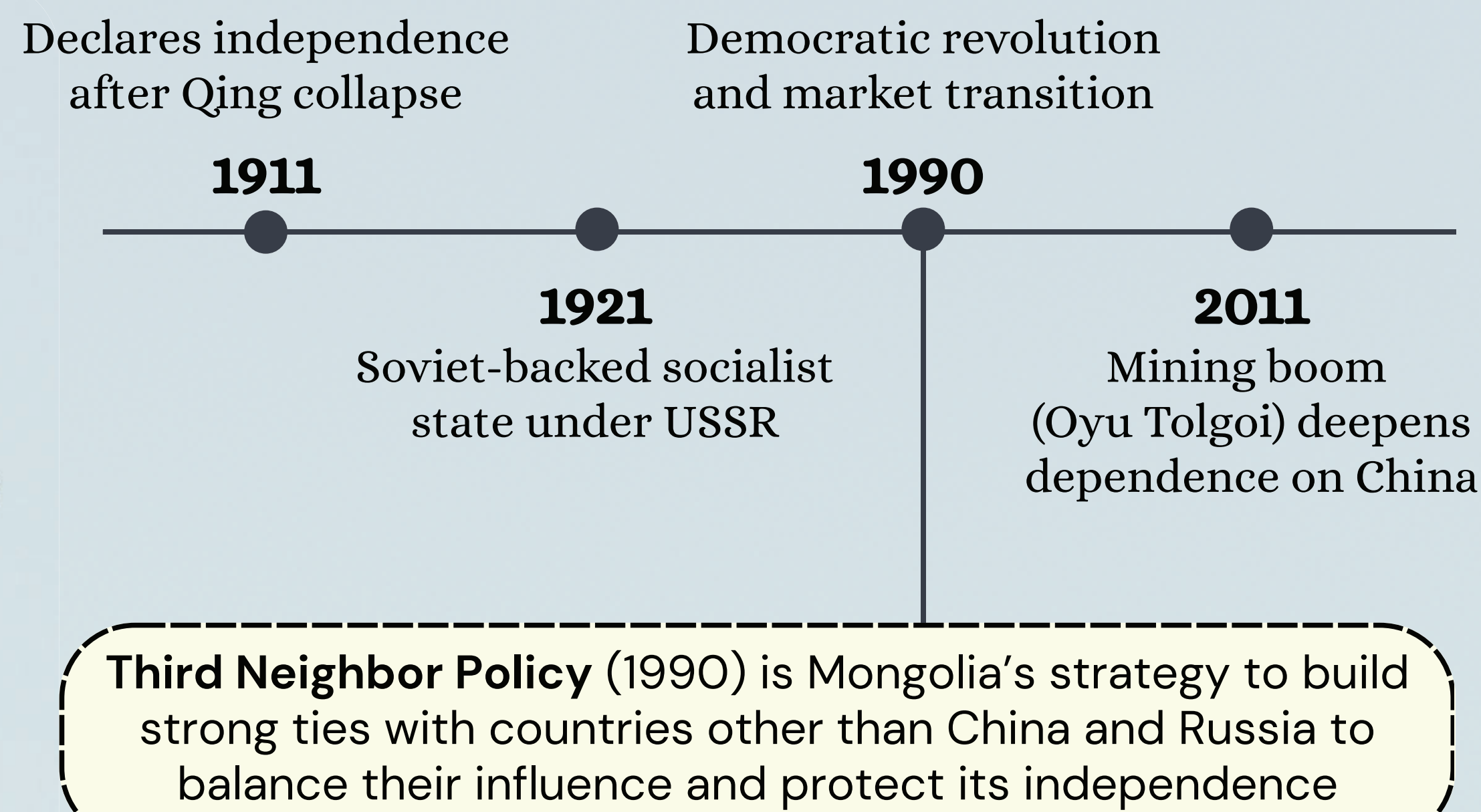


SMALL-STATE HEDGING AND ECONOMIC CONSTRAINTS: THE CASE OF MONGOLIA'S THIRD NEIGHBOR POLICY

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Research Question

How do structural dependence and institutional fragmentation limit the economic diversification outcomes of Mongolia's Third Neighbor Policy?

