “core” USAID program over the next five years is unlikely to increase beyond half a dozen or so “large” contracts or cooperative agreements, these other programs can on occasion be used to supplement and further advance broader program objectives.

From a Mission standpoint, the size of staff is unlikely to change much during the next strategy period. A second program-funded US PSC should certainly be contemplated if the annual program budget increases to, say, \$15 million. Under such circumstances, one or two

additional Mongolian staff would also need to be considered. But, under most scenarios, USAID/Mongolia will continue to rank among the smallest of USAID Missions in terms of both staff size and OE budget.

One possible exception would be implementation of a substantial MCA program in Mongolia. It seems unlikely that A.I.D. will be heavily involved at a formal level. However, USAID is perceived within the country team as the key interlocutor on all matters related to development in Mongolia. Depending on the nature and magnitude of any MCA program in Mongolia, Washington may wish to contemplate the addition of another USC PSC or possibly a second USDH officer focused solely on MCA-related management and policy oversight.

Issues related to MCA also affect any discussions on a potential “graduation” of the USAID/Mongolia program. Realistically, Mongolia still has a long, hard road ahead. For all the positive developments of the last five years, neither this strategy nor ongoing discussions with our various development partners should overstate the length of that road or the difficulties that will almost certainly be encountered along the way. It is probably premature to be talking about “graduation” at this stage. However, *if* an MCA program develops and *if* that program sets the stage for substantial further progress related to both economic growth and democracy, it would certainly be appropriate to begin discussions on an eventual “phase out” of a USAID Mission in Mongolia. The fact that the USAID “bureaucracy” in Mongolia is small will make the discussions a lot easier. As any visitor to Ulaanbaatar will attest, this is a program that is far more interested in results outside the Mission than in the trappings of an extensive or complicated internal office structure.

**USAID/Mongolia  
Country Strategic Plan, 2004 -2008**

**ANNEXES**

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**Annex A:**  
**Map of Mongolia**



Source: CIA World Factbook 2002

## **Annex B:**

### **Mongolia at a Glance: Basic Statistics**

#### **STATISTICAL TRENDS IN MONGOLIA, 1998 – 2002**

<b>Indicator</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
GDP (current prices; TG million)	817	925	1,019	1,116	1,231
GDP growth rate	3.5%	3.2%	1.1%	1.0%	3.9%
Private output as % of GDP	70%	70.3%	72.2%	75.0%	NA
Industry as % of GDP	24%	21%	22%	22%	24%
Agriculture as % of GDP	40%	37%	29%	25%	21%
Transport as % of GDP	7%	9%	11%	13%	14%
Trade as % of GDP	18%	21%	24%	27%	28%
Services as % of GDP	12%	12%	14%	13%	13%
Inflation on (CPI change at end-year)	6%	10%	8.1%	11.2%	1.6%
Net domestic credit growth	101%	-14%	-27%	52%	55%
Of which private sector	55%	-28%	45%	152%	78%
Non-performing loans in banking System (% of loans outstanding)	34%	36%	15%	6%	6%
Exchange rate at end of year (Togrog/US\$)	902	1,072	1,097	1,102	1,125
Exports (US\$million)	462	454	536	522	501
Exports as % of GDP	48%	50%	57%	51%	45%
Copper as % of total exports	26%	26%	28%	32%	28%
Gold as % of total exports	25%	21%	13%	16%	23%
Cashmere as % of total exports	7%	10%	10%	9%	6%
Other textile as % of total exports	7%	12%	17%	17%	
Exports to China as % of total	37%	45%	50%	44%	41%
Exports to Russia as % of total	9%	11%	8%	9%	9%
Exports to US as % of total	12%	17%	24%	28%	32%
Imports (US\$million)	503	513	615	638	659
Imports as % of GDP	52%	57%	65%	63%	59%
Imports from China as % of total	13%	12%	18%	19%	20%
Imports from Russia as % of total	30%	27%	24%	35%	34%
Imports from US as % of total	7%	6%	5%	2%	3%
Imports from Japan as % of total	12%	10%	12%	9%	6%
Imports from S. Korea as % of total	7%	7%	9%	9%	12%

Net Int'l Reserves (US\$million)	80	117	141	160	226
In weeks of imports	8.3	11.9	11.9	13.0	17.8
Foreign Direct Invest (US\$million)	19	30	54	43	78
Budget expenditures (TG million)	342	365	430	490	537
Budget expenditures as % of GDP	42%	39%	42%	44%	44%
Current expenditures as % of GDP	27%	27%	31%	32%	33%
Budget deficit (Tg million)	-102	-110	-79	-51	-70
Budget deficit as % of GDP	-12%	-11.9%	-7.7%	-4.5%	-6.0%
Population (million)	2.349	2.373	2.408	2.443	2.475
Population growth rate	1.4%	1.0%	1.5%	1.5%	1.3%
Infant mortality (per 1,000 live births)	35	36	31	30	30
Maternal mortality (per 1,000 who gave birth)	1.58	1.75	1.58	1.69	1.24
Number of pupils /students (1,000)	531	561	595	621	652
Of which:					
Number of pupils in 10-year general education (1,000)	447	475	498	515	534
School enrollment rate (age 8-15)	87%	87%	90%	95%	N/A
School enrollment rate (age 16-17)	24%	36%	46%	49%	N/A

**Annex C:  
USAID Funding Levels, FY 1991 – FY 2003**

**ESTIMATED USAID/MONGOLIA FUNDING LEVELS, FY 1991 - 2003**

<b>Fiscal Year</b>	<b>ESF</b>	<b>FSA</b>	<b>DA</b>	<b>Total</b>
1991	\$10.0 million		\$2.0 million	\$12.0 million
1992	\$12.0 million		\$2.9 million	\$14.9 million
1993	\$8.1 million		\$2.2 million	\$10.3 million
1994			\$7.0 million	\$7.0 million
1995	\$3.5 million		\$5.2 million	\$8.7 million
1996	\$4.5 million		\$1.2 million	\$5.7 million
1997	\$7.0 million		\$3.0 million	\$10.0 million
1998	\$8.0 million		\$4.0 million	\$12.0 million
1999	\$0.5 million	\$10.0 million		\$10.5 million
2000	\$6.0 million	\$6.0 million		\$12.0 million
2001	\$12.0 million			\$12.0 million
2002	\$12.0 million			\$12.0 million
2003	\$10.0 million			\$10.0 million
<b>TOTAL</b>	<b>\$93.6 million</b>	<b>\$16.0 million</b>	<b>\$27.5 million</b>	<b>\$137.1 million</b>

**Annex D:**  
**Mongolia Country Strategy 2004-2008**  
**Illustrative Funding Levels**

**(Annual, in Millions)**

<b>Funding Scenario</b>	<b>High Case</b>	<b>Low Case</b>	<b>Base Case</b>
SO 1: Economic Growth	\$10.0-11.0	\$5.0-6.0	\$7.0-9.0
IR 1.2: Enabling Environment	\$4.0-5.0	\$2.0-3.0	\$3.0-3.5
IR 1.2: Competitive Sectors	\$2.0-3.0	\$0.5-1.5	\$1.0-2.0
IR 1.3: Economic Opportunity	\$4.0-5.0	\$2.0-3.0	\$2.5-3.5
SO 2: Democracy & Governance	\$4.0-5.0	\$2.0-3.0	\$2.5-4.0
IR 2.1: Legal Reform	\$3.0-3.5	\$1.5-2.0	\$2.0-3.0
IR 2.2: Political Processes	\$1.0-2.0	\$0.5	\$0.5-1.5
<b>TOTAL</b>	<b>\$15.0</b>	<b>\$8.0</b>	<b>\$10.0-12.0</b>

## **Annex E:**

### **USAID Program Impact, FY 1998 – FY 2003**

The internal program assessment prepared as one of the background documents to this strategy included considerable detail on earlier USAID programs in Mongolia, not only during the last strategy period (FY 1998 – FY 2003) but also going back to fall 1991. Annexes to that assessment included lengthy retrospectives specifically focused on policy dialogue and civil society programs.

Rather than repeat these assessments in detail, this annex simply highlights some of the most significant accomplishments of USAID/Mongolia during the last five years. Achievements in the banking sector are especially notable, but important progress has also been made in other areas. For a program that averages around \$10 - \$12 million annually (and is managed on an OE budget that never exceeds \$400,000 and is often much lower), it is hard to imagine a country in which A.I.D. gets more “bang for the buck”:

-- ***Brought about the two largest privatizations in Mongolia’s history***, that of the Trade and Development Bank (\$12.2 million to a US-Dutch/Swiss consortium in December 2002) and Agricultural Bank (\$6.8 million to a Japanese company in February 2003). These two transactions have been accompanied by a commitment on the part of the buyers to invest an additional \$40 million in Mongolia over the next two or three years. During the late 1990s, USAID also orchestrated the sale of a series of some 47 smaller companies for \$15 million. Taken together, ***these transactions provide nearly \$75 million in private sector investment to Mongolia.***

-- ***Restructured AgBank, turning it from bankruptcy to profitability and then turning it over to new Japanese ownership in less than 30 months.*** During the restructuring period, the USAID-funded management team increased the number of branch offices from 269 to 356; nearly doubled bank staff from 800 to 1,600; increased salaries; provided financial services to more than 500,000 households; extended more than 400,000 loans; and pioneered new approaches to corporate arts support and philanthropy. Reflecting confidence in the USAID management team, the new Japanese owners extended the management contract for another two years. The “AgBank story” was featured in several publications, including the *Asian Wall Street Journal* and *Far Eastern Economic Review*. It is also increasingly being mentioned in the development literature as an unusual and possibly unprecedented example of the complete transformation of an agricultural bank.

-- ***Established XacBank in January 2002. It is already one of the half dozen largest Mongolian commercial banks with more than thirty branches in every province of the country.*** The bank specializes in small and medium sized businesses. Its loan portfolio includes more than 13,000 active clients. XacBank was formed following the merger of

two donor-funded non bank financial institutions, one supported by USAID and the other funded by the UNDP. This too is a “first” within the development literature.

-- ***Founded Rural Business News. With a circulation of 100,000, this monthly periodical has the largest readership of any publication in Mongolia.*** Also pioneered several innovative radio programs targeted on herders with a wide audience, including *MarketWatch*, *WeatherWatch* and *Herder from the Future*.

-- ***Launched first systematic donor-funded business development programs in rural Mongolia (1999) and in peri-urban Mongolia (2003),*** the latter addressing growing concerns over rural-to-urban migration. As an early entrant, USAID/Mongolia helps set the agenda and provides important “lessons learned” for other donors on how to address these critical concerns.

