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IMPACTS OF EVFTA ON VIETNAM'S FDI

Nguyễn Thị Ngọc My[1], Đỗ Thị Thảo Hiền, Dương Văn An, Tường Thị Yến Linh

Sinh viên K58, Kinh tế đối ngoại

Cơ sở II Trường Đại học Ngoại thương tại TP. Hồ Chí Minh, Việt Nam

Trần Nguyên Chất

Giảng viên Bộ môn Nghiệp vụ

Cơ sở II Trường Đại học Ngoại thương tại TP. Hồ Chí Minh, Việt Nam

Abstract

The paper aims to investigate whether EVFTA drives changes in the attraction of Vietnam FDI and examine which EVFTA factors affect Vietnam FDI inflows based on annual time-series data between 2000 and 2020. The authors discover that EVFTA exerts a significantly positive impact on the increase of Vietnam FDI. Moreover, tariff reduction from EVFTA contributes to increasing Vietnam FDI. The results are consistent with previous research. The authors determine the EVFTA factors affecting Vietnam FDI inflows and offer a valuable reference for Vietnam's government and policymakers. Vietnam's government should maintain a stable rate of the macroeconomic index, take advantage of EVFTA commitments effectively and continue the trade liberalization process. And Vietnam businesses need to utilize cheap labor and tariff reduction from EVFTA to boost their competitive strength regarding price.

Keywords: EVFTA, Vietnam FDI, tariff reduction

ẢNH HƯỞNG CỦA HIỆP ĐỊNH EVFTA LÊN THU HÚT ĐẦU TƯ TRỰC TIẾP NƯỚC NGOÀI VÀO VIỆT NAM

Tóm tắt

Nghiên cứu khảo sát liệu hiệp định EVFTA có tác động tới đầu tư trực tiếp nước ngoài vào Việt Nam hay không và tìm ra yếu tố nào của hiệp định EVFTA ảnh hưởng tới thu hút FDI vào Việt Nam dựa trên dữ liệu chuỗi thời gian hàng năm từ năm 2000 đến năm 2020. Các tác giả nhận thấy rằng EVFTA tác động tích cực có ý nghĩa thống kê đến sự gia tăng của FDI Việt Nam. Hơn thế nữa nữa, cắt giảm thuế quan từ EVFTA góp phần làm tăng lượng FDI vào Việt Nam. Kết quả nghiên cứu đồng nhất với các nghiên cứu trước đây. Tác giả chỉ ra các yếu tố EVFTA ảnh hưởng đến FDI của Việt Nam và đóng góp tài liệu tham khảo có giá trị cho chính phủ và các nhà hoạch định chính sách Việt Nam. Chính phủ cần duy trì các chỉ số kinh tế vĩ mô ổn định, tận dụng cam kết EVFTA một cách hiệu quả và tiếp tục quá trình tự do hóa thương mại. Và các doanh nghiệp Việt Nam cần tận

[1] Tác giả liên hệ, Email: nguyenngocmy123@gmail.com

dụng các lợi ích về chi phí nhân công thấp và cắt giảm thuế quan từ EVFTA để nâng cao lợi thế cạnh tranh về giá.

Từ khóa: Hiệp định EVFTA, Vietnam FDI, Cắt giảm thuế quan

1. Introduction

Vietnam, an emerging economy in the Southeast Asia region, has recently improved its integration policies and significantly gained a lot of achievements in diplomatic relations over the past few years. Besides, a huge number of foreign investors have been attracted to invest in the country by its stable politics, constant economic growth, and numerous government incentives.

A new generation FTA between 27 European Union member countries and Vietnam, named EU-Vietnam Free Trade Agreement (EVFTA), was ratified by the European Parliament in February 2020. Six months later, the FTA was officially approved by the Vietnam National Assembly on June 8, 2020, and took effect on August 1, 2020.

