FOREIGN DIRECT INVESTMENTS AND SPILLOVER EFFECTS IN VIETNAM

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Abstract

Foreign direct investment (FDI) plays an important role in developing countries in general and Vietnam in particular. It not only provides a large source of investment capital, increase density contribution to growth in GDP, but also affects the process of restructuring the economy, contributes to solving the problem about employment in the economy. In addition, FDI enterprises are also factors that promote export activities as well as bring spillovers to the economy on changes in technology or modern management skills to the host country. However, attracting FDI does not always create positive spillover effects, but there are still some limitations. That reduces the efficiency of the FDI sector, or does not make full use of this resource in terms of productivity growth and economic efficiency. Therefore, researching and evaluating the spillover effects of FDI on the economy in order to offer solutions to promote the efficiency of the FDI sector is a necessary issue in the current period.

Keywords: Foreign direct investment, Spillover effects, FDI

1. Introduction

Today, developing countries are competing fiercely to attract foreign investors by offering different fiscal incentives in the expectation of improving productivity through technology spillover from foreign direct investment (FDI) to domestic enterprises. Local governments have used the different investment strategies in a bid to obtain more FDI. And FDI attraction depends on the existence and magnitude of the positive spillover effects from that FDI capital. Empirical studies on the evidence surrounding FDI spillover effects have not reached consensus. The further research is therefore need to determine the impact of FDI on the development of the social economy in a country.

Most empirical studies on the spillover effects of FDI have tend to bring about positive effects of the FDI sector on the domestic economy through a classical production model which measures the productivity of local firms. Empirical studies of spillovers have not found effective interactions between local firms and foreign firms. This paper examines the spillover effects of the FDI sector on the domestic sector in Vietnam in the past period.

2. Literature Review

2.1. Spillover effects from FDI

The role of FDI in the spillover of skills, knowledge and technology has been recognized in many studies in the regional development literature . In researches of many authors as: Martin and Ottaviano (1999), Lucas (2001), Baldwin and Martin (2004), and Audretsch and Feldman (2004)) have combined theory of endogenous growth and models position to consider the impact of spillovers to the development economy. They point out that firms location is important for stronger growth and spread in certain gaps. More specifically, they show that the spillover of knowledge or technology which occur through a variety of mechanisms, such as skill acquisition , competition and production integration are more likely to materialise and be more efficient when the companies are located in close proximity.

An important influence of geographic proximity lies in the concept of industrial zones and industrial clusters (Porter, 2000). Driffield and Girma (2003) and Driffield (2006) argued that cluster give rise to agglomerate externalities because the local market is specialized for labor and intermediate goods. Geographic proximity may also aid in the diffusion of knowledge between companies, for example making communication less expensive. The roles of geographical distance has also gained attention in the FDI literature. Baltagi, Egger, and Pfaffermayr (2007) and Blonigen, Davies, Waddell and Naughton (2007) found that the space of interdependence has a significant effect on the distribution of FDI between neighboring countries . Blonigen et al. (2007) pointed out that spatial econometrics can provide useful techniques that can be applied to many countries as well as regions within a given country to explain spatial interdependence. Driffield (2006) publishes the first study to incorporate spatial modeling in the study of spillover FDI . The results show that conflicting findings in previous studies on the spillover effects of FDI were due to the failure in capturing spatial dependence. This is demonstrated by using the estimation model which allows detecting the spatial dependence among firms in examining the spillover effects of FDI.

2.2. Social interaction and spillover

Social interaction refers to specific types of externalities, in which the actions of a reference group, usually family, neighbours, friends or colleagues, influence an individual's preferences (Scheinkman, 2002). The main theoretical discussion on this issue can be found in Topa (2001), Manski (2000), Jackson (2009) and Easley and Kleinberg (2010). They propose three specific forms of social interaction; namely the binding interaction, the expectation interaction, and the preferred interaction which have positively impact productivity. According to experience, social interactions have been noted in a number of studies from different economists. In the literature on economic growth and technology transfer, Antonelli and Scellato (2013) found that a company's productivity is significantly affected by localized social interaction, both in terms of spillover and creative response.