Figure 1. FDI by sector (% of Total FDI, 1990-2024)

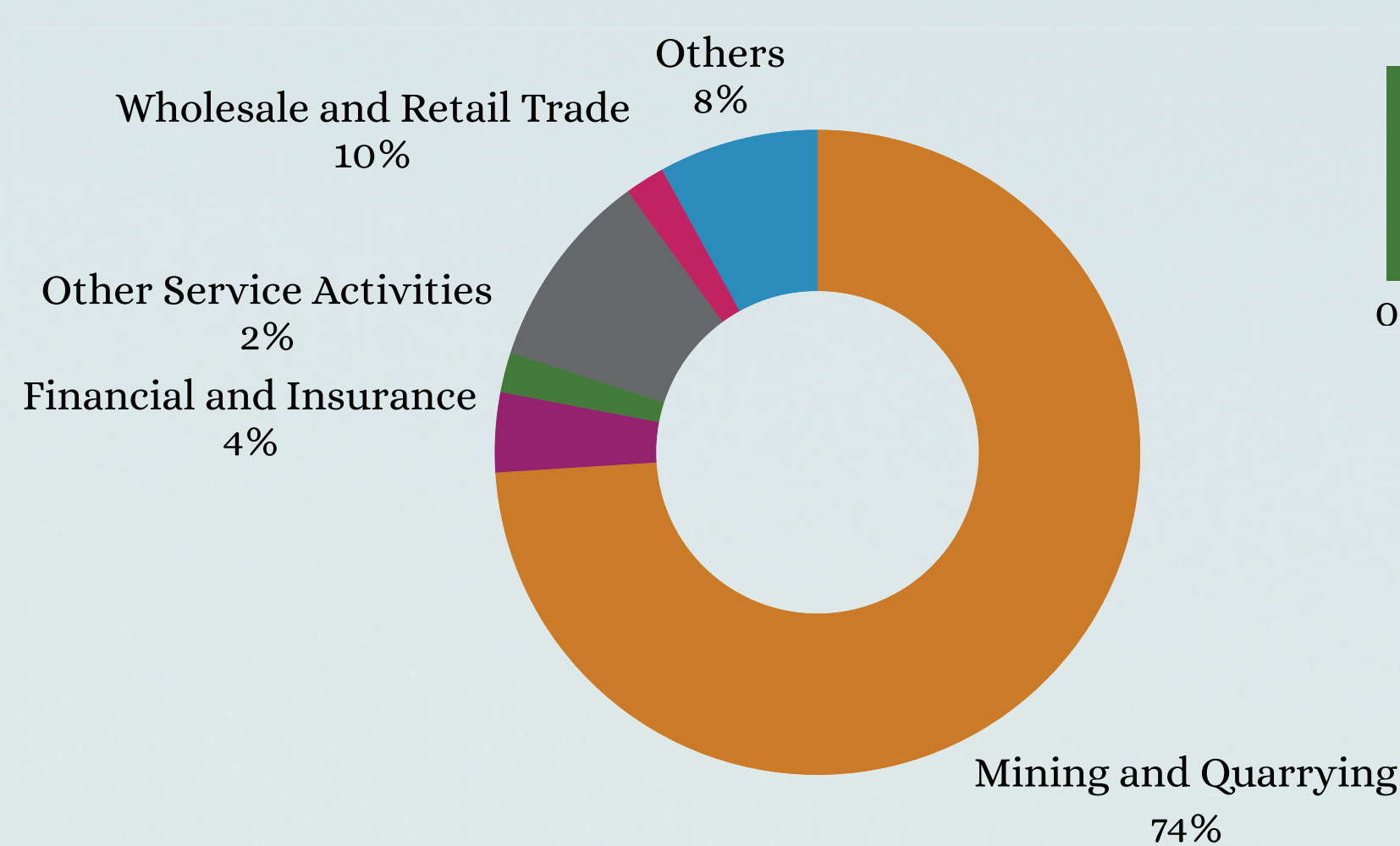


Figure 2. Major export partners (as a percentage of total exports, 2024)



Figure 3. Major import partners (as a percentage of total imports, 2024)

