



“INVESTMENT CLIMATE: STABILITY”

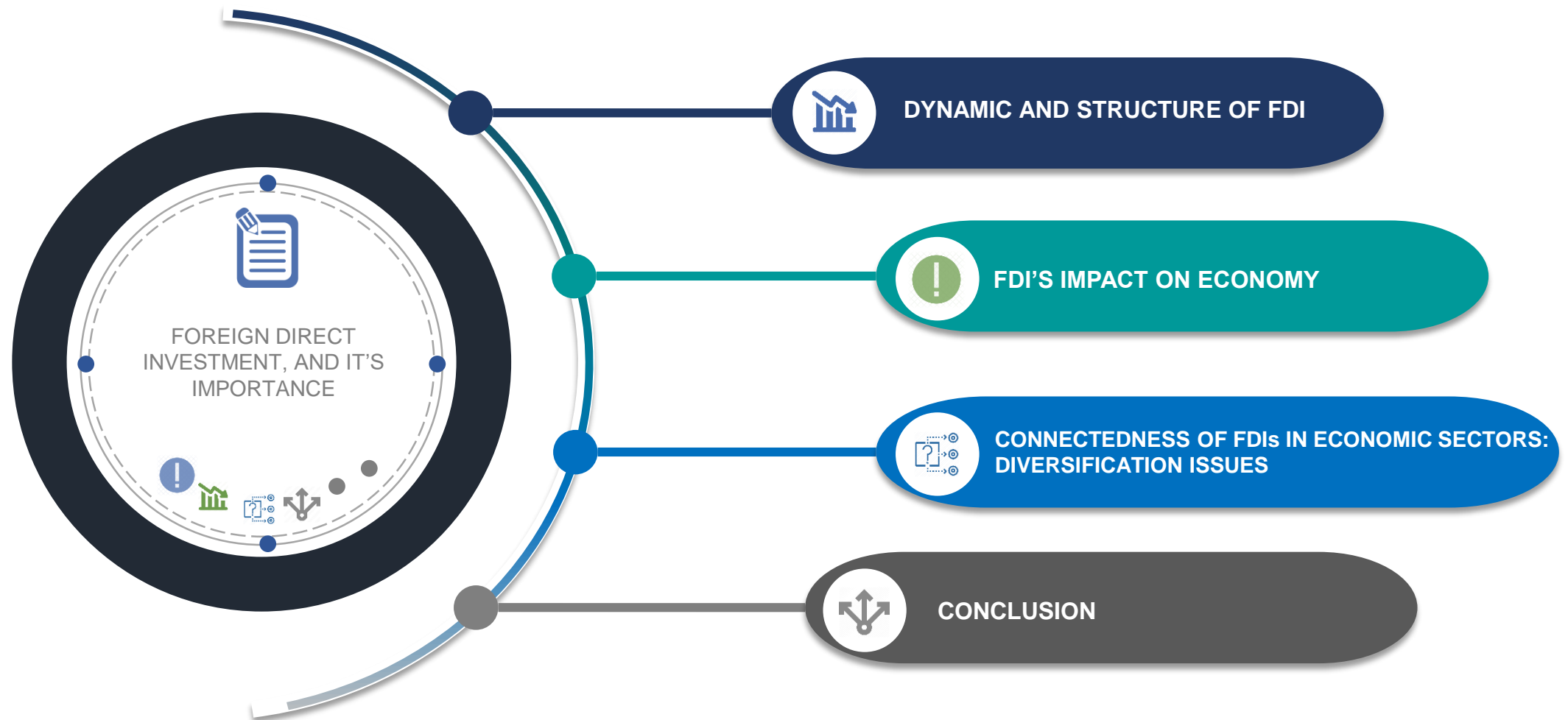
Conference

FOREIGN DIRECT INVESTMENT (FDI), AND IT'S IMPORTANCE

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