Since the ratification, various forms of foreign investment have been invested in Vietnam by developed nations, especially by non-EU governments. In addition, as EVFTA makes Vietnam more attractive to foreign investors in terms of a transparent and better business environment, the country is making an effort to open many manufacturing industries such as Food & Beverage, Fertilizers & Nitrogen Compounds, Tires, Gloves & Plastic Products, and Pottery & Building Materials. For example, in the machinery industry, Vietnam promises to remove restrictions on the assembly of marine engines, agricultural machinery, home appliances, and bicycle manufacture, VCCI (2020).

Thus, it is urgent to have a deep understanding of the relationship between the EVFTA agreement and Vietnam FDI to find out how EVFTA factors are affecting Vietnam FDI inflows; thereby, producing recommendations for Vietnam government and businesses to fully take advantage of the free trade agreement. However, most of the previous studies have determined factors of the agreement influencing the country's FDI.

The atuhors use annual time-series data of 28 member states of the EVFTA, involving 27 EU countries and Vietnam between 2000 and 2020.

2. Literature Review

The research of Artige (2005) used disaggregated regional data to analyze the determinants of FDI inflows in three European regions. It is concluded that regional FDI inflows depend on a combination of factors that are different from one region to another. Artige's study shows that regional wealth is not the motive to attract a large amount of FDI. The relationship between GDP and FDI per capita is always found positive and statistically significant. This research paper is not thorough due to the lack of required data.

Kok (2007) used a panel of data (FMOLS-fully modified OLS) and cross-section SUR (seemingly unrelated regression) to investigate the best determinants of foreign direct investment (FDI) in 24 developing countries from 1983 to 2005. It is revealed that investors prefer a good business environment to special favors offered by the governments.

Bhatt (2000) used panel data by pooled least square method and fixed-effect model in five ASEAN countries between 1976 and 2003. The relationship between the variables and the foreign direct investment differs from one country to another.

Yeyati *et al.* (2003) used panel data analysis with country-pair fixed effects to study the impact of regional integration agreements (RIAs) on the location of foreign direct investment. The dataset includes bilateral outward FDI from 20 OECD countries to 60 host countries over the period between 1982 and 1999. It is suggested that countries participating in RIAs to expand their market size can attract more FDI. However, the extent of benefits is not equally distributed as it relies on the conditions and business environment of the host countries.

Jaumotte (2004) formulated the hypothesis about the role of the market size of the regional trade agreement in attracting foreign direct investment of participating countries. The hypothesis was examined on a sample of 71 developing countries between 1980 and 1999. It is concluded that the RTA market size has a positive impact on the inflows of foreign direct investment of member countries. Nevertheless, there is a difference in the extent of benefits from RTAs between countries since investors prefer those with a better business environment.

Li & Maani (2018) used a panel dataset with 30 sectors during the period between 2000 and 2010. The research focused on two FDI promoting effects: market expansion and vertical fragmentation through a sector-level examination of FDI in China's manufacturing industry. The partners of FTAs can affect the inflow of FDI of the host country. While signing FTAs with big markets would attract market-seeking FDI while signing FTAs with countries on the same production value chain would attract vertical FDI. The authors followed the model of Kim and Lyn (1987) by employing the industry indicators of the FDI host country (China) to analyze entry barriers. The four barriers are capital intensity, monopolistic power, advertising expenditure, and R&D expenditure.

Phuong (2018) uses both qualitative research and quantitative research about the impact of EVFTA on FDI to Vietnam from EU countries and other countries in the world with data in the years from 1991 to 2018 in Vietnam. The author stated that the amount of FDI from EU countries last year has a markedly positive effect on the amount of FDI attracted next year. Moreover, signing in the same FTA could increase about 20% of the value of FDI from the EU into developing countries. Nevertheless, the author only studies the FDI inflows from EU countries, not all the trade partners all over the world. Since the research is conducted in 2018, the time series does not include the year of took-in-effect. Moreover, the variables included do not reflect the factors of EVFTA as the model only has 1 dummy variable to represent the year of took-in-effect. The research also has not mentioned the trade costs when investing in Vietnam.

3. Methods

3.1. Model

The empirical model involves a sample of annual-series data with independent variables based on Erdal & Mahmut (2008). Based on the reference, we still adjust the method of data collection and add more variables.

