

**PROJECT INFORMATION DOCUMENT (PID)  
APPRAISAL STAGE**

Report No.: AB3749

<b>Project Name</b>	Mongolia Mining Sector Technical Assistance Project
<b>Region</b>	EAST ASIA AND PACIFIC
<b>Sector</b>	Mining and other extractive (60%);Central government administration (40%)
<b>Project ID</b>	P108768
<b>Borrower(s)</b>	GOVERNMENT OF MONGOLIA
<b>Implementing Agency</b>	
<b>Environment Category</b>	<input type="checkbox"/> A <input checked="" type="checkbox"/> B <input type="checkbox"/> C <input type="checkbox"/> FI <input type="checkbox"/> TBD (to be determined)
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1. Country and Sector Background

**Background.** Mongolia has managed the transition from a centrally planned socialist economy to a market economy well. Since 1990 it has made good progress in undertaking fundamental economic reforms centered on price liberalization, privatization, and the establishment of market institutions. Despite early losses in GDP during the early to mid 1990s with the withdrawal of subsidies from the Russian Government, the benefits of the reform efforts can now be seen in the growth performance of the Mongolian economy and the accompanying structural changes in the economy.

**Development Challenges.** However, formidable challenges remain in managing Mongolia's "tyrannies of distance and isolation," delivering services equitably and cost effectively, and generating broad-based growth with jobs and income for Mongolians living in rural and urban areas, especially the poor. Mongolia's heavy dependence on the exports of a few key commodities—copper, gold, and cashmere—has made the economy particularly vulnerable to fluctuations in commodity prices and natural disasters. This makes it all the more urgent to ensure that Mongolia makes best use of the ongoing commodity boom period to meet its poverty alleviation and development goals most effectively. The country faces the challenge of creating economic opportunities for its rural population and urban unemployed in an economy whose GDP growth over the next few years will depend largely on the mining sector, which traditionally has been an enclave activity in Mongolia as in most countries and, given its capital-intensive nature, does not create much direct employment. Meanwhile, progress in reducing maternal mortality rates, as well as in improving water and sanitation services, has been insufficient to meet the Millennium Development Goals. The recent World Bank Poverty Assessment (2006) for Mongolia found that rural herder households had the highest incidence of poverty (41.2 percent). A 2002 analysis of household survey data found that the most pressing

poverty challenges in Mongolia are related to widespread livestock mortality risks, attrition before upper secondary schooling, and the burden of heating costs on households.<sup>1</sup>

***Mining's Contribution to the Economy.*** Mining is a major and increasing contributor to the economy. Historic output is largely copper, gold, coal and fluorspar, with most production coming from the majority state-owned Erdenet copper mining company, which earns about half of all foreign exchange and provides almost 25 percent of government revenues. Most gold production has historically come from small-scale placer (alluvial) operations. But this changed following the commencement of commercial scale hard rock gold mining at Boroo in 2003 and production from newly commissioned private sector mines increased gold production substantially in 2004 and 2005 to an annual level of around 24,000 kilograms (kg) compared to about 5,000 kg previously. In 2007, mining directly accounted for about 20 percent of real GDP (at 2005 constant prices), 56 percent of gross industrial output, 69 percent of exports, and 36 percent of government revenue. The economy grew at 9.9 percent in 2007 up from 8.6 percent in 2006 and 7.3 percent in 2005. A significant proportion of the GDP growth attributable to the mining sector has to a large extent offset some declines in other sectors including agriculture. The formal mining sector employs over 14,500 people and informal/artisanal mining involves four to five times this number.

***Large-scale Mining.*** Mongolia's mineral potential is extensive, with over 6,000 mineral occurrences comprising 80 different mineral commodities currently identified, the most significant of which being base metals (mainly copper and zinc), gold, coal, uranium, and fluorspar. Following the passage of the Mineral Law of 1997 investment in mineral exploration has risen dramatically. Foreign direct investment (FDI) in mineral and petroleum exploration and development was US\$148 million in 2004 and US\$191 million in 2005, of which US\$40 million was for grass roots exploration. FDI for the sector constituted 68 percent of total FDI for 2005. The boom in exploration has resulted in the discovery of an impressive pipeline of potential world class mineral projects including Oyu Tolgoi (copper and gold) and Tavan Tolgoi (coal) in the South Gobi as well as Tsagaan Suvraga (copper and molybdenum), Tumurtei (iron ore), Ulaan (lead and zinc), Gatsuurt (gold), and Golden Hills (gold). The mining sector has the potential to increase output substantially over the next decade and is projected to double or even triple from 2005 levels by 2010 if the Oyu Tolgoi and Tavan Tolgoi projects receive development approvals and are successfully brought into production. An investment of over US\$5 billion will be required just for these two projects which is twice the GDP of the country