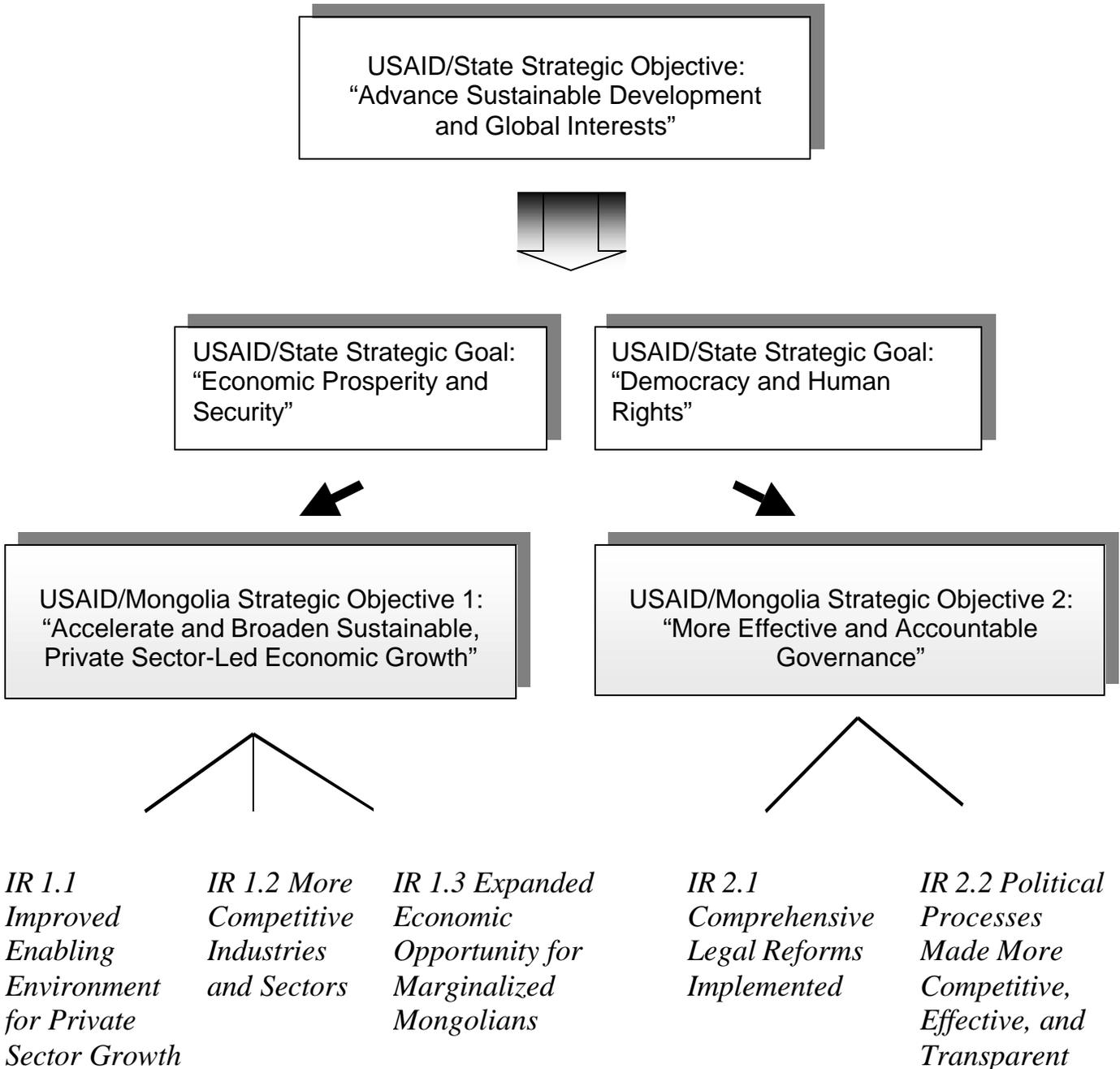
-- ***Introduced a “collective mark” for Mongolian cashmere,*** with a view toward setting Mongolian cashmere apart as a premium, quality product and distinguishing Mongolian cashmere from cashmere produced in China. An organization to serve as a custodian for the mark has been established; the design of the mark has been approved; and the mark will soon be registered in the US and elsewhere and formally introduced into the international marketplace.

-- ***Shaped new approaches to tourism in Mongolia,*** including marketing the country as an adventure travel destination. Dramatically improved the quality of promotional material. Promoted websites as important marketing tool (see [www.travelmongolia.org](http://www.travelmongolia.org)). Transformed the previously moribund Mongolian Tourism Association (MTA), increasing its membership from less than six companies to more than eighty companies.

-- Shaped and helped *Strategic Plan for the Justice System of Mongolia* approved by parliament in May 2000. Provided significant input to new criminal and civil codes that took effect in September 2002. ***Well on path toward automating every courtroom in Mongolia, including the installation of public access terminals in every automated courtroom.*** Also, worked with parliament to launch first public hearings on pending legislation.

**Annex F: Results Framework**

**USAID/Mongolia Strategic Plan, FY 2004 – 2008\***



\* Based on Joint USAID/State Strategic Planning Framework for FY 2004 – 2009 (Draft version: April 2003).

## ***Annex G: Illustrative Indicators***

In accordance with USAID guidance, a full-scale monitoring plan along with specific targets and indicators will be developed within twelve months after the new strategy is approved. Certainly, it will need to be finalized by the FY 2004 obligations, when changes will be made in the program description accompanying the SOAG amendment documents signed between USAID and the Government of Mongolia.

“Lessons learned” from the last strategy suggest that monitoring plans that are too extensive, too complicated or include too many targets and indicators become dated much too soon. Instead, it makes most sense to concentrate on a smaller number of indicators that reflect broader and more strategic trends, especially at the SO level. In this regard, it is worth noting that some of the most successful activities undertaken by USAID/Mongolia during the 1998–2003 period—including the AgBank restructuring and the establishment of XacBank—were *not* anticipated anywhere in the October 1998 strategy document. Yet, the strategy was flexible enough to accommodate these opportunities, as and when they occurred.

The types of indicators that will be considered as part of the FY 2004 – FY 2008 monitoring plan are listed below. Other suggestions from readers of the strategy are most welcome.

### ***SO 1: Accelerate and Broaden Sustainable, Private Sector-Led Economic Growth***

- Annual rate of economic growth
- Private sector share of total economy
- Mongolia’s relative ranking within economic-related MCA criteria

#### ***IR 1.1: Improved Enabling Environment for Private Sector Growth***

- Annual private sector growth rates
- Days to start new business
- Mongolia’s ranking in specific areas of global competitiveness surveys related to business environment

#### ***IR 1.2: More competitive industries and sectors***

- Annual private sector growth rates within specific sectors
- Export growth/foreign exchange earnings within specific sectors

#### ***IR 1.3: Expanded Economic Opportunity for Marginalized Mongolians***

- Number of business plans approved for credit
- Number of Mongolians participating in business training programs
- Number of new businesses created

- Readership, audience of specific information programs

## ***SO 2: More Effective and Accountable Governance***

- Results of national elections in summer 2004
- Mongolia's ranking within MCA criteria related to corruption, governance
- Trends in corruption-related indicators

### ***IR 2.1: Comprehensive Legal Reforms Implemented***

- Degree of judicial independence on 18-point scale
- Trends in public perceptions on judiciary, as measured by periodic surveys
- Mongolia's ranking within MCA criteria related to rule of law

### ***IR 2.2: Political Processes Made More Competitive, Effective, and Transparent***

- Number of "open hearings" organized by parliament
- Results of periodic by-elections before and after national elections
- Trends in public perceptions on political processes, as measured by periodic surveys

## ***Annex H:***

### **A Note on the Millennium Challenge Account (MCA)**

Even as this new strategy for Mongolia is developed, considerable uncertainty surrounds a potential new aid mechanism for Mongolia—the Millennium Challenge Account (MCA). This new initiative, announced by President Bush in March 2002, would increase world-wide US aid levels by as much as \$5 billion between FY 2004 and FY 2006. Funds would be made available on a competitive basis to a select number of countries, based on achievement and commitment in three main areas:

-- ***Ruling justly***, including a commitment to good governance, fighting corruption, respect for human rights and adherence to the rule of law;

-- ***Investing in people***, including provision of adequate education and health care to the citizens of a country;

-- ***Sound economic policy***, including approaches that emphasize entrepreneurship, open markets, sustainable budgets and economic growth

Criteria and operating mechanism for the new MCA account are still being developed by Congress in consultation with the Bush administration. However, even at this early stage, media reports indicate that Mongolia could emerge as a potential qualifier. In particular, Mongolia's commendable achievements in education and health care; its relatively high degree of political openness; and its commitment to economic reform set it apart from other potential candidates. Any "back-tracking" on these and related issues would adversely affect Mongolia as far as competitiveness for MCA funding is concerned.

Under draft legislation, a stand-alone MCA corporation will be set up to develop criteria, select candidates and implement programs. This institution will have a high degree of autonomy and will be separate from A.I.D., State or any other government institution. However, at a country level, programs would necessarily have to be closely coordinated with Embassy country teams representing all USG agencies in any particular country. In that context, USAID/Mongolia would likely become involved in at least an advisory capacity.

Regardless of how MCA is implemented, one thing is very clear: *the planned new USAID strategy ensures that our program will be intimately involved in those areas that matter most to MCA, especially with regard to "ruling justly" and ensuring "sound economic policy."* Indeed, these two areas lie at the very heart of what USAID will be about over the next five years. It is perhaps also worth noting that the Embassy as well as USAID have significantly strengthened their dialogue on corruption issues over the past years, the one "make or break" selection criteria as far as potential MCA involvement is

concerned. In fact, from a country team perspective, the very possibility of accessing MCA funds has proved to be a useful policy dialogue tool in conversations with Mongolian counterparts. Counterparts are well aware that the entire MCA concept is premised on good governance as well as sound economic policy reform.

The Government of Mongolia is also very much aware of MCA as a potential new source of funding. It follows reports about MCA in the international media with interest. Already, the government has established an MCA “working group” within the Ministry of Foreign Affairs to coordinate government discussions on the issue. There has also been talk about setting up an “MCA corporation” within Mongolia, both as a coordination unit and as a potential monitoring and implementing agency should Mongolia be selected as an MCA target country.

From a field perspective, the hardest part about MCA will be program selection, management and implementation. If appropriate, USAID/Mongolia along with other donors could certainly help develop MCA proposals for potential funding. However, the biggest challenge lies in effective implementation. Even at this early stage, the Mongolia country team sees possible merit in three approaches to MCA in Mongolia—and offers a strong cautionary note on one mechanism that is sometimes mentioned in the MCA literature.

First, the note of caution: *A cash transfer or policy-based budget support program would almost certainly be inappropriate in the case of Mongolia.* Already, the IMF, World Bank and ADB have policy based lending programs. The practical effect would be to simply “crowd out” these programs without gaining any corresponding additional impact. Accountability and sustainability issues would almost certainly emerge. Absorptive capacity concerns are also very likely, given the relatively small size of Mongolia’s economy in relationship to the amount of foreign assistance received,

Second, three types of programs that merit some further exploration:

-- The MCA literature includes references to possible infrastructure projects. A land-locked country desperately needs well developed transport routes. Yet Mongolia has one rail line, less than 1,000 miles of paved road and a single international airport with very limited capacity. Indeed, airports are as important for land-locked countries as ports are for nations having access to the sea. The Ulaanbaatar airport is small, hemmed in by hills and has a sloped runway that some consider problematic and not in keeping with international safety standards. At some point in the next decade, Mongolia will have to figure out a way to improve this situation. An MCA financed airport for Mongolia would have very positive economic consequences for the country.

