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SIGNIFICANCE OF MONGOLIA'S

"THIRD NEIGHBOR" POLICY TO ENSURE

ITS ECONOMIC SECURITY (1990-2012)

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THESIS ACCEPTANCE CERTIFICATE

The undersigned, appointed by

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ABSTRACT

Significance of Mongolia's "Third Neighbor" Policy to ensure its Economic Security (1990-2012)

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Having adopted a democratic system and a market economy since 1990, Mongolia has ended its transition period and stepped on the road of an intensive economic development using its enormous natural resources. In this historical moment, maintaining and ensuring national economic security is crucial for Mongolia's future prosperity and wellbeing.

Therefore from this point of view, this study tries to address security issues from an economic perspective taking into account that balanced investment and trade policy are the most important factor for Mongolia in ensuring its economic security and achieving long-term economic growth and development.

Mongolia has been attempting to implement the "Third Neighbor Policy" for the past two decades in order to create a more favorable condition for its national security and to address its economic and development challenges by developing economic cooperation with development countries. However, this study reveals that it is still economically overly dependent on its two large neighbors and "third neighbors" are still weak in eliminating this dependence.

Therefore, the research concludes that in order to overcome economic security challenges it is extremely necessary to diversify its economic structure and an effective implementation of the 'Third Neighbor' Policy is imperative. The Policy will mitigate issues such as diversification of foreign investment and trade and aid in addressing other development challenges.

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ABBREVIATIONS AND ACRONYMS

CMEA   Council for Mutual Economic Assistance

EU   European Union

FDI   Foreign Direct Investment

FIRRD   Foreign Investment Regulations and Registration Department,
            Ministry of Economic Development of Mongolia

UNCTAD   United Nations Conference on Trade and Development

UNIDO   United Nations Industrial Development Organization

USA   United States of America

WB   World Bank

WEF   World Economic Forum

WTO   World Trade Organization

CHAPTER I.

INTRODUCTION

Mongolia is a country with no access to the sea, located between the Russian Federation and People's Republic of China. In 1990's, Mongoliaunderwent a transition from a socialist country with centrally planned economy to a democracy with market oriented economy.

As strongly stressed in the Diplomatic Blue Book of Mongolia (2011), the stability and development of the relations between Mongolia and its two neighbors Russia and China has large influence on Mongolia's economy. The external environment such as stable economic growth of China, and economic power of Russia is crucial for Mongolia's economic interst.Successfully developing relations with these two countries in strategic partnership level is one of the most important factors for establishing favorable conditions for security and development of Mongolia.

According to the World Bank(2013) Mongolia has been undergoing a drastic transformation inspired by its enormous natural mineral resources. The economic transformation is represented by a boom in the economic growth rate which stands at 17.3 percent in 2011 from 6.4 percent in 2010. It is estimated that the GDP will growth rate will hit a double digit between 2013 and 2017.

Meanwhile, Davaadorj (2012) rightly asserted that "Mongolia's economy is one-sided and fragile since the supply of common consumer goods like food and oil heavily depends on the import; raw material solely takes the biggest chunk in the

export of the country; control over the resources are limited; national production and labor forces have badly deteriorated; price changes frequently affect the economy; and the country is geographically isolated"(p.22).

Thus, the priority of Mongolia's National Security concern transformed from a traditional military threat to ensuring its economic security, strengthening its economic competitiveness on the international arena, and improving the standard of living and citizen's well-being.

1.1 Statement of the Problem.

In the year 1994, Mongolian Parliament approved and adopted the National Security Concept of Mongolia to address the socio-economic problems arising from its transition from planned economy to free enterprise economic system. During this period of transformation, economic security issues became the centre of the national policy to achieve economic and social development of the country.

More than twenty years ago, Mongolia was an underdeveloped and isolated country. Geographic and economic conditions kept Mongolia outside the global economic dynamics.

Nonetheless, nowadays Mongolia has transformed into a major destination for Foreign Direct Investment inflows with its large natural resources endowments. This transformation poses huge opportunities as well as challenges(Bayasakh, 2010).

It is evident that the external environment of Mongolia as well as its internal situation has dramatically changed since Mongolia's democratic transition in 1990. Thus the 1994 National Security Concept of Mongolia failed to sufficiently address the security issues and challenges that Mongolian government faces today.

Furthermore, as acknowledged by a number of scholars the prevision security policies and guidelines were too general to deal with urgent specific security matters(Davaadorj, 2012).

This consideration has made the government adopt a concept of national security to incorporate both economic and political agendas that would be very useful in ensuring proper management of national economy.

In 2010, Mongolian Parliament adopted a new revised National Security Concept of Mongolia that practically addressed the challenges of today.

To ensure a country's economic growth, considerable degree of independence from external interference and self-sufficient means of production from its internal sources are at the core priority of the country long term and sustainable growth. Therefore, economic security matter was and still is an important prerequisite to achieving that objective.

Moreover, the development of market economy was meant to secure sustainability of people's wellbeing by aligning national and international development goals. However, it is believed that leaving the market alone, would not adequately address all issues of sustainable development, balanced economy, society as well as

environment. For this reason, state management and supervision of the economy were also included in the provision of the new National Security Concept to ensure sustainability and reduce risks of the economy(Davaadorj, 2012).

In additional, according to Davaadorj (2012) the geo-political situation that Mongolia is in was also for the country in overcoming its economic challenges. Surrounded by two big super powers with centrally controlled economy has put the country into a stressful situation which impeded with achieving its economic goals. Therefore, economic security became even more important for the country's wellbeing.

Since its democratic transition, Mongolia has been implementing the "Third Neighbor" Policy within the framework of the "multi-pillar" foreign policy to address its economic and development challenges.

1.2 Objectives of the research

The purpose of the research is to examine the role that the "Third Neighbor" Policy played in ensuring Mongolia's economic security in terms of balanced investment and sound trade policy by comparing economic relations maintained between Mongolia and its two neighbors and with its "third neighbors".

1.3 Research Questions

The research will aim to answer the following research question:

How has Mongolia's "Third Neighbor" Policy influenced its economic security in terms of balanced investment and effective foreign trade policy?

This study will also address the following research sub-question:

If it failed, what are the main factors affecting the failure of the "Third Neighbor" Policy in ensuring its economic security in terms of balanced investment and effective foreign trade policy?

1.4 Method of Analysis

The existing literature on Mongolia's economic security and "Third Neighbor" Policy are limited. However, it is pertinent consider the works of authors like Udo. B.Barkmann, Kh.Olzvoi, A.Tuvshintugs, D.Ulanbayar, J.Bayasakh, Mashbat, Ganbat. They provide an overview of Mongolia's "Third Neighbor" Policy while. authors like Tsetsgee, and Tungalag cover the economic security issues.However, it is imperative to note that there is insufficient research on this subject matter.

The primary sources that the thesis relies on are; Mongolia's laws, official documents, publicly available statistics provided by FIRRD and Mongolia's Ministry of Finance. The secondary sources will include books, articles, research papers, reports and surveys from academic journals and other materials available on the Internet.

1.5 Data Description and Limitation of Research

The data used in this thesis is collected from the Foreign Investment Regulations and Registration Department of the Ministry of Economic Development of Mongolia, Ministry of Finance of Mongolia and covers the period from 1990 to 2012.

As indicated in the Foreign Policy Concept of Mongolia, the "third neighbors" are the U.S., Japan, the EU, South Korea, India, Turkey. Taking into account that "third neighbors" are not limited to countries listed in the Concept I also included Australia and Canada with whom Mongolia maintains broad economic relations.

1.6 Thesis structure

This thesis is consisted of the following five chapters:

Chapter I provides a brief introduction of changes in Mongolia's environment, defines statement and objectives of the research, poses research questions, outline the methodology and data, and provide brief description of the following chapters.

Chapter II explains the "Third Neighbor" Policy, and gives an overview of the "Third Neighbor" Policy in the context of Mongolia's foreign relations and diplomatic history.

Chapter III examines balanced investment policies and the role of the "third neighbors" in maintaining such balance in the investment sector of Mongolian economy. Based on the relative data, analysis on investments trends and the main findings are also presented in this thesis.

Chapter IV gives a brief overview of Mongolia's foreign trade, conducts trend analysis of Mongolia's main trade partners, and presents the main findings of the analysis.

Chapter V summarizes the main findings of the previous four chapters.

CHAPTER II.
MONGOLIA'S "THIRD NEIGHBOR" POLICY

2.1. The notion of the "Third Neighbor" Policy.

The collapse of the Soviet Union in 1991 marking the end of the Cold War gave birth to the formation of a brand new enviroment in the international arena. This offed Mongolia opportunities to undertake a truly independent foreign policy. In 1994 for the first time in its history, Mongolia's Foreign Policy Concept was adopted.

The Concept stipulates that any independent foreign policy implemented by the Government "shall be based on national interests, peaceful, open and multi-pillar" (The Foreign Policy Concept of Mongolia, 1994, Clause 5).

Ganbat (2012) noted that "the relations and balance between the Russian Federation and the People's Republic of China - Mongolia's two big neighbors - have always been the pre-condition of the very existence of Mongolia" and "Mongolia's century-long experience of alliance and hostility with China and Russia, have shown that good-neighborly and balanced relations with the two neighbors is the best effective policy for Mongolians" (Ganbat 2012, 15-16).

The Foreign Policy Concept (2004, 2011) states that "maintaining friendly relations with the Russian Federation, People's Republic of China shall be a priority

directions of Mongolia's foreign policy activity. It shall not adopt the line of either country but shall maintain in principle a balanced relationship with both of them and shall promote all-round neighbourly cooperation"(Clause 12, a, Clause 14, 1). It is evident that the provision of the Foreign Policy Concept is a direct indication that maintaining friendly and balanced relations with Mongolia's great neighbors is of the highest priority.

On the contrary, while acknowledging the importance of maintaining good foreign relations with its two great neighbors, it is also in the country's best interest to understand that Mongolia's national security is not guaranteed only by maintaining partnerships with Russia and China given the drastic changes developing countries experience with globalization. Considering the importance of successfully maintaining a "balanced relationship," the country geographic location presents security challenges. During the Cold War, Mongolia was gravely concerned that Mongolia's "sandwiched" geographic location is politically and economically isolating the country from the rest of the world. (Mashbat, 2011)

Therefore, since its transition to democracy in 1990 Mongolia has been implementing the "Third Neighbor" Policy incorporating the "multi-pillar" foreign policy objective in order to deal with development issues, deepen its relationship and cooperation with world's powers and thus creating a favorable condition to its security.

According to Olzvoi (2002) the "Third Neighbor" Policy is a comprehensive policy covering political, economic, geo-political and security issues. This policy is

directly related to national security concerns of a small country caused by superpowers' foreign policies. Therefore, this study includes eastern and western nations that support democracy and market economy of Mongolia, and international organizations influential to shaping of states' foreign policy such as the United Nations.

As Mendee (2011) asserted "third neighbor" for Mongolia shall have political, economic and cultural, as well as humanitarian implications rather than defense or military, and is aimed at promotion of bilateral and multilateral cooperation" (p.3).

The National Security Concept of Mongolia (2010) stipulates that "within the framework of "third neighbor" strategy, bilateral and multilateral cooperation with highly developed democracies in political, economic, cultural and humanitarian affairs shall be undertaken"(Clause 3.1.1.5).

Meanwhile, the Foreign Policy Concept of Mongolia (2011) states that "partnership and cooperation within the policy of "third neighbor" will be expanded and developed with the western and eastern countries and unions such as the United States, Japan, the European Union, India, the Republic of Korea, and Turkey"(Clause 14.2).