Vietnam's recent experience in attracting FDI and achieving rapid economic growth has generated great interest to many researchers. Most studies focused on considering the determinants of FDI (Nguyen & Nguyen, 2007 ; Pham, 2002 ; Vu, Le & Vo, 2007). Others investigated the contribution of FDI to job creation, poverty reduction and economic growth (Pham, 2003). Some studies on the spillover effects in Vietnam include Nguyen, Nguyen, Vu, and Nguyen (2006), Tran (2001), and Anwar and Nguyen (2014) about the current situation of foreign direct investment (FDI) in Vietnam.

3. Results

3.1. Foreign Direct Investment (FDI) in Vietnam

After more than 30 years of attracting FDI, Vietnam became one of the successful countries after all of government efforts to attract FDI with policy system which were consistent, but flexible, suitable for each period of development of the country. FDI has proven its important role through not only direct effects but also indirect effects in the economy.

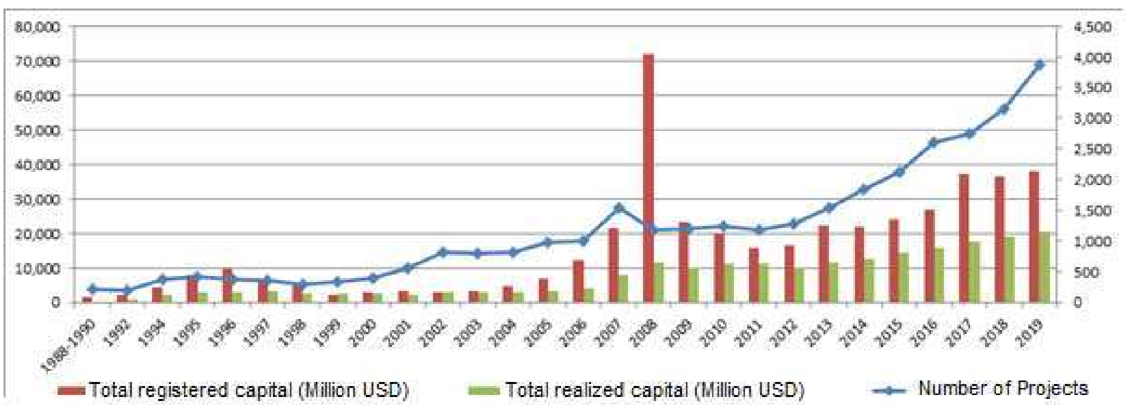

Figure 1: FDI growth rate between 1988 and 2019

Source: Foreign Investment Department - Ministry of Planning and Investment

In early years of attracting FDI, from 1988 to 1990, although it was a difficult period in the beginning of innovation, Vietnam attracted 213 FDI projects with a total registered capital of nearly 1.8 billion USD. However, after that, with the gradual changes, Vietnam increasingly integrated with the development of the world and the region. Vietnam had joined regional and international trade organizations such as ASEAN, WTO ... or bilateral and multilateral free trade agreements to integrate deeper into the international playing field. In addition, the Government has continuously revised and supplemented the Law of Investment and in 2005 has agreed on a common investment law with many changes in decentralization of investment licensing and project management. In 2014, Law of Investment Law was born and replaced the 2005, which continued the open policy in accordance with the economic capacity and the purpose of attracting FDI in each phase of the country. Beside policy corridors, Vietnam also changed and prepared both hard and soft infrastructure which created a pull point to attract FDI and promote FDI effectively as for investment, management qualifications, or quality human resources ... In 2019, the Law of Public Investment was born that showed a new direction in investment in general and foreign direct investment in particular.