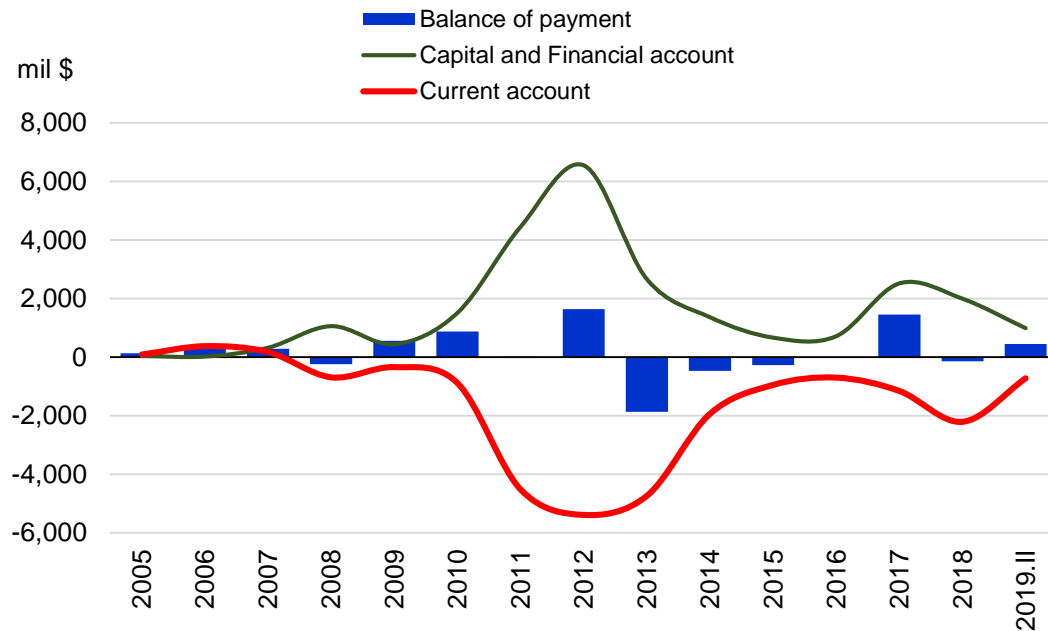
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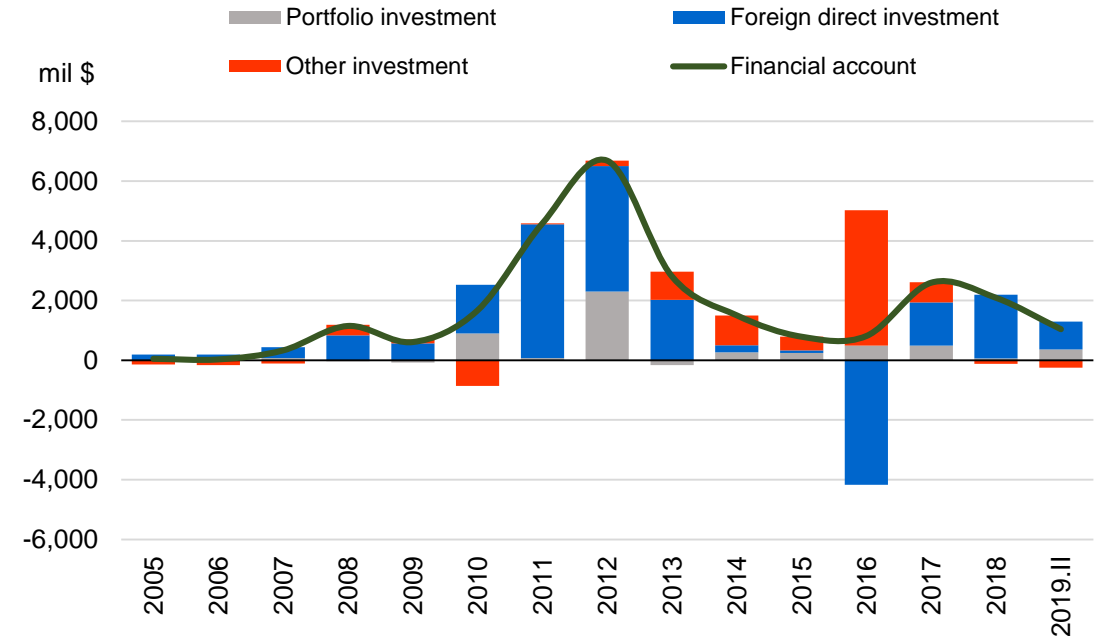
FDI promotion is an inevitable choice: Development opportunities