Moreover, The Diplomatic Blue Book of Mongolia (2011) illustrates the fundamental nature of the "Third Neighbor" Policy framework by stating that the policy concept addresses expansion in partnership and cooperation with Western and Eastern states like the United States, Japan, European Union, India, Turkey and the Republic of Korea. The inclusion of the policy is a strategic progress in the

country's overall foreign policy. The policy is encompassing in the sense that it underscores the development of inter-regional and international relations and cooperation with countries and organizations inclusive of its two traditional development partners.

However, it is important to explicitly underline that the policy will not destabilize the existing diplomatic partnership with Russia and China. The "Third Neighbor" Policy is an inclusive approach to development that will open opportunities and prospects for Mongolia while at the same time accommodating the usual spirit of diplomacy traditionally maintained with Mongolia's great neighbors Russia and China.

2.2. The "Third Neighbor" Policy in the History of Mongolian Foreign Relations and Diplomacy.

The term "third neighbor" was coined by the Secretary of State of the United States of America James Baker. During his official visit to Mongoliaon July 6th 1990, he mentioned to Mongolia's Foreign Minister Ts.Gombosuren that while Russia and China are the giant neighbors that Mongolia shares borders with, Mongolia has the possibility to develop relationship with the United States of America as a "third neighbor" (Olzvoi, 2002).

However, the importance of the "Third Neighbor" Policy to Mongolia dates back to its history. Scholars have highlighted that the "Third Neighbor" Policy is not a new concept. Ulambayar (2011), Ganbat, (2012), and Batbayar (2011) stated that in the early 19th century, Mongolia made an effort to establish partnerships with Western

countries and Japan. However, these efforts were not documented and politicized hence the development of the "third neighbor concept" has lagged until recently with its eventual inclusion in the national foreign policy framework of Mongolia.

The necessity of "Third Neighbor" Policy was originally born during the process of the announcement of Mongolia's independence in 1911. There was a great demand to be accepted by Western and Eastern nations, and establish commercial relations through diplomacy(Ganbat, 2012).

The note sent by the government of Bogd Khaan on 29th of October 1911 to Austria, United States, Belgium, Germany, Holland, Denmark, France and Japan stated that "our willingness is to exchange diplomatic mission with above mentioned states, establish agreements, encourage trade and deepen the peaceful relations"(Ulambayar, 2011) .

Many historical records provide us with evidence supporting that Ts.Dambadorj, Director of the Central Committee under the Mongolian Revolutionary Party was seeking to establish connection with Europe through his private visits to Germany and France. In addition, Mr.Jadambaa, Head of the Central Committee was encouraging to get in close contact with Germany, Britain, United States and Japan in order to develop multilateral commercial relations(Olzvoi, 2002).

These facts support the fact that establishing connections with "third neighbors" or western countries besides Russia and China was a crucial aspect in the Mongolian political and economic policy in the 19th century.

CHAPTER III.

STUDY ON BALANCED INVESTMENT POLICY AS PREREQUISITE TO ECONOMIC SECURITY OF MONGOLIA

3.1. Overview of Foreign Direct Investment in Mongolia.

Neoliberal economists share the idea of usefulness of Foreign Direct Investment (FDI) in leading to knowledge spillover, competition, and development of local firms as well as increased government income through corporate taxes(Ariunzul & Dehong, 2012).

In the beginning of Globalization the collapse of Soviet Union in 1991 forced most developing countries to open their economies to allow more trade and investments and Mongolia was not an esception.

The Mongolian Government has put significant importance in FDI as a key factor in achieving its national development goals. Also the National Security Concept declares that FDI is "a significant factor in increasing competitiveness, financial and managerial efficiency, introducing new technologies and defining long-term development goals"(The National Security Concept of Mongolia, 2010, Clause 3.2.2.4.) .

For the past 23 years, since its radical transition to democracy and market economy, Mongolian Government has been pursuing a policy to attract FDI and measures

were taken to provide more favorable condition to promote and protect the foreign investment.

In this context, the Foreign Investment Law of Mongolia was adopted in 1991 and several amendments were made in 1993, 1998, 2002, 2008, and 2013 respectively.

As of 2011, Mongolia has concluded the "Promotion and Protection of Foreign Investments" Agreements with 43 countries and "On avoidance of double-taxation" Agreements with 34 countries(Diplomatic Blue Book, 2011).

Figure 1. FDI inflows in Mongolia (1990-2011)
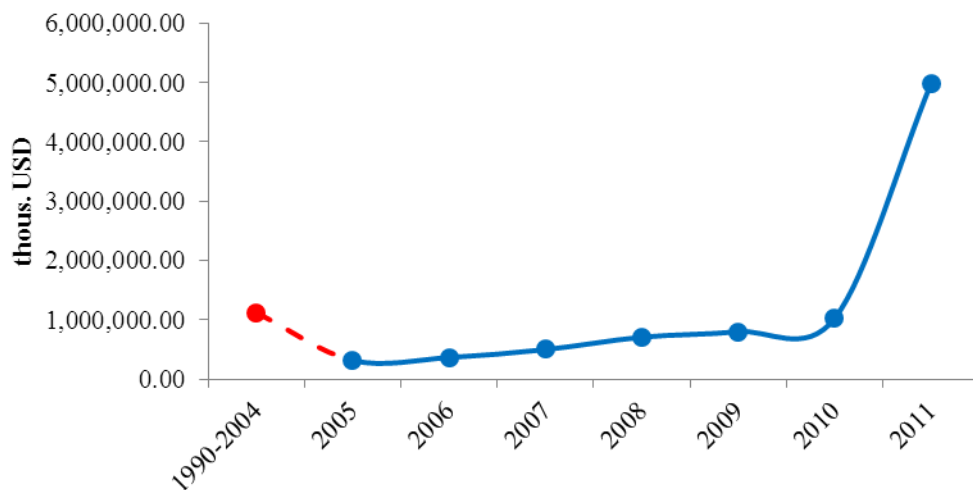
Source: FIRRD

As shown in figure 1, since the 1990s, Mongolia has received a reasonable amount of FDI with annual flows up to USD100 million until 2003. After 2003, inflows started to rise dramatically as Mongolian government opened its mining sector to allow foreign investment.

According to FIRRD data, 11380 foreign invested joint ventures and wholly owned enterprises was registered by 108 countries from 1990 to 2011. In 2011, estimate of total FDI inflows in Mongolia was 4986.0 million USD which was 15.7 times more compared to 316.8 million USD in 2005. From 1990 to 2004, merely 21 percent of the total FDI was made while the remaining 79 percent was mad in the past eight years.

Increase of foreign investment inflow to the country set a favorable condition to expand the domestic business and improve its competitiveness. For the first time 2007, tax revenue of more than 1 trillion tugrik (715 million USD) was generated from foreign investment companies. A total of 5.4 trillion tugrik (3.86 billion USD) was made in the last 6 years and employment increased to 180 thousand. FDI prompted the development of suburban infrastructure and created more workforces, which helped decrease the poverty. There are 450 Mongolian companies operating as part of the Oyu Tolgoi project. (UNCTAD, 2013)

3.2. Balanced Investment Policy by countries.

Figure 2.FDI inflows into Mongolia by countries (1990-2011)
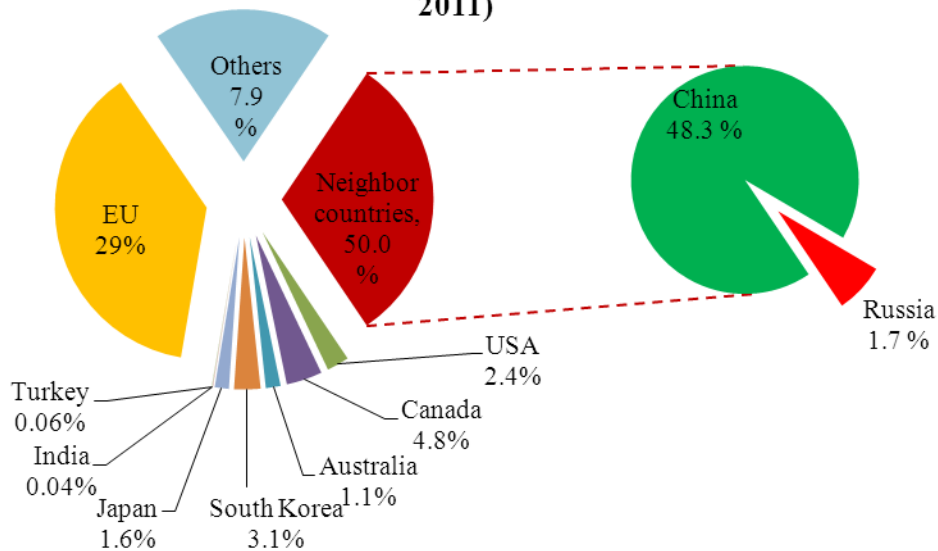
Source: FIRRD

As shown in figure 2, from1990 to 2011, 48.3 percent of the total FDI was made by China, followed by the European Union (29 per cent), Canada (4.8 per cent), the Republic of Korea (3.1 per cent), the USA (2.4 per cent) and Japan (1.6 per cent).

3.2.1. Trend analysis of China, Russia and "third neighbors" FDI in Mongolia.

3.2.1.1. Chinese FDI with trend analysis.

Based on the relevant FDI data, I determined the trend of investment. In order to conduct the study I clustered the countries as shown above. Then I estimated the

regression model using Microsoft Office Excel in order to determine the possible trends scientifically.

General form of the trend equation: **y=f(x)**

Estimation method: **Least square**

Where:

y – Chinese direct investment

x – Time

In order to specifically determine the trend, 5 main types of trend equation models were estimated, tested, and then the most statistically proven model was chosen to explain the trend.

Table 1. Results of the trend analysis

Name of trend models	Model equation	Estimated equation	Goodness of fit
Linear	$y=a+bx$	$y = 62336x + 154924$	$R^2 = 0.2911$
Exponential	$y=e^x$	$y = 229203e^{0.1039x}$	$R^2 = 0.1635$
Logarithmic	$y=\ln(x)$	$y = 159815\ln(x) + 223590$	$R^2 = 0.1578$
Polynomial	$y=a+bx+cx^2$	$y = 24173x^2 - 155219x + 517516$	$R^2 = 0.4662$
Power	$y=ax^b$	$y = 263251x^{0.2483}$	$R^2 = 0.077$

Figure 3. Chinese FDI in Mongolia (1990-2011)

$$y = 24173x^2 - 155219x + 517516$$
$$R^2 = 0.4662$$
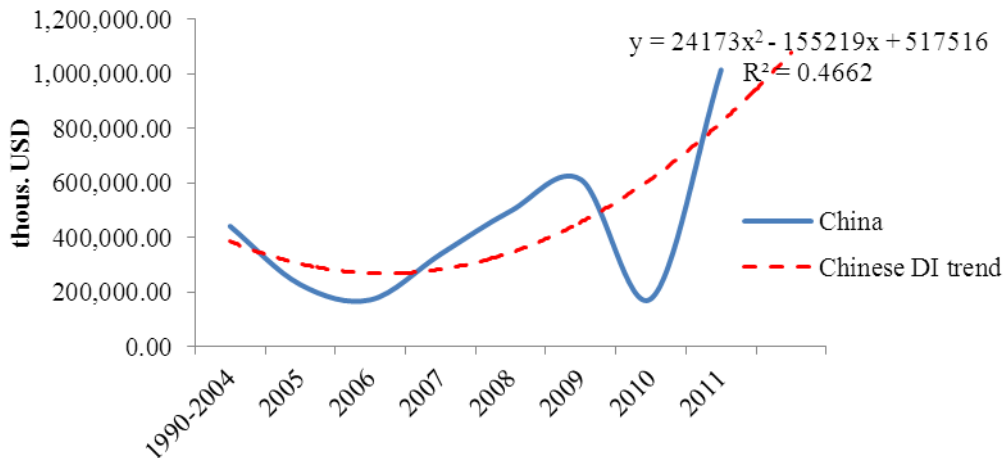
Source: FIRRD

According to the FIRRD data, China represents 48.3% of the total FDI recorded between 1990 and 2011.