***Artisanal and Small-scale Mining (ASM).*** There were an estimated 67,000 full time and part time artisanal and small-scale miners in Mongolia in 2007. ASM gold production in 2007 has been estimated by the Swiss Agency for Development and Cooperation (SDC)-supported Sustainable Artisanal Mining Project at 5,200 kg with an estimated value of US\$140 million. After agriculture, ASM is the largest generator of rural incomes, supporting an estimated 250,000 people, including the miners and their extended family members. Thus, close to 10 percent of the population derive direct or indirect cash benefits from ASM. However, income benefits from the sector must be balanced against potentially high environmental and community health costs. The ASM miners generally have low levels of understanding of mining risks,

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<sup>1</sup> A new HIES-LSMS is currently underway as a result of which more recent poverty estimates will become available towards the end of 2008.

engage in unsafe mining practices, and liberally use mercury and occasionally cyanide (for gold extraction) without understanding the risks for their own health and the natural environment.

***Challenges in the Mining Sector.*** Mongolia's mining sector has the potential to contribute significantly to economic growth and to provide revenues to help address the poverty alleviation and development challenges noted above. Indeed, Mongolia is on the verge of a major minerals investment boom with final approvals and negotiations presently taking place for investments in excess of US\$5 billion. However, this raises the challenges of sound overall macroeconomic management in the face of volatile commodity prices and risks of "Dutch disease". The existing industry has greatly benefited from the world commodities price boom which is now in its third year, and is likely to be sustained for some time to come. Meanwhile, tax revenues have not increased as anticipated due to a variety of reasons including, significant under-pricing of coal exports for tax avoidance purposes. In fact, some companies are reporting coal sales export prices that are a small fraction of prevailing world market prices while other mining companies are simply holding back from selling their gold production to the Central Bank (which is required by Mongolian law) and borrowing against them as collateral. With the lack of clarity in intergovernmental fiscal arrangements, there is a mis-match of revenue and spending authority at the sub-national levels of Government. As a result, sub-national governments (aimags and soums) lack adequate funds to deal with the increasing pressure for basic service delivery and essential infrastructure as mining developments take place. In addition, there are gaps in environmental protection regulations and no provision for mandatory social impact assessments. The state is planning to take an equity participation in new "strategic" mining projects but lacks a guiding policy. The equity will be held by a state holding company — Erdenes MGL LLC (Erdenes) — which has only recently been established and its management systems need to be put in place. Licensing lacks transparency and can be subject to discretionary actions. There is a wealth of geological data but it is not suitably formatted to be readily available and usable by interested investors or widely disseminated for analyses. Artisanal and small-scale mining (ASM) are widespread but for the most part informal and illegal with poor health, safety and environmental practices. Thus, the successful future development of the sector will to a large extent depend on the government's ability to establish and maintain an effective regulatory and fiscal framework, prudently and transparently manage its mineral wealth to the benefit of all of its population, and ensure sound environmental and social performance of the sector.

***Governance Context.*** According to Transparency International and the World Bank's Governance Indicators, perceptions of corruption in Mongolia have worsened substantially since 2001, and perceptions of corruption as an obstacle to growth are more widespread in Mongolia than in a number of comparator countries. The 2006 World Bank Investment Climate Survey results suggest that corruption in Mongolia may be a symptom of rising inequalities, stemming from perceptions of lack of transparency and accountability in the public sector. The survey results indicate that unofficial payments required for obtaining exploration and mining licenses were high, and estimated at around 40 percent of the official fees. Twenty-six percent of firms reported being required to pay bribes to obtain access to electricity, water, and/or communications infrastructure. Mongolia's ranking in the latest *World Bank Governance Indicators* (2008) has also fallen relative to other countries as compared to 2007 rankings. Mongolia is one of the twenty-six Country Governance and Anti-Corruption (CGAC) pilot countries in the World Bank. In that regard, a Governance Assessment involving diagnostic

work, civic consultation, and stakeholder dialogue is currently underway including a focus on the mining sector.

***Anti-Corruption Measures.*** The recent passage of the anti-corruption legislation, the implementation of the Asset and Income Declaration requirements for senior government officials and Parliamentarians, and the adoption of the Extractive Industries Transparency Initiative (EITI) are commendable steps by the Government in the right direction. However, much remains to be done, and the Government has stated its intention to continue to strengthen its public sector governance capacity and implement the anti-corruption law effectively, and promote transparency in government-business interactions. The proposed Project will support the anti-corruption agenda through building effective policy and institutional capacity to manage mining revenue flows including through the further development and implementation of EITI. It will support the ongoing development of a transparent and efficient mineral licensing system as well as assist in the development of clearly articulated legislation and regulations relating to mining sector development and management, which are not subject to discretionary powers.