During 30 years of FDI attraction, the average growth rate of Vietnam is 1,000%, was showed that Vietnam was one of the attractive destinations with foreign investors. In the early years of attraction, the growth rate increased with slight fluctuations. From the 2000s, the growth rate started to increase gradually, especially in the period from 2006 to 2008, when the capital flowed to Vietnam which had a growth rate 3 times. This was time that Vietnam officially became a member of the International Trade Organization WTO (2007). However, after that, dueing to the impact of the world economic crisis (2008), the growth rate of FDI had gradually decreased. However, Vietnam appeared a number of large million-dollar projects such as Nui Phao Mineral Mining and Processing Joint-Venture Company with USD 147 million or Thanh Cong Investment and Development Company with 114,58 million USD. It may be said that in this period, Vietnam had significantly improved the investment - business environment, and had flexible policies to suit the world's development flows. Therefore, big investors from developed countries such as the US, Japan, Korea ... started to come and pour capital into Vietnam. In 2018, summarizing 30 years of investment attraction, FDI accounted for 55% of industrial production, 70% of revenue from exports, 18% of tax revenue, creating 3.7 million jobs. The year 2019 was again an important step when the highlight of FDI disbursement at a record high of 20.38 billion USD. Currently, by the end of 2019, the total newly registered, adjusted and contributed capital and purchased shares of foreign investors had reached 38.02 billion USD, up 7.2% over the same period in 2018. Total projections valid projects were 30,827 valid projects with a total registered capital of 362.58 billion USD. Implementation of capital projects accumulated foreign direct investment estimated at 211.78 billion US dollars, by 58,4 % of the total registered capital in force. In 2020, due to the influence of Covid epidemic in the first months of the year, the situation of attracting FDI had decreased significantly. In the first three months of the year, "the total newly registered, adjusted and contributed capital and purchased shares of foreign investors reached 8.55 billion USD, equaling 79.1% as compared to the same period in 2019".

About investment field: until now, FDI had invested in 19/21 sectors in the sub-sector system of the national economy of Vietnam, in which FDI enterprises still prioritized investment in the field of processing and manufacture industries which accounted for the highest proportion with 214.2 billion USD or 59.1% of total investment capital. The following was the business areas of real estate with 58.4 billion (accounting for 16.1% of total investment); then production and distribution electricity with 23.65 billion USD (accounting for 6.5% of total investment capital).

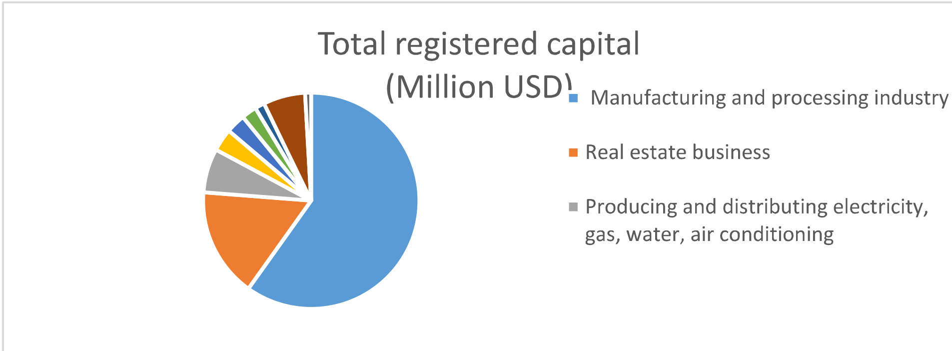

Figure 2: FDI by investment field

Source: Foreign Investment Department - Ministry of Planning and Investment

About foreign investors: by the end of 2019, Vietnam had welcomed investors from 135 countries and territories. In which, Asian countries were the the largest proportion of FDI to Vietnam, the first by South Korea with a total registered capital of 67.71 billion USD (accounting for 18.7% of total investment capital); followed by Japan and Singapore, Taiwan, Hong Kong.