The FDI made by China accounted 50.9 percent of the overall investment in 2010. However, this percentage decreased to 35.5 percent in 2011 due to the increased involvement by other countries in the mining sector.

As figure 3 shows, Chinese FDI rapidly increased during the given period except in 2010. Also the most reliable trend equation to explain the investment pattern in terms of statistics shows that Chinese investment will increase in the future.

Even though FDI coming from China constitutes the one third of the overall foreign investment to Mongolia, Chinese companies that pay tax represetns below 5

percent in the total of 1373.41 billion tugrug paid for tax by all foreign companies(Indra, 2013).

3.2.1.2. Russian FDI with trend analysis.

Table 2. Results of the trend analysis

Name of trend models	Model equation	Estimated equation	Goodness of fit
Linear	$y=a+bx$	$y = 803.94x + 17165$	$R^2 = 0.0087$
Exponential	$y=e^x$	$y = 17356e^{-0.084x}$	$R^2 = 0.03$
Logarithmic	$y=\ln(x)$	$y = -1479\ln(x) + 22743$	$R^2 = 0.0024$
Polynomial(order=2)	$y=a+bx+cx^2$	$y = 2409x^2 - 20877x + 53301$	$R^2 = 0.321$
Polynomial(order=3)	$y=a+bx+cx^2+dx^3$	$y = 804x^3 - 8444x^2 + 20527x + 13504$	$R^2 = 0.444$
Power	$y=ax^b$	$y = 21908x^{-0.462}$	$R^2 = 0.0743$

Above table shows the results of the trend analysis of Russian FDI.

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Figure 4. Russian FDI in Mongolia (1990-2011)

$$y = 803.96x^3 - 8444.5x^2 + 20527x + 13504$$
$$R^2 = 0.444$$
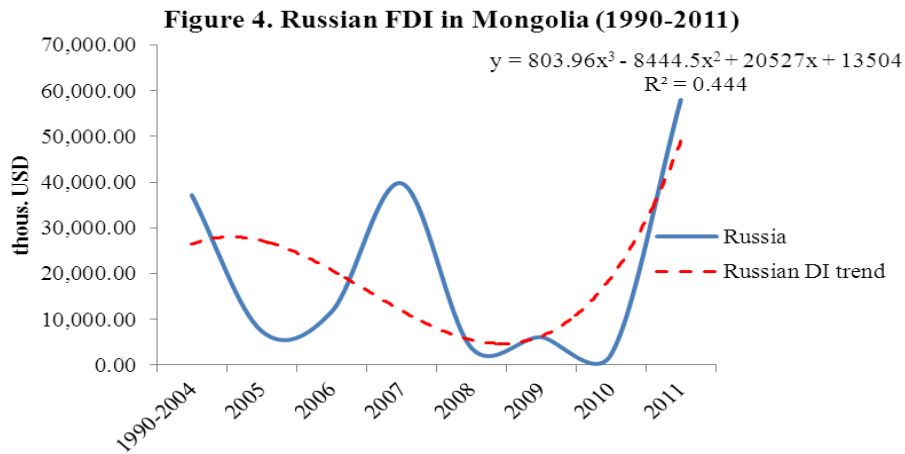
Source: FIRRD

Despite its close ties with Mongolia, Russian FDI is not as large, especially when compared to investment coming from China. This is mainly due to very strict and complicated procedures implemented by the Russian authorities to screen outflow investment(Ariunzul & Dehong, 2012).

Meantime, based on the FIRRD data, FDI inflow from Russia to Mongolia is mainly concentrated in the mining sector followed by construction and construction materials (USD5.5 million), banking and financial services (USD4.1 million), and food industry (USD 4million).

Russian direct investment shows a unstable pattern making it difficult to analyze the trend. However, it can be determined by the most statistically significant model. In this case, Polynomial model with 3 orders is best suited to this situation and it concludes that Russian FDI will increase in the future.

3.2.1.3. "Third neighbors" FDI in Mongolia with trend.

Figure 5. The US, Canadian, Australian FDI in thous.USD (1990-2011)

Between 1990 and 2004, FDI from Australia accounted for 3.7 million USD, and 12.1 million USD and in 2005 and 2011, that numbers increased up to 82.5 million USD showing an increasing trend of FDI from Australia annually. The FDI from Australia includes wide range of sectors such as trade and catering service (101.2 million USD), geology-mining (81.3 million USD), tourism (1.6 million USD), and engineering, construction and construction materials (1.1 million USD). In general, the share of Australian FDI accounted for 1.1% of total FDI.

In the case of the U.S., from 1990 to 2004, 45.8 million USD of FDI was made to in Mongolia from the U.S. According to statistics on 2005, FDI from the U.S. was 5.5 million USD and it reached 127.2 million USD by 2011. FDI from the U.S. is concentrated on sectors like geology-mining (111.9 million USD), trade and

catering service (109.7 USD million USD), banking (25.7 million USD), light industry (4.6 million USD), and engineering, construction and construction materials (3.3 million USD). U.S. made FDI accounted for 2.5 per cent of total FDI.

Canada invested 472.3 million USD of FDI in Mongolia from 1990 to 2004, and 172.2 million USD in 2005. A positive growth of the Canadian FDI can be observed and the number reached 72.3 million USD in 2011. Canadian FDI covers the following fields: geology-mining (437.6 million USD), trade and catering services (39.3 million USD) and banking (8.7 million USD). In general, Canada makes 4.8 percent of total FDI in Mongolia.
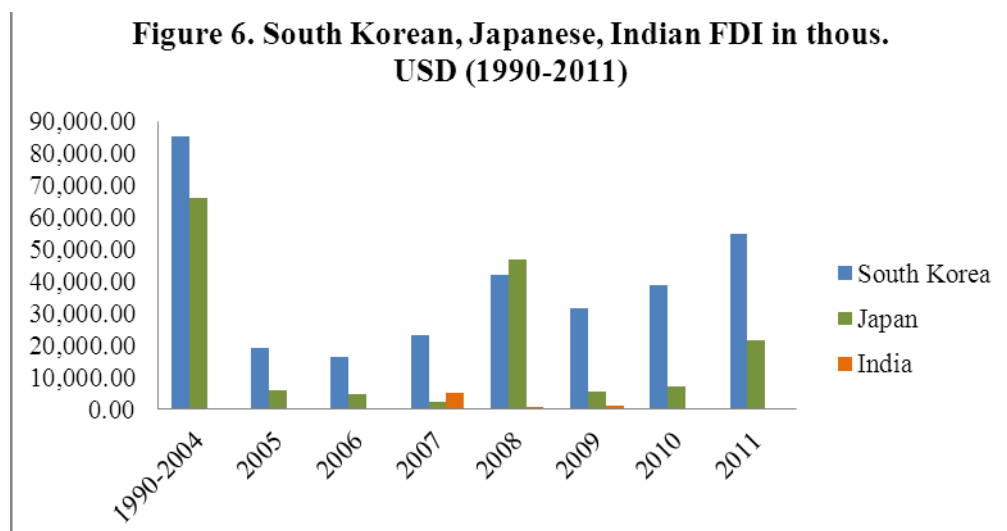
Source: FIRRD

Between 1990 and 2004, Mongolia attracted 85.2 million FDI from the Republic of Korea. As shown in the figure 6, amount of FDI from the Republic of Korea has been growing dramatically during the last 3 years, and it peaked at 55.0 million USD in 2011.

The structure of FDI from the Republic of Korea consists of 50.6 million USD in geology-mining, 11.7 million USD in telecommunication, 6.7 million USD in light industry, and 18.6 million USD in engineering and construction materials.

According to statistics for 1990-2004, total FDI from Japan was 66.2 million USD. In 2005, 5.8 of FDI was registered and reached 21.5 million USD in 2011. The data for Japan shows that the main targets are trade and catering services (99.2 million USD), light industry (28.1 million USD), and telecommunication (9.7 million USD). Japanese FDI accounted for 1.6 per cent of total FDI.

Meanwhile, Indian FDI accounted 5.0 million USD in 2007 and decreased to 0.75 million USD in 2011. Main areas of attraction are information, telecommunication (4.9 million USD), trade and catering services (1.2 million USD) and geology-mining (0.9 million USD).

Figure 7. EU & Turkish FDI in Mongolia (1990-2011)
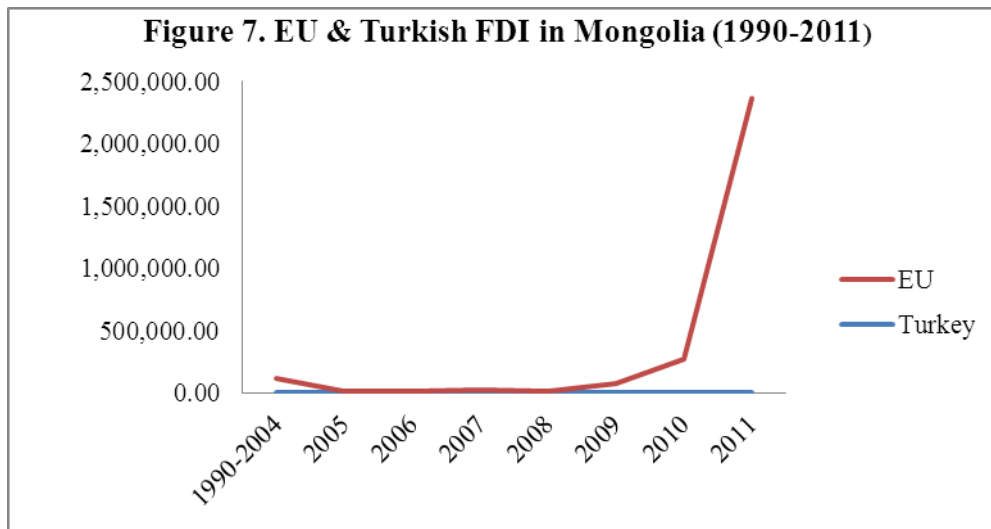
Source: FIRRD

The European Union represented 29 per cent in the overall investment to Mongolia from 1990 to 2011. Netherlands is the biggest investor followed by Luxembourg (5.2 per cent), Great Britain (0.7 per cent), Germany (0.5 per cent), and France (0.4 per cent) respectively.

Between 1990 and 2004, FDI from Turkey accounted for 5.6 million USD, and 1.9 million USD in 2005 and slightly increased to 2.3 million USD in 2011. FDI from Turkey is mainly focused in the trade (5.5 million USD), and furniture production (0.4 million USD) and food production (0.1million USD) services. Turkey's FDI accounted for 0.06 per cent of total FDI.

Based on the FIRRD data, I determined the "third neighbors" trend of investment.

Table 3. Results of the trend analysis

Name of trend models	Model equation	Estimated equation	Goodness of fit
Linear	$y=a+bx$	$y = 210915x - 425809$	$R^2 = 0.3251$
Exponential	$y=e^x$	$y = 64245e^{0.2675x}$	$R^2 = 0.2515$
Logarithmic	$y=\ln(x)$	$y = 497807\ln(x) - 136569$	$R^2 = 0.1493$
Polynomial(order=2)	$y=a+bx+cx^2$	$y = 127067x^2 - 932691x - 898476$	$R^2 = 0.7971$
Polynomial(order=3)	$y=a+bx+cx^2+dx^3$	$y = 34321x^3 - 336271x^2 + 834860x - 218706$	$R^2 = 0.9189$
Power	$y=ax^b$	$y = 111975x^{0.489}$	$R^2 = 0.0693$

Table 3 shows the results of the "third neighbors" FDI trend.

