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Indicators of Attracting Foreign Direct Investment in Developing Countries: Evidence from Vietnam

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Abstract:

In today's global economy, whether in advanced or emerging markets, the importance of being open to trade and investment is widely acknowledged as a key driver of economic growth. This economic openness is primarily demonstrated through the unrestricted exchange of goods and services as well as the free movement of international capital. While previous studies have investigated the effects of export-driven, import-driven, and capital-driven growth strategies, this research focuses on analyzing the impact of each indicator of the Provincial Competitiveness Index (PCI) on attracting foreign direct investment (FDI). By utilizing a panel data model covering 63 provinces and cities in Vietnam from 2018 to 2022, this study explores the correlation between PCI, FDI, and economic expansion. Findings suggest that export-oriented growth policies can be more effective in fostering the development of Asian emerging economies than FDI-centric approaches. Nonetheless, FDI continues to be crucial for technology transfer, capital accumulation, and knowledge exchange in management. Regions with advanced economies are more appealing to FDI, while provinces with distinctive industrial strengths also attract foreign investment. To further boost FDI inflows, it is advised that the government streamline market entry procedures, reduce administrative and tax burdens, increase transparency, and promote fair competition. These measures are anticipated to improve the investment climate and enhance competitiveness on the global stage.

Keywords: Economic openness; foreign direct investment; economic growth.

1. Introduction

In the global economy, economic openness is considered a crucial factor in promoting economic growth, whether in developed or developing economies. Economic openness primarily manifests through the free trade of goods and services and the free flow of international capital. Existing studies have explored the impacts of export-led growth, import-led growth, and capital-led growth. Still, this study focuses on the role of each Provincial Competitiveness Index (PCI) indicator in attracting foreign direct investment (FDI). Using a panel data model for 63 provinces and cities in Vietnam from 2018 to 2022, this paper analyzes the relationship between PCI, FDI, and economic growth.

In recent years, southern Southeast Asia has drawn significant foreign direct investment, playing a pivotal role in propelling Vietnam's economic progress. To foster private sector advancement, Vietnam has introduced the Provincial Competitiveness Index (PCI) to evaluate and rank provincial governments' performance, capabilities, and willingness to cultivate a business-friendly regulatory environment. The 2008 iteration of the PCI underscored the essential role of economic governance. Provinces that are well-governed display not only more efficient resource utilization but also marked enhancements in business performance and revenue in subsequent years, regardless of the initial circumstances. The PCI's achievements can be attributed to the longstanding partnership between the Vietnam Chamber of Commerce and Industry (VCCI) and the Vietnam Competitiveness Initiative (VNCI), a project funded by the United States Agency for International Development (USAID). The project is managed by DAI, with significant contributions from The Asia Foundation (TAF) as a partner in VNCI. The PCI evolved from a study conducted by The Asia Foundation (TAF) and VCCI in 2003-2004 titled "Best Practices in Provincial Economic Governance," which covered 14 non-metropolitan provinces. Even though PCI employs varied approaches, its investigative tools are built upon the research of TAF-VCCI. Edmund Malesky from the University of California, San Diego, spearheaded the development of PCI research methodology and authored the analytical report.

This study utilizes FDI and GDP data for provinces and cities in the southern Southeast Asia region between 2018 and 2022, employing a panel data set to estimate the impact of the PCI on FDI. The research focuses on the direct impact of FDI on economic growth, land use rights indicators, and time costs associated with administrative procedures. Indicators related to informal costs and corruption are also included, as well as those covering fair competition, such as entry barriers and the moderating role of factors like market competition and trade openness. Through this study, the aim is to provide valuable references for policymakers to promote sustainable economic development in the region.

2. Literature Review

Research on foreign direct investment should be based on Vietnam's development and the investment preferences of foreign investors.

Numerous research findings indicate that Foreign Direct Investment (FDI) is crucial for fostering economic development, enhancing technological advancements, and boosting employment opportunities. For instance, research has demonstrated that FDI not only stimulates economic growth but also enhances technological innovation and operational effectiveness [1]. Moreover, foreign direct investment (FDI) plays a crucial role in bringing in capital and technology, thereby enhancing the capabilities and competitiveness of local businesses. Additionally, research findings on the determinants of FDI location decisions reveal that factors such as inflation, trade, level of education, and telecommunications infrastructure are significant. Notably, in Asian nations, evidence suggests that economic growth leads to FDI, indicating a one-way causal relationship between FDI and economic prosperity. This underscores how an initial economic upturn can attract increased FDI, consequently fostering further economic development [2]. The theoretical research discussed in this study highlights the significant role of foreign direct investment in fostering economic growth in recipient countries. Foreign direct investment plays a crucial role in driving economic growth through two primary mechanisms: firstly, by promoting the integration of new technologies into production processes via technology spillovers, and secondly, by facilitating the transfer of knowledge, which encompasses employee training, skills development, and the implementation of improved management strategies and organizational structures [3]. Efforts to enhance governance efficiency and foster innovation in less industrialized regions may not yield the anticipated economic outcomes due to underlying structural limitations. This implies that simply improving governance efficiency is insufficient in driving economic development in these areas. The research revealed a notable correlation between economic growth and two governance effectiveness indicators: the efficacy of collaboration with the central government in legislation drafting and ingenuity in addressing business challenges. This correlation was more pronounced in highly industrialized regions. In less industrialized provinces experiencing rapid growth, focusing on modest, achievable initiatives like simplifying business licensing procedures and ensuring consistent regulatory compliance could have an immediate impact. Conversely, less industrialized provinces with slower growth rates may require financial support from the central government to compensate for the reduced tax revenues compared to more competitive regions [4]. Vietnam's Changing Landscape: The Impact of Internal Migration