Balance of Payment



Source: Bank of Mongolia

Financial account

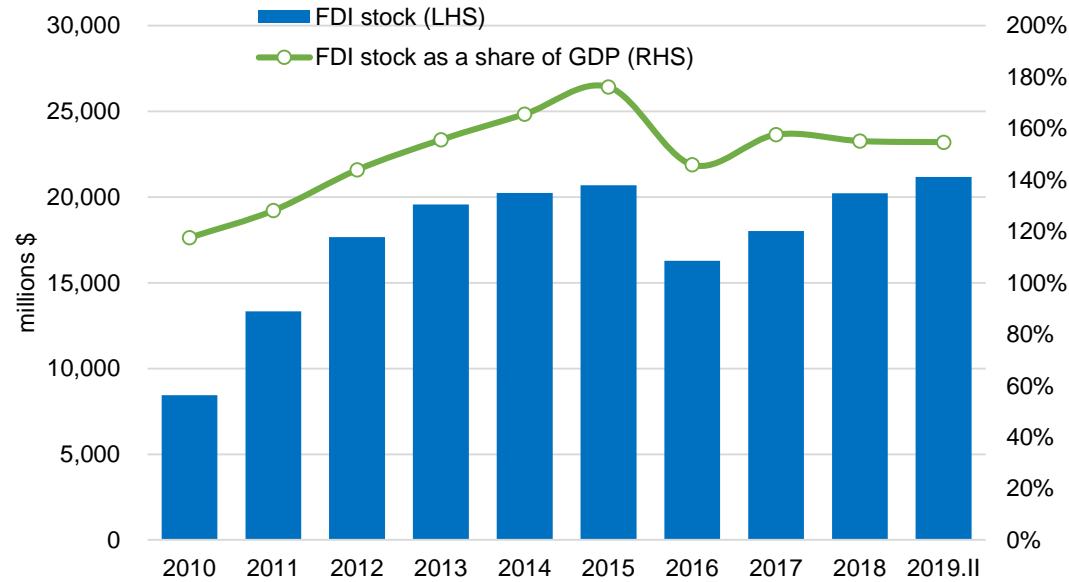


Source: Bank of Mongolia

- Since 2017 Mongolia's balance of payments improved due to increase in FDI inflows.
- The current account deficit has been financed by **foreign loans through 2013-2016**. Since 2017, FDI has become main source in financing the current account deficit.
- **Lessons learned:** Decline in foreign capital and trade in 1929 => 1929-1932 crisis; 2013-2016 FDI sudden stop => Economic slowdown in 2016
 - **Undermine household livelihoods and increase in income inequality => to appeal nationalism and populism => "Impossible promise", "Abuse the general public desires"**

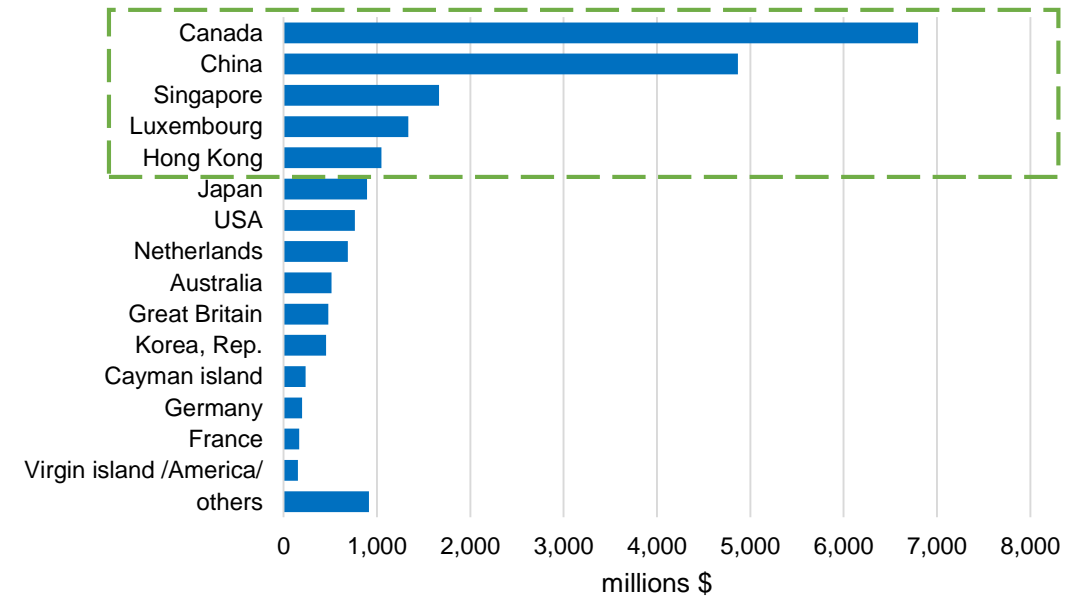
FDI inflows: Development funding & transfer of technology and know-how