Figure 8. "Third neighbors" FDI in Mongolia (1990-2011)

$$y = 34321x^3 - 336271x^2 + 834860x - 218706$$
$$R^2 = 0.9189$$
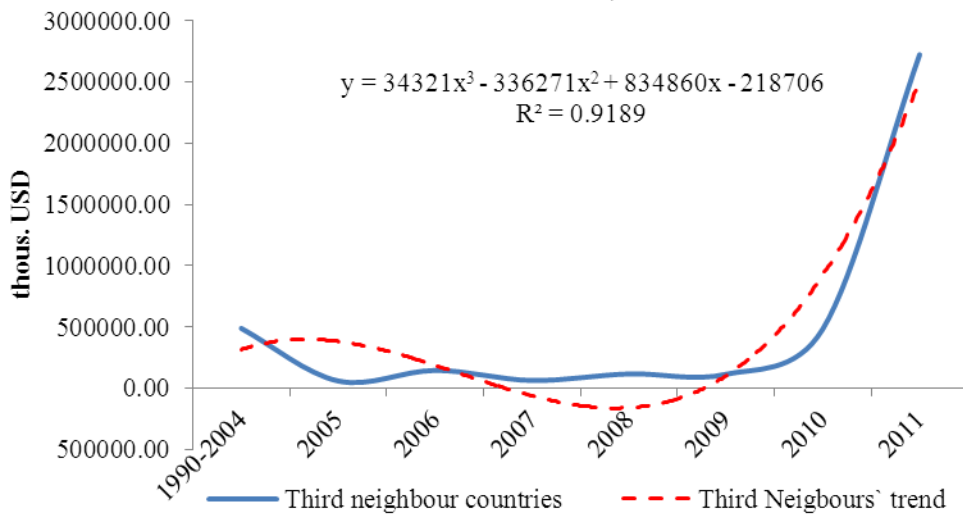
Source: FIRRD

"Third neighbors" direct investment shows a gradual increase until 2010, then it boosted in 2011 making it difficult to analyze the trend. However, it can be determined by the most statistically significant model. In this case, Polynomial model with 3 orders is the best among these models and the result of the model shows that "third neighbors" investment will increase in the future.

3.3. Balanced Investment Policy by sectors.

Figure 9. Mongolian FDI inflows by sectors (1990-2011)

- Geological prospecting, oil exploration & mining
- Trade and catering services
- Others
- Bank and financial services
- Transportation
- Engineering construction and production of construction materials
- Light industry
- Processing of animal originated raw materials
- Tourism
- Production of foods and beverages
- Information, Telecommunication
- Agriculture, animal husbandry
- Culture, education, science and printing

Source: FIRRD

Above figure shows FDI inflows to Mongolia in the last two decades by sectors. There are only two sectors with more than 5 percent to total FDI and other sectors have considerably low percentage. This indicates that there has been no balance in terms of sectors in Mongolian inflow FDI since a single sector has accounted for 74 per cent of total FDI for two decades.

In addition, other important sectors such as industrial, high-tech, energy and tourism constitutes less than 5 percent indicating that Mongolian government should review the current FDI policy in order to make optimal balance.

Figure 10. FDI inflows in Mongolia by sectors
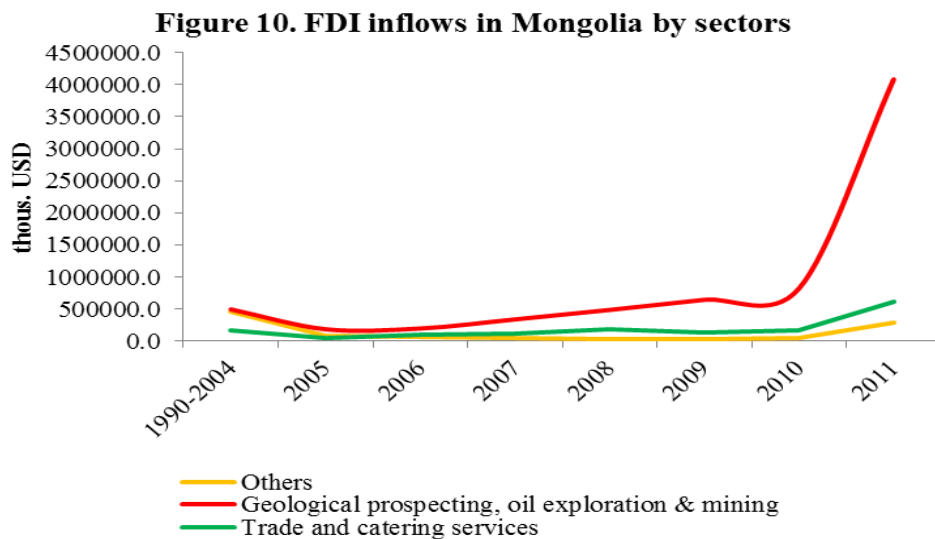
Source: FIRRD

As shown in figure 10, geological prospecting, oil exploration & mining sector have been booming and especially in 2011, whereas trade and cater service and other sectors have been increasing gradually.

According to the FIRRD data, in 2011, most FDI was registered in mining exploration for about 4083.2 million USD, followed by trade 620.6 million USD, banking and financial services 24.1 million, tourism 22.2 million USD, information, telecommunication 8.9 million USD, and engineering and construction 5.2 million USD.

3.3.1. Trend analysis of sectors.

3.3.1.1. Trend analysis of geological prospecting, oil exploration & mining sector.

Table 4 shows the results of the trend of geological prospecting, oil exploration and mining sector.

In this case, Polynomial model with 3 orders is the best model in terms of statistical significance and the results of the model indicates thatgeological prospecting, oil exploration and mining sector investment will increase in the future(see figure 11).

Table 4. Results of the trend analysis

Name of trend models	Model equation	Estimated equation	Goodness of fit
Linear	$y=a+bx$	$y = 354716x - 690979$	$R^2 = 0.4453$
Exponential	$y=e^x$	$y = 130324e^{0.3119x}$	$R^2 = 0.607$
Logarithmic	$y=\ln(x)$	$y = 932449\ln(x) - 330790$	$R^2 = 0.2537$
Polynomial(order=2)	$y=a+bx+cx^2$	$y = 157242x^2 - 1E+06x + 2E+06$	$R^2 = 0.7953$
Polynomial(order=3)	$y=a+bx+cx^2+dx^3$	$y = 46375x^3 - 468826x^2 + 1E+06x - 627931$	$R^2 = 0.9029$
Power	$y=ax^b$	$y = 179058x^{0.819}$	$R^2 = 0.3452$

Figure 11. Geological prospecting, oil exploration & mining sector investment with trend

$$y = 46375x^3 - 468826x^2 + 1E+06x - 627931$$
$$R^2 = 0.9029$$

Geological prospecting, oil exploration & mining — — Trend of this sector
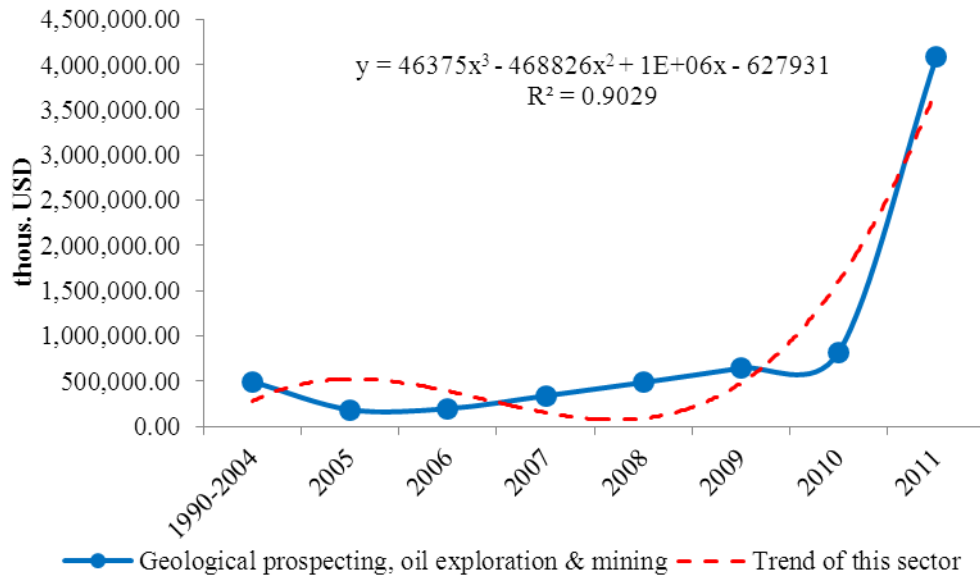
Source: FIRRD

According to figure 11, this upward trend will definately undertake a major role in the future investment of Mongolia.

The aggressive booming of this sector renders other sectors seem relatively low in terms of percentage to total investment. Thisbias trend will jeopardize the optimal balance unless the government undertake a radical measure to correct the bias.

As the Oyu Tolgoi mine becomes fully operational, the economy's dependence on the mining sector will increase which in turn will make the economy heavily dependent on the global commodity investment speculations. In this regard, an appropriate management of increasing mining revenue will be essential for the Mongolian government and its agencies. Consequently, the Mongolian Parliament has been formulating "Fiscal Stability Law", and "Integrated Budget Law" that could facilitate the management of the revenue influx(UNCTAD, 2013).

3.3.1.2. Trend analysis of trade and catering service sector.

Table 5 indicates the results of the trend of trade and catering services sector.

Polynomial model with 3 orders is the best model in terms of statistical significance.

Table 5. Results of the trend analysis

Name of trend models	Model equation	Estimated equation	Goodness of fit
Linear	$y=a+bx$	$y = 46598x - 17906$	$R^2 = 0.4099$
Exponential	$y=e^x$	$y = 62811e^{0.1929x}$	$R^2 = 0.4612$
Logarithmic	$y=\ln(x)$	$y = 120549\ln(x) + 31987$	$R^2 = 0.2262$
Polynomial(order=2)	$y=a+bx+cx^2$	$y = 20811x^2 - 140704x + 294264$	$R^2 = 0.737$
Polynomial(order=3)	$y=a+bx+cx^2+dx^3$	$y = 5622x^3 - 55082x^2 + 148816x + 15988$	$R^2 = 0.8213$
Power	$y=ax^b$	$y = 76935x^{0.5018}$	$R^2 = 0.2574$

Figure 12. Trade and catering services sector`s investment with trend

$$y = 5621.8x^3 - 55082x^2 + 148816x + 15988$$
$$R^2 = 0.8213$$

Source: FIRRD

31
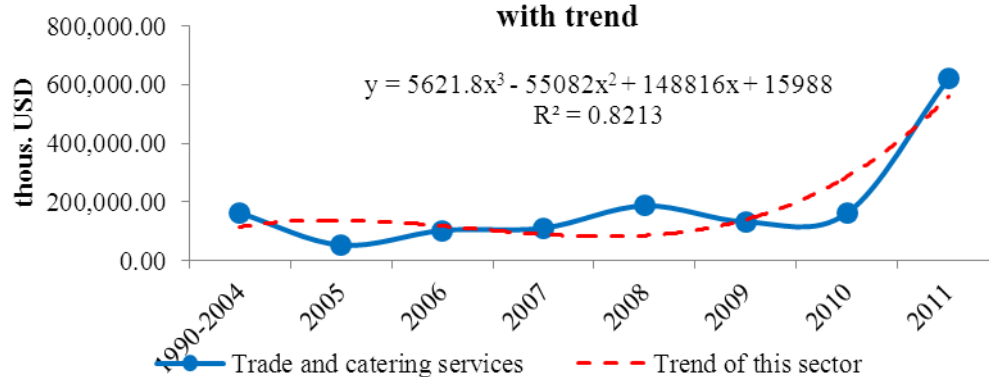
If we look at the trend, it is possible to project that FDI in trade and catering services may go up in the future. FDI in this sector is the second largest sector in total FDI inflows to Mongolia and accounts for 16 per cent of total investment.