The extended model is specified as below:

$$Log(FDI_t) = \alpha_0 + \alpha_1 Log(LC_t) + \alpha_2 gro_t + \alpha_3 inf_t + \alpha_4 Log(open_t) + \alpha_5 Log(GDPPC_t) + \alpha_6 DEBT_t + \alpha_7 MOBILE_t + \alpha_8 Tariff_{ijt} + \alpha_9 EVFTA_t + \varepsilon_t$$

In which:

i: host country (Vietnam), **j**: home countries (EU), **t**: at year t

FDI: the foreign direct investment inflows of Vietnam

LC: labour cost proxied by the basic salary of workers in Vietnam

gro: the economic growth rate of Vietnam

inf: the inflation rate of Vietnam

Open: the degree of trade openness of Vietnam measured by the ratio of exports and import values to GDP

GDPPC: gross domestic product (GDP) per capita (per person) of Vietnam

DEBT: total external debt of Vietnam

MOBILE: Mobile cellular telephone subscriptions per 100 people of Vietnam

Tariff: The tariff of country i (Vietnam) charging on the importation from countries j (EU)

EVFTA: dummy variable, representing the year of took-in-effect, with the value of 1 when EU and Vietnam signed the EVFTA, with the value of 0 when EU and Vietnam have not signed the EVFTA.

3.2. Variable explanation and data collection

Market size

Market size plays an important role in attracting FDI. GDP per capita is the variable used as a proxy for market size in most empirical studies and is derived from a direct division of total GDP by population. GDP per capita is in US dollars (USD) and is a measure of the size of the host country's market.

Data source: data.worldbank.org.

Growth of the market

The growth of the market is measured by GDP growth. GDP growth is measured by the by the difference in Vietnam's GDP between the later year and the previous year.

Data source: data.worldbank.org.

Trade openness

Trade openness is the ratio of exports and import values between Vietnam and the EU to GDP. Exports are calculated according to the value of exports of goods and services in US dollars, while imports indicate to the values of imports of goods and services in US dollars.

Data source: data.worldbank.org.

Labour cost

The basic salary of Vietnamese citizens is used as a proxy for labor costs. The mean values are used due to regional variation in Vietnam. The basic salary of Vietnamese citizens is expressed in 1000 VND.

Data source: molisa.gov.vn.

Inflation

Inflation is measured by the annual growth rate of the Consumer Prices. Inflation is a proxy for economic stability.

Data source: data.worldbank.org.

Infrastructure

Mobile cellular telephone subscriptions to a public mobile telephone service that provides access to the PSTN using cellular technology. Mobile cellular telephone subscriptions are shown per 100 people for the entire country.

Data source: data.worldbank.org.

Total external debt

Total external debt is debt owed to nonresidents repayable in foreign currency, goods, or services. Data are in current US dollars.

Data source: data.worldbank.org.

Tariff

This is the average tariff of Vietnam charging the importation from the EU. This data is averaged over the total product. For the period from 2017 to 2020 when the data has not been updated on WITS, the author has calculated the average tariff based on the customs tariff of the Vietnam General Department of Customs.

Data source: WITS and Vietnam General Department of Customs.

EVFTA

To evaluate the impacts of signing the EVFTA on the outflows of FDI of EU to Vietnam, the dummy variable FTA is included in the model with the value EVFTA = 1 when EU and Vietnam signed the EVFTA, in 2020. EVFTA = 0 when EU and Vietnam have not signed the EVFTA, from 2000 to 2019 according to data in this research.

3.3. Data and methodology

The authors uses the annual time-series model to summarize and clarify the economic significance of influential factors and FDI before testing statistical hypotheses in a theoretical study.