***Government Mining Sector Strategy.*** The Government has prepared a draft Private Sector Development strategy, aimed at accelerating economic growth through export-oriented, private sector driven economic development. This strategy highlights mining as a lead industry for private sector development. The strategy for large-scale mining is to encourage environmentally and socially sustainable mineral exploration, development, and production that contributes to economic development through exports and taxes. However, the Government has also recently adopted a strategy of mandatory State equity participation in mining. The Government's decision to take a 51 percent State equity at sites designated as "strategic deposits" such as Oyu Tolgoi and Tavan Tolgoi has stirred controversy internationally, having been viewed unfavorably by international investors. The Government holding company, Erdenes will need to mobilize US\$2.5 billion or more as its share of these first two projects. The establishment of Erdenes provides an opportunity for the government to broaden ownership in the ownership of the mining industry by Mongolian people by listing part of the Erdenes equity on the Mongolian Stock Exchange which would not only mobilize capital for Erdenes but also enable ordinary Mongolians to own shares in Erdenes. To attract foreign investment with high technology and modern management resources in the mining sector, the Government needs to further develop and stabilize mining regulations that are responsive to investors' concerns, and implement an internationally competitive fiscal regime and a sound macroeconomic policy framework to effectively manage revenue from the sector.

***Strategy to Improve ASM.*** The Government's strategy towards ASM has previously been to discourage the sector through banning the use of mercury and cyanide in an attempt to reduce the harmful health, safety, and environmental impacts. However, this has not proven effective and with today's high gold prices and increased incomes from ASM gold mining, ASM activities are rapidly expanding. In order to reduce the negative impact of the artisanal miners and develop small and medium sized commercial enterprises in the sector, the Government has recently approved a temporary regulation (with effect until 2015) aimed at coordinating artisanal mining activities and introduced a program so that ASM miners can develop micro-mining sector enterprises. The passage of the regulations for this program is the first step towards developing and improving the regulatory framework for artisanal miners leading to a systematic program of artisanal miner formalization. However, there is an ongoing and urgent need to pass enabling

legislation and provide on-site training and extension services to support improved ASM mining practices and the adoption of new environmentally sound technologies, as well as training in environmental management and rehabilitation.

***Mining Sector Development Constraints.*** The rapid escalation of mineral development activity in Mongolia at a time of a sustained boom in world commodity prices has resulted in some pushback by the State toward private sector-led development including the establishment of Erdenes (as noted in para 6) which is supported by a new Minerals Law that was passed in 2006. However the regulations to support the law and provide details of due process and standards for mineral licensing, occupational health and safety standards, and environmental and social guidelines have not yet been prepared or promulgated. New tax measures, including increased royalty rates and a windfall profits tax on gold and copper production, have also been introduced. These measures are having a distortionary effect, particularly on officially recorded gold production and export performance with the dramatic fall in gold sales to the Bank of Mongolia since the introduction of the tax, and a corresponding reduction in recorded production and government receipts.

***Potential Macroeconomic Impacts.*** The pending development of Oyu Tolgoi and Tavan Tolgoi, both world class deposits located in the South Gobi, present the State with particular challenges. These developments will likely increase Mongolia's mineral exports to over 90 percent of total exports, and tax receipts from the mining industry will likely exceed 50 percent of total tax receipts. In addition, these large new mining exports will also create large balance of payments surpluses which are likely to impact on the value of the Mongolian Tugrug which will need to be carefully managed. Recent engagement with the Government on the potential mining investment boom in Mongolia has primarily been on issues of policy and investment climate, and it is clear that the Government needs urgent assistance to manage the macro economic and physical development impacts of mining and to ensure that economic growth remains stable and the sector is effectively managed and monitored.

***Institutional Framework.*** There is a growing recognition within the Government that the current institutional framework for mining sector management has developed in a fragmented manner and may not be the most efficient and effective. For example, for historical reasons the Mining Rescue Service is housed in the Ministry of Fuel and Energy (MoFE), while mining inspections are undertaken by the State Specialized Inspection Agency, and licensing administration and other technical responsibilities lies with the Mineral Resources and Petroleum Authority of Mongolia (MRPAM), which is currently in the Ministry of Industry and Trade (MoIT). The separation of functions means that specialist expertise is split between agencies making it difficult for mining sector technical development issues to be managed in a coherent manner and keep up with rapidly evolving mine technological developments. The Government is currently considering a number of functional re-organizations and in April 2008 announced a proposal to reduce the number of Ministries from 13 to 9. The proposal includes creating a Ministry of Mining and Natural Resources, which combines the current Ministries of Nature and Environment (MoNE), with the part of MoIT that is responsible for minerals mining and the part of MoFE that is responsible for coal mining. MRPAM's technical expertise is expected to be folded into this new Ministry. The proposed support to MoIT/MRPAM under this Project can easily shift to the new Ministry if and when it is established.

