

## **ABSTRACT**

Foreign Direct Investment (FDI) is expected to benefit developing countries through raising domestic investment, creating jobs, transferring technology, enhancing domestic competition and producing positive externalities. However, each developing country has different initial conditions and distinctive institutional setups. Heterogeneity in each country implies that the benefit of FDI may vary from country to country.

The purpose of this thesis is to examine the role of FDI on economic growth in Vietnam using time series data over the period 1986-2006. The period includes the 1990s, when Vietnam launched economic reform Doi Moi and financial liberalization process. We construct an endogenous growth model in which the rate of technological progress is the primary determinant of the long term growth rate of income.

Cointegration technique is utilized to verify the adoption of endogenous growth model of Vietnam. The result indicates that there exists a long-run relationship between FDI and economic growth. Employing the Error Correction Model (ECM), we examine the speed of adjustment toward the long run equilibrium. Our finding shows that both FDI and human capital have positive effects on economic growth. Domestic investment is stimulated by FDI. Nevertheless, the negative effects of interaction terms between FDI and human capital on economic growth show that the low labor skills in Vietnam restrict the contribution of FDI to economic growth. It means that absorptive capability of FDI in Vietnam is still slow and thus Vietnam needs to improve labor skills to maximize the benefits of FDI on economic growth.