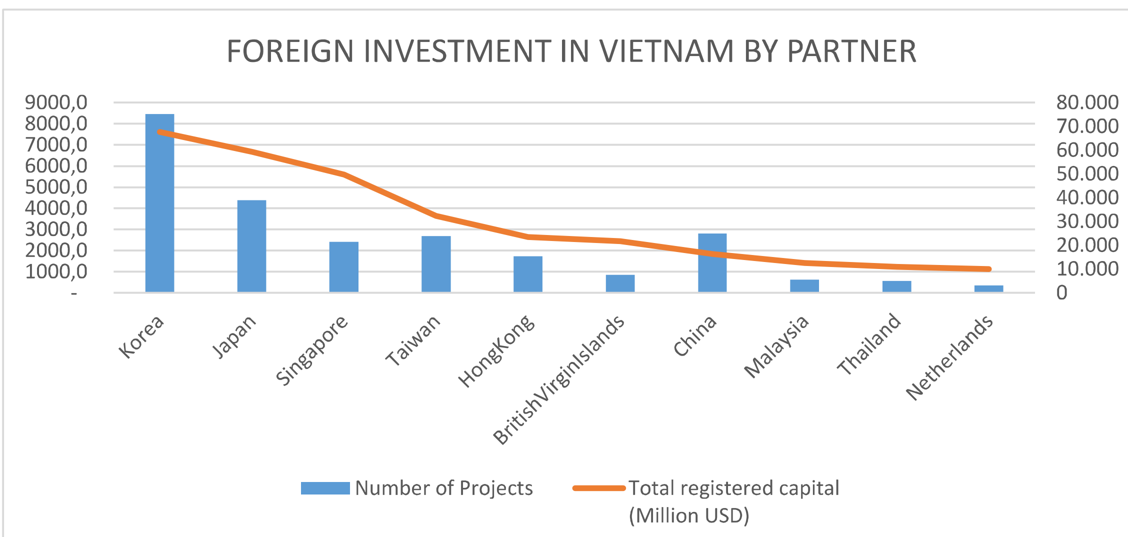

Figure 3: FDI by major foreign investors

Source: Foreign Investment Department - Ministry of Planning and Investment

About investment locations: FDI had been present in all 63 provinces and cities nationwide. FDI was still looking to cities that were political and economic centers of the country such as: Ho Chi Minh City, Hanoi, Hai Phong ... And Ho Chi Minh City was still the leading province in attracting foreign investment with 47.34 billion USD (accounting for 13.1% of total investment capital); followed by Binh Duong with 34.4 billion USD (accounting for 9.5% of total investment capital); Hanoi with 34.1 billion USD (accounting for 9.4% of total investment capital).