**Key Areas for Support.** The Government anticipates that this proposed Mining Sector Institutional Strengthening Technical Assistance Project will make a contribution towards achieving both the large and small scale mining strategies of the Government. The proposed Project has been designed in close consultation with officials in various ministries and government agencies, who have identified several key risks and development needs, which are to be addressed by the proposed Project and are presented below.

#### **Macroeconomic Management, Policy Development and Economic Risk Mitigation:**

- Lack of a clear policy framework for managing mining revenues, associated risks from commodity price volatility, and their macroeconomic impacts;
- Lack of instruments to smooth revenue flows to the budget through upswings and downturns of commodity price cycles;
- Lack of effective and transparent process for mineral related revenue sharing between central government, aimags (districts), and soums (local level government);
- Lack of a set of consistent mining sector policies, fiscal framework, and deficiencies in mineral tax legislation;
- Missed opportunities for revenue collection from existing mining operations;
- Risk of companies engaging in speculative rather than productive activities;
- Fragmented and overlapping institutional framework for mining sector management;
- Lack of a State mineral investment policy and model investment agreements.
- Incomplete development of the Government holding company to manage state equity holdings;
- Lack of independent sector policy analysis and civil society consultation and engagement.

#### **Regulation, Control, and Environmental and Social Risk Mitigation:**

- Incomplete mining sector regulatory and policy frameworks to ensure that the large scale mining industry can be licensed, administered, and regulated in a fully effective manner;
- Absence of an ASM regulatory framework so that ASM activities can become formalized and the widespread use of unsafe and environmentally damaging ASM mining practices can be reduced through both regulatory requirements and outreach activities;
- Lack of standard procedures and guidelines that would ensure developers in the sector utilize best practices to address the occupational health and safety, environmental and social dimensions of mining;
- Lack of modern company reporting requirements
- Lack of institutional capacities in the area of mining licensing, environmental protection, safety, and technical audit and compliance enforcement;
- Lack of transparency and accountability in the management of mining and exploration licenses;
- Outdated classification of mineral reserve and resource data;
- Underdeveloped digital geological information systems for investors to use, which currently cover a very limited range of information types.

## 2. Rationale for Bank Involvement

**Bank Support for the Sector.** The Bank has been engaged with and supporting the development of the regulatory framework in Mongolia for private sector-led mining sector exploration and development for more than 10 years although in a minor way and without specific Technical Assistance programs. During this time the focus of activities has been largely on establishing the initial legislative and fiscal regimes to apply to mining and supporting work on improving the efficiency of State-owned coal mining operations at Baganuur near Ulaanbaatar. This work culminated in the passage of the 1997 Mineral Law and adoption of a reasonably competitive fiscal regime for the sector. This led to a rapid increase in private sector mineral exploration and mine development including the development of the Boroo gold mine and the discovery of the Oyu Tolgoi Copper deposit. However there have been a number of new initiatives by Government in recent times which have reduced the competitiveness of the sector and the proposed Project will provide support for an orderly analysis of different policy initiatives on sector development.

**Comparative Advantage.** IDA's comparative advantage is its long-term engagement and depth of knowledge of Mongolia's mining sector, combined with IDA's international mining sector experience and practice. IDA brings experience with mineral development and macroeconomic issues, as well as with regulatory, fiscal, and economic management, revenue sharing, community development, gender, social safeguards, the demand side of governance, and sustainable mining development aspects including international experience and good practice regarding the governance and development of the sector. Through engagement in public expenditure management, IDA is well-placed to integrate mining sector reform with the broader macroeconomic and fiscal management issues and ensure that results are shared with other sectors. There are no other sources of assistance in Mongolia that can have such broad, cross-sectoral impacts. Moreover, IDA's involvement and value added in mining is recognized by other development partners in Mongolia who have confirmed that the proposed Project fits well with their activities and approaches.

## 3. Description

**Project Development Objective** The **project development objective (PDO)** for this first phase of support is to assist the Government to develop further the policy, fiscal, legal, regulatory and institutional framework for the mining and extractive sector that meets the needs of government, industry, and civil society. This includes the operation of Erdenes MGL LLC according to good international practice associated with a commercial entity. The primary target groups of this Project are the staff of the government regulatory and commercial agencies involved in the managing the mining sector and the economy, as well as Members of Parliament, mining industry, and civil society stakeholders. Table 1 outlines the PDO, expected outcomes and key indicators to track progress against expected outcomes. The second and subsequent phases would make sure that conditions are in place to ensure the progress under this project is sustained and would inter alia address the effective use of mining-related funds especially by sub-national governments and scale up pilot assistance to be undertaken as part of this project to GDNT for tax assessments and audits. It would also build on initiatives under this project to improve the impacts of ASM and develop informed consultation with affected communities and other civil society groups regarding mining sector development and enable their participation in monitoring

both mining sector environmental and social impacts and the outcomes of national, aimag and soum use of mining-related income.

