

# **The empirical analysis of Political stability and inflow foreign direct investment: Case of Mongolia**

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## **Abstract**

Based on many studies, economic theories and real life experiences, we can understand that political instability has been a harmful factor that would hinder the flow of foreign direct investment (FDI) and the growth of an economy. In our study, we would like to focus on Mongolia, which had its fair share of political instability issues due to the differences and existence of various races. According to economists and researchers, political instability is harmful for economic development of any country. Mongolia is also facing the problem of political instability, since political instability causes a decrease in investment and rapidly of economic development process. The paper investigates the relationship between the foreign direct investment and political stability by investigating the political stability measures of social survey. This paper also find that FDI inflow positive relationship with political stability, while negative relationship with political instability and its political effects.

**Key words:** political instability, foreign direct investment, government instability, political factor

## **1. Introduction**

Foreign direct investment has become the important issue in economic development of the country since the globalization of capital markets.

Political instability, foreign direct investment and economic development are closely interrelated to each other. Due to, uncertainty comes in an economy and as a result investment decrease and economic development is also affected. Because of reduction in investment, the level of output correspondingly decreases. The powerless political society, instability of government and carelessness of political parties create the situation for a political instable state. For economic development of any country, political stability

is required. FDI affects economic growth and development process because it supplies capital for developing nations for investment purpose (Kulsoom Rani, 2016).

Many researchers in political and economics try to find the factors that affect the FDI. For example, Lucas (1990) argues that only political risk is an important factor in limiting capital flows. Investments in many developing countries are expose to large political risks, so FDI inflows are large for politically instable countries. Similarly, FDI outflows are large for politically stable countries to invest in countries with large political risks. Fry, Classens, Burridge, & Blanchet (1995) found that the requirement to surrender export proceeds to the monetary authorities and the existence of special exchange rates for some capital account transactions reduces the probability that FDI is independent. The more liberal a country's foreign exchange system, the more likely FDI is to be independent or exogenous. FDI is associated with a larger increase in capital formation when it is independent than when it is "Granger-caused" by other capital flows. Singh and Jun (1995) also show that political risk and business operating conditions have been important determinants of FDI for countries that have historically attracted high FDI. For countries with relatively low FDI, a key determinant was the degree of sociopolitical instability. A country's orientation toward exports is the strongest variable for explaining why a country attracts FDI. Chan and Gemayel (2004) find that the degree of instability associated with investment risk is a much more critical determinant of foreign investment in the Middle East and North Africa region countries than it is for developing countries, which have lower level investment risk (Haksoon, 2010).

## **2. Hypothesis**

In view of related literature, numerous political factors affect FDI.

*Hypothesis: Foreign direct investment inflows are low for political instability is high.*

## **3. Empirical analysis**

I made this research work for the purpose to express influences of political factors on foreign investment to Mongolia. In the framework of this research, I had a purpose to determine the political reason to decrease foreign investment since 2012.

Within survey respondents 72,4% answered because of unsustainable political condition and 34,5% answered because of decreasing internal economic situation and became the

reason to decrease foreign investment, 32,8% answered that decreased demand of raw materials economic growth slowed down in international market, 29,8% answered that the flow of foreign investment is declining due to the legal status in Mongolia.

The survey results show that the decline in foreign investment in the economy depends on domestic economic, legal, and political conditions, with the slowdown in global economic growth and declining commodity prices in the world. The main coordinator for these conditions is political situation and political factors.

The main reason for the decline in foreign investment inflow is the fact that the political situation is an important factor. Government instability is 55.2%, interests of political factions 39.7%, lack of activities of members of Parliament and government 37.9%, interest of politicians 29.3%, and 25.9% of political parties.

The reason for the decline in foreign investment is the fact that 55.2% of political factors, including the government's instability, indicate that what political factors are important to them, 74.1% of the government's sustainability is seen as a result of foreign investment the environment and the policy of attracting it is a political factor that is the most important influence on government activity and its sustainability. The answer to the interests of the political party fractions was 53.4%, indicating the position of the fractional and fractional position within the political party and their interests and interests. 51.7% of respondents answered the next policy link of succession. After that, corruption was 43.1% and politicians' interests were 37.9%.

The survey questions show that the reasons for the decline in foreign investment and the key factors affecting them are political factors. If we forward to challenge foreign investment we forward we need have the law of foreign investment answered 44,8% and improve legal environment of the investment and supply sustainability of the government work 43,1% answered and need to activate activities of Mongolian Government need improve the law of foreign investment answered 34,5% of respondents. Looking at what foreign investment is worth, foreign investment is about 44.8%, Enhancing Investment Climate and Government Strengthening 43.1%, Enabling Government Activity 37.9%, Investment 34.5% answered that the law would improve.

#### **4. Results**

The hypothesis presented in this study is confirmed by the results of sociological research. The survey results show that most of the surveyed population considered foreign investment as a factor contributing to Mongolia's socio-economic development.

In particular, the current situation of foreign investment is poor and inadequate, and its main reason is that political factors are more precisely defined as political instability.

Researchers have shown that foreign investment affects political issues in foreign investment as an important part of government policy and its funding attracts politicians because they are politically linked to each other.

Survey participants considered that political factors influence on foreign investment and foreign investment is main part of policy and such investment pays more attention of politicians so its connected with one's policy.

The main reason of decreasing for foreign investment is considered political unsustainability influences on policy irrelevance, political interest among them political party fraction interest and personal interest.

To attract foreign investment need law of foreign investment first of all and need meet sustainability of the government, improve environment of investment, need maintain law of investment. Increasing and decreasing of foreign investment directly depends on sustainable and unsustainable condition of our government.

Research shows that to be sustainable or unsustainable government activity mostly depends on interest of political party fractions.

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