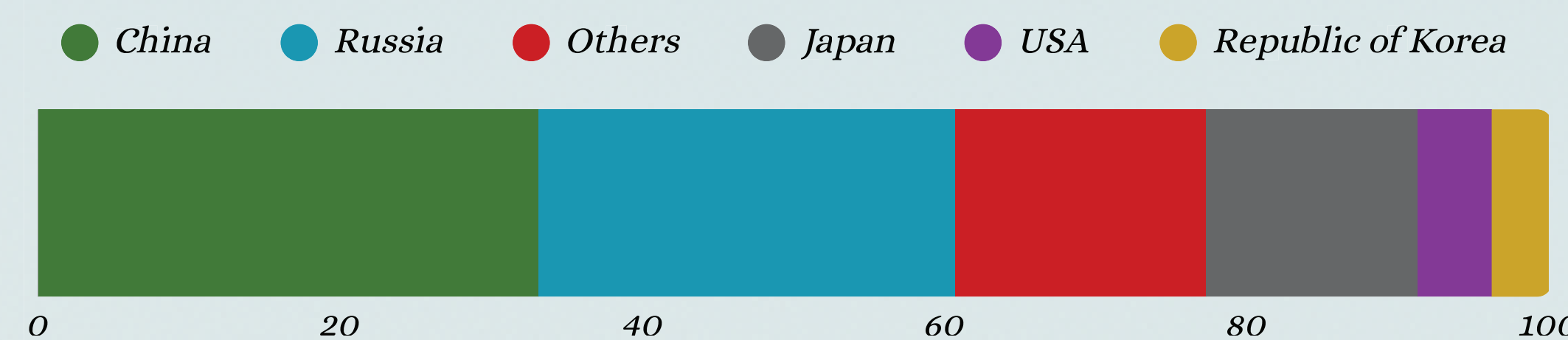
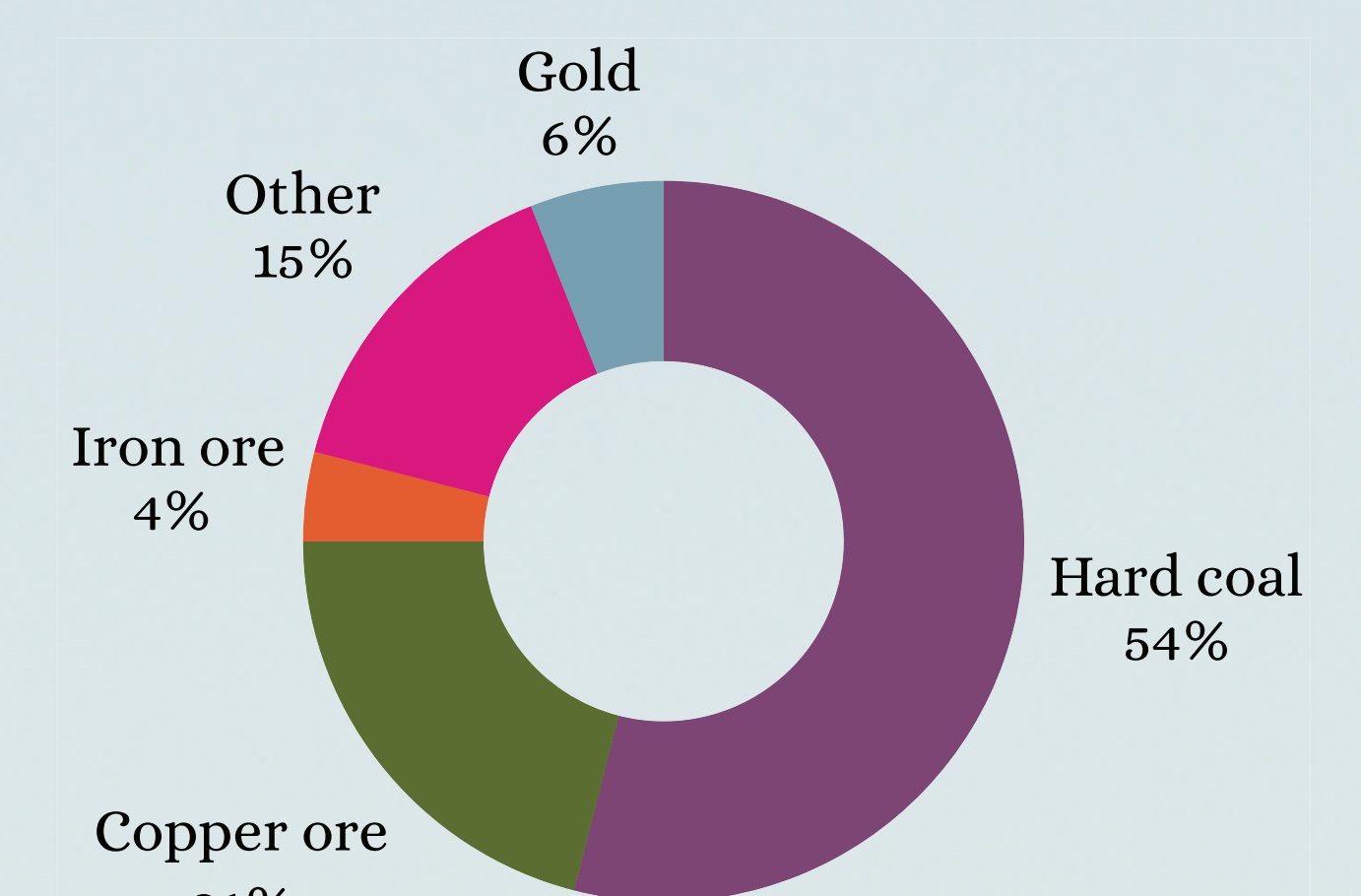