**Table 1. Project Development Objective, Expected Outcomes, and Key Indicators**

	<b>Targets</b>	<b>Key Indicators</b>
<b>PDO</b>	The project development objective (PDO) for this first phase of support is to assist the Government to develop further the policy, fiscal, legal, regulatory and institutional framework for the mining and extractive sector that meets the needs of government, industry, and civil society. This includes the operation of Erdenes MGL LLC according to good international practice associated with a commercial entity.	<ul style="list-style-type: none"> <li>• Annual budget decisions to replenish or withdraw from the newly established Sovereign Wealth Fund are made based on agreed macro-economic criteria</li> <li>• Level of mining-related transfers from national government to aimag and soum authorities is known and disclosed publicly.</li> <li>• Pilot mining tax audits are completed and assessments raised.</li> <li>• Clear authority and responsibilities for Government mining sector management institutions, especially regarding environmental and social aspects associated with mining activities.</li> <li>• Mineral licensing procedures streamlined and processing times reduced.</li> <li>• Companies and civil society express satisfaction (through surveys) that pieces of legislation and regulation reflect their concerns and needs as per the outcomes of the participatory process.</li> <li>• Geological information is digitized and published and readily available in user-friendly digital formats.</li> <li>• Establishment of good practice internal management systems and standard operating procedures for state equity holding company Erdenes MGL</li> </ul>
	Improved effectiveness of key economic management institutions	<ul style="list-style-type: none"> <li>• Sovereign Wealth Fund or alternative mineral revenue stabilization mechanism established</li> <li>• Preparation and adoption of good practice draft Model Mining Investment Agreements</li> <li>• Preparation, adoption and publication of a good practice policy statement on State equity participation in the mining sector</li> <li>• Establishment of an independent, local policy “Think Tank” which produces professional quality mining sector economic and policy reports</li> </ul>
<b>Expected Outcomes</b>	Improved effectiveness of key revenue collection agencies	<ul style="list-style-type: none"> <li>• Income tax law on mining amendment and supporting regulations drafted, enacted, and implementation started</li> <li>• GDNT tax audit staff trained and competent to carry out mining company tax audits</li> <li>• Options study prepared based on review of Double Taxation Treaties</li> </ul>
	Improved effectiveness of key extractive industry sector institutions and improved management for ASM	<ul style="list-style-type: none"> <li>• Modern Mining cadastre regulations are prepared, promulgated, implemented, and monitored</li> <li>• Modern company reporting requirements regulations are prepared, promulgated, implemented, and monitored</li> <li>• Modern occupation, health and safety regulations are prepared, promulgated, implemented, and monitored</li> <li>• Socioeconomic Impact Assessment and social mitigation provisions including resettlement and compensation regulations are prepared, promulgated, implemented, and monitored</li> <li>• Modern mine closure and post closure regulations are prepared, promulgated, implemented, and monitored</li> <li>• Increased number of outreach and education programs for artisanal and small scale miners on technology, safety, and environmental issues</li> </ul>
	Erdenes establishment, operation and management	<ul style="list-style-type: none"> <li>• Enactment of modern statutory corporation legislation for Erdenes</li> <li>• Preparation and adoption of suitable corporate charter for Erdenes</li> <li>• Provision of management-related and governance-related training events to build capabilities needed within Erdenes</li> </ul>

**The Project consists of four components:** (a) Strengthening the Capacity to Manage Mining Revenues and Develop Economic and Sector Policies, (b) Improving Regulatory Capacity to Manage Mining Sector Development, (c) Developing the Capacity for Management of State Equity, and (d) Project Management. In addition, there will be a parallel but closely linked activity, funded by the Public-Private Infrastructure Advisory Facility (PPIAF) and AusAID, to support the development of a Southern Mongolia Regional Infrastructure Strategy. The focus is on helping the Ministry of Finance, the Ministry of Industry and Trade, the Ministry of Fuel and Energy, and the Ministry of Roads, Transport and Tourism to prepare a number of option studies leading to the preparation of a strategic plan to integrate mining into the regional transport, energy and urban infrastructure in the South Gobi in anticipation of the Oyu Tolgoi and Tavan Tolgoi mines. The program will also examine the potential for public-private partnership agreements for infrastructure development.