-- One reason that Mongolia is mentioned as a potential MCA country is because of its well educated population. However, the comparative advantage that Mongolia has in this area is under threat. Rural educational systems are especially weak. The higher education system is also inadequately financed and in need of management reform. One possible MCA proposal might involve creating a “Mongolian-American Educational Trust”

designed to play a central role in promoting a knowledge-based economy for Mongolia. Possible areas of interest could include establishment of a Mongolian-American University; a scholarship program for Mongolians to study in the US; or a grants program benefiting all levels of education. Such a trust would need to be “off budget” and completely autonomous. It would need to reflect a degree of professionalism and commitment to excellence that would not be possible within a “regular” ministry or bureaucratic setup. It would need to have a distinguished and committed international oversight board. And it would need to recruit internationally to ensure that the management staff is visionary, creative and can implement the best management practices so vital to its success.

-- Finally, it bears repeating that the USAID program over the next five years will address core MCA concerns, especially those related to good governance and economic reform. Mongolia needs to maintain progress in these areas to ensure that it is competitive for MCA funds, whether now or in the future. *If* Mongolia is selected as an MCA country and *if* this is perceived as a potential path toward “graduation” from USAID entirely, it could well make sense to discuss with the new MCA corporation as well as with Mongolian counterparts the idea of allocating a portion of MCA funding directly to the several political and economic transformation activities envisaged under this strategy.

Whatever decisions are made regarding MCA and Mongolia, at least two things should be very clear: *concerns reflected in the establishment of the MCA were central in the development of the new USAID strategy; and the analysis undertaken as part of this strategy is very relevant for any MCA assessment that might be contemplated for Mongolia during the coming months and years.*

## ANNEX I:

### OE Costs in Comparative Perspective

USAID/Mongolia ranks among the “leanest” Missions in both the Asia Near East (ANE) bureau and the Agency, and will likely remain so throughout the next strategy period. Staffing consists of a single USDH Mission Director, supported by three Mongolian professional staff, two support staff and a driver. Three of the five Mongolian staff are program-funded. A program funded US PSC is slated to join the Mission in mid May 2003. Annual OE budgets have never exceeded \$400,000 and in some years have been considerably lower. Some variation is to be expected between years, depending in part on such factors as family size, the annual ICASS assessment and the fact that a new 4x4 needed to be ordered every third or fourth year. For comparative purposes, some indication of program size, staffing size and OE budgets within the Bureau are provided below:

<b>Country</b>	<b>Program Budget (FY 2002)*</b>	<b>OE Budget (FY 2003)**</b>	<b>Staff Size (Sept. 30, 2002)***</b>
Bangladesh	\$89 million	\$3.82 million	17 USDH 91 total
Cambodia	\$36 million	\$2.84 million	5 USDH 104 total
Lebanon	\$36 million	\$0.71 million	1 USDH 7 total
<b>Mongolia</b>	<b>\$12 million</b>	<b>\$0.38 million</b>	<b>1 USDH 7 total</b>
Morocco	\$11 million	\$2.67 million	7 USDH 55 total
Nepal	\$33 million	\$2.33 million	8 USDH 80 total
Sri Lanka	\$10 million	\$0.73 million	0 USDH 24 total

\*FY 2004 Budget Justification to Congress (ANE Bureau)

\*\*April 2004 Estimates (ANE Bureau)

\*\*\*Quarterly USAID Worldwide Staffing Report, September 30, 2002 (M/HR/PPIM)

## **Annex J:**

### **Summary of Gender Analysis<sup>1</sup>**

Mongolia's transition has brought both positive and negative impacts to women in terms of their opportunities and choices, and the balance between men's and women's social, political, and economic status. In comparison to many countries in the region, Mongolia today is a relatively gender-equal society. Mongolia women participate actively in economic, political, and social life, men and women have similar access to social services, and there is relative gender equity in terms of basic human rights. Compared to Mongolian men, women enjoy similar levels of health, higher life expectancy, higher levels of education ("reverse gender gap"), and lower but relatively high levels of participation in the labor force.

Over Mongolia's 12 years of transition, both men and women have come to enjoy much greater individual freedoms, along with greater personal responsibilities. On the positive side, both men and women have greater choices in terms of education, health care, employment, and economic opportunities. Democratic reforms since 1990 have further advanced the favorable legal framework for women's rights that was established in socialist times. Women's rights are recognized and gender-based discrimination is prohibited by the Constitution of 1992, the civil and criminal codes, and other laws (e.g., laws on public servants, labor, social insurance). Mongolia is also signatory to numerous international treaties and conventions. However, implementation and enforcement often fail to meet the spirit of these laws.

On the other hand, many women and men experienced declines in per capita income and increased poverty and vulnerability as Soviet subsidies and trade ended and many state-provided social and economic services collapsed. Demographic transition resulted in a significant rise in the number of women-headed households (44 percent increase from 1993 to 1998). These female-headed households typically have a higher incidence of poverty. The economic transition also increased the scope and volume of herder women's work in rural areas and created a "double or triple work burden" for women in large urban areas, as they typically are responsible for child-rearing, domestic household work, and income-earning employment. In addition, the shrinking of public expenditure in social services has intensified domestic and care work for women.

Despite the favorable legal framework and generally pro-women policies, in practice, there are many ways in which women are disadvantaged in terms of their opportunities for participation in economic, social, and political life. In short, many of the difficulties of transition have fallen more heavily on women than men, while many of the economic and social opportunities of transition have been harder for women to realize than men.

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<sup>1</sup> Full pre-strategy background paper on *Mongolia Gender Analysis* (January 2003) by Christopher Finch can be found on the USAID Development Experience Clearance (DEC) database at [www.dec.org](http://www.dec.org).

More women (63 percent) than men (37 percent) lost their jobs in the economic restructuring that took place from 1992 to 1995. In addition, women generally have lower positions and incomes than men, despite typically higher education levels. While women have a higher share of jobs in professional and “white collar” occupations and industrial sectors than men, they are also concentrated in middle and lower levels, while men are in senior management positions. Women’s unfavorable economic status relative to men could be due to a number of factors:

- Discrimination and gender biases in the labor market
- Poorer access to assets and credit (e.g., lack of collateral due to privatized assets registered in the name of the head of household)
- Inadequacy of legal mechanisms and institutions to enforce constitutional and legal provisions requiring gender equity
- The decline in social services and state policies that enabled and encouraged women to work as wage-earners
- Traditional gender-based division of labor, and high domestic labor burden of women in both rural and urban Mongolia.

Women have limited participation in Mongolia’s democracy and civil society. Although men and women exercise their right to vote in roughly equal percentages, and women have a relatively strong voice in public debate, few women reach the high and mid-level decision making positions in government. Women occupy only 9 of the 76 seats in Parliament, no ministerial or cabinet posts, no *aimag* (provincial) governors or city mayors, and only two women sit on the Supreme and Constitutional Courts (although 60 percent of judges are women).

Finally, there is a “reverse gender gap” in Mongolia in the area of education. Though literacy rates are high for both women and men, women have higher rates of educational enrollment and attainment, particularly at higher levels of the educational systems where 70 percent of students are women (tertiary level). Reasons cited for the gender gap include families’ need for boys to help tend livestock herds and the perception among parents that education is necessary for women to obtain employment but not so for men. Men’s lower education level may also contribute to family tensions and domestic violence.

Domestic violence is a serious problem in Mongolia. Roughly one-third of women have suffered some form of domestic violence. However, police, courts, and hospitals lack standardized systems for recording and reporting domestic violence cases. Victims are often reluctant to report cases, and this is exacerbated by the lack of state policy and institutions to provide shelter, the long processing time for cases and small sentences for offenders, and the lack of a strong legal framework for prosecution.

### **Assessment of How Gender Relations Affect the Achievement of Sustainable Results and How Proposed Results Affect the Relative Status of Men and Women**

- USAID can address gender concerns indirectly and directly through the **judicial reform program**. For example, USAID provides legal training for the new civil code which addresses gender discrimination and should ensure that it is better enforced. Similarly, training for judges and prosecutors on domestic violence cases (e.g., obtaining testimony and preserving evidence) should help establish the framework for effective prosecution of domestic violence cases. Given that 60 percent of the judges are female, professional opportunities for women should increase as the judiciary becomes more competent, professional and respected.
- USAID can help women participate in rural civil society and business development under **rural development** programs, such as the Gobi Initiative. Women are active in the Gobi Initiative sponsored training, including business development. However, one challenge is that traditional divisions of labor in rural areas may constrain the achievement of proposed results. For instance, closer proximity of training to places of residence strongly affects women's participation. The program's efforts to reflect the important role of women in herder households and in rural business should expand economic opportunities during the coming years. Similar opportunities are apparent in the **peri urban initiative**.
- For the IRI **democracy strengthening** project, low numbers of women in decision-making roles in political parties may be a constraint for improving organizational structure and downward accountability. IRI conducted training programs for political parties and conferences for NGOs on women in politics prior to the 2000 parliamentary elections.
- Gender biases against women in the labor market, women's lack of access to assets, restricted access to credit, and high domestic workload are all potential constraints for women's **economic participation**. However, USAID programs help address these constraints. The Gobi Initiative's gender focus is described above. Under the USAID-finance management team, the Agriculture Bank expanded credit to rural women and men. Women borrowers accounted for 58 percent of pension loans, 56 percent of salary loans, and 44 percent of small business loans. Males have taken most of the herder loans (89 percent as well as larger investment loans. Women are well represented, both among the Agriculture Bank senior management in Ulaanbaatar and as branch managers.

## **Annex K:**

### **Summary of Environmental Analysis for Sections FAA 118/119<sup>2</sup>**

Mongolia's biodiversity is a globally significant natural resource, as well as a basis for private sector growth that can provide better living standards and a deepened foundation for democratic governance. Mongolia's relatively pristine environment and range of ecosystems, its small population scattered across a territory the size of Alaska, its relatively intact nomadic traditions and culture, its limited infrastructure and harsh climate pose a fundamental challenge and opportunity.

Mongolia is highly reliant on the environment for its economy and semi-nomadic herding lifestyle. More than most countries, it has managed to keep a balance between using the land for sustenance and over-exploiting it. However, economic transition has increased pressure on the environment and people increasingly turned to the exploitation of natural resources – often in illegal and damaging ways – to sustain themselves. Mongolia's environment is relatively unspoiled, but it is also fragile, and vulnerable. The country's relative poverty, its lack of value-added manufacturing and reliance on primary product for employment, labor, and exports, and the natural resource demands of neighboring countries create formidable pressure to overexploit natural resources.