The annual time-series model is used in collecting, building up regression models, and analyzing the statistical aspects of data. One more point to notice is that, due to the availability of data and the characteristics of the topic, it is impossible to collect primary data. Therefore, all the data used in this research are secondary data acquired from open reliable sources. FDI net inflows (BoP) in constant US dollars data are from the World Bank Open Data and the data for the year 2020 are from Vietnam's Ministry of Planning and Investment Portal. Labour Cost measured by the average salary of Vietnamese citizens is obtained from Vietnam's Law Library. GDP Growth (annual %) and

Inflation rate (Consumer price, annual %) are from the World Bank Open Data and General Statistics Office of Vietnam. Trade openness is the ratio of exports and import values to GDP; exports (US$) and imports (US$) are collected from World Bank Open Data. Vietnam's GDP per capita, and Total External Debt are from World Bank Open Data. The data of average tariff from 2000 to 2017 are taken from WITS and the data from 2018 to 2020 are based on authors' calculation from the data of General Department of Vietnam Customs. EVFTA is the dummy variable to represent the year of took-in-effect (2020). The authors involve descriptive statistics, Pearson correlation analysis, and OLS regression analysis during the data analysis process. The authors apply Eviews 10 and Microsoft Excel 2019 for processing and analyzing the data.

1. Results and discussions

	Mean	**Max**	**Min**
FDI	8.37E+09	2.85E+10	1.30E+09
GDPPC	1472.461	3504.507	390.0933
GRO	6.5135	7.5472	5.2474
LC	1467.02	3710	180
OPEN	1.5551	2.10	1.11
INF	6.2015	23.1155	-1.7103
DEBT	53.0762	150	13.2
MOBILE	885.5282	1839.37	9.868
TARIFF	12.0305	16.82	2.48

Table 1: Descriptive statistics

The variable FDI has a mean value of 8.37E+09, a maximum value of 2.85E+10, and a minimum value of 1.30E+09.

Although the maximum value is 3504.51, the mean value of variable GDPPC is only 1472.46.

The variable GRO has a mean value of 6.51 that does not differ much from the maximum and minimum values.

While having the maximum value is 3710, the mean value of variable LC is only 1467.02.

The variable OPEN has a maximum value of 2.10 and a minimum value of 1.11 that does not differ much from the mean value of 1.56.

The variable INF is the only variable in the model whose minimum value is negative.

The variable DEBT has a mean value of 53.08, quite balanced with the maximum and minimum values.

While having the maximum value is 1839.37, the mean value of variable MOBILE is only 885.5282.

The variable TARIFF has a mean value of 12.03, a maximum value of 16.82, and a minimum value of 2.48.

Variables	Coefficient	Prob
Log(LC)	-1.33	0.0002
GRO	-0.28	0.0017
INF	-0.04	0.0006
LOG(OPEN)	5.85	0.0001
MOBILE	0	0.2502
LOG(GDPPC)	2.11	0.0006
DEBT	-0.01	0.016
TARIFF	-0.1	0.0219
EVFTA	1.31	0.0089

Table 2. The estimation results

Firstly, there is a significantly positive impact between FDI inflows and GDP per capita. This result supports hypothesis 1, "*A larger market size of the host country, which is measured by GDP per capita, is associated with the rise of FDI"*. Charkrabarti (2001) claims that a large market is needed for efficient utilization of resources and exploitation of economies of scale. FDI flows would move to countries where consumers have high income and purchase strongly. Hence, businesses are able to receive a higher return and generate higher profit. Since GDP per capita reflects the average income of citizens.

Figure 1. Vietnam GDP per capita (USD) and GDP growth (%)

Source: data.worldbank.org

From less than 500 USD in 2000, GDP per capita experienced a rapid increase to around 3500 in 2020. Contrasting to the trend of GDP per capita (USD), the GDP growth (%) fluctuated between 5 – 8% during the research time.

Secondly, the research result reports that the market growth, proxied by the GDP growth, is significantly positive to FDI inflows. Nevertheless, the result contradicts hypothesis 2, "*Higher market growth rate leads to more FDI attraction".* As the direction of growth in stimulating FDI has been controversial in previous research when the results are significantly negative, significantly positive and insignificant. Nigh (1985) shows a negative relationship for attracting FDI from developed countries. When Vietnam's economy is growing rapidly, people's living standard has been improved, contributing to the rise in labor costs. Furthermore, environmental policy, food safety, regulations on establishing companies become more rigorous, which is a huge hindrance to foreign investors, driving them to invest more capital on hiring employees.