**Project Description.** The Project includes support for activities in four main agencies: Ministry of Finance (MoF), the General Department of National Taxation (GDNT), the Ministry of Industry and Trade (MoIT) and the Mineral Resources and Petroleum Authority of Mongolia (MRPAM). In addition there will be collaboration with the Ministry of Nature and Environment (MoNE). Project assistance would address a range of issues across these agencies, including development of mining sector policy and strategy; review and simplification of the institutional framework for mining; establishment of a modern legal and regulatory regime for mining, including the need for the Government to introduce a robust mechanism for the promulgation of regulations by Cabinet; management of macroeconomic impacts of large mining sector developments to reduce the potentially harmful impacts of commodity cycles and “Dutch disease”, including improved minerals sector tax collection and audit capacity to ensure that taxes are properly assessed and paid; clarification and improvements in minerals sector benefit distribution so that mineral districts and mining communities are able to better share in the benefits of mining; and capacity building to minimize and mitigate the negative environmental and social impacts of mining (including artisanal and small-scale mining). Another core focus of all Project activities will be the development of human resources capacity within Government agencies which is needed for both shorter term and longer term effective administration of the sector. In addition to on-the-job training provided under each component, the Project will support formal training programs as well as training workshops and participation in targeted learning events and conferences. The Project will also support study tours and staff twinning or secondment programs for government staff into counterpart agencies in other countries.

- **Component 1: Strengthening the Capacity to Manage Mining Revenues, and Develop Economic and Sector Policies (US\$3.88 million).** The principal target group for this component is the staff of the MoF and the GDNT. MoF will be provided with support to enhance capabilities of their staff to (a) prepare various mineral sector policies related to sustainable mining development, revenue sharing with sub national levels of government, state equity participation, minerals taxation and exploration; (b) carry out mineral sector financial planning and forecasting, (c) prepare model contracts and investment agreements for future projects; (d) establish a sector communications strategy; and (e) undertake a review of the institutional framework and responsibilities and authorities of the various government agencies engaged in mining sector management. GDNT will be provided support to (a) prepare new mining tax legislation; (b) carry out a review of Double Taxation Treaties; (c) receive training on mining taxation assessment techniques, including risk assessments; and

(d) carry out full mining and petroleum project tax audits. In addition, there is currently a lack of independent, informed policy analysis and comment on the strategic directions being taken by the Government in the mining sector and the proposed Project will support establishment of at least one independent policy unit or “think tank” to undertake objective, expert analysis of government policy initiatives and foster informed debate on the policy initiatives being taken by the Government.

- ***Component 2: Improving Regulatory Capacity to Manage Mining Sector Development (US\$3.82 million).*** The principal target group for this component is the staff of MoIT and MRPAM. This component will include five main activities: (a) support to MoIT and MRPAM to improve the legal and regulatory framework governing the sector especially regarding licensing, environmental protection, social mitigation and mineral sector institutional roles and responsibilities; (b) ongoing support to the cadastre office to complete the establishment and operation of a fully computerized mineral licensing system (i.e., cadastre) and completion of the cadastre regulations; (c) support to MRPAM and MoNE to further develop the regulatory frameworks for environmental and social management of large- and small-scale mining, including establishment of mine closure regulations and coordination and clarification of mineral sector institutional roles and responsibilities; (d) supplementing the assistance given by the Swiss Development Cooperation Small and Artisanal Mining Project to develop environmental training programs for operations and rehabilitation of ASM sites, support the formalization of the sector and outreach activities, including miner education and training, establishment of a database of artisanal and small-scale locations and miners; and (e) support to improve the management of mineral reserve and resource data, particularly with respect to strategic mineral deposits, develop an information management policy and support for an increase in the scale and scope of data digitizing of the very large stores of geological information.
- ***Component 3: Developing the Capacity for Management of State Equity (US\$0.80 million).*** The principal target groups for this component are the staff of Erdenes and the staff of the MoF and the State Property Commission who are building the capacity and institutional framework for the management of State mining sector equity holdings through Erdenes. The component will assist the Government to put in place the proper legal framework, governance and oversight structure, and financial and fiduciary arrangements for Erdenes as well as help to develop the technical capacity of its staff for mineral project assessment and economic evaluation. The component will also assist Erdenes staff, management and Board of Directors to put in place management systems, reporting practices and corporate governance in line with good international practice.
- ***Component 4: Project Management (US\$0.80 million).*** The principal target group for this component is the Project Management Unit (PMU), which will be established in MoF. PMU staff will be supported to monitor, supervise, and provide technical and administrative assistance to the proposed Project. The Project will finance a Project Coordinator, Procurement Specialist, and Financial Management Specialist dedicated to the proposed Project. Ad-hoc international advisors may also be required from time to time to monitor implementation of specific specialist activities.