- FDI stock



Source: The Bank of Mongolia, NSO

- FDI stock by countries /2019.II/



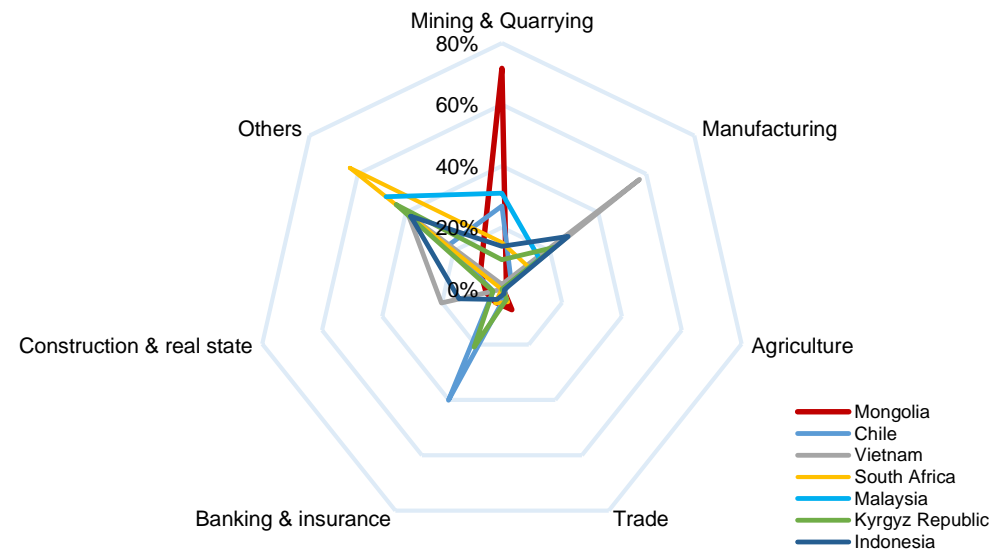
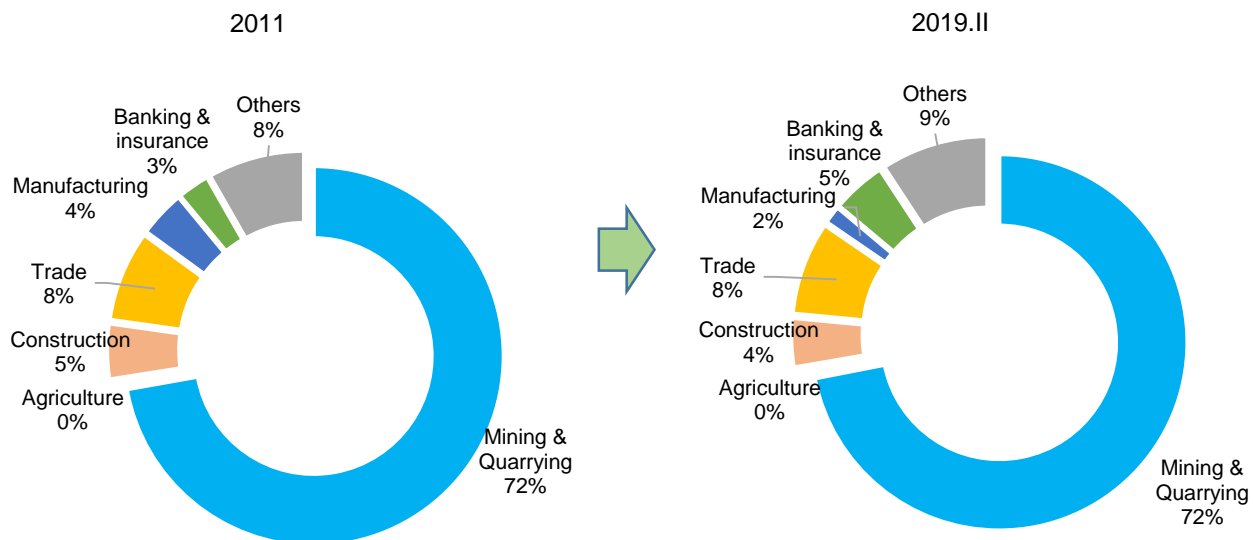
- In the first half of 2019, FDI stock in Mongolia reached USD 21.2 billion or **155% of total GDP**.
- In terms of source countries, **over 50 percent of FDI is originated from Canada and China**: Dependent on a few countries.



FDI concentration is high: need for diversification

- FDI by sector

- FDI by sector across developing countries /2018 OH/



- Mining and quarrying sector alone constitutes about 70 percent of total FDI inflows.
- FDI is heavily concentrated in one sector (mining) relative to other developing countries => Investment reforms to attract FDI in other sectors are important => As the foundation for multi-pillar economy.



II. FDI'S IMPACT ON ECONOMY (1)



Batsaikhan.T (2002):

- FDI has a **positive impact on GDP** through improving technology, equipment and human resource capacity.
- Foreign company's operation creates competitive environment that **improves quality and standard of domestic companies.**

Gan-Ochir.D (2005): data 1990-2004

- High concentration of FDI: Mining & trade sector; Canada & China
- Production elasticity of the sector affected by FDI: Agricultural (0.25), Mining (0.29) & Service (0.29)
- FDI => The Granger causality test of GDP: As a result of 1 percentage point increase in the FDI/GDP ratio, GDP will increase 1.87 percent.