Thirdly, the result reports a significantly positive sign in the regressions of trade openness of Vietnam, which supports hypothesis 3, "*The higher degree of openness of the host country, the more FDI will be attracted".* In the paper of Kiki Verico (2015), a country with higher open degree to the world market is more appealing for foreign investors. Vietnam Financial magazine reports that Vietnam has marked a turning point in stimulating FDI inflows due to the innovation process and opening up the economy, joining in WTO, signing several FTAs. Vietnam is trying to seek more international markets to export goods, which is confirmed by six continuous years of trade surplus. A higher degree of trade openness will encourage international investors to join Vietnam market. At the moment, Vietnam's major trade partners are countries in Asia region (accounting for 50% of export turnover and 80% of import turnover). EVFTA enables firms to enter and exploit foreign markets, which is a great opportunity for Vietnam export activities Vietnam. In 2019, EU is the second largest import market in the world with an import value of 1,934 billion Euros. Nevertheless, Vietnam export turnover accounts for only1.8% market share. Thus, EVFTA will pave the way for Vietnam businesses to export more goods due to preferential tariffs. Hence, the trade openness degree of Vietnam will increase considerably, thereby attracting more FDI.

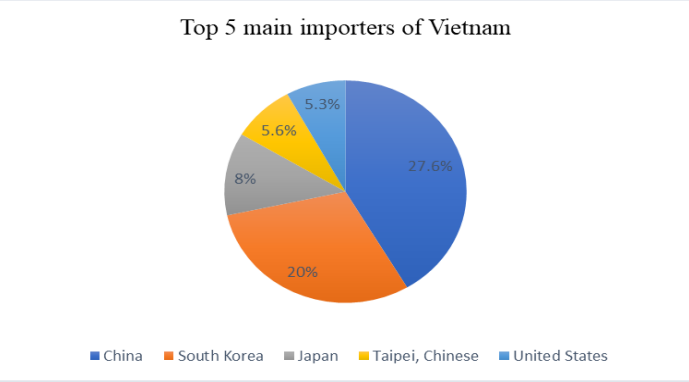

Figure 2. Top 5 main importers of Vietnam

Source: Vietnam Ministry of Industry and Trade

Among top 5 import partners of Vietnam, China accounts for the biggest market share in 2020 with 27.6%. A fifth of the turnover is owned by the Korea. Meanwhile, the percentages of Japan, Taipei and the US are only 8%, 5.6% and 5.3% respectively.

Figure 3. Top 5 largest exporters of Vietnam in EU in 2019 (USD)

Source: Trademap

Germany was the biggest product exporter of Vietnam in EU in 2019 with total value of 3,698,442 USD, followed by Ireland with total value of 2,497,413. Italy and France ranked at the third and fourth largest exporter respectively, with the similar value of 1,884,181 USD and 1,601,598 USD. 661,857 was the export value from EU to Vietnam of the United Kingdom.

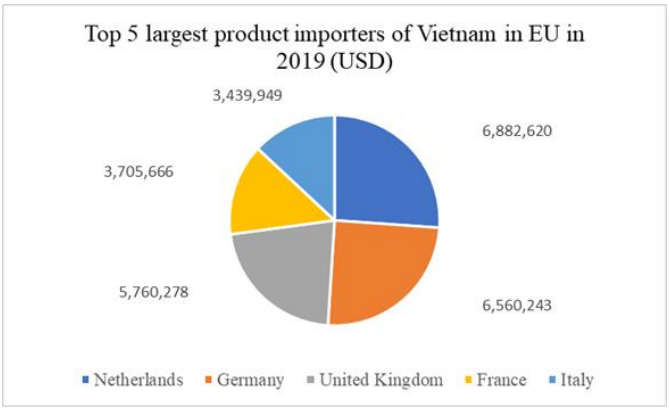

Figure 2. Top 5 largest importers of Vietnam in EU in 2019 (USD)

Source: Trademap

Overwhelmingly, Netherlands is the biggest importer with 6,882,620 USD in 2019. The next most intimate foreign buyer is Germany, accounting for 6,560,243 USD of the total. United King dom and France respectively ranked 3rd and 4th with 5,760,278 USD và 3,705,666 USD. Finally, Italy makes up with 3,439,949 USD.