#### 4. Financing

Source:	(\$m.)
BORROWER/RECIPIENT	1.0
International Development Association (IDA)	9.3
Total	10.3

#### 5. Implementation

**Memorandum of Understanding.** Project activities will be coordinated closely with development partners interested in the sector—including the Asian Development Bank (ADB), the European Bank for Reconstruction and Development (EBRD), the International Finance Corporation (IFC) and the World Bank who signed a joint Memorandum of Understanding (MOU) with the Government in April 2007. The objective of the MOU is to assist the Government to deal with mining sector development issues. The MOU focused on the following four areas of support: (a) assessment of the infrastructure needed for the development of the mining sector; (b) development of mining regulations and capacity building in government agencies; (c) assistance in the legal and institutional establishment of Erdenes and (d) advisory services in relation to the selection of strategic investors for the development of the strategic deposits. This Project supports objectives (b) (c) and (d). IDA is leveraging parallel PPIAF and AusAID trust funds of US\$0.7 million to support objective (a).

**Development Partners Support.** In addition to the PPIAF and AusAID support noted above, preliminary discussions have indicated that the following development partners will be supporting this project through parallel grant financing. These include US\$1.5 million from the Asian Development Bank, US\$2.3 million from the European Bank for Reconstruction and Development and US\$5 million from GTZ of Germany.

**Artisanal and Small-scale Mining (ASM).** In the area of ASM, SDC is the main development partner, assisting with regulatory development, providing staff development and training for MRPAM's ASM Division as well as logistical support for site visits and the preparation and publication of educational materials. The support for ASM under the proposed Project is complementary to SDC assistance. Several other development agencies are presently involved in supporting Mongolia particularly in the area of environmental management and training, mining safety and laboratory development, including the United Nations, the Netherlands and Germany. The Netherlands BNPP trust fund has a particularly important role with respect to this Project as it will support a World Bank managed Strategic Environmental and Social Assessment (SESA) which will help identify mining sector environmental and social regulatory and policy gaps which the Project should address. During Project implementation opportunities will be identified to increase collaboration with interested development partners to enhance Project activities.

**Implementing Role.** A Project Management Unit (PMU) will be established for the project in the Ministry of Finance, which has prior experience in implementing World Bank projects and is presently responsible for implementing the GAP. The PMU will be responsible for overall Project coordination and management, including all fiduciary requirements. The PMU will provide substantial support to the each of the four Project beneficiary agencies to assist them in efficient and effective Project implementation. Responsibility for achievement of outputs and

objectives of each of the Project components will rest with the management of each beneficiary agency. All four agencies to receive support, i.e., MoF, GDNT, MRPAM, and MoIT, have the necessary capabilities and a demonstrated track record in project implementation as demonstrated under the ongoing GAP, The PMU for the proposed Project and the GAP PMU (both located in MoF) will coordinate closely and the new PMU will derive operational support from the GAP PMU during its early operations. The PMU will report to an inter-ministerial Steering Committee, which will be responsible for providing policy guidance and supervision of inputs and outputs during Project implementation. The Steering Committee will be comprised of senior representatives from each of the implementing and beneficiary agencies.

## 6. Sustainability

***Borrower Ownership and Commitment.*** The Government has demonstrated very strong commitment in the identification and preparation of the proposed Project. The request for assistance came directly to IDA from the Minister for Finance, who asked that IDA provide support to the Government to manage the macroeconomic impacts of mining revenues as well as address issues of sector development and management. The design of the Project components for the MoF, GDNT, and MRPAM has been based on initial submissions and extensive work with the management and staff of each institution, as a result of which there is very substantial ownership of and commitment to implementation of the components relevant to the respective institutions. In the case of MRPAM, the success of the ongoing GAP-funded cadastre development component provides positive indications that future activities will be well received. Institutional champions for each component include the Chairman, MRPAM; the Vice Minister, MoIT; the State Secretary, MoF; and the Deputy Director of GDNT. MRPAM has already appointed a manager for Foreign Aid Coordination to work in close coordination with the Project and other government and donor agencies.

***Inter-governmental Coordination.*** The Project will provide support for improved coordination relating to mining development between Ministries in the Government, in particular, regarding the engagement of MRPAM and MoNE with mining companies, and in developing effective monitoring and evaluation arrangements for social impacts and the effectiveness of mining community social programs. Another area that the Project will support is working with MRPAM, MoF, MoIT and mining area local governments with the aim of establishing appropriate revenue sharing arrangements to ensure that the affected aimags (districts) and soums (local governments) have sufficient resources to respond to the increased demand for services and infrastructure that inevitably arise as a result of increased expectations and immigration to mining areas as mineral deposits are developed. The Project will help establish monitoring arrangements regarding the use of funds that are channeled back to mining areas in order to ensure that aimags and soums deliver increased quality and quantity of social programs and service delivery. This will involve establishing a collaborative and effective working relationship between MRPAM staff and local government officials.