#### **Biodiversity Status, Trends, and Threats**

Mongolia lies within a transition zone of several ecosystems: the northern edge of the Gobi deserts, southern edge for the Siberian taiga, the Altai mountains and the Central Asian steppe. Mongolia's ecosystems provide habitat for a variety of plants and animals, some of which are globally threatened, such as the Gobi bear, wild Bactrian camel, and snow leopard. Due to low precipitation, thin topsoils, and long, cold winters, natural productivity is low and the ecosystems are fragile and susceptible to irreversible damage.

**Major threats** to these fragile ecosystems include the following:

- *Pasture degradation and desertification*: overgrazing and pasture degradation due to increases in livestock numbers and numbers of herding households; concentration of herds near settlements, transportation corridors, and other market access points; accompanying reductions in livestock mobility; and changes in the composition of livestock herds.
- *Climate change*: increased frequency and severity of drought and winter natural disasters or “dzuds”

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<sup>2</sup> Full pre-strategy background paper on *Mongolia Environmental Analysis* (January 2003) by Christopher Finch can be found on the USAID Development Experience Clearance (DEC) database at [www.dec.org](http://www.dec.org).

- *Deforestation*: unsustainable legal and illegal commercial logging, firewood gathering, fire, and insect infestations.
- *Unsustainable use of wild flora and fauna*: illegal hunting and poaching, e.g., collection of species for Asian traditional medicine market, collection of globally rare saker falcons for falconers in the Arab world
- *Air and water pollution*, e.g., coal-burning in gers, inefficient power plants, domestic sewage and industrial effluents in urban areas, mining activities.
- *Rapid expansion of mining*, including large number of illegal placer gold miners.
- *Loss of and competition for water sources*, especially in Gobi region.

The Government of Mongolia has developed a strong legal framework for environmental protection, including adopting 23 laws relating directly to the environment, signing almost every major environmentally-related international convention, setting up a network of 48 protected areas, national parks, and reserves, and developing and implementing several action plans in conjunction with donors and NGOs. In addition, Mongolia has been internationally recognized for its biodiversity, e.g., four UNESCO-designated Man and Biosphere Reserves

### **Assessment of Actions Necessary to Conserve Biodiversity**

- Generating income from biological resources in a way that provides an incentive to conserve them, e.g., promoting eco-tourism, valuation and implementation of fees for use of natural resources
- Strengthening markets, value-added natural resource processors, and financial services that reduce pressure on pasturelands and associated biodiversity. The lack of agro-processing and alternative livelihood options means that individual households have an economic incentive to maximize exploitation of commonly held resources. Also, improved access to savings and credit services reduces environmental pressures as herders replace livestock as de facto bank accounts.
- Improving land tenure and regulation of pastureland use.
- Improving energy policy and energy efficiency
- Improving enforcement of environmental laws and regulations, e.g., transparency of and public participation in environmental policy, implementation, and enforcement

### **Protecting Biodiversity in Mongolia**

In cooperation with the Mongolian Ministry of Nature and Environment, donors have supported more than \$40 million in environmental programs and projects in Mongolia. Major donors involved include the UNDP, GTZ, World Bank, ADB, the Dutch government, and the EU. Several have undertaken joint initiatives under the Global Environmental Facility (GEF). Examples of donor funding include the UNDP in environment and natural resource planning, the ADB in supporting Mongolia's environmental impact assessment system, and the World Bank in the creation of the national environmental action plan.

### *USAID Efforts in Democracy and Governance related to the Environment*

- USAID-supported programs to strengthen the judiciary and rural civil society indirectly touch on environmental concerns, especially issues of **public participation in environmental decision-making**, and with transparency and accountability in the enforcement of environmental laws and resolution of conflicts over the use of natural resources.
- The Gobi Initiative includes programs to develop **information resources** to serve herders and other rural residents and new forms of association and participation in economic life. Such programs can also become vehicles to help promote public participation in environmental policies, resource use decisions, and environmental monitoring and enforcement.
- USAID's work with parliament and with political parties is environmentally-neutral, although it does promote **public information, accountability, and transparency** that are important for biodiversity and environmental issues. For example, its recent work to promote open committee hearings could be extended to cover environmental issues as well.

### *USAID Efforts in Economic Growth related to the Environment*

- The economic growth work of the Gobi Initiative is directly related to the economic causes of **pasture degradation**, and more indirectly, deforestation. The rangeland and water management component of the initiative seeks to strengthen environmentally sustainable pasture management practices to improve the use and care of Mongolia's productive land and water resources. The herder management and livestock improvement component seeks to increase the market value of livestock products and emphasizes quality rather than quantity. The business development component also is potentially beneficial to the environment and pastures by strengthening productive and profitable business that add value to livestock and other products, thereby potentially reducing the numbers of animals and grazing pressure.
- Under the Competitiveness Initiative, USAID's emphasis on **tourism** offers an opportunity for local communities to economically benefit from its special environmental and biodiversity attributes and to increase national and local commitment to conserving these resources. The introduction of the "leave no trace" ethic to Mongolia's guide training program and curriculum helps to conserve the environment.
- USAID work in **cashmere production** under the Gobi Initiative and the Competitiveness Initiative focuses on the quality (not the quantity) of cashmere and developing value-added cashmere products for niche markets. Rather than having a detrimental effect on the environment, these activities should result in fewer, more carefully bred animals and more value added through processing, meaning greater income and employment for a given amount of cashmere.
- USAID **financial market work** has helped improve the extension of financial services to many rural residents. Improved access to savings accounts provides herders with an alternative to keeping their savings in their livestock.

Furthermore, improved credit provision provides an opportunity for alternative employment and income generation for marginal and other herders.

- The economic side of USAID's portfolio could explore ways to make greater use of Mongolia's comparative advantage in environmental and biodiversity values in ways that maintain these values to the fullest extent possible.

## **Annex L:**

### **Summary of Conflict Analysis<sup>3</sup>**

Mongolia's vulnerability to widespread conflict is considered extremely low, both in its relationships with its two large neighbors and within its own population. Yet potential sources of conflict remain, especially given the widespread violence that occurred during the 1930s and the fact that Central Asia historically has experienced periods of great upheaval and change. By and large, this potential conflict is based in domestic concerns over such issues as socio-economic inequalities, land tenure and distribution, and problems of transparency, corruption, and rule of law.

#### **International and Regional Conflict**

Mongolia is a peaceful part of a volatile region stretching from the Korean peninsula to Afghanistan. The potential for serious international conflict with Mongolia's two large neighbors is extremely low. Since transition, Mongolia has followed a "third neighbor" foreign policy, emphasizing good relations with Russia and China, while at the same time cultivating improved relations with the West. There are occasional reports of conflicts and violence along the border. However, they are generally limited to incidents involving smuggling and theft of livestock and natural resources.

*Transnational Crime:* Reports from official and unofficial sources attest to a growing presence of organized crime in Mongolia, with linkages to Russian and Chinese organized crime. In particular, reports say that Mongolia is increasingly becoming a location for money-laundering, a conduit for drug trafficking, mostly from Russia to China, and occasionally for human trafficking. Weak legal and financial structures and problems of law enforcement leave Mongolia vulnerable to exploitation by these criminal interests.

#### **Domestic Sources of Instability and Conflict**

Conflict in Mongolia in recent years has been resolved peacefully within the boundaries of the democratic process. Mongolia has enjoyed a peaceful and widely supported transition to democracy and a market economy. Three sets of free and fair parliamentary and presidential elections have been conducted since transition; the legal system and media are functioning despite strains and problems; there is rapid growth in the number of civil society organizations; and the transfer to market economic policies and institutions has been swift and effective. Freedom House's survey on political openness describes Mongolia as the only post-communist country outside of Eastern Europe to receive a rating as a "free" polity. However, there is some potential for increasing social, economic, and political tensions and conflict in the following areas:

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<sup>3</sup> Full pre-strategy background paper on *Mongolia Conflict Vulnerability Analysis* (January 2003) by Christopher Finch can be found on the USAID Development Experience Clearance (DEC) database at [www.dec.org](http://www.dec.org).

*Increasing socio-economic inequalities:* The transition has been marked by increasing economic disparity between urban centers and the rest of the country. Within urban centers, there has been growth of large peri-urban “ger” districts due to rural to urban migration. Income inequality rose 13 percent between 1995 and 1998 and 35.6 percent of the population lived below the poverty line in 1998. Nearly 40 percent of the population resides in the bustling capital city. Ulaanbaatar’s traffic jams, building construction, internet cafes, universities, and a booming informal sector provide a stark contrast to typical provincial capitals (*aimag* centers) and rural towns, and to the everyday life of Mongolia’s many livestock herders.

*Land tenure and land distribution:* The issue of land tenure, both in rural and urban areas, is one of the most significant sources of potential conflict in Mongolia. Mongolia’s lack of a tradition of land ownership, the underdeveloped legal, administrative, and institutional framework for assigning and tracking rights to or ownership of land, the difficult task of effectively enforcing and resolving conflicts over land across Mongolia’s large territory, and a lack of citizen participation and education in the land policy making process contribute to the potential for newly introduced land legislation (e.g., Land Law and the Law on Land Ownership of June 2002) to result in the inequitable distribution of land, widespread disagreement, and potentially, conflict.

*Lack of transparency, corruption, problems with the rule of law:* Problems with transparency, accountability, and corruption in both government and the private sector are potential sources of tension and conflict. Transparency International’s 1999 Corruption Perceptions Index ranked Mongolia 43<sup>rd</sup> out of 99 countries. Public opinion surveys in Mongolia conclude that corruption has become a widespread phenomenon, is increasingly organized and systematic, and creates an unfavorable environment for business and undermines incentives for merit-based competition. The sheer number of laws passed since transition, their conflicting provisions, and the relatively weak mechanisms for engaging the public in draft legislation and for sharing legal information reduces transparency and accountability. The enforcement and implementation of these laws is constrained by limited financial and human capacity of the executive and judicial branches.

*Potential for politically based violence/conflict:* Politically generated instability and violence has been virtually absent from Mongolia’s transition. Although party politics resulted in four different cabinets and prolonged political stalemates over the appointment of new prime ministers during the Democratic Coalition’s rule from 1996-2000, the political conflicts were not accompanied by unrest or violence. The only significant exception was the murder of Sanjaasuren Zorig in October 1998, a leader of the pro-democracy movement who was nominated to become Prime Minister. The rule of the Mongolian People’s Revolutionary Party (MPRP), which captured 72 of 76 seats in July 2000 parliamentary elections, has also generated concern about a lack of political discussion and the exclusion of opposition voices from the national political debate.

## **USAID Efforts**

USAID strategic objectives and programs to support economic growth and democratic governance directly address potential sources of tension and conflict.