Anand.A (2011):

- FDI has a both direct and indirect positive impact on Mongolian economic growth.
- But FDI into the mining sector has negative effect on this sector's growth: no production, expanding the activities of other sectors + weak institution, bad productivity, foreign workforce

Munkhtsetseg.D, Gantumur.P (2015):

- FDI growth was **the biggest contributor to economic growth** in 2011.
- In 2011, as a result of the 1 percentage increase in FDI, the production of wholesale and retail trade sector, mining sector and repair of motor vehicles sector of Mongolia were increased dramatically.

Tsagaan.P (2018):

- Since 1990, the Government has embarked on the National Program of attracting FDI, but it has not been able to achieve sustainable results: The Government's **policies and management were unstable.**
- Steady flows of FDI are crucial for sustainable economic growth: **urge for more effective policy on FDI** => The Government policies towards inward FDI + Investment Promotion Agency + Mongolian Direct IF



II. FDI'S IMPACT ON ECONOMY (2)

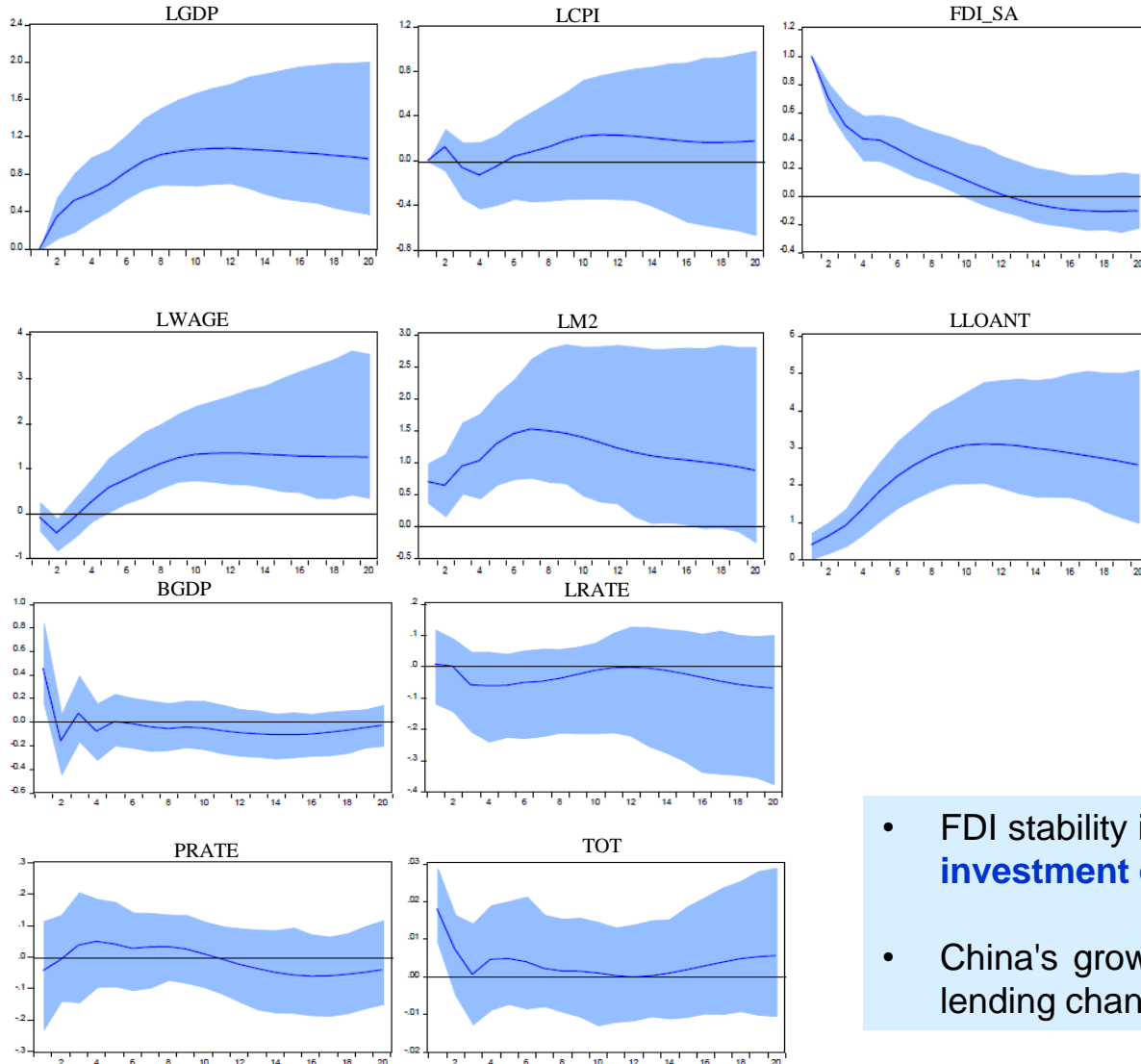


Table 1. BVAR (4) model, variance decomposition, as a %

	Structural shock	Real GDP	CPI
External shock	GDP growth of China	5	32
	Copper price shock	12	21
	Coal price shock	6	2
	Oil price shock	3	1
	FDI shock	20	1
	Total	46	57
Internal shock	Fiscal expenditure shock	6	1
	Money supply shock	11	1
	Exchange rate shock	1	1
	Supply shock	6	20
	Total	24	23
Other factors	30	20	
Total	100	100	

Source: D.Gan-Ochir & L.Davaajargal 2019, "External shocks ad business cycle fluctuations in Mongolia: Evidence from a Large Bayesian VAR", *International Economic Journal*, vol. 33, no. 1, pp. 42-64.

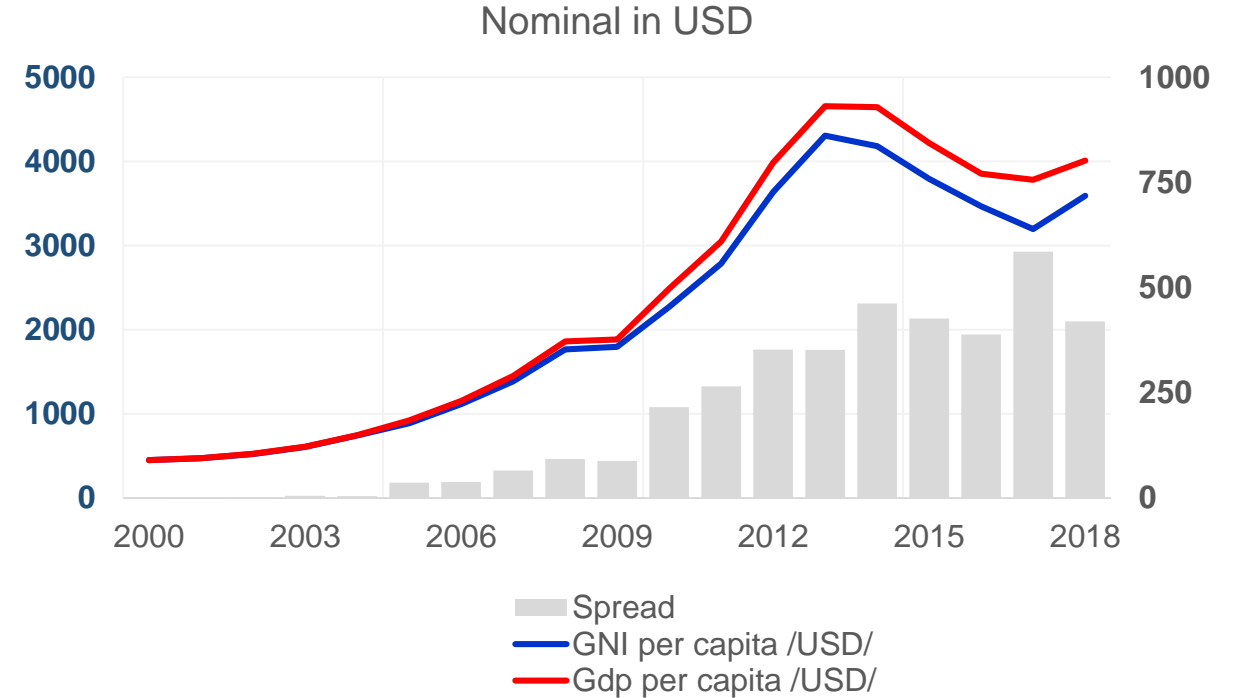
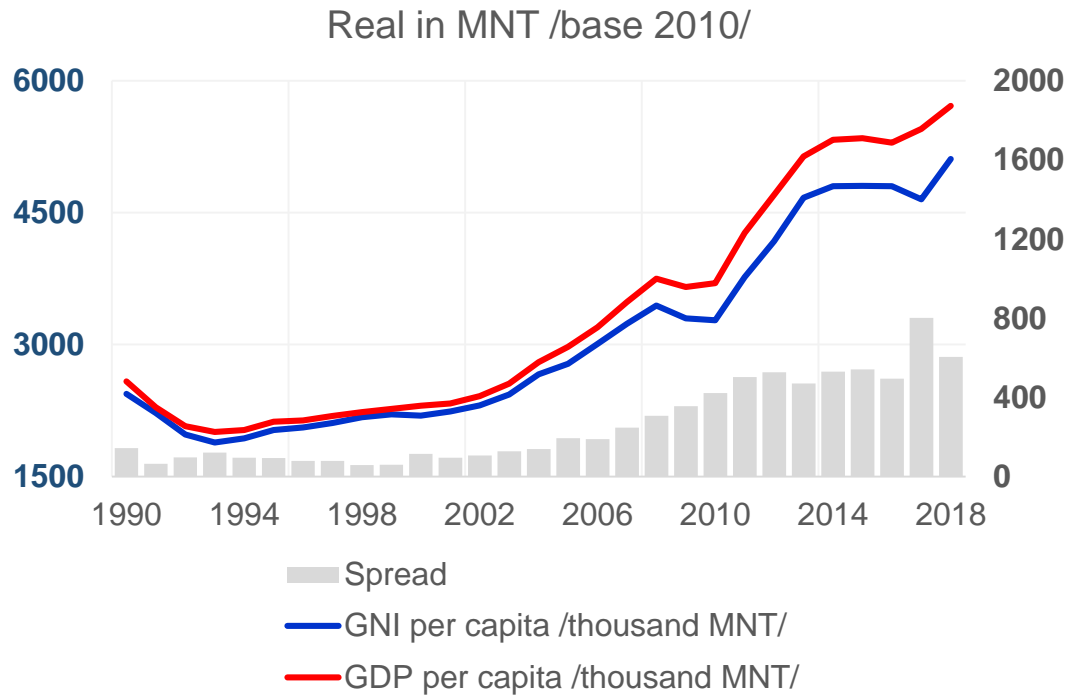
- FDI stability is crucial factor in macroeconomic stability: **FDI promotion and improving investment climate**
- China's growth and FDI shock affects the economy through the real sector and bank lending channels: **structural policy + macroprudential policy**