3.3.1.3. Trend analysis of other sectors.

As shown in the table below, for these sectors, Polynomial model with 3 orders is best suited in terms of statistical significance.

Table 6. Results of the trend analysis

Name of trend models	Model equation	Estimated equation	Goodness of fit
Linear	$y=a+bx$	$y = -18997x + 216756$	$R^2 = 0.0868$
Exponential	$y=e^x$	$y = 132777e^{-0.117x}$	$R^2 = 0.0791$
Logarithmic	$y=\ln(x)$	$y = -1E+05\ln(x) + 290473$	$R^2 = 0.286$
Polynomial(order=2)	$y=a+bx+cx^2$	$y = 27565x^2 - 267078x + 630224$	$R^2 = 0.8176$
Polynomial(order=3)	$y=a+bx+cx^2+dx^3$	$y = -1893.6x^3 + 53128x^2 - 364597x + 723956$	$R^2 = 0.8298$
Power	$y=ax^b$	$y = 204874x^{-0.724}$	$R^2 = 0.2506$

Figure 13. Other sectors` investment with trend

$$y = -1893.6x^3 + 53128x^2 - 364597x + 723956$$
$$R^2 = 0.8298$$
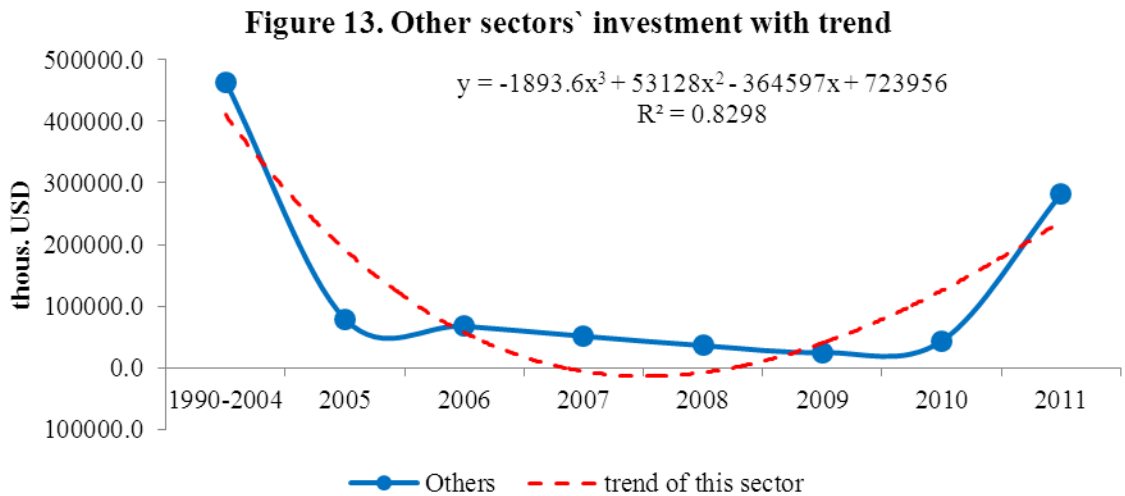
Source: FIRRD

As figure 13 shows, based on the tested models of the trends I conclude that the other sectors' investment will increase in the future.

3.4. Analysis of the main findings.

In order to ensure economic security and avoid overdependence on a single foreign country or over utilization of natural resources, the National Security Concept of Mongolia states that "the investment of any foreign country does not exceed one third of overall foreign investments and the volume of investments by neighboring and highly developed nations should be balanced within strategically important sectors"(The National Security Concept of Mongolia, 2010, Article 3.2.2.2.).

In spite of the fact that Mongolian Government aims to implement policy in promoting Foreign Direct Investment in different sectors of the economy, mining

sector still holds the largest FDI share(see figure 9). In additional to this, China is the largest share holder of Mongolia FDI inflow constituting one third of the overall investment volume(see figure 2).

The study reveals that Mongolian Government's policy aimed at maintaining balanced investment policy has already collapsed. The fact that the FDI made by the two large neighbors represent 50 percent of the total FDI while the "third neighbors" only hold 42.1 percent support this evaluation.

During a technical meeting between donor countries to Mongolia held in 2009, it was concluded that there is a need to place 10 billion USD in the economy to implement the 2015 National Development Strategy of Mongolia. Also one billion dollar should be invested in the country for successful implementation of big projects, FDI outlook, business environment and economic efficiency. Mongolia has the full capacity to soak up FDI in the domestic market (Sanjmyatav, 2011).

As Davaadorj has asserted, "to enforce the provision of the National Security Concept, it will be required to focus not on reducing FDI from China, but rather on promotion and increase of investments from other countries"(as cited in Munkhtur, 2011, p.64).

Therefore for the government, challenges remain on how to maintain optimal balance by increasing "third neighbors" investments.

According to World Bank's WEF report on Global Competitiveness 2012-2013, "the governance and institutional weaknesses and the uncertainty that characterize the legal and regulatory framework for investment, together with infrastructure and

skills inadequacies, are considered the main obstacles to the diversification of foreign investment"(as cited in UNCTAD, 2013, p.).

Figure 14. Top 10 most problematic factors for doing business in Mongolia, 2012 (*per cent of responses*)
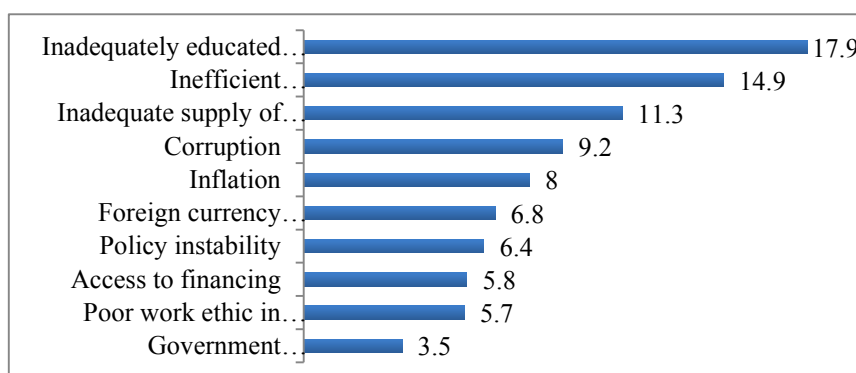
Source: WEF Global Competitiveness Report 2012-2013 (as indicated in UNCTAD, 2013)

Poor infrastructure and misstatement remain the biggest challenges for many developing countries in attracting FDI and Mongolia is not an exception. For example, only 12 percent of the roads are paved in Mongolia leaving a large percentage of the country's roads either poorly paved or not paved at all. This reduces expected returns from investment due to increased costs of production(UNCTAD, 2013).

In additional, Mongolia also faces the problem of corruption involving many public officials. 30 percent of the firms in Mongolia has either paid or required to pay informal payment in the process of business registration and licensing(Ibid).

Despite several measures that the Mongolian government took to combat this problem, corruption and conflict of interest remain major challenges in attracting FDI from other countries, making it difficult for Mongolia to successfully implement its "Third Neighbor" Policy.

Anand(2011) revealed the real effects of FDI on the sectors of the Mongolian economy using data from 1995 to 2009. The study showed that FDI has positive correlations with the economic growth but it negatively affects some sectors of the economy especially the mining sector.

As he concluded, factors that were brought on by FDI such as increasednumber of foreign workers in a construction sector and a wide wage discrepancy between local and foreign workers cause a negative effect on some sectors of the economy. In other words, a significant portion of wage outflow to abroad prevents the country from producing final goods. Thus it is important to increase local workers' labor skills in the main sector of the economy (Ibid).

Sachs and Warner(2001) noted that resource-rich economies tend to grow slowly due to the curse of natural resources. The capital influx in a mining sector provokes unproductive and inefficient spending on benefit-seeking operations such as speculating land sales.

Thus, concentration of FDI in the mining sector poses the risk of "resource curse" or "Dutch disease" which will hardly put the country into a long term sustainable growth track.

Mining sector accounts for 2/3 of the total Foreign Direct Investment in Mongolia, and the two big neighbors are mostly engaged in the mining sector. This trend is contrary to what is stipulated in economic security policy of the country which calls for a sector diversification of the economy.

Thus, a balanced FDI policy is an issue of fundamental importance for Mongolia due to the challenges remaining. When China and Russia still hold more than one third of total FDI inflow, on the issue of how to balance FDI companies from across the world is of critical matter..

In terms of sector distribution, whole FDI is going into only one sector and the result of the trend analysis shows that the biased trend will continue in the future while other sectors' investment will remain comparatively small.

Therefore, in order to maintain optimal balance, Mongolian government should focus on creating more favorable condition to attract FDI from "third neighbors" and implement an effective policy for sector diversification.

CHAPTER IV. STUDY ON SOUND TRADE POLICY AS PRECONDITION OF MONGOLIA'S ECONOMIC SECURITY

4.1. An overview of Mongolian Foreign Trade.

Foreign trade plays a major role in the Mongolian economy since the amount of foreign trade is almost at the same level as the country's GDP, putting Mongolia in the list of countries dependent on foreign trade(Diplomatic Blue Book 2011).

Mongolia's foreign trade before 1990 was characterized by the following criteria; a state monopoly on trade, limited export markets where the Council for Mutual Economic Assistance (CMEA) countries under the former Soviet Union occupied the dominant share and enforced a centrally planned pricing system(Enkhbayar, 2010).

Since Mongolia's accession to the WTO on 29 January 1997 with a developing country status, its foreign trade regime and legal environment have been changing to gradually liberalize foreign trade.

Nowadays, Mongolia maintains trade relations with over 130 countries and has bilateral agreements on trade and economic cooperation, such as Agreements on Mutual Protection and Promotion of Investments and Agreements on Avoidance of Double Taxation with more than 40 countries, including the People's Republic of China, the Russian Federation, the United States of America, the Republic of Korea and Japan. Furthermore, the United States of America, Japan, Canada, the

European Union, Australia. Also Norway involved Mongolia in their Generalized System of Preferences (GSP) schemes(Diplomatic Blue Book, 2011).

The priority of the Mongolian foreign trade policy is to create a more favorable trade condition with its main partner countries and expand its export markets based on liberalization principles.
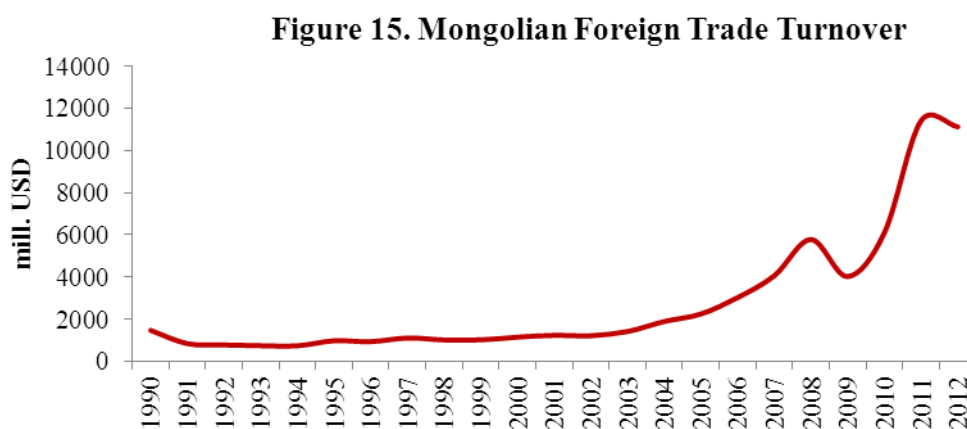
Source: Ministry of Finance

As shown in figure 15, Mongolia's foreign trade has steadily increased every year since 2004, except in 2009 when the global economic recession took place.
According to the Mongolian Ministry of Finance's data, total foreign trade has exceeded 11.4 billion USD in 2011, compared to 6.1 billion USD in 2010 and 4.1 billion USD in 2007. In 2012, foreign trade fell by 2 percent from the previous year and reached 11.1 billion USD.