## 7. Lessons Learned from Past Operations in the Country/Sector

Similar mining technical assistance projects have been and are being implemented in several other countries, with satisfactory or generally satisfactory ratings. Success has been achieved by taking a holistic, integrated approach to sector reform, with carefully and tightly designed

components that have clear outputs and outcomes and integration of stakeholder concerns into project design, with an emphasis on engaging with civil society groups as a way to help achieve improved development outcomes from mining. The main lessons learned from such projects and reflected in this proposed Project include: (a) the requirement to establish a sector-specific focus with clear delineation of authority and responsibility of various ministries and agencies involved in the sector; (b) strong beneficiary participation in project preparation, organization, and coordination at the field level; (c) sustainability of project components built around institutional champions for different components; and (d) strong ownership and political commitment to project objectives. The components proposed for support under the proposed Project were largely identified and scoped by staff from the various ministries and agencies involved in managing the sector.

#### 8. Safeguard Policies (including public consultation)

<b>Safeguard Policies Triggered by the Project</b>	Yes	No
<a href="#">Environmental Assessment (OP/BP 4.01)</a>	[ X ]	[ ]
Natural Habitats ( <a href="#">OP/BP 4.04</a> )	[ ]	[ X ]
Pest Management ( <a href="#">OP 4.09</a> )	[ ]	[ X ]
Physical Cultural Resources ( <a href="#">OP/BP 4.11</a> )	[ ]	[ X ]
Involuntary Resettlement ( <a href="#">OP/BP 4.12</a> )	[ ]	[ X ]
Indigenous Peoples ( <a href="#">OP/BP 4.10</a> )	[ ]	[ X ]
Forests ( <a href="#">OP/BP 4.36</a> )	[ ]	[ X ]
Safety of Dams ( <a href="#">OP/BP 4.37</a> )	[ ]	[ X ]
Projects in Disputed Areas ( <a href="#">OP/BP 7.60</a> )*	[ ]	[ X ]
Projects on International Waterways ( <a href="#">OP/BP 7.50</a> )	[ ]	[ X ]

**Environmental Category.** The proposed Project rated category B for environmental purposes. The Project will not involve direct investment in mining activities, but through its policy and regulatory strengthening may have indirect environmental impacts by encouraging increased commercial-scale mining and ASM activities. There will be no construction under the Project and hence no resettlement or acquisition of land or assets will take place. Hence the resettlement policy is not triggered. No other safeguards policies are triggered by the Project

**Strategic Environmental and Social Assessment.** The Bank has conducted an overall review of the status of environmental and social issues, and policies in the mining sector to identify institutional and regulatory gaps that should be addressed to strengthen existing compliance monitoring with regulations, and to investigate whether additional resources and standardized procedures might be needed to mitigate any identified risks. Based on the findings of the completed review, in the context of the Project particular attention will be given to (i) institutional strengthening actions to deal with environmental and social impacts associated with the growth and development of the mining sector (including artisanal and small scale mining); (ii) measures to overcome existing and projected policy, institutional and budgetary constraints that result in limited enforcement and implementation capacity; and (iii) ways to improve public participation and monitoring processes. In addition, the Project will benefit from the findings of a Strategic Environmental and Social Assessment (SESA) for the Southern Gobi Region; this

\* By supporting the proposed project, IDA does not intend to prejudice the final determination of the parties' claims on the disputed areas.

exercise will be conducted to help frame a vision for a sustainable natural resources management in the context of the planned mining developments in the region. During Project implementation further consultation will take place with NGOs, landowners, and industry representatives regarding mining sector environmental and social issues.

## **G. Policy Exceptions and Readiness**

The proposed Project does not require any exceptions from IDA policies. The Project is expected to meet regional requirements for readiness for implementation with the following exceptions:

- MoF needs to put in place a PMU. The process will commence shortly and will be funded by MoF under retroactive financing until IDA funds are available.

### 9. List of Factual Technical Documents

Millennium Development Goals-Based Comprehensive National Development Strategy of Mongolia  
Mongolia Minerals Law 2006 & 1997  
Mongolia: The Fiscal Regime for the Mining Sector and the Development Fund (IMF)  
Fraser Institute Annual Survey of Mining Companies 2005/2006 (Fraser Institute)  
Mongolia Mining Sector: Managing the Future (World Bank)  
Mongolia: Sources of Growth - Country Economic Memorandum (World Bank)

### 10. Contact point

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