Fourthly, labor cost of Vietnam, measured by the average salary of Vietnamese citizens, reports a significantly negative correlation, which is consistent with the hypothesis 4, "*Low labor cost would motivate foreign investors to invest in the host country".* Furthermore, the research result is also the same as previous studies. Albert & Stuart (2008), Ali & Guo (2005), Casi & Resmin (2010) and Janicki & Wunnava (2004) discover the role of low labor cost in FDI attraction from foreign enterprises. Concerning the Vietnam economy, ODI (1997) also reports a significantly negative sign, especially for foreign capital in labor-intensive sectors. With edge of having a myriad of young human resources, Vietnam has succeeded in attracting enormous FDI

amount from developed countries and large corporations. Cheap labor can be considered a major factor to allow firms to reduce production costs, lower prices and enhance their competitive edge.

Figure 3. Labor cost in Thailand and Vietnam (USD)

Source: MOLISA & TRADING ECONOMICS

Between 2000 and 2011, both the labor cost in Thailand and Vietnam witnessed a steady increase and reached the peak at the final year. During the research time, there was always a big gap in the minimum wage between Thailand and Vietnam.

Fifthly, inflation rate of Vietnam is significantly negative, which proves hypothesis 5 and is compatible with Erdal Demirhan & Mahmut Masca (2008). This means low inflation rate motivates foreign investors to enter the market. The most reasonable inflation threshold for Vietnam economy is around 3.5%.

Sixthly, there is a significantly negative correlation between imported tariff of Vietnam and FDI inflows, thereby proving hypothesis 9. The direction of tariff variable is consistent with Yann & Chorthip (2014). This means Vietnam is more likely to attract FDI by applying lower imported tariff on EU goods. According to Dunning (2008) the market-seeking FDI can be considered as tariff-jumping when it comes to FDI motives. Not only EU firms consider Vietnam as a more attractive destination to invest in owing to lower imported tariffs from the bilateral agreement, but other trade partners also regard Vietnam as the third country for production to then export to the EU. Tariffs motivate MNEs to participate in FDI activities by entering Vietnam market to overcome such trade barriers.

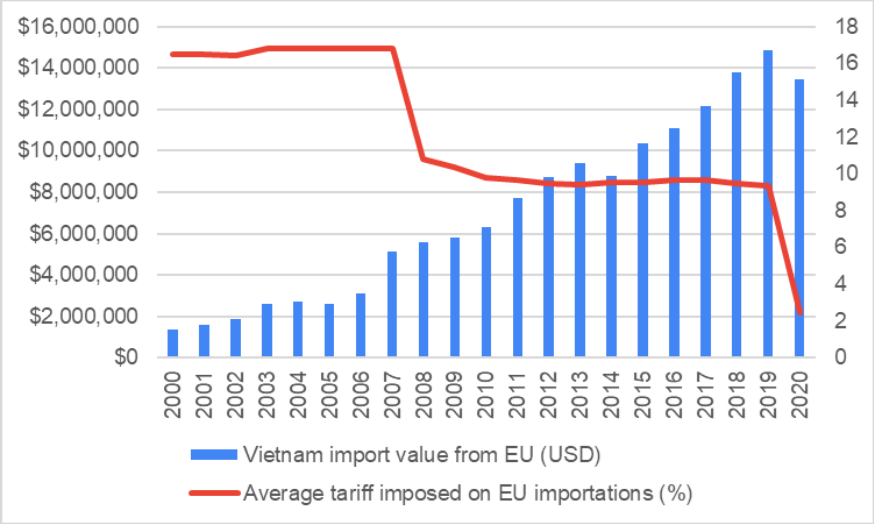

Figure 4. Vietnam import value from EU (USD) and average tariff imposed on EU importations (%)

Source: WITS and General Department of Vietnam Customs

The average imported tariffs remained around 16.81% in the period of time between 2000 and 2007 before declining sharply to 10.82% in 2008. This downward trend can be explained by the participation in WTO of Vietnam in 2007. The figure then hit the lowest rate of only 2.48% in 2020 when EVFTA comes into effect, after a slight fluctuation around 10% from 2009 to 2019. Meanwhile, Vietnam import value of products to EU have experienced a rapid increase from under 2 million USD in 2000 to nearly 14 million USD in 2020.