Figure 16. Foreign Trade Turnover percentages by countries in 2012
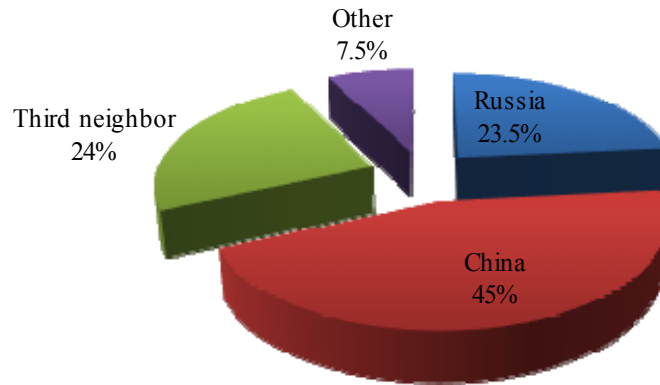
Source: Ministry of Finance

As attested earlier, Russia was the dominant trade partner to Mongolia prior to Mongolia's transition to a market-oriented economy in 1990. Mongolia's trade with Russia accounted for 77.9 percent of the total trade. In comparison, trade with China accounted for 2.1 percent.

However, after 1990, the situation completely changed. China has since become Mongolia's biggest trading partner and in 2009 Mongolia's trade with China accounted for 47.8 percent, while Russia only accounted for 20.7 percent.

As figure 16 shows, "third neighbors" such as the U.S., Great Britain, Germany, Canada, Italy, Japan and the Republic of Korea are Mongolia's next main trade partners and accounted for 24 percent of the country's total foreign trade in 2012.

Figure 17. Mongolian exports and imports
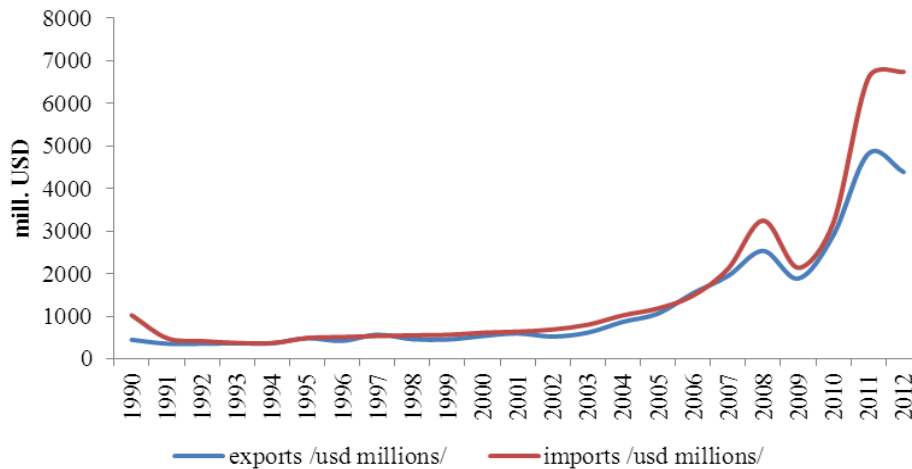
Source: Ministry of Finance

Mongolia has never had a positive net export in its history, yet it might change in the future owing to the mining boom.

Compare to 1997, the total export increased by 7.7 times from 568.5 million USD to 4384.7 million USD in 2012.The total import increased by 12.5 times to 6738.4 USD million in 2012 from 537.4 million USD in 1997.

During the last five years, the average annual import growth was 75 percent, while that of export was 23 percent. The share of mineral raw materials export has been persistently increasing annually, constituting about 90 percent of the country's total export. This trend heightens the risks for distorting Mongolia's foreign trade structure, impeding with sustainable economic growth as well as balanced economic development.

In mid-1990s, domestic production collapsed and total export decreased in half. During this period, the U.S. and Japan provided most favorable nation treatment for Mongolian exports. As a result of this treatment, during the period of 1991-2004, Mongolia exported knitted and tailored products worth of USD 795.6 million to the U.S. market free of duties. Since this treatment ceased to be applied in 2004, Mongolia has been under the "GSP+" negotiation that enables 7200 type of goods for free trade transmission to the European Union markets. The negotiation is valid and will be implemented until December 31st, 2013. But it's performance have been extremely unsuccessful, exporting only 10 types of products from the 7200 types that are allowed.

Figure 18. Mongolian export' percantages by countries in 2012
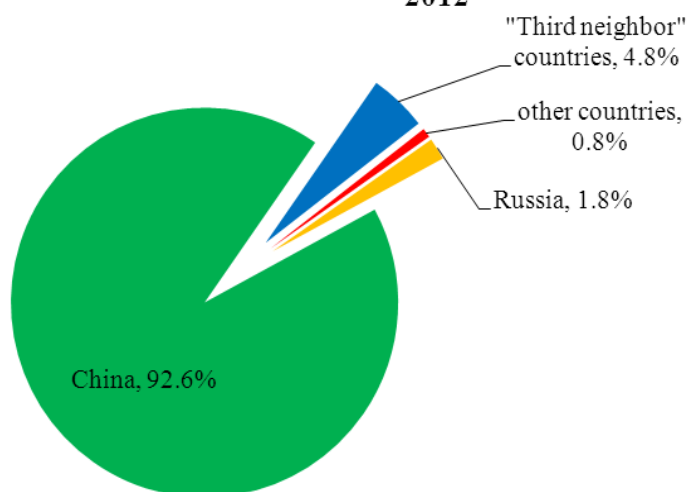
Source: Ministry of Finance

China is the largest trading partner of Mongolia. Total trade turnover between the two countries was USD 2 billion in 2007, 3.4 billion USD in 2010, and it reached 5.9 USD billion in 2012.

As of the 2012, Mongolia exported USD 4.1 billion worth of products to China. Export to China constituted 41 percent of total export in 2002 and it reached 92.6 percent in 2012.

Meanwhile, Mongolia-Russia trade and economic cooperation is developing though at a moderate pace. A target of bringing the bilateral trade volume up to 1 billion USD was reached in 2008. The trade turnover reached 1,162 billion USD in 2010, of which 80 million USD was Mongolian exports.

Now I will examine the dynamic of Mongolian exports' percentage by countries.

Figure 19. Mongolian exports' percentage by countries
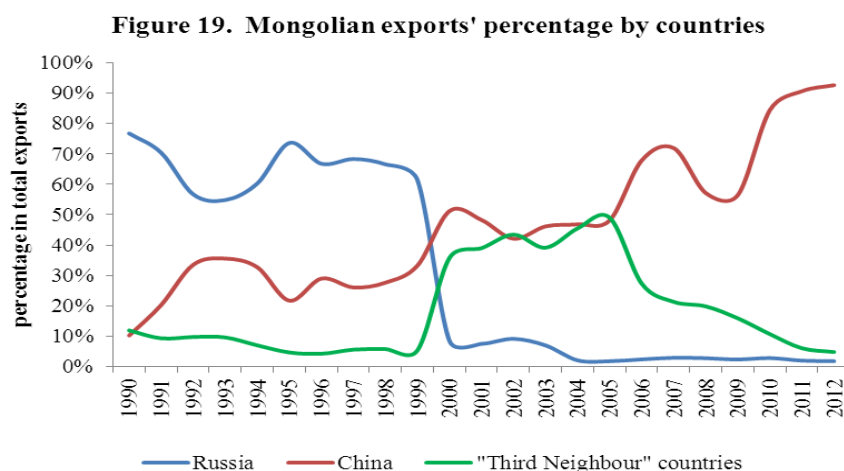
Source: Ministry of Finance

Exports to "third neighbors",Mongolia's important trade partners for economic security and diversification, have been decreasing since 2005. Also, Mongolian exports to Russia shows a tremendous decrease during this period. In particular, a sudden drop was recorded in 2000.

In order to determine the future of foreign trade, it should be necessary to conduct a trend analysis of Mongolia's trade with its major trade partners. The analysis will allow me to predict what Mongolia might face in terms of foreign trade in the future and how it might affect its economic security. Nevertheless it is worth noting that, while determining the trends, I consider only one variable which is time, and begin with an initial condition that "if everything goes as same as previous years". This method of analysis poses the risk of excluding the vicissitudes of global and domestic economy.

4.2. Trend analysis of key trade partners.

4.2.1. Trend analysis of exports to China.

As we can see in table 7, China is the biggest trade partner of Mongolia. To estimate the statistically proven trend equation it is better to analyze all possible trend models, and then narrow down the most accurate and proper model for determining the trend.

Table 7. Results of the trend analysis

Models	Equation	Goodness of Fit
Linear	$y = 138.11x - 832.62$	$R^2 = 0.5839$
Exponential	$y = 37.333e^{0.1853x}$	$R^2 = 0.9152$
Logarithmic	$y = 847.28\ln(x) - 1076.4$	$R^2 = 0.3263$
Polynomial	$y = 16.058x^2 - 247.29x + 773.19$	$R^2 = 0.8601$
Power	$y = 17.487x^{1.3289}$	$R^2 = 0.6991$

Exponential model is more reliable to determine the trend of exports to China judging by the 'Goodness of Fit'. Of all equations, exponential model's Goodness of Fit is $R^2 = 0.9152$, is recorded the highest.

Figure 20. Exports to China with trend & equation

$$y = 37.333e^{0.1853x}$$
$$R^2 = 0.9152$$
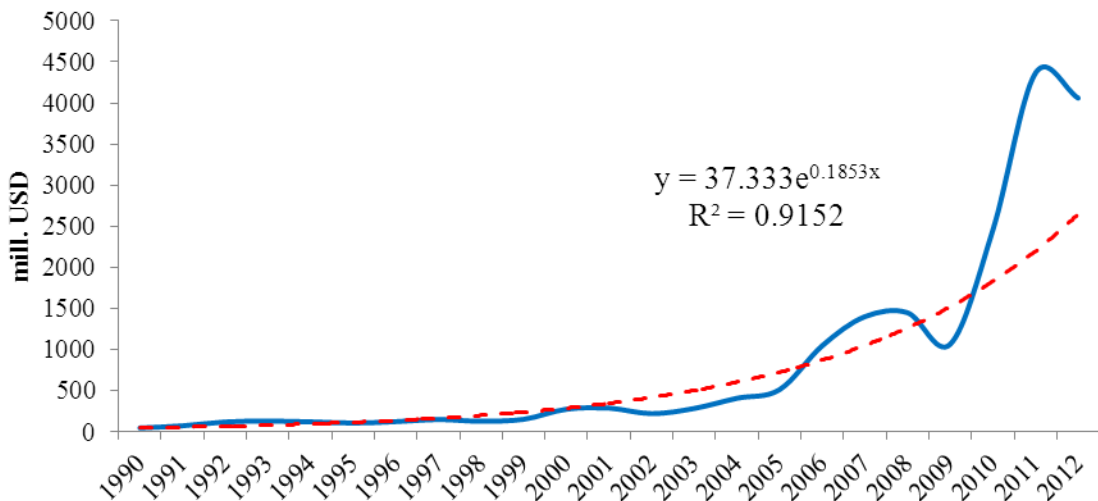
Source: Ministry of Finance

According to this equation, exports to China are likely to grow continuously in the future and it will cause a great imbalance for Mongolia'aeconomic security unless Mongolian government takes measures to change this trend. Without proper remedy, Mongolia's entire export revenue will be dependent on and controlled by a single country. Based on the analysis, I conclude that if China's economy faces a down turn, Mongolia will also suffer tremendously.