In the wake of reforms in the mid-1980s that shifted Vietnam towards a market-oriented economy, internal migration within the country has surged. This movement of people from rural to urban areas has been primarily driven by the promise of better economic prospects and opportunities that the new economic landscape presents. While the distinction between government-led and spontaneous migration remains blurred in available data, the trend is clear - individuals are flocking to urban and industrial hubs where job opportunities abound. The urban population is experiencing a rapid annual growth rate of 3.4%, far outpacing the rural areas at 0.4%. This internal migration wave has been instrumental in Vietnam's economic progress. By catering to the labor demands generated by industrial growth and foreign investments, migrants are not only improving the livelihoods but also contributing to the overall economic development of the nation. Many migrants also play a crucial role in bridging the income gap between urban and rural areas by sending a portion of the earnings back to hometowns. While challenges such as limited access to basic services and subpar living conditions persist for many migrants, the overall sentiment of post-migration seems positive. Reports of increased income and better living standards highlight the tangible benefits that internal migration can bring. By facilitating the redistribution of labor and resources from urban centers to rural areas, internal migration is playing a pivotal role in reducing regional disparities within Vietnam. However, income inequality still looms large, with urban dwellers enjoying a significantly higher standard of living compared to rural counterparts. As Vietnam continues to evolve, the impact of internal migration on its socio-economic fabric remains a dynamic and evolving phenomenon, shaping the future trajectory of the nation's development. [5].

Research shows that export-led growth policies can promote the growth of developing countries in Asia more than FDI-led growth. However, FDI still plays an important role in technology introduction, capital accumulation, and transfer of management experience [6]. Foreign investors venturing into emerging economies are often met with a complex landscape influenced by market government agencies. Understanding the interplay between institutional factors and available resources is crucial for devising effective entry strategies. By integrating institution-based strategic perspectives with resource-based considerations, investors can navigate the challenges and opportunities presented in these dynamic markets. A theoretical model is presented to examine the impact of institutions in developing countries on the decisions regarding entry strategies. Through this framework, the factors influencing entry strategy choices related to the location and mode of entry in Vietnam are explored. It is observed that subnational institutional factors play a crucial role in both aspects. The presence of limited resources influences the choice of FDI location and the preference for greenfield investments. Additionally, pressures from established state-owned enterprises and the domestic market focus of investors tend to steer them towards forming joint ventures [7]. In the realm of burgeoning economies, the enhancement of institutional structures, infrastructure, and factor market dynamics plays a pivotal role in bolstering the growth potential. A key focus lies on mid-range emerging economies, situated between established emerging markets and newly industrialized nations, striving to allure investments and foster sustainable development. Delving into the realm of multinational corporations navigating regional and global landscapes, the research sheds light on the strategic imperatives of internationalization for corporations in these medium-sized economies. Factors such as governmental policies, resource management, market penetration, and corporate governance intersect to shape the trajectory of emerging multinational enterprises in these dynamic economic landscapes [8]. At the same time, Research UK found another phenomenon, where acquirers make very substantial gains during FDI announcement periods. Perhaps surprisingly, acquirers who invested in countries with high political risk and high corruption rates achieved the highest returns. The type of assets acquired also has a significant impact on the returns of the acquirer's shareholders, with acquirers of physical assets receiving the highest returns. Additionally, the highest returns can be achieved by investing in real assets in emerging markets with high corruption rates. They argue that in emerging markets with high corruption rates, British firms following resource-seeking strategies are more likely to obtain resources on favorable terms [9]. The strategies for foreign direct investment (FDI) by companies in various newly industrialized economies vary from those of companies in advanced economies. Research indicates that the decision on subsidiary ownership is influenced by the level of family and institutional ownership in the parent company. Moreover, establishing a strong commitment upon entry is linked to locating the subsidiary in a region that shares economic, cultural, and historical connections with the parent company. High-commitment entry is found to be positively associated with the location of the subsidiary in a region with close economic, cultural, and historical ties to the parent firm. Furthermore, entry mode and location decisions appear to be interrelated [10].

3. Method

3.1 Model

The time series dimension of the model captures the association between attracting outward investment and the time-varying dependent variable of provincial governance. The presence of continuous data over time for the identical observation units (such as provinces) supports the application of a fixed effects model. By considering potential correlations between the individual (provincial) characteristics and the target variable, adjusting for variations among cases aids in assessing the significance of factors like various governance indicators.

$$FDI_{it} = \beta_0 + \beta_1 PCI_{it} + \beta_2 GDPpc_{i(t-1)} + \gamma X_{it} + \alpha_i + u_{it} \tag{1}$$

$$FDI_{it} = \beta_0 + \beta_1 CSTP1_{it} + \beta_2 CSTP2_{it} + \beta_3 CSTP3_{it} + \gamma X_{it} + \alpha_i + u_{it} \tag{2}$$

Where:

FDI_{it}: Foreign direct investment in the i th region in the year t

PCI_{it}: Vietnam's provincial competitiveness index in the i th region in the year t

$GDPpc_{i(t-1)}$: GDP per capita in the i th region in the year $t-1$.

$CSTP1_{it} CSTP2_{it} CSTP3_{it}$: $CSTP1 CSTP2 CSTP3$ in the i th region in the year t

X_{it}: Other control variables

α_i: Fixed effects in the i th region

u_{it}: Error term

3.2 Data

The study utilizes data from two main sources: the Vietnam Provincial Competitiveness Index (PCI) dataset and the General Statistics Office (GSO) database of Vietnam. The PCI initiative, managed jointly by the United States Agency for International Development (USAID) and the Vietnam Chamber of Commerce and Industry (VCCI), aims to enhance the business environment in Vietnam. This index assesses economic governance