*Democracy and Governance:* Mongolia's constitution and body of law provide a framework of rights and responsibilities and means of resolving disagreement and conflict through discussion and political participation rather than through violence. USAID programs have both contributed to this framework and to strengthening the institutions that implement it, including the judiciary, political parties, parliament, and rural civil society. The judicial reform project addresses possible sources of conflict by working to improve the efficiency, accountability, and transparency of the judiciary. It does this by building the capacity of legal professionals and increasing citizen awareness of their rights and responsibilities in the legal system. It also directly support ongoing anti-corruption concerns. IRI's Democracy Strengthening project addresses many of these same goals through parliament and political parties. The Economic Policy Support Project's (EPSP) work on the legal and regulatory framework for economic growth also addresses issues of equity, participation, and transparency (e.g., consulting to Parliament on the draft Land Law, increasing transparency through the development of a web site for the Prime Minister's office).

*Economic Growth:* Programs to accelerate economic growth address potential sources of conflict that arise from poverty, unemployment, and economic marginalization. USAID funded projects—including EPSP, Gobi Initiative, Competitiveness Initiative, and newly established peri-urban project—attempt to accelerate economic growth by contributing to policy, strengthening economic associations and support institutions, sharing new models, and building individual skills and knowledge that bring the benefits of economic growth to broad segments of Mongolia's population. While USAID support for privatization is increasing the private sector share of Mongolia's economy, it potentially could contribute to economic inequality. At the same time, through the Gobi Initiative and the new peri-urban project, USAID has especially targeted segments with the higher risk of economic marginalization. Both projects make economic opportunity for previously marginalized populations an explicit element of the USAID program in Mongolia over the next five years. They also address the growing issue of rural impoverishment that is fueling the increased migration from the countryside.

### **Annex M: Summary of Other Donor Activity<sup>4</sup>**

Official Donors	Economic Reform	Financial Markets	Private Sector	Agriculture	Governance	Energy	Comments
IMF	x						\$37 million poverty reduction and growth facility for macroeconomic stability, private-sector led and outward-oriented growth, and broad-based and equitable distribution of benefits from growth.
World Bank	x	x		x	x	x	\$32 million financial sector adjustment credit. \$18 million sustainable livelihoods project. Legal and judicial reform. Transport and energy.
ADB		x		x	x	x	\$25 million governance reform loan. TA on public sector and civil service reform. \$15 million second financial sector program. \$17 million agriculture sector development loan. Energy: rehabilitated station #4 and improve district heating grid.
UNDP		x	X	x	x		Lead organization for good governance and anti-corruption. TA at the policy level on good governance and poverty reduction. Supported merger with USAID of XasBank. \$2.5 million sustainable grassland management project. Enterprise Structural Restructuring project.
EU		x	X			x	Rural development and integrated crop and livestock production project. EU-TACIS Credit Mongol program. Private sector.
FAO				x			Project in Uvs and Tov aimags for pastoral risk management

<sup>4</sup> Full pre-strategy background papers on 1) *Assessment and Profile of Other Donor Activity in Mongolia* and 2) *Assessment of Donor-Funded Policy Initiatives in Mongolia* (January 2003) by Christopher Finch can be found on the USAID Development Experience Clearance (DEC) database at [www.dec.org](http://www.dec.org).

GTZ		x		x	x	x	TA to Ministry of Agriculture to improve the economic and legal framework for cooperatives and rural self-help activities. Commercial law project in close consultation with USAID. Renewable Energy project.
Japan				x		x	Renewable energy. Also rehabilitated combined heat and power station #3. Also involved in health, education, transport, infrastructure, human resource development; some limited engagement on broader economic management issues.
Spain						x	Renewable energy and energy efficiency.
Kuwait						x	Hydro power, roads.
China						x	Hydro power, housing.

**Annex N:**  
**Guidance Cables**

**Strategy Parameters Cable**

UNCLAS            AIDAC            SECSTATE 117253

Lasers:

ACTION: AID

INFO:        DCM AMB

DISSEMINATION: AID /1

CHARGE: AID

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INFO RUEHML/AMEMBASSY MANILA 3116

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UNCLAS SECTION 01 OF 03 STATE 117253

AIDAC

E.O. 12958: N/A

TAGS:

SUBJECT:        USAID/MONGOLIA: PROGRAM REVIEW AND PARAMETERS FOR  
DEVELOPMENT OF A NEW STRATEGIC PLAN

1.        SUMMARY: THE PURPOSES OF THIS CABLE ARE TO REPORT ON THE MAY 2002 TRIENNIAL REVIEW OF THE USAID/MONGOLIA PROGRAM AND TO ESTABLISH PARAMETERS FOR A NEW MONGOLIA COUNTRY STRATEGIC PLAN. A SERIES OF MEETINGS WAS HELD THE WEEK OF MAY 6, 2002 FOR THESE PURPOSES. THE WEEK BEGAN WITH A WELL-ATTENDED PRESENTATION BY MISSION DIRECTOR JONATHAN ADDLETON ON THE USAID/MONGOLIA PROGRAM. AGENCY-WIDE TECHNICAL REVIEW MEETINGS WERE HELD FOR EACH OF THE MISSION'S TWO STRATEGIC OBJECTIVES (ECONOMIC GROWTH/ENVIRONMENT/ENERGY AND DEMOCRACY). A PARAMETERS-SETTING DISCUSSION WAS HELD FOR THE PROPOSED NEW STRATEGIC PLAN BEGINNING IN FY 2004. THE WEEK WAS CAPPED BY A WRAP-UP MEETING THAT ADDRESSED AGENCY-WIDE PROGRAM CONCERNS AND STRATEGY DEVELOPMENT. BACKGROUND MATERIALS FOR THE REVIEW WEEK INCLUDED THE MISSION'S FY 2002 ANNUAL REPORT AS WELL AS AN EXCELLENT ASSESSMENT BY USAID/MONGOLIA OF ITS FYS 1998-2003 STRATEGY. END SUMMARY.

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PROGRAM REVIEW  
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2. STRATEGIC OBJECTIVE 438-001, 'ACCELERATE AND BROADEN ENVIRONMENTALLY SOUND PRIVATE SECTOR GROWTH':

ANE AND EGAT ECONOMIC GROWTH TEAM MEMBERS COMMENDED THE MISSION FOR ACHIEVING MEANINGFUL, TANGIBLE RESULTS IN A SHORT PERIOD OF TIME AND WITH LIMITED RESOURCES. THE EG TEAM PERCEIVED THAT THE MISSION'S PROGRAM IS HEAVILY FOCUSED AT THE DISCRETE FIRM AND MARKET ACTIVITY LEVELS, HOWEVER, AND RAISED THE OBSERVATIONS AND RECOMMENDATIONS OUTLINED IN PARAS A TO F BELOW. THE MISSION AGREED TO CONSIDER THESE CONCERNS, PARTICULARLY IN THE DEVELOPMENT OF THE PROPOSED NEW FY 2004-2008 STRATEGY.

OBSERVATIONS:

- A. USAID/MONGOLIA'S SUCCESSFUL ECONOMIC REFORM ACTIVITIES MAY NOT BE SUSTAINABLE UNLESS BROAD AND BASIC ECONOMIC POLICY ISSUES ARE ADDRESSED. ARE THERE POLICY CONSTRAINTS, TRANSACTION COST ISSUES, AND REGULATORY PROBLEMS IN THE SECTORS OF USAID INVOLVEMENT IN PARTICULAR, AND IN THE ECONOMY IN GENERAL, THAT USAID/MONGOLIA'S PROGRAM COULD ADDRESS?
- B. IS MONGOLIA'S OVERALL ECONOMIC INEFFICIENCY RELATED TO BAD SECTOR POLICIES, HIGH TRANSACTION COSTS, AND DISTORTING REGULATIONS? OR IS THE LOW (ONE PERCENT) ECONOMIC GROWTH RATE ATTRIBUTABLE TO WEATHER CONDITIONS AND THE GLOBAL ECONOMIC SLOWDOWN?
- C. PRIOR USAID PROGRAMS IN CAPITAL MARKETS, PENSION REFORM, CUSTOMS, AND TAX HAVE NOT MADE THE SIGNIFICANT PROGRESS THAT WAS ANTICIPATED. IS THIS A REFLECTION OF THE POLICY ENVIRONMENT, LACK OF DONOR COORDINATION, OR SOME OTHER REASON?
- D. ARE OTHER DONORS COVERING OTHER IMPORTANT POLICY/PROGRAM AREAS, INCLUDING THE MINING SECTOR?

RECOMMENDATIONS:

- E. THE MISSION SHOULD CONTINUE TO PROVIDE SUPPORT FOR THE PROCESS OF PRIVATIZING STATE-OWNED ENTERPRISES UNTIL OTHER MULTILATERALS BECOME ENGAGED.
- F. THE MISSION SHOULD CONTINUE TO CONSIDER NATURAL RESOURCE MANAGEMENT ISSUES UNDER THEIR EG SO, I.E., ENERGY, HERDING AND RANGELAND MANAGEMENT, AND ENVIRONMENTAL SUSTAINABILITY.

3. STRATEGIC OBJECTIVE 438-002, "CONSOLIDATE MONGOLIA'S DEMOCRATIC TRANSITION": NO MAJOR ISSUES WERE RAISED REGARDING THE MISSION'S DEMOCRACY PROGRAMS. OBSERVATIONS AND RECOMMENDATIONS DISCUSSED DURING

THE TECHNICAL REVIEW MEETING ARE SUMMARIZED IN PARAS A TO D BELOW. THE MISSION AGREED TO CONSIDER THESE CONCERNS, PARTICULARLY IN THE DEVELOPMENT OF THE PROPOSED NEW FY 2004-2008 STRATEGY.

- A. OBSERVATION: WHAT ARE THE IMPLICATIONS FOR USAIDIS DG PROGRAMS NOW THAT ONE PARTY CONTROLS THE CURRENT GOVERNMENT? IS MONGOLIA IN DANGER OF ADOPTING A ONE-PARTY POLITICAL SYSTEM?

RECOMMENDATIONS:

- B. THE MISSION SHOULD SEEK LINKAGES BETWEEN THE ECONOMIC GROWTH AND DEMOCRACY/GOVERNANCE STRATEGIC OBJECTIVES. THE MISSION SHOULD ENSURE THAT PROGRAM INTERSECTIONS ARE CLEAR AND HAVE MEASURABLE RESULTS.

- C. BECAUSE AGENCY ANALYSIS HAS DETERMINED THAT MANY PARLIAMENTARY PROGRAMS ARE NOT EFFECTIVE, PPC URGED THE MISSION TO CAREFULLY EXAMINE THIS PART OF ITS PROGRAM AND ANALYZE THE PROSPECTS FOR ACHIEVING MEASURABLE RESULTS.

- D. THE MISSION SHOULD INCLUDE THE ISSUE OF CORRUPTION IN ITS STRATEGY ANALYSES. THE MISSION ALSO SHOULD CONTINUE TO URGE OTHER DONORS AND THE GOVERNMENT TO ADDRESS CORRUPTION.

4. PROGRAM REVIEW DECISIONS: THE FOLLOWING DECISIONS WERE TAKEN AT THE MONGOLIA WRAP-UP MEETING:

- A. TECHNICAL REVIEWS: ANE BELIEVES THAT THE MISSION'S TWO STRATEGIC OBJECTIVES ARE ON TRACK AND ARE ACHIEVING TANGIBLE RESULTS. THE MISSION IS URGED TO TAKE INTO CONSIDERATION USAID/WASHINGTON'S OBSERVATIONS AND RECOMMENDATIONS (OUTLINED IN PARAS 2 AND 3 ABOVE) WHEN DEVELOPING ITS NEW STRATEGY.