4.2.2. Trend analysis of exports to Russia.

Russia was Mongolia's major trade partner back in the socialist period, but Mongolian exports to Russia have been decreasing dramatically since 2000 and it has remained very low. Table 8 illustrate the trend models' estimations using the least square method.

Table 8. Results of the trend analysis

Models	Equation	Goodness of Fit
Linear	$y = -13.497x + 314.96$	$R^2 = 0.5331$
Exponential	$y = 330.19e^{-0.098x}$	$R^2 = 0.4582$
Logarithmic	$y = -105.2\ln(x) + 389.13$	$R^2 = 0.4812$
Polynomial	$y = 0.5052x^2 - 25.622x + 365.48$	$R^2 = 0.5592$
Power	$y = 606.21x^{-0.794}$	$R^2 = 0.4482$

Again, the exponential model is statistically proven. Therefore, I can provide scienfitic background to this research by using this model.

Figure 21. Exports to Russia with trend & equation

$$y = 0.5052x^2 - 25.622x + 365.48$$
$$R^2 = 0.5592$$
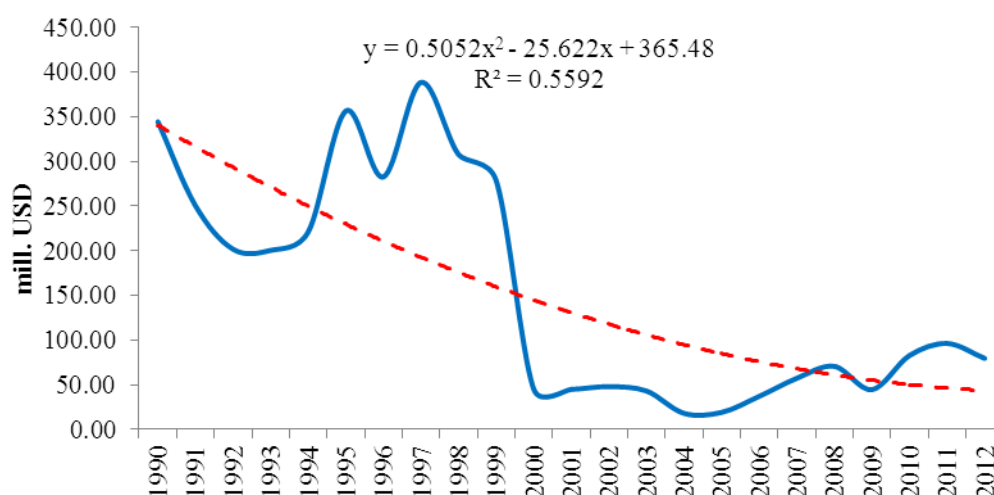
Source: Ministry of Finance

As shown in figure 21, the amount of exports to Russia has been decreasing every year along with its share in total exports which makes Mongolian exports dependent on a single country.

4.2.3. Trend analysis of exports to "third neighbors".

Exports to "third neighbors" are extremely important for Mongolian economic security therefore, we should encourage it in all possible ways. Are the "third neighbors" in fact Mongolia's important trade partner to prevent Mongolia from

dangerously depending on a single country? One way to answer this question is to conduct the trend analysis.

Here are the estimates of the trend models using the least square method.

Table 9. Results of the trend analysis

Models	Equation	Goodness of Fit
Linear	$y = 18.454e^{0.1499x}$	$R^2 = 0.6762$
Exponential	$y = 19.95x - 40.619$	$R^2 = 0.6187$
Logarithmic	$y = 147.47\ln(x) - 132.1$	$R^2 = 0.502$
Polynomial	$y = -0.5697x^2 + 33.623x - 97.59$	$R^2 = 0.6364$
Power	$y = 10.132x^{1.0691}$	$R^2 = 0.5105$

From the results of the table, none of them has enough statistical significance to predict the future. One of the methods to improve these models is by increasing the order from 2 to 3 for polynomial model which has shown good results.

Figure 22. "Third neighbors" exports with trend & equation

$$y = -0.3764x^3 + 12.98x^2 - 99.235x + 195.98$$
$$R^2 = 0.8941$$
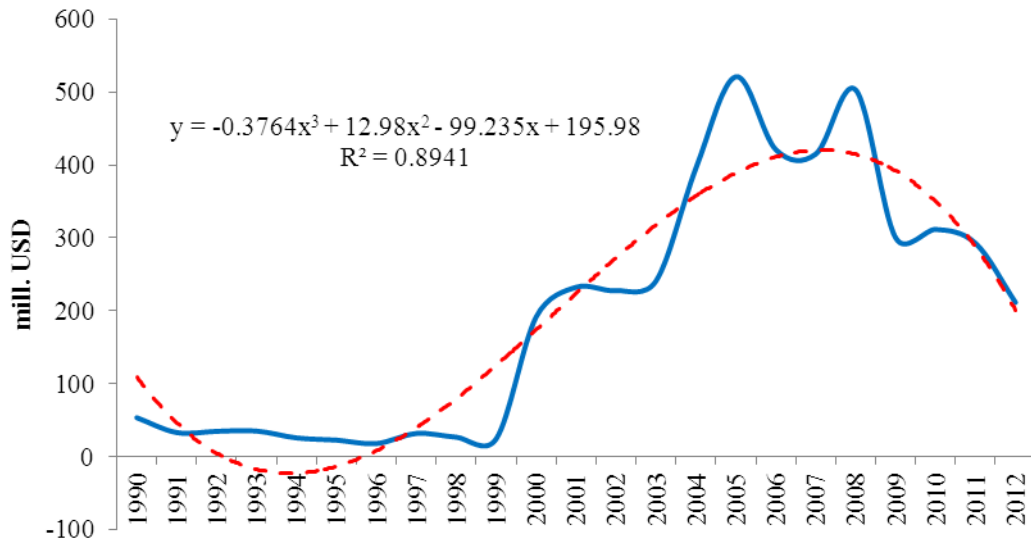
Source: Ministry of Finance

According to this trend, exports to "third neighbors" are going down and which shows that Mongolian "Third Neighbor" Policy is not efficient enough.

4.3. Study on Mongolian import.

Imports show a considerably balanced trend over the previous years compared to exports.

The total imports increased 12.5 times reaching USD 6738.3 million in 2012 from USD 537.4 million in 1997.. In 2012, oil product was covered 23.5 percent of total import. With the price increase of World oil market and mining industry, the role of

foreign investment in the exploration output sector is increasing along with machine, and equipment import.

Figure 23. Mongolian imports by countries
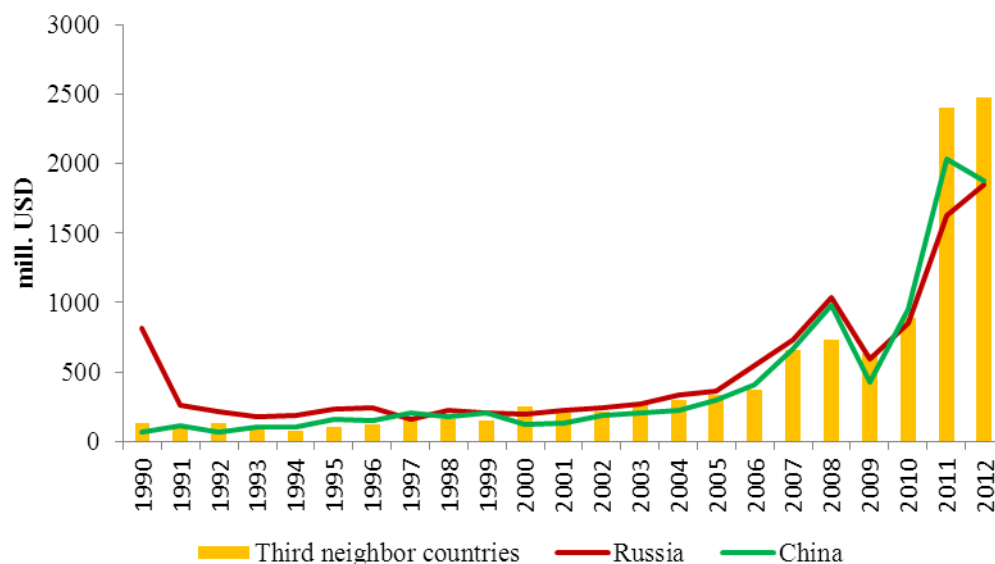
Source: Ministry of Finance

Furthermore, import structure in 2012 shows that the share of imports from "third neighbors" is larger than the two big neighbors.

In 2012, Mongolia's imports from Russia was 1.8 billion USD in which oil products accounted for 60 percent supplying almost 90 percent of its domestic consumption. Imports from Russia on the other hand decreased to 27.0 percent in 2012 from 77.5 percent in 1990.

The amoung of imports from China was 1.9 billion USD reaching 28 percent of the country's total imports in 2012. This is a tremendous increase from 2.4 percent in 1990.

Figure 24. Mongolian imports' percentages by countries in 2012
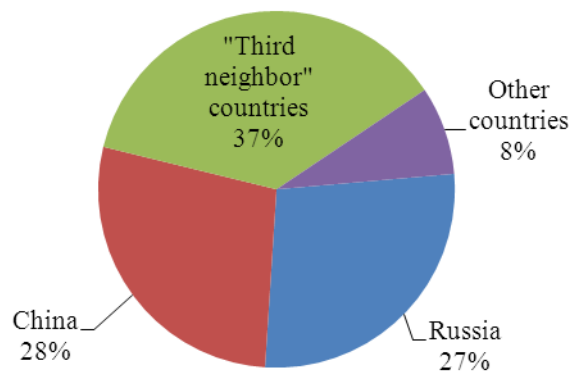
Source: Ministry of Finance

"Third neighbors" are Mongolia's third biggest trade partners after China, and Russia. Imports from the "third neighbors" totaled 173.2 million USD in 1997 and 2477.7 million USD in 2012.

4.4. Trend analysis of imports from Mongolia's major partners.

4.4.1. Trend analysis of imports from Russia.

General form of the trend equation: **y=f(x)**

Best fit model for this current pattern: **Polynomial (orders=3)**

Equation of linear trend model: $y=a+bx+cx^2+dx^3$

Estimation method: **Least square**

Estimated equation: $y = 0.2069x^3 + 0.1023x^2 - 63.008x + 554.74$

Goodness of fit: $R^2 = 0.8713$

Where:

y – Imports from Russia

x – Time

Figure 25. Imports from Russia with trend and equition

$$y = 0.2069x^3 + 0.1023x^2 - 63.008x + 554.74$$
$$R^2 = 0.8713$$
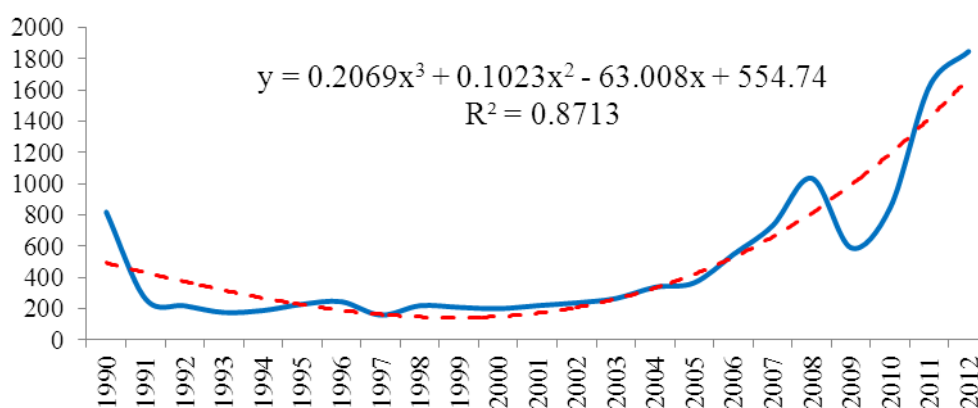
Source: Ministry of Finance

Imports from Russia has had an upward trend except for 2009. Reason for this increase is a growing petrol demand in Mongolia, for Russia has been the major supplier of petrol and other oil related products. If Mongolian government does not initiate a program that allows for the production of petrol products for its own need, imports will go up in the future as estimated from this trend equation.