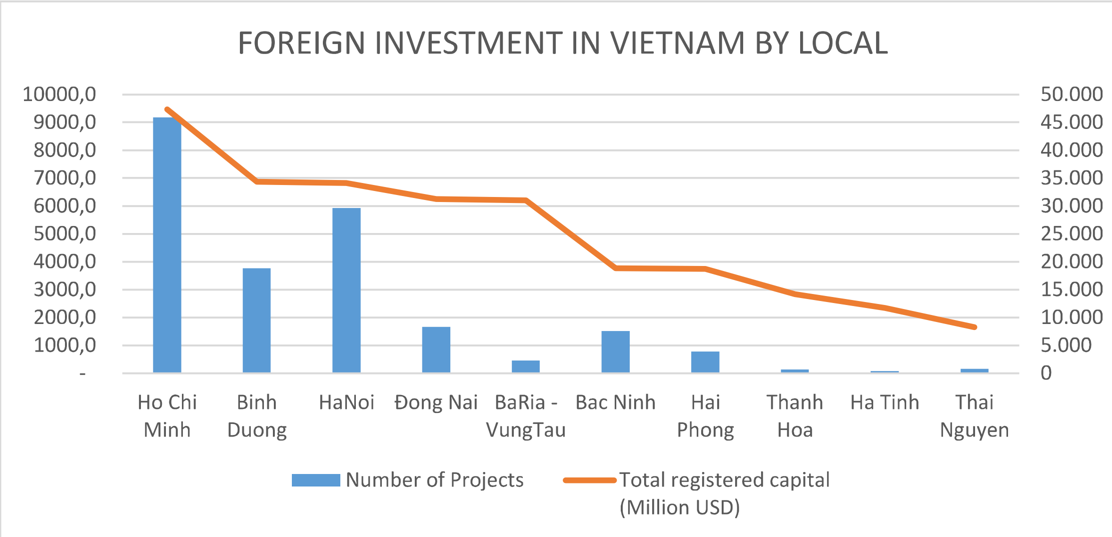

Figure 4: FDI by localities

Source: Foreign Investment Department - Ministry of Planning and Investment

Despite the impressive results of FDI, Vietnam had gradually realized that it was necessary to have strategic policy change to maintain competitiveness in ASEAN and ensure sustainability FDI inflows received and accelerated FDI with higher added value to achieve development goals. The Government of Vietnam wisely judged about 5-6 years ago that the quality of FDI which needed to be improved in terms of value-added enhancement and spillover benefits, as reflected in Resolution No. 103. / NQ-CP issued by the Prime Minister at the end of August 2013. Over 30 years with many changes, efforts moving towards a complete environment have brought remarkable results with Vietnam.

3.2. Spillover effects of FDI in the Vietnamese economy

Currently, the spillover effects in Vietnam are done most through 4 ways, which are: labour movement, technology dissemination & transfer, production linkage and competition.

Labour movement

Positive effects were created when the employmees was trained on skills, qualifications and absorb the knowledge or technology from FDI enterprises, then they moved from FDI to sector in domestic firms. When employees used the knowledge, skills there and applied to the domestic enterprises, it meaned generate spillover effect was positive for investment-receiving countries. These employees could set up their own companies or work for domestic enterprises in the same industry in which FDI enterprises are operating.

Technology transfer

This is considered as an important positive spillover effect of the FDI sector. Currently, the commonly indicator which was used to measure technology absorption from FDI enterprises, was the education level or the professional qualifications of the labour force and the technology innovation of the business through indicators for activities of R&D. FDI enterprises' ability absorbed new technology was also an important factor creating spillover effects. The parent companies were the places that created new technologies, so the higher the absorption of new technologies by subsidiaries, the more beneficial spillover effects were.

Over the past years, FDI enterprises had stimulated and encouraged domestic enterprises to innovate and improve their technological capacities. FDI enterprises created opportunities for domestic enterprises to acquire the most favorable scientific and technological achievements. Many modern technological lines of many industries such as information technology, light industry, agriculture ... had been put into production, thereby increasing labour productivity and enhancing commodity competitiveness of Vietnam on the world market.

Production association

Spillover effects were created mainly through production association. In the production linkage, there were two forms such as: vertical linkage and horizontal linkage, so there are two ways of spillover effects: (1) Horizontal spillover effect which was affected to companies in the same industry; (2) The vertical spillover effect which was the spillover effect from FDI enterprises to regional enterprises in another sector which provided inputs material to this FDI or from FDI enterprises to regional enterprises in another sector which FDI firms provide inputs.

Another type of interdisciplinary spillover effect is suplybackward: FDI firms can also create demand for local output. These "backlinks" can increase strengthen supply industries, which in turn supplies the material (via downlink) to other local companies.

Competitive environment

FDI enterprises created great competitive pressure for domestic enterprises, that increased the competitiveness of the domestic economic sector. It was a positive spillover effect on the economy. Domestic firms in the same industry would had to innovate if they did not want to lose the market. Domestic businesses could have to improve product quality, change management forms, marekting, technology ... to have a chance to compete. Since then, domestic enterprises gradually aimed to compete with the international market. In addition, FDI enterprises also had to compete with domestic enterprises in terms of products such as types, designs, customers, price .. which made the product quality increasing and consumers will be using more quality products.