- B. STAFFING: ANE AGREES WITH MISSION PROPOSAL TO HIRE ONE OR TWO ADDITIONAL PSC STAFF.

- C. OPERATING EXPENSES: MISSION RELIES ON TDY ASSISTANCE FROM USAID/ PHILIPPINES FOR ADMINISTRATIVE MATTERS AND FROM USAID/W FOR TECHNICAL PROGRAM MATTERS. MISSION REQUESTS OE LEVELS IN THE DOLS 350,000 TO DOLS 400,000 RANGE TO MEET THESE NEEDS. ANE WILL TAKE THESE NEEDS INTO CONSIDERATION WHEN FY 2003 OE DECISIONS ARE MADE.

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PARAMETERS GUIDANCE  
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5. PARAMETER-SETTING DISCUSSION: AT A PARAMETERS-SETTING MEETING ON MAY 8, 2002, PARTICIPANTS DISCUSSED A NUMBER OF ISSUES, INCLUDING WHETHER THE MISSION SHOULD PREPARE A NEW STRATEGY OR EXTEND THE EXISTING STRATEGY; THE TYPE OF STRATEGY (TRANSITION OR SUSTAINABLE DEVELOPMENT); THE LENGTH OF THE STRATEGY; EXPECTED FUNDING LEVELS; AND STRATEGY PREPARATION ASSISTANCE. PARTICIPANTS NOTED THAT THE ASIAN DEVELOPMENT BANK AND WORLD BANK COUNTRY STRATEGIES FOR MONGOLIA WILL BE UNDERTAKEN

AT ROUGHLY THE SAME TIME AS USAID-S, PROVIDING A USEFUL OPPORTUNITY FOR COORDINATION AND POSSIBLY COOPERATION ON SPECIFIC AREAS OF ANALYSIS. PARTICIPANTS' RECOMMENDATIONS WERE PRESENTED AT THE MAY 10, 2002 WRAP-UP MEETING. AGREED PARAMETERS ARE SHOWN IN PARA 6 BELOW.

6. STRATEGY DEVELOPMENT PARAMETERS: THE PARAMETERS APPROVED AT THE MAY 10, 2002 WRAP-UP MEETING ARE AS FOLLOWS:

- A. STRATEGY TYPE AND DURATION: THE MISSION WILL PREPARE A NEW, FIVE-YEAR (FY 2004-2008) SUSTAINABLE DEVELOPMENT STRATEGY.
- B. SECTORAL EMPHASES- MISSION PROPOSES, AND USAID/W AGREES, THAT THE STRATEGY WILL CONTINUE TO FOCUS IN THE AREAS OF ECONOMIC GROWTH/ENERGY/ AGRICULTURE AND DEMOCRATIC TRANSITION.
- C. ANTICIPATED FUNDING TYPE AND LEVELS: THE MONGOLIA PROGRAM HAS BEEN FULLY ESF-FUNDED FOR THE LAST SEVERAL YEARS. ACCORDING TO THE STATE DESK, USAID CAN EXPECT CURRENT ESF FUNDING LEVELS OF DOLS 12 MILLION ANNUALLY TO CONTINUE THROUGH THE TERM OF THE CURRENT ADMINISTRATION (I.E., THROUGH FY 2004). SUBSEQUENT TO THE FORMAL PARAMETERS MEETING, HOWEVER, USAID/W INDICATED THAT PROVIDING ADDITIONAL FUNDING FOR THE MONGOLIA PROGRAM IS AN AGENCY PRIORITY. THUS, FOR STRATEGY DEVELOPMENT PURPOSES, MISSION SHOULD USE A DOLS 15 MILLION LEVEL (DOLS 12 MILLION ESF AND DOLS 3 MILLION DA).
- D. FUNDING DECREASES OR INCREASES: MISSION SHOULD PRIORITIZE ACTIVITIES WITHIN THE NEW STRATEGY SO THAT IF FUNDING LEVELS DECREASE, PROGRAM ADJUSTMENTS CAN BE MADE WITHOUT AMENDING THE STRATEGY. SHOULD ADDITIONAL FY 2004 FUNDS BE IDENTIFIED FOR MONGOLIA DURING THE STRATEGY DEVELOPMENT PROCESS, ANE WILL NOTIFY THE MISSION IMMEDIATELY SO THAT THE STRATEGY CAN BE ADAPTED TO THESE HIGHER LEVELS.

7. STRATEGY DEVELOPMENT TIMELINE: MISSION AND USAID/W HAVE DEVELOPED THE FOLLOWING ILLUSTRATIVE TIMELINE FOR STRATEGY DEVELOPMENT AND REVIEW.

- FALL 2002: A THREE-TO-FIVE PERSON USAID/W TEAM WILL VISIT MONGOLIA TO: (A) REVIEW AVAILABLE RELEVANT SECTORAL ANALYSES; (B) EXPLORE THE APPROPRIATE MIX AND STRUCTURE OF MISSION ACTIVITIES; AND/OR (C) VALIDATE THE MISSION'S PROPOSED OVERALL STRATEGIC APPROACH. ANE ALSO HAS OFFERED SERVICES AT THAT TIME UNDER THE PRICEWATERHOUSECOOPERS (PWC) STRATEGIC PLANNING CONTRACT (UP TO TWO PERSONS FOR TWO WEEKS, AT BUREAU EXPENSE).
- SPRING 2003: MISSION PLANS TO SEND A PRELIMINARY DRAFT STRATEGY TO USAID/W FOR VETTING WITH TECHNICAL STAFF. MISSION ALSO HAS INDICATED INTEREST IN RECEIVING USAID/W ASSISTANCE IN CONNECTION WITH THE REQUIRED ENVIRONMENT AND GENDER ANALYSES, WHILE HOPING TO DRAFT THE REQUIRED CONFLICT ANALYSIS IN THE FIELD.
- SPRING 2003: MISSION PLANS TO HOST A PWC TEAM TO ASSIST WITH DEVELOPMENT OF THE PERFORMANCE MONITORING PLAN. (ANE WILL PROVIDE TWO

PWC CONSULTANTS FOR THIS PURPOSE FOR UP TO TWO WEEKS, AT BUREAU EXPENSE.)

- FALL 2003: MISSION PLANS TO FINALIZE THE STRATEGIC PLAN FOR FYS 2004-2008, ALONG WITH THE PERFORMANCE MONITORING PLAN, AND SUBMIT BOTH TO USAID/W. USAID/W WILL REVIEW AND APPROVE THE NEW STRATEGY AT THAT TIME (NOTE: PMPS DO NOT REQUIRE USAID/W APPROVAL).

8. IN CLOSING, USAID/W NOTES THAT WITH THE RISING INTEREST IN CENTRAL ASIA, THE MISSION'S GOOD WORK AND PROGRESS OVER THE PAST FEW YEARS ALREADY HAVE PUT MONGOLIA ON THE MAP. ANE COMMENDS THE MISSION ON AN INTERESTING AND PRODUCTIVE WEEK REVIEWING THE MISSION'S PROGRAM AND ESTABLISHING PLANS FOR THE DEVELOPMENT OF A NEW STRATEGY. USAID/W LOOKS FORWARD TO CONTINUED COLLABORATION WITH USAID/MONGOLIA IN THE COURSE OF DEVELOPING THE NEW COUNTRY STRATEGIC PLAN. BEST REGARDS.

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## Country Strategy Team Visit

UNCLAS

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ACTION: AID

INFO: DCM AMB

DISSEMINATION: AID /1

CHARGE: PROG

APPROVED: AMB:JDINGER

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UNCLAS SECTION 01 OF 02 ULAANBAATAR 000812

USAID/WASHINGTON ANE/ESA CDOWNNEY

MANILA FOR USAID

E.O. 12958: N/A

TAGS: OTRA, MG

SUBJECT: COUNTRY STRATEGY TEAM VISIT TO MONGOLIA

REF: STATE 117253

1. USAID/MONGOLIA MUCH APPRECIATES RECENT VISIT BY FOUR-PERSON USAID STRATEGY TEAM TO MONGOLIA. FROM OUR PERSPECTIVE, THE TRIP WAS A SUCCESS. IT ALSO REPRESENTS AN IMPORTANT MILESTONE IN TERMS OF EFFECTIVELY LAUNCHING THE PREPARATION OF A NEW USAID STRATEGY, A PROCESS THAT SHOULD CONCLUDE WITH THE FORMAL PRESENTATION OF A NEW STRATEGY DOCUMENT FOR WASHINGTON APPROVAL NEXT YEAR.

2. THE STRATEGY TEAM INCLUDED REPRESENTATIVES FROM THE ASIA/NEAR EAST (ANE) BUREAU (TEAM LEADER REBECCA COHN AND ECONOMIC ANALYST JENNIFER TIKKA) AND THE GLOBAL BUREAU (ECONOMIST FRED WITTHANS AND POLITICAL SCIENTIST CORBIN LYDAY). THEY WERE JOINED BY THE ENTIRE USAID/MONGOLIA STAFF WHO ALSO PARTICIPATED IN THE TWO-WEEK STRATEGY VISIT.

3. THIS INITIAL STRATEGY EXERCISE CONSISTED OF A SERIES OF SITE VISITS; MEETINGS WITH COUNTERPARTS, INTERNATIONAL DONORS AND OTHER DEVELOPMENT PARTNERS; AND A JOINT RECEPTION AS WELL AS FOUR SEPARATE "ROUNDTABLES" INVOLVING SENIOR MONGOLIANS BOTH INSIDE AND OUTSIDE

GOVERNMENT. CERTAINLY, THE ESSENTIAL CONSULTATIVE ASPECT OF ANY STRATEGY PREPARATION PROCESS WAS IN LARGE PART COVERED BY THIS TDY. SEVERAL DOZEN MONGOLIANS PARTICIPATED IN THE DISCUSSIONS, RANGING FROM HERDERS TO MEMBERS OF THE BUSINESS COMMUNITY TO GOVERNMENT MINISTERS AND FORMER HEADS OF STATE.

4. AMONG OTHER THINGS, TEAM MEMBERS VISITED MONGOLIA'S THREE LARGEST CITIES AND TOWNS (ULAANBAATAR, DARKHAN AND ERDENET); THE NORTHERN BORDER CROSSING WITH RUSSIA AT ALTANBULEG; AND MONGOLIA'S LARGEST AND MOST SPARSELY POPULATED PROVINCE THAT BORDERS CHINA (SOUTH GOBI). SIDE MEETINGS WERE HELD WITH MEMBERS OF THE EMBASSY COUNTRY TEAM; EVERY USAID CONTRACTOR AND GRANTEE; MAJOR INTERNATIONAL DONORS, INCLUDING THE INTERNATIONAL MONETARY FUND (IMF), ASIAN DEVELOPMENT BANK (ADB) AND WORLD BANK; AND LEADING MONGOLIANS FROM A WIDE POLITICAL SPECTRUM. AMONG OTHER THINGS, THESE CONVERSATIONS INVOLVED CURRENT GOVERNMENT MINISTERS AND PARLIAMENTARIANS AS WELL AS A FORMER PRESIDENT, A FORMER PRIME MINISTER AND A VARIETY OF MONGOLIANS WORKING IN BOTH THE PUBLIC AND PRIVATE SECTOR.