Figure 4. Major export products (as a percentage of total exports, 2024)



Source: Investment and trade agency of Mongolia

Literature Review

Hedging as a Small-State Foreign Policy

- Structural Uncertainty → Risk Mitigation
- Relative Equidistance → Avoidance of Forced Choice
- Counteracting Policies → Countervailing Forces
- Insurance-Seeking → Response to Power Shifts

TNP as a Hedging Strategy

- Diplomatic Diversification: formal ties with US, Japan, S. Korea
- Strengthens Mongolia's global standing
- Symbolic Autonomy
- Strategic Projects: external partners support infrastructure and human-capital development

Findings

Gaps

- Limited empirical research
- Economic hedging underexplored – few studies examine TNP's economic and FDI effects

METHODOLOGY

Design:

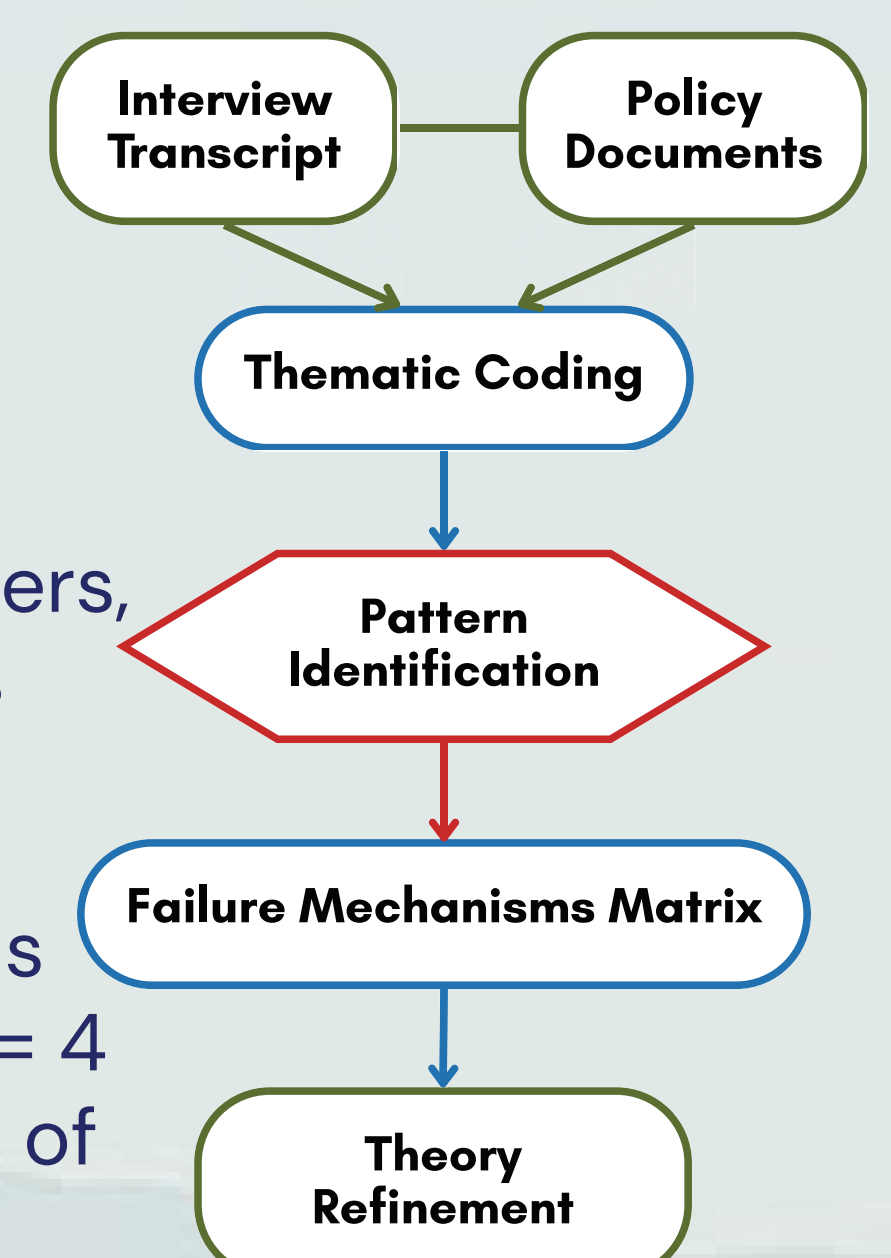
- Qualitative approach

Methods Used:

- Semi-structured interviews
- Document analysis
 - official reports, policy papers, and investment guidelines

Sample

- Total participants: 7 senior officials
- Central Bank of Mongolia – n = 4
 - Investment and Trade Agency of Mongolia – n = 3



Findings

Structural dependence – concentrated and sticky

Roughly 90% of exports go to China, so prices, routes, and FX shocks transmit quickly to the domestic economy

Institutional fragmentation – too many hands, no owner

Investment promotion and project negotiation are split across the Prime Minister, Deputy PM and MED. The Investment & Trade Agency aspires to be a one-stop window, but overlapping mandates persist

Implementation gap – diplomacy outruns delivery

Court cases can take 1.5 – 16 years, and tax enforcement is inconsistent, so pilots stall and few third-party projects reach bankable scale

“Projects like the oil refinery with India are ongoing... Despite government changes, our foreign policy has stayed consistent and neutral.”



