

## Chapter 23

# Locational Determinants of Foreign Direct Investment in the Vietnamese Economy

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### ABSTRACT

*This chapter investigates the determinants of inward Foreign Direct Investment (FDI) in the Vietnamese economy and their connection to the rapid economic growth the country has experienced. Using the concepts drawn from the extant Ownership-Location-Internalization (OLI) paradigm and Institutional-Based View (IBV) literature, and adopting a quantitative research with the application of secondary data analysis, the study found seven significant locational factors determining FDI inflows into the Vietnamese economy, such as business freedom, market size, labor cost, trade freedom level, inflation rate, human capital, and the effectiveness of property rights. Political risk, monetary freedom, corruption, the country's WTO accession, and the global financial crisis are found to be irrelevant to the inbound investments in the modern economy. A macro-level account and the policy implications are suggested for the promotion of FDI inflows into Vietnam to ensure the country's continuous and sustainable economic development.*

### INTRODUCTION

After a long period of economic hardship, the political and economic reform named “Doi Moi” was launched in 1986 marking a comprehensive change in the Vietnamese economy from a centrally planned to a market-oriented system (John & Bruce, 2006). The movement towards a market economy has enabled Vietnamese companies to diverge from doing business under traditional arrangements of the Vietnam-

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ese government and other partners within the Soviet trading block to being more liberalized and open to foreign trade (Nguyen, Barrett, & Fletcher, 2006). As a result, Vietnam has transformed itself from one of the poorest countries in the world to a lower middle income country with income per capita of US\$1,130 by the end of 2010 (World Bank, 2013). It then has experienced an impressive constant GDP per capita growth, being the fourth highest in the Emerging Asia by the end of 2011, and expected to be the second highest by 2016 (OECD, 2012). There has also been a gradual evolvement of Vietnam's politics and society towards greater openness and opportunity for civil participation. This progress is very essential as it supports Vietnam's vision to become a modern industrialized society.

Furthermore, compared to the state sector, the private sector has become increasingly emergent and important to the country's economic growth, which is regarded as a restructuring focus on more strategic activities (World Bank, 2009). Indeed, in 2012 the government started a privatization programme to attract more foreign investment (Euronews, 2014). Moreover, since accessing to the WTO in 2007, Vietnam has shown a more proactive engagement in international integration and has also made various commitments to be a more friendly investment destination such as liberalizing its economic policies, easing regulatory restrictions on investment and joining Free Trade Agreements (FTAs) not just regionally but also globally (Petro Vietnam, 2014; World Bank, 2013). In fact, to welcome more global investment the government's legal body gave a more equal regulation environment with almost no discrimination for both domestic and foreign businesses. Vietnam has also started to negotiate FTAs with countries beyond its Asia border such as with European countries in 2011-2012.

The country has also become a negotiating member of Trans-Pacific Strategic Economic Partnership (TPP) where major economies such as Australia, Brunei Darussalam, Chile, Malaysia, New Zealand, Peru, Singapore, and the USA join together to create a more compatible business environment to assist each other in the promotion of innovations, economic development, job creation, and active participation in international trade (USTR, 2013). This event clearly creates great potential for the TPP members seeking investment opportunities in Vietnam and vice versa. Therefore, Vietnam strives to expose to a broader investment community beyond the local region. Although a major challenge for many foreign investors in Vietnam might be to adapt to the one-party system, the country's constant improvement in its legal, economic, and political systems with the practical advancements offers great benefits and potential for foreign investors in the long term. This constitutes Vietnam emerging as a key FDI destination in the region.

In comparison with other countries in the region, FDIs in Vietnam have a fairly short history and slow development due mainly to the late participation start only after the 'Doi Moi' renovation reforms in 1986 were launched. However, the country has managed to attract a considerable amount of FDI inflows to become the fourth largest FDI recipient in Southeast Asia in the 2000s despite the impact of Asian economic crisis 1997 (UNCTAD, 2013). The FDI inflows began to develop again in the 2000s because the countries in the region had recovered from the crisis and together with the positive impact of US-Vietnam Bilateral Trade Agreement in December, 2001 (Moosa, 2002). The majority of FDI inflows into Vietnam during the period 1988 to 2005 were into manufacturing and processing industry with 8,072 projects and nearly US\$106 billion of registered capital accumulation until 2012 (GSO, 2013). In the service sector, despite the smaller amount in relative terms and marginal amount or even the non-existence of FDIs in the early start of the FDI history in many important service sectors such as the construction of industrial zones or offices and apartment, they are now increasingly attracting more FDI inflows (GSO, 2013). In terms of FDI origins, Vietnam mainly has attracted investors from the Asian region, accounting for nearly 80% of total number of projects with South Korea being the biggest

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