5. REF CABLE CALLED FOR A "THREE TO FIVE PERSON USAID/WASHINGTON TEAM" TO VISIT MONGOLIA BY FALL 2002, WITH A VIEW TOWARD REVIEWING RELEVANT SECTORAL ANALYSES; EXPLORING THE APPROPRIATE MIX OF MISSION ACTIVITIES; AND VALIDATING THE MISSION'S PROPOSED OVERALL STRATEGIC APPROACH. EACH OF THESE OBJECTIVES WAS MET. IN PARTICULAR, THE TEAM WAS ABLE TO CRITICALLY EXAMINE AND THEN AFFIRM THE TWO MAIN PILLARS OF BOTH THE CURRENT STRATEGY AND THE PLANNED NEW ONE, NAMELY DEVELOPMENT OF A SUSTAINABLE MARKET-BASED ECONOMY AND STRENGTHENING OF A STABLE DEMOCRACY. THE DRAFT SET OF RECOMMENDATIONS THAT THE TEAM LEFT BEHIND WILL BE VERY HELPFUL AS THE MISSION WORKS TO RESHAPE OUR CURRENT STRATEGIC OBJECTIVES AND INTERMEDIATE RESULTS FRAMEWORK TO RESPOND EFFECTIVELY TO A CHANGING SITUATION IN MONGOLIA AND BEYOND.

6. IN PARTICULAR, COMMENTS ON STAYING THE COURSE ON JUDICIAL REFORM; ON BROADENING CERTAIN OTHER ELEMENTS OF THE CIVIL SOCIETY PORTFOLIO; AND ON RESHAPING ECONOMIC POLICY PROGRAMS TO RATCHET UP PUBLIC DEBATE ON ECONOMIC POLICY ISSUES IN MONGOLIA WERE WELCOME AND SHOULD CERTAINLY BE REFLECTED IN ANY NEW USAID STRATEGY FOR MONGOLIA. OTHER RECURRING THEMES INVOLVING CONSENSUS AMONG BOTH USAID/MONGOLIA STAFF AND THE WASHINGTON TEAM INCLUDE THE IMPORTANCE OF EXPANDING LINKS AND ACHIEVING SYNERGY AMONG OUR "DEMOCRACY" AND "ECONOMIC" PROGRAMS; THE NEED FOR EFFECTIVE DONOR COORDINATION, ESPECIALLY, GIVEN THE FACT THAT BOTH THE WORLD BANK AND THE ADB ARE PLANNING COUNTRY STRATEGIES AT THIS TIME; THE IMPORTANCE OF GREATER TRANSPARENCY AND INFORMATION FLOWS AT ALL LEVELS OF MONGOLIAN SOCIETY; THE GROWING IMPORTANCE OF "GOOD GOVERNANCE" AS AN ORGANIZING PRINCIPLE; AND THE NEED TO FOCUS HEAVILY ON IMPLEMENTATION. USAID/MONGOLIA HAS ACHIEVED AN ENVIABLE REPUTATION FOR ITS PRAGMATIC, RESULTS-ORIENTED APPROACH TO MONGOLIA'S DEVELOPMENT CONCERNS. WE NOW NEED TO MAINTAIN AND STRENGTHEN THIS ASPECT OF OUR PROGRAM THROUGHOUT THE NEXT STRATEGY PERIOD.

7. NEXT STEPS: AS PER ADS GUIDANCE, SEPARATE, STAND-ALONE ANALYSES ARE BEING PREPARED BY THE MISSION ON GENDER ISSUES; ON ENVIRONMENTAL CONCERNS; AND ON POTENTIAL SOURCES OF CONFLICT. THESE SHOULD BE READY BY THE END OF THE YEAR AND WILL FORM THE BASIS FOR ANNEXES IN THE NEW

STRATEGY. HOPEFULLY, AN INFORMAL STRATEGY CONVERSATION CAN BE ARRANGED IN WASHINGTON IN LATE JANUARY/EARLY FEBRUARY 2003, EITHER JUST BEFORE OR JUST AFTER THE MISSION DIRECTOR TRAINING PROGRAM. SUCH A CONVERSATION NEED NOT BE LONG BUT WOULD HOPEFULLY INVOLVING MEMBERS OF THE WASHINGTON STRATEGY TEAM AS WELL AS OTHER WASHINGTON STAFF WHO ARE INTERESTED IN THE MONGOLIA STRATEGY PROCESS.

8. AMONG OTHER THINGS, THE PURPOSE OF THIS JANUARY MEETING WOULD BE TO SOLICIT INFORMAL FEEDBACK ON A "NEAR FINAL IF STRATEGIC CONSTRUCT DOWN TO THE IR LEVEL BASED ON THE OCTOBER 2002 STRATEGY TEAM VISIT; DISCUSS ANY REMAINING ISSUES (SUCH AS WHETHER THE NEW STRATEGY CAN BE ORGANIZED AROUND A REFORMULATION OF THE MISSION'S TWO EXISTING STRATEGIC OBJECTIVES OR WHETHER IT SHOULD INSTEAD PRESENT TWO ENTIRELY NEW ONES); AND FINALIZE A TIMELINE FOR SUBMITTING A NEW STRATEGY TO WASHINGTON. BASED ON DISCUSSIONS WITH THE WASHINGTON STRATEGY TEAM, USAID/MONGOLIA WOULD LIKE TO MAKE A BEST EFFORT TO SUBMIT THE PROPOSED NEW STRATEGY TO WASHINGTON BY MID APRIL 2003, POSSIBLY SETTING THE STAGE FOR A WASHINGTON REVIEW IN MID TO LATE MAY 2003.

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**Strategy Approval Cable**

Subject: 03071624166 | STATE 206447 | USAID/WASHINGTON APPROVAL OF MONGOLIA

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BMCONNELL CLYDAY DCHADG EGATAG EGATPAICO  
EGATPDAM EGATWID GC1 GCAN GGRIGSBY JMARION  
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DRAFTED BY: AID/ANE/SPO:JWEATHERILL:JW:MONGOLIA -- 7/10/2003 712-465  
APPROVED BY: AID/DAA/ANE:GWEST  
AID/ANE/EAA:PLAPERA (DRAFT) AID/DCHA/DG:JKAUFMAN (DRAFT)  
AID/EGAT/PDSP:SLOW (DRAFT) AID/ANE/AMS:ALUCK  
AID/ANE/TS:RCOHN(DRAFT) AID/PPC/P:BRENISON (DRAFT)  
AID/GC/ANE:MWILLIAMS (DRAFT) STATE:AMORROW  
AID/M/FM/CONT:DJOHNSON (DRAFT)  
AID/ANE/SPO:ETTRAN (DRAFT)

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TAGS:

SUBJECT: USAID/WASHINGTON APPROVAL OF MONGOLIA COUNTRY STRATEGIC PLAN  
(FY 2004-2008)

1. SUMMARY. THE USAID STRATEGIC PLAN FOR MONGOLIA, FOR FISCAL YEARS 2004 THROUGH 2008, WAS APPROVED BY THE USAID BUREAU FOR ASIA AND THE NEAR EAST DURING AN ISSUES MEETING HELD ON MAY 22, 2003. TWO REVISED STRATEGIC OBJECTIVES, IN ECONOMIC GROWTH AND DEMOCRACY AND GOVERNANCE, WERE ACCEPTED FOR THE PERIOD OF THE STRATEGY. THIS CABLE AND THE REVISED STRATEGY DOCUMENT CONSTITUTE THE MANAGEMENT AGREEMENT BETWEEN USAID/MONGOLIA AND USAID/WASHINGTON. END SUMMARY.

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USAID STRATEGY FOR MONGOLIA APPROVED  
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2. THE USAID STRATEGIC PLAN FOR MONGOLIA, FOR FISCAL YEARS 2004 THROUGH 2008, WAS APPROVED BY THE BUREAU FOR ASIA AND THE NEAR EAST (ANE) ON MAY 22, 2003 IN AN ISSUES MEETING CHAIRED BY DELBERT MCCLUSKEY. THE MEETING WAS ATTENDED BY THE USAID MISSION DIRECTOR FOR MONGOLIA, JONATHAN ADDLETON, AND REPRESENTATIVES OF ANE/SPO, ANE/TS, ANE/EAA, PPC, DCHA/DG, EGAT/AG, EGAT/PAICO, AND EGAT/EIT.

3. ANE BUREAU COMMENDS USAID/MONGOLIA FOR DEVELOPING AN EXEMPLARY STRATEGIC PLAN AND FOR WORKING CLOSELY WITH ANE AND USAID PILLAR BUREAU TECHNICAL TEAMS TO RESOLVE OUTSTANDING ISSUES RELATED TO THE TWO STRATEGIC OBJECTIVES (SOS).

4. TIMEFRAME. THE USAID STRATEGIC PLAN FOR MONGOLIA WAS APPROVED BY THE USAID ANE BUREAU FOR THE PERIOD OCTOBER 2003 THROUGH THE END OF SEPTEMBER 2008.

5. TWO STRATEGIC OBJECTIVES APPROVED. THE NEW USAID STRATEGIC PLAN FOR MONGOLIA APPROVES TWO EXISTING SOS INCLUDED IN THE FORMER STRATEGY, WHICH ARE:

-- 438-001: ACCELERATE AND BROADEN SUSTAINABLE, PRIVATE SECTOR-LED ECONOMIC GROWTH

-- 438-002: MORE EFFECTIVE AND ACCOUNTABLE GOVERNANCE

THESE EXISTING SOS HAVE BEEN AMENDED AND WILL RUN FROM OCTOBER 2003-SEPTEMBER 2009 (AN ADDITIONAL YEAR BEYOND THE STRATEGIC PLAN END DATE) SO THAT THE MISSION HAS ADEQUATE TIME TO COMPLETE ALL SO ACTIVITIES BY THE SO END DATE.

6. FUNDING LEVEL. AN ESTIMATED DOLS 50 TO DOLS 60 MILLION OF ESF RESOURCES IS APPROVED OVER THE LIFE OF THE STRATEGY, PENDING THE AVAILABILITY OF FUNDS. THIS FUNDING LEVEL IS BASED ON A "BASE CASE" ANNUAL PROGRAM BUDGET OF DOLS. 10 TO DOLS. 12 MILLION. THE STRATEGY INCLUDES TWO OTHER ANNUAL PROGRAM BUDGET SCENARIOS, A "HIGH CASE" WITH DOLS. 15 MILLION ANNUALLY AND A "LOW CASE" WITH DOLS. 8 MILLION ANNUALLY. IN EACH OF THESE SCENARIOS, THE PROGRAM BUDGET IS INCREASED AND DECREASED PROPORTIONATELY BETWEEN THE TWO SOS.