II. FDI'S IMPACT ON ECONOMY (3)



Need for increasing effectiveness of FDI: Economic connectedness, diversification



$GNI = GDP + [(Income\ earned\ on\ all\ foreign\ assets) - (Income\ earned\ by\ foreigners\ in\ the\ country)]$

Spread between GNI and GDP is due to dividend payments, administrative expenses and salaries of foreign enterprises (FDI).

FDI ↑ ⇒ investment ↑ ⇒ GDP ↑ (direct effect) ⇒ **economic connectedness, spillover effect** ⇒ Domestic companies income, employment ↑ ⇒ household income ↑ ⇒ tax revenue, welfare measures for targeted group ↑



Connectedness of Sector's FDIs (Diebold & Yilmaz (2009)): Diversification issues

	Mining	Retail	Construction	Finance	Real state	Manufacturing	Service	Others	Contribution from others
Mining	34.3	7.9	24.6	2.1	0.6	6.2	15.6	8.7	65.7
Retail	8.2	39	6.6	5.8	12.5	12.5	6.8	8.7	61.0
Construction	10.3	1.7	50.5	5.1	12.4	16.4	1.4	2.3	49.5
Finance	10.2	6.4	22.1	31.7	5.2	6.7	10.4	7.3	68.3
Real state	7.8	7.9	6.9	8.4	32.4	8.2	18.8	9.6	67.6
Manufacturing	5.3	13.8	7.5	8.5	11.2	36.1	10.7	6.9	63.9
Service	2.8	7.9	0.8	33	2.5	3.1	37.8	12.2	62.2
Others (Transport, management fees)	15.9	5.8	9.4	10	2.9	8.4	9.5	38.1	61.9
Contribution to others	60.5	51.3	77.9	72.9	47.3	61.4	73.2	55.6	