4.4.2. Trend analysis of imports from China.

General form of the trend equation: **y=f(x)**

Best fit model for this current pattern: **Polynomial (orders=3)**

Equation of linear trend model: $y=a+bx+cx^2+dx^3$

Estimation method: **Least square**

Estimated equation: $y = 0.6699x^3 + 17.249x^2 + 131.46x - 124.89$

Goodness of fit: $R^2 = 0.8919$

Where:

y – Imports from China

x – Time

Figure 26. Import from China with trend and equation

$$y = 0.6699x^3 - 17.249x^2 + 131.46x - 124.89$$
$$R^2 = 0.8919$$
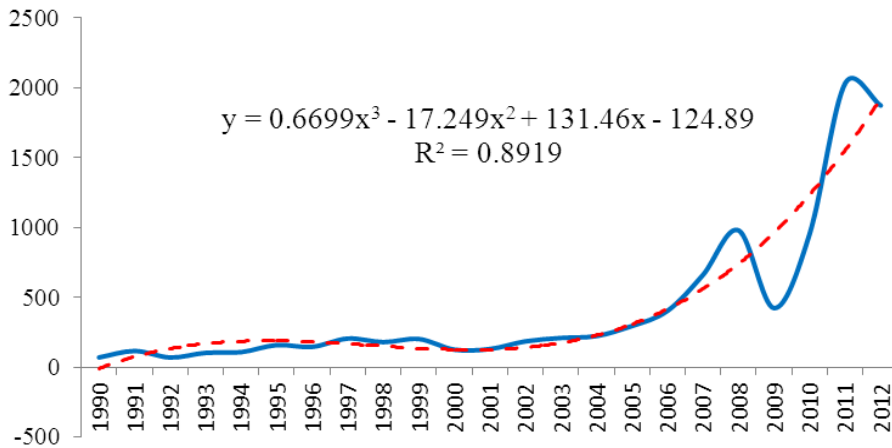
Source: Ministry of Finance

According to the estimation, imports from China has had an upward trend. This means imports from China will increase in the future and threaten the balance of external trade.

4.4.3. Trend analysis of imports from "third neighbors".

General form of the trend equation: **y=f(x)**

Best fit model for this current pattern: **Exponential**

Equation of linear trend model: $y=e^x$

Estimation method: **Least square**

Estimated equation: $y = 56.516e^{0.1318x}$

Goodness of fit: $R^2 = 0.8452$

Where:

y – Imports from "third neighbors"

x – Time

Figure 27. Imports from "third neighbors" with trend and equation

$$y = 56.516e^{0.1318x}$$
$$R^2 = 0.8452$$
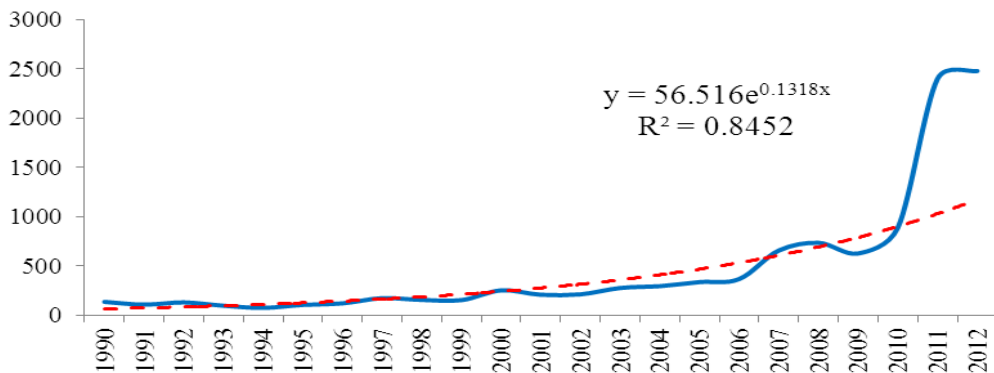
Source: Ministry of Finance

Import from the "third neighbors" has been growing. In the last couple of years it has increased enormously showing an upward trend. If Mongolia maintains this trend, it will give the country a chance to balance imports. Thus, the best way to keep the balance is to reduce imports from Russia and China by supporting national industries.

4.5. Analysis of the main findings.

As noted in the Mongolian Foreign Policy Blue Book(2000), the main objective of Mongolia's foreign trade policy is to ensure that Mongolia doesn't transform into a natural resource exporter for bigger economies or fall bate to international organizations.

The National Security Concept of Mongolia(2010) stipulates the principles of "reducing the nation's economic vulnerability as a small market with an excessive dependency on imports and a small number of export goods" as well as "avoiding excessive dependency on one country's goods in the overall import spectrum"(Clause 3.2.5.1).

However, the dependence of the Mongolian economy on the external market is related with foreign trade. According to the findings of World Bank research in 2010, of 20 countries, Mongolia falls under weak country category with one sided economic structure. Countries in this category collect nearly ¾ of their foreign trade income solely from mining export.

In terms of exports, raw minerals have been continuously increasing in the past few years. In 2012, the dollar value of export to China reached 19 billion USD, representing 92.6 percent of entire exports of the country. This signals a major source of imbalance in the trade dynamics of the country. These exports include gold, crude oil, iron ore, copper ore, and coal. The prices of these products are extremely volatile in the sense that they are heavily dependent on the international

markets especially Chinese markets. On the other hand, Mongolia's imports from Russia mounted to 12 billion USD. Oil products represented 60 percent of the total imports, which fuels almost 90 percent of Mongolia's domestic consumption. Many consider this to show a distortion of the foreign trade structure of the country as well as an obstacle to economic growth.

In the future, as the trend analysis shows, trade turnover with neighbor countries as well as foreign trade dependency on a few minerals might increase.

To sum up, this study clearly shows that Mongolia's "Third Neighbor" Policy has not exhibited any significant results for the trade sector.

Therefore, the challenge remains to government on how to make sure that the "Third Neighbor" Policy is implemented or promoted.Boosting trade relations with other developed countries like the U.S., Japan, the Republic of Korea, Canada, Australia and other countries of the European Union will help Mongolia in diversifying its economy and reducing the risk of over dependence on its two great neighboring countries.

Thus, while noting the importance of sound trade policy in ensuring economic security of Mongolia and developing foreign trade relations with "third neighbors", the Government should pay attention to the following recommendations:

1. According to the UNIDO(2011), Mongolia's landlocked location leading to high transport expenses is the main hindrance to maintaining and extending trade relations with developed countries. Therefore, focus should be on

solving transit transportation issues. Also, co-operation with its two neighbor countries and establishing bilateral or multilateral agreements to ease the transit transportation problems of the landlocked country should be taken into consideration.

2. In order to make Mongolia's legal environment more conducive to foreign trade, improving trade structure, and increasing export, approving the "Law on Trade", as well as the "The National Strategy on Export Promotion" is crucial.

3. In order to enhance the export structure, Mongolia should diversify its market and increase export of value-added products. Also, it should explore the possibilities to export to "third neighbor" countries, and develop production substituted import products and decrease excessive dependency on import.

4. The main priority is to implement a policy of industrialization of Mongolia and formation of appropriate economic structure that will increase the export goods and its types. Therefore, Mongolian government should consider only using the smallest portion of opportunity among the the 7200 goods that are exported without taxation in scope of the European Union General System of Preferences.

5. At this time, Mongolia is the only country among WTO members without concluding any bilateral or multilateral preferential trade agreement yet. Thus, it is necessary to immediately develop human resource, improve negotiation skills of the governmental officials involved in participation of multilateral trade negotiations.

CHAPTER V. CONCLUSION

In terms of mineral endowment ratio, Mongolia is considered to be one of the wealthiest countries in the world. Mongolia is at the edge of a new development era to increase economic capacity by exploiting its mass natural resources and to enhance living standards of its population.

To ensure Mongolia's future prosperity, flexible adjustments to fast changing environment, economic security, and wide contribution to country's development is essential.

Wiber(1987) assumes that small economies attempting to avoid being adjunct to bigger economies do so by implementing economic diversification policies(Mashbat, 2012).

Likewise, Mongolia has witnessed an over dependence on its two large adjacent economies of Russia and China. Therefore, Mongolian Government has been attempting to design a "multi-pillared economic structure" and to implement the "Third Neighbor" Policy.

In line with the goal mentioned above, Mongolia's National Security Concept(2010) embraces the principle of prohibiting "investments from any foreign country from exceeding one third of the total foreign investments and investments from third neighbors and highly developed countries should be balanced in strategically important sectors" due to its geopolitical and economic security concerns(Clause 3.2.2.2.).

Unlike what the policy says, unbalanced economic structure and increasing overdependence in the mining sectors has put Mongolia into an alarming stage as far as economic security policy is concerned and sustainable development in particular. The two big neighbors are mostly engaged in mining sector leaving the "third neighbors" engaged in other sectors of the economy very much dependent on economic security demand.

Citigroup forecasts that Mongolia is on the track of being one of the fastest growing economies over the next four decades. Mongolia has great economic growth potential due to its rapid economic growth experience and vast mineral wealth.

Mongolian domestic market has considerable amount of potential to absorb FDI. The large volume of Foreign Direct Investments in mining is expected to provide large sums of foreign capital. The Mongolia government has set forth plans to finance infrastructure and mining projects through the inward capital. Therefore, to compel stipulation of the National Security Concept, Mongolian Government should pay attention to encouraging investments from the "third neighbors" rather than reducing investment from the two large neighbors.

Therefore, in order to attract FDI from the "third neighbors", Mongolian government should consider the concerns and rebukes addressed by foreign investors with regard to corruption and red tapes derived from failures to carry out laws and regulations. The financial system is not secure enough and transferring money from a bank account involves unnecessary lagging. Issues such as

commercial banks being too dependent on politics, market being too small, underdeveloped infrastructure, and its landlocked location should be solved quickly.

Even though FDIs play a crucial role in stimulating the economy, they have failed to introduce new and advanced technologies to the country. Thus, it is important to encourage them to boost manufacturing final goods. In addition, it is crucial to improve their human resources and financial capacity to develop the necessary infrastructure to ensure the favorable foreign investment and implementation environment which would bring increased investment efficiency.

Mongolia's foreign trade sector is heavily dependent on its neighbors especially its two big neighbors China and Russia. Since Mongolia cannot satisfy its demands of food security, goods and services and fuel through domestic means, exports to China and imports from Russia are crucial for Mongolian economy..

As stressed by many scholars, Mongolia's landlocked location leading to high transportation costs is the main impediment to trade. This is perhaps one of the most important points that the Mongolian government must address in order to enhance the trade sector.Such high transportation costs provide protection for the domestic market but at the same time, makes it harder to export. Many reports highlight other problems such as lack of skilled labor, strict bureaucratic procedures for new businesses, poor financial institutions and credit system(UNCTAD, 2013).

Furthermore, trade institutions in Mongolia are weak and there is a severe lack of capable trade promotion mechanisms and policies.

Although Mongolia has been attempting to implement th "Third Neighbor" Policy in order to enhance economic security and ensure sustainable development, it still remains economically overly dependent on its two large neighbors.

In the wake of the democratization of Mongolia, it is suffering from the absence of long and short term planning. Consecutive administrations develop diverse plans that would be eliminated as soon as the next administrations take over office.

The reasons for the failure of the "Third Neighbor" Policy can be attributed to weak implementation and failure to processit into a program. It is important to refine further concepts that can add value to this policy and deeply instill them to Mongolian government agencies.

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