7. STAFFING. USAID/MONGOLIA IS CURRENTLY AUTHORIZED EIGHT STAFF MEMBERS, INCLUDING ONE U.S. DIRECT HIRE EMPLOYEE (USDH), ONE U.S. PERSONNEL SERVICES CONTRACTORS (USPSC) AND SIX FOREIGN SERVICE NATIONALS(FSNS). SYMPATHETIC CONSIDERATION WILL BE GIVEN FOR A SECOND PROGRAM-FUNDED US PSC IF FUNDING LEVELS INCREASE AND IF THE MISSION CAN JUSTIFY ADDITIONAL STAFF. ALSO, AS PER THE DISCUSSION ON STAFFING IN THE STRATEGY DOCUMENT, IF A SUBSTANTIAL MCA PROGRAM EMERGES, THE POSSIBILITY OF ADDING ANOTHER US PSC OR POSSIBLY A SECOND USDH OFFICER FOCUSED ON MCA-RELATED ISSUES CAN ALSO BE CONSIDERED.

8. SUBMISSION OF STRATEGIC PLAN. USAID/MONGOLIA IS REQUESTED TO PROVIDE ANE/SPO AND THE CDIE/DEVELOPMENT EXPERIENCE CLEARINGHOUSE WITH THE FINAL VERSION OF THE STRATEGIC PLAN WHICH INCORPORATES ALL SUBSEQUENT REVISIONS DUE TO TECHNICAL, ISSUES, AND DECISION MEETINGS BY SEPTEMBER 30, 2003.

9. SUBMISSION OF PERFORMANCE MANAGEMENT PLAN (PMP). AS PROVIDED IN ADS 203.3.3, OPERATING UNITS MUST PREPARE A COMPLETE PMP FOR EACH SO WITHIN ONE YEAR OF APPROVAL OF THE SO. THEREFORE, USAID/MONGOLIA MUST COMPLETE AND SUBMIT A PMP TO ANE/SPO FOR EACH SO BY MAY 2004.

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APPROVED STRATEGIC OBJECTIVES  
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10. ECONOMIC GROWTH. SO 438-001, "ACCELERATE AND BROADEN SUSTAINABLE, PRIVATE SECTOR-LED ECONOMIC GROWTH," WILL START IN OCTOBER 2003 AND END ON SEPTEMBER 30, 2009. THE AUTHORIZED LIFE-OF-SO FUNDING FOR THIS SO IS DOLS. 40 MILLION (DOLS. 8 MILLION PER YEAR). ALL ACTIVITIES FUNDED UNDER SO 1 WILL BE COMPLETED BY THE SO END DATE. SO 1 IS COMPOSED OF THREE INTERMEDIATE RESULTS (IRS):

- IR 1.1: IMPROVED ENABLING ENVIRONMENT FOR PRIVATE SECTOR GROWTH
- IR 1.2: MORE COMPETITIVE INDUSTRIES AND SECTORS
- IR 1.3: EXPANDED ECONOMIC OPPORTUNITY FOR MARGINALIZED MONGOLIANS

11. DEMOCRACY AND GOVERNANCE. SO 438-002, "MORE EFFECTIVE AND ACCOUNTABLE GOVERNANCE," WILL START IN OCTOBER 2003 AND END ON SEPTEMBER 30, 2009. THE AUTHORIZED OYB LIFE-OF-SO FUNDING LEVEL FOR SO 2 IS DOLS. 20 MILLION (DOLS. 4 MILLION PER YEAR). ALL ACTIVITIES FUNDED UNDER SO 2 WILL BE COMPLETED BY THE SO END DATE. SO 2 IS COMPOSED OF THE FOLLOWING TWO IRS:

- IR 2.1: COMPREHENSIVE LEGAL REFORMS IMPLEMENTED
- IR 2.2: POLITICAL PROCESSES MORE COMPETITIVE,EFFECTIVE, AND TRANSPARENT

12. USAID/W APPRECIATES USAID/MONGOLIA'S HARD WORK IN DEVELOPING THE AMENDED STRATEGY, AND THANKS USAID/MONGOLIA FOR THE COLLEGIAL, COLLABORATIVE REVIEW, AND APPROVAL PROCESS.

POWELL  
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## **Annex O:**

### **Summary Response to Items Raised in Guidance Cable**

The reporting cable (02 State 117253) on the May 2002 Mongolia program review included several observations and some recommendations related to various aspects of strategy development. A “check list” incorporating Mission comments on these various items follows below:

#### **A. Economic Growth SO**

- 1. Are there policy constraints, transaction cost issues and regulatory problems in the sectors of USAID involvement in particular and in the economy in general that USAID/Mongolia’s program could address? As a rule of thumb, the “resolution” of one policy issue is almost always accompanied by the identification of other ones. The new economic policy/competitiveness program now being completed will provide USAID/Mongolia with an important mechanism for addressing these “second generation” concerns. For example, we have been heavily involved in the financial sector over the last five years, especially banking. New issues and new areas of potential involvement have emerged as we have deepened this engagement, including in potential new areas such as insurance, mortgages and leasing.*
- 2. Is Mongolia’s overall economic inefficiency related to bad sector policies, high transaction costs or distorting regulations? Or is the low (one percent) economic growth rate attributable to weather conditions and the global economic slowdown? The 3.9 percent growth rate record in 2002—the highest in five years—suggests that bad weather conditions as well as the global economic slowdown have indeed had an adverse effect on the Mongolian economy. However, there is no question that bad policies, high transaction costs and a distorted regulatory environment also affect growth. These concerns are addressed under the new strategy in SO 1.*
- 3. Prior USAID programs in capital markets, pension reform, customs and tax have not made the significant progress that was anticipated. Is this a reflection of the policy environment, lack of donor coordination or some other reason? The situation varies in each of these areas. In some areas (such as customs), USAID support—sometimes involving simply a report or set of recommendations—was probably too meager to achieve lasting results. In some areas (such as pension reform), other donors have become more heavily involved. In some areas (such as tax reform), significant progress has been made, though the corporate tax rate remains much too high. Finally, USAID/Mongolia has so far refrained from any real engagement with capital markets, in*

part because of skepticism about the relative priority of the Mongolian stock exchange among other competing development demands.

*4. Are other donors covering other important policy/program areas, including the mining sector?* The background paper on other donor programs and approaches toward policy issues prepared as part of this strategy process partly covers this concern. The World Bank and the ADB in particular are especially involved in policy issues, in part through conditionality associated with their program loans. The UNDP, ADB and others are involved in a range of governance issues. The current Mongolian mining law is considered “world class” in terms of its ability to attract foreign investors. This is also suggested by the significant mining interest now being shown on the part of potential international investors in Mongolia. A principal concern of the Embassy as well as the broader donor community is to avoid the uncertainties and potential pitfalls of any further amendments.

*5. The Mission should continue to provide support for the process of privatizing state-owned enterprises until other multilaterals become engaged.* Current “hands on” privatization mechanisms are expected to continue through the end of this calendar year. After that, the Mission is positioned to continue involvement in privatization under its policy/competitiveness program now being completed. An EBRD management contract with the national airlines related to privatization appears to be moving forward. The EBRD has also expressed an interest in supporting commercialization and privatization in the energy sector. There will probably be ADB interest in privatization as well. Reductions in the USAID budget will preclude any significant USAID involvement in prospective large-scale privatizations such as the national airlines. Despite recent successes in the privatization of Agricultural Bank and Trade and Development, the momentum on privatization will likely slow in the lead-up to the next elections scheduled for summer 2004.

*6. The Mission should continue to consider natural resource management issues under the economic growth SO, i.e., energy, herding and rangeland management and environmental sustainability.* This concern is embedded within the existing strategy and will be addressed within the constraints imposed by a diminishing budget.

## ***B. Democracy SO***

*1. What are the implications of for USAID’s democracy programs now that one party controls the current government? Is Mongolia in danger of adopting a one-party political system?* This issue is well reflected in the text of the strategy. Over the short term, it has led the Mission to develop differing approaches in terms of political party development. Engagements with the ruling MPRP focus on transparency while programs with the democratic opposition emphasize “unite and focus.” National elections scheduled for summer 2004 will be an important “test” in terms of the extent to which a

competitive political system is being established in Mongolia. The biggest concern is that Mongolia might “go the way of Kyrgyzstan,” a Central Asian country that once seemed committed to democracy but has to some extent “back-tracked” in recent years.

*2. The Mission should seek linkages between the economic growth and democracy/governance strategic objectives. The Mission should ensure that program intersections are clear and have measurable results.* These linkages, already implicit in the current program, will be made even more explicit during the next five years, especially with regard to judicial reform programs (implemented under the democracy SO) and transparency/information dissemination programs (implemented under the economic SO). Specific targets and indicators will be developed during the twelve months after the strategy has been approved.

*3. Because agency analysis has determined that many parliamentary programs are not effective, PPC urges the Mission to carefully examine this part of its program and analyze the prospects for achieving measurable results.* The main focus of our modest parliamentary development program over the past year has been to launch open hearings on pending legislation. This has in fact occurred, in the first instance on pending bills related to foreign aid and the judicial budget. In addition, our program is assisting in the development of ethics codes for senior officials, including those in parliament. Our parliamentary and political party development programs will both be reviewed following the summer 2004, possibly leading to programmatic changes.

*4. The Mission should include the issue of corruption in its strategy analyses. The Mission should also continue to urge other donors and the government to address corruption.* This concern was repeatedly expressed over the last several months, including at the July Consultative Group meetings in Ulaanbaatar, when the USG emerged as *the* key interlocutor on corruption. Subsequently, this concern has been raised in many forums by various other donors. The Embassy “froze” the local currency account until a corruption case related to the wheat program was properly addressed. More recently, the judicial reform program has been assisting in the development of an anti-corruption unit within the Ministry of Justice. Corruption concerns are repeated throughout the strategy and are partly addressed through our strong interest in strengthening our efforts related to transparency and accountability.

### ***C. Other Comments (Parameters)***

*1. The Mission will prepare a new, five year (FY 2004 – FY 2008) sustainable development strategy.* This has been completed.

*2. The Mission proposes, and USAID/Washington agrees, that the strategy will continue to focus on the areas of economic growth, energy, agricultural and democratic transition.* These are the major themes of the planned new strategy.

3. *For strategy development purposes, Mission should use a \$15 million level (\$12 million ESF and \$3 million DA):* The situation changed during the course of strategy development. Current figures suggest a level of \$10 million ESF in FY 2003, \$10 million ESF in FY 2004 and \$12 million in ESF in FY 2005. The current strategy reflects these numbers, though alternate scenarios are also discussed.

4. *Mission should prioritize activities within the new strategy so that if funding levels decrease, program adjustments can be made without amending the strategy.* See above. This has been done, with the first part of Section VII including “high,” “low,” and “base” scenarios.

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