“The biggest challenges are governance and implementation. Even after central approval, investors face resistance at the local level.”

“Multiple ministries have overlapping investment promotion functions... We need one clear organization to take responsibility.”



Conclusion

→ Mongolia's “Third Neighbor” policy has expanded diplomatic partnerships and preserved strategic autonomy. However, structural dependence and fragmented domestic institutions have constrained its ability to achieve economic diversification and resilience.

Implications

→ Hedging buys diplomacy, not economic transformation

Third-neighbor ties preserved Mongolia's foreign-policy flexibility and opened financial links, but they did not change the China-centric export structure or reduce exposure to price/FX shocks

→ Domestic implementation capacity determine outcomes

Even willing third-party investors stall when responsibilities are fragmented across ministries and local authorities resist projects. Institutional coherence matters more than external offers

→ Structural constraints make diversification costly and slow

Landlocked logistics, energy dependence, and mineral-led exports create sticky path dependence that diplomatic hedging alone cannot undo—infrastructure and sectoral prerequisites are binding

Policy recommendations

→ Create one accountable diversification authority

Unify investment promotion and project approval under a single body to remove overlaps and speed decisions

→ Strengthen implementation and rule-based governance

Create mechanisms to enforce decisions across local governments, speed up commercial dispute resolution, and ensure predictable tax and regulatory environments for investors



Reference