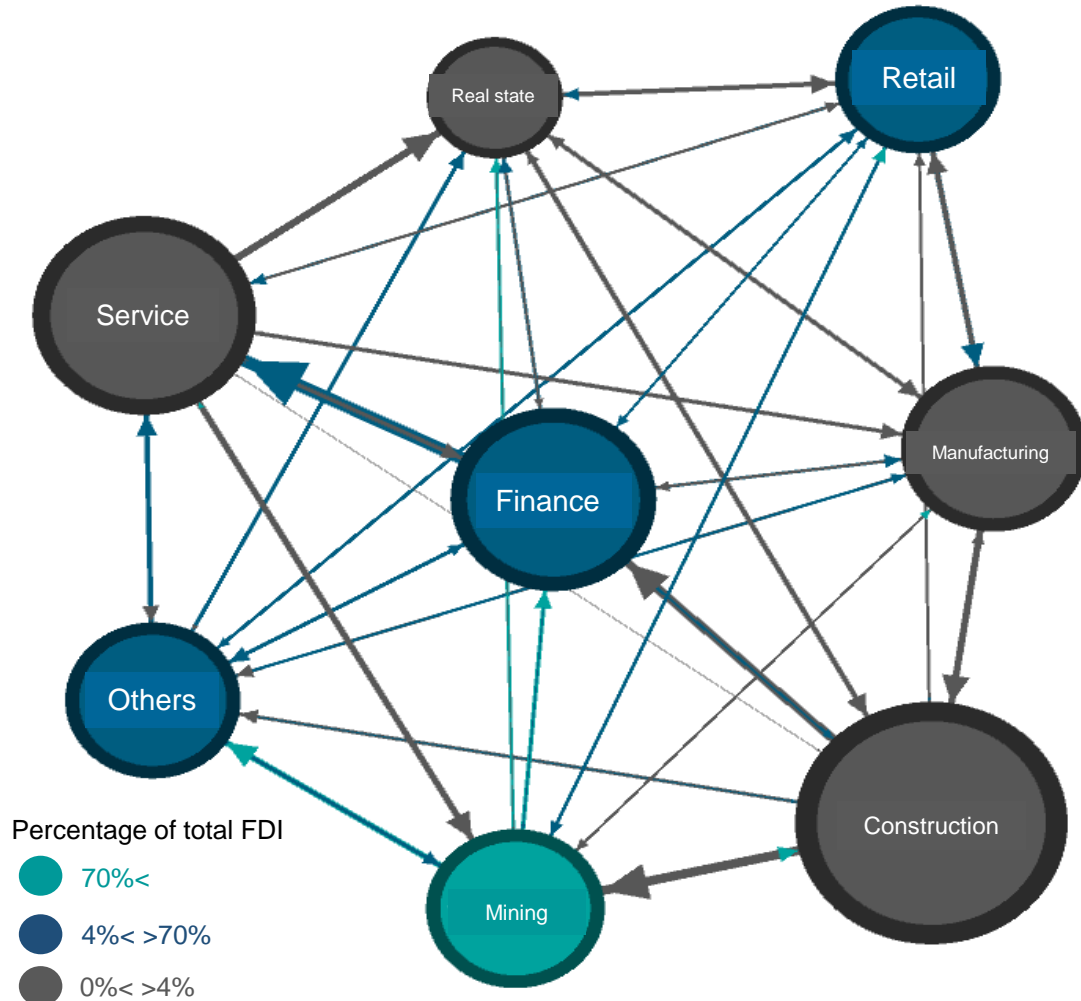
Note: Result are calculated with DY add-ins of Eviews.

Construction, financial and **service** sector FDIs have the **highest spillover effect** on other sector's FDIs.

The influence of the **construction sector FDI** on other sectors is high, with most impact on the **mining** and **financial** sectors.

Indirect impacts of **mining sector** FDI in other sectors are relatively **low**. **Mining** sector FDI has relatively high spillover effect on the **construction** and other sectors such as **transport** and **management support**.

III. CONNECTEDNESS OF ECONOMIC SECTORS FDI (2)



In the network visualization, two sectors **connected** by links based on their FDI's probability of **being co-increased**.

FDI in our country is highly dependent on a **single sector**, which makes the economy **vulnerable to volatility**.

The FDI in the **mining sector** has indirect influence on the transport, the management support and the construction sector.

The **financial sector** plays an important role in the country's FDI system, and the **impact** on other sectors FDI is **evenly distributed**.

Growth of **mining** and **construction** sector FDI will increase the **concentration** of FDI through sectors.

FDI Promotion through improving business environment in **finance**, **service**, and **manufacturing** sectors will effectively **diversify** country's FDI.



- Since Mongolia has low domestic savings and high investment needs, FDI will continue play an important role in the future development:
 - No populism or nationalism against foreign capital and investment
- “FDI diversification \Leftrightarrow Export diversification \Leftrightarrow Economic diversification” necessary:
 - FDI dependent on few countries and one sector creates economic vulnerability.
 - FDI environment reform and policy
 - Improving business environment: One possible way to diversify the FDI through sectors is to develop the finance, service and manufacturing sectors.
- Stable inflow of FDI plays a crucial role to macro economic stability.
 - FDI has a positive effect on GDP growth and sectors that has high spillover effects on other sectors.
 - Mongolia still needs external funding with international assistance to strengthen domestic and external balances over the medium term.
- It is important to focus on increasing and extending the benefits of FDI:
 - Policy issues: innovation, technology, knowledge, transfer of productivity expansion
 - Economic connectedness, vertical diversification, policy on increasing the spillover effect, measures.





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Thank you for your attention

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