Seventhly, the research reports that total external debt is negative, and its coefficient is significant. Hypothesis 7 is supported by the results, which means a higher amount of total external debt might discourage foreign investor to join the host market. Recep Kok (2009) finds that low total external debt of the host country is a critical factor for offering a reliable and friendly environment for the social, environmental, and economic life of businesses.

Eighthly, the dummy variable (EVFTA) is reported significantly positive, which is consistent with previous studies such as Bae & Jang (2013), Feils & Rahman (2011), Kiki Verico (2015), Qiaomin Li & Sholeh Maani (2016) and Phuong (2018) about the direction of FTA impact on attracting FDI. This result supports Hypothesis 10, "*Signing the EVFTA helps Vietnam attract more FDI".* EVFTA is examined to induce a larger amount of Vietnam FDI. Signing EVFTA is a vital turning point of Vietnam investment and trade. The trade liberalization under EVFTA to remove tariff and quotas will develop immensely key export sectors such as textiles, footwear, agricultural - forestry - aquatic products, plastic products, etc. EVFTA will contribute to the economic development, labor productivity and enable Vietnam's businesses participate in more intensive production stages with higher added value due to the transfer of modern innovation and more elite management from EU partners.

5. Limitations and recommendations

5.1. Limitations

The independent variable Tariff is measured based on the average tariff for all goods imported from the EU. Hence, the research is unable to offer a specific direction of taking

advantage of EVFTA incentives for each industry to attract FDI. In addition, the research results might only offer an overview of the whole European Union rather than a specific country. Meanwhile, The European Union consists of 27 members which have different levels of development and have a big gap with one another in the total value of export and import with Vietnam.

5.2. Recommendations

5.2.1. For Vietnam's government

Governors should develop and soon implement a new generation FDI attraction strategy in line with the orientation, strategy and goals of sustainable economic development of Vietnam. Besides, continuing to review, amend, supplement and perfect the document system the law is in line with the orientation and strategy of Vietnam's sustainable economic development and the new generation of FDI attraction strategy.

Government have to focus on developing infrastructure in special economic zones, regions and localities has a comparative advantage that facilitates efficient FDI operations. Continuing to reform administrative procedures, improve management efficiency and invest in human resource development is significantly important.

5.2.2. For Vietnam's business

It is necessary to use investment incentives and support policy tools to target investors and priority areas, with appropriate investment methods, focusing on joint ventures to learn, improve endogenous capacity, promote economic restructuring towards sustainability.

They ought to develop a connected and synchronous infrastructure system to ensure investors operate effectively when choosing sustainable investment options. Moreover, ensuring the quality as well as the availability of resources to meet the requirements of investors, especially high-quality human resources is a fundamental action.

CONCLUSION

In conclusion, this study was conducted with the aim of examining whether the participation in the EVFTA agreement affects foreign direct investment, and pointing out the factors of the EVFTA that make up the difference in the change of Vietnam's FDI by applying annual time-series data over the period from 2000 to 2020. The research shows that the implementation of the EVFTA agreement brings about positive changes in Vietnam's activities to promote foreign direct investment. Also, the research results are also consistent with most of the previous studies concerning the direction of the impact of FTAs on FDI. Moreover, the tax incentives from joining the EVFTA also contribute significantly to the increase in foreign direct investment for Vietnam.

The results from the regression model reveals that the average tax variable, market growth, inflation, labor costs, tariffs and total external debt have a negative impact on FDI. Meanwhile, trade openness and market size significantly promote Vietnam's investment attraction. Thus, the current urgent issue of the Vietnamese government is the need to maintain a stable pace of macro indicators and at the same time, take advantage of the incentives provided by the EVFTA and accelerate the process of trade liberalization. And Vietnamese businesses need to take advantage

of the advantages of cheap labor as well as tariff reductions from the signing of the EVFTA to increase their competitiveness in both the domestic and international markets.

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