In general, the emergence of FDI enterprises had pushed Vietnamese enterprises, especially large enterprises made efforts to invest in production, innovate product designs, develope brands, and expand distribution to dominate domestic and international market share. Domestic enterprises had become more professional, increasingly responding to market fluctuations and increasing competition with international businesses.

Over the years, FDI has created a positive spillover effect on the economy in Vietnam, but there are still some limitations such as:

The competitiveness of Vietnamese enterprises was still limited in receiving spillover effects from FDI. Vietnamese enterprises were mainly small and medium enterprises, so the appearance of FDI enterprises made domestic enterprises more fierce competition. This was a playground for large businesses or businesses that had internal resources and businesses with poor "resistance" were easily eliminated or reduced their production scale.

The dissemination and transfer of technology from foreign enterprises to domestic ones was also problematic. Domestic enterprises - which received investment, had wanted to receive technology transfer, need to depend on their internal technological capacity or their ability to absorb technology and the level of technology difference between FDI enterprises and domestic enterprises. Many domestic enterprises still have limited technological capacity, technical qualifications and human resources, so they cannot accept technology transfer from FDI enterprises.

Vietnamese enterprises still have limited autonomy in raw materials and input factors. The association in spillover effects requires development of supporting industries to facilitate the development of businesses in general. However, some production and business industries in Vietnam are not proactive in raw materials and depend on imports, leading to spillover effects that are not really effective.

Participating in the global supply chain of Vietnamese enterprises was low. According to economists, Vietnam had 21% of enterprises participating in the global supply chain, while in Thailand this rate was 30%, Malaysia was 46%. Some industries in Vietnam, our businesses mainly focused on low value-added stages such as garment, footwear, raw product processing ... Also due to this lack of tight association, Vietnamese enterprises had relatively low competitiveness while labor productivity had not improved much.

4. Discussion and Conclusion

In order to promote the positive spillover effects and overcome the limitations of the FDI sector spillover effects, some solutions was offered as:

Firstly, improving the competitiveness of domestic enterprises. Enterprises need to be confident and proactively participate in the global supply chain and have a strategy to develop and adapt to FDI enterprises. In addition, domestic enterprises may be increased to regularly renew and improved their management skills to meet general international requirements.

Secondly, promoting the development of high-quality human resources: Human resources are considered the decisive factor to take advantage of and exploit the positive spillover effects of FDI on Vietnam. Therefore, improving the quality of human resources in terms of physical strength, mental strength and skills is an urgent requirement for Vietnamese businesses today. In addition, it is necessary to have a policy to "retain" labor, prevent "brain drain" and attract workers from the FDI sector.

Thirdly, increasing investment in science and technology development and improving the quality of technology transfer. Improving the level of technological equipment in parallel with the improvement of the quality of human resources are the basic conditions for improving technology absorption and management skills from the spillover effects of FDI on Vietnamese enterprises. .

Fourthly, to develop supporting industries, strengthen linkages in production and supply of raw and auxiliary materials for Vietnamese textile and garment enterprises. Supporting industries are an important industry in the production chain. This is both a pull factor to attract FDI and a bridge between domestic enterprises and the FDI sector. Therefore, supporting industry development should also be given attention and priority to develop in the coming time.

The last, developing industrial clusters/ zone production toward creat value.

The impact of this trend on FDI was through improving competitiveness compared to enterprises outside the cluster. From the perspective of economic development and FDI Attraction Strategy, Vietnam would have opportunities to attract businesses specializing in supporting industries to increase the ability that created value for the cluster and favorable business environment, especially in skills development and streamlining start-up and business processes. And the formation of cluster groups is required the participation of the management and initiation of the state to avoid the over-formation and not achieve the desired effect.

Conclusion: FDI has shown its role in the economic growth of countries. The correct assessment of the effects of FDI including spillover effects has a great influence on promoting the efficiency of the FDI sector. That is also the basis for giving effective solutions to the development of enterprises in the economy in the coming period.

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