

## **CHAPTER 6**

### **CONCLUSION AND POLICY IMPLICATIONS**

#### **6.1 Conclusion**

Since the promulgation of Law on Foreign Investment, Vietnam has achieved quite impressive performance in attracting FDI inflows. Together with the magnificent GDP growth, FDI sector accounts for an increasing share in GDP. This resulted from reform policies that Vietnam has pursued for the past years, while suggesting the interrelationship between FDI and economic growth. However, to date, there are still few researches on how FDI effect growth in Vietnam. Meanwhile, analyses of such topic may be useful for a consideration to give out a policy making in order to maximize the benefits of FDI inflows to Vietnam.

The study analyzes the role of FDI on economic growth in Vietnam for the period 1986-2006 using the endogenous growth theory framework. We find that FDI contribute significantly to economic growth. The results also show that FDI stimulate domestic investment and FDI will be better utilized if Vietnam has better stock of human capital. This result partly reflects the characteristics of the economic transition, yet it may be a drawback of the model using time series data for a short period. The interaction term of FDI and human capital shows that low secondary enrollment rate and low tertiary rate limit the contribution of FDI to growth. It means that absorptive capability of FDI in Vietnam is still slow and low labor skills may restrict the effect of FDI on growth.

The result of estimation is highly consistent with the actual trends in development process of the economy. It is also comparable with other studies. Such conclusion was confirmed by regression analysis on investment equation. FDI was found to be significantly correlated with domestic investment. Cointegration techniques and error correction model were employed to examine both short-run

impact and long-run equilibrium of relationship between FDI, economic growth and domestic investment.

The empirical results show that FDI is an important factor for growth in Vietnam in long run. However, the benefit from FDI is limited by the low level of human capital in the country. In the long term, Vietnam should improve its capacity, such as labor skills, R&D capacity, infrastructure etc, to attract large foreign investment and to increase absorptive capability. The foreign investment policy should focus on both the quantity and quality of the capital.

The results of this study might be a good reference for future studies on the relationship between FDI and growth. However, it suffers from at least two considerable drawbacks: the quality of data and sufficient length of time-series. The study has utilized various sources of data, thus consistency of data might be questionable. The short time-series of 21 annual observations from 1986 to 2006 though acceptable for statistical analysis, the problem of degree of freedom may draw concern. It is more valuable if the causality test was performed on the relationship between FDI, domestic investment and economic growth. Given few observations, such limitation can be overcome in the future by availability of better dataset. This research is also a good reference for studying the indirect effect of FDI via spillover effects at both macro and micro levels.

In conclusion, the result of this study indicates that the promotion of FDI is crucial for economic growth sustainability in Vietnam. Government should devise an implementable strategy for a resurgence of FDI flows into Vietnam. The new wave of FDI inflow into Vietnam is needed for the realization of industrializing the country by the year 2020.

## 6.2 Policy implications

FDI is an important component which effectively induces the growth of the whole economy. A lot of opportunities have been opened up through this channel of investment such as capital, technology, international experiences and networks. In the age of regional integration and globalization, the country can quickly access into the international playing field through the support from these foreign enterprises. In order to motivate more foreign investors to bring capital into the economy, the Foreign Investment Law has been changed many times to encourage foreign investors to invest in the country. However, the most important factor is how to implement these regulations in the reality. Government action will determine the behavior of foreign investors if they can enter or not, which type of investment they will undertake, long term or short term, good or bad for the host country. This is a key to the development of the economy.

The government needs have a long-term strategy on FDI utilization. This will provide clear guidelines for foreign investors about government priorities given to FDI in short, medium and long term. The lack of clear strategy on FDI may have generated unnecessary confusion for foreign investors determining their long term plans for doing business in Vietnam. That may also be the reason why a considerable number of foreign investors have invested in Vietnam for a short term benefits and immediately, withdrawn their investment when the situation became less favorable.

The improvement of the macroeconomic environment is another measure to attract more FDI inflows. A high and stable economic growth rate, controllable inflation and appropriate exchange rate will increase foreign investor confidence in Vietnam and create more business opportunities to attract FDI inflows.

The government policies that helps maximize the positive impacts and minimize the detrimental effects of FDI so far should be maintained. These include the insistence on local content, local resource development, local partners, exports and minimum wage requirements.

The improvement of the infrastructure in poorer provinces in order to enhance the attractiveness to FDI investors, speeding up the diffusion of foreign investment outward from current centers and hence to achieve more equal regional distribution of FDI. The government needs to shift its concentration of public expenditure toward poorer, densely populated provinces located around big cities or less developed provinces or mountainous provinces with rich natural resources in order to improve their physical and social infrastructure. Only with significant improvements in infrastructure such as transportation, energy and water supply as well as the quality of labor force will those poor provinces be able to attract larger amount of FDI.

The analysis shows that human capital plays a crucial role in the long-run growth. The country have benefited from the human resources, which have played a key role in absorbing advanced technology from the developed countries. However, the low level of human capital analyzed in this study shows that human capital in Vietnam is the barrier for the absorbing ability of FDI and restricts the contribution of FDI to economic growth in Vietnam. Thus, improving the quality of education in Vietnam as well as enhancing the quality of labor is necessary. Government should invest more to improve the human resources in order to get the most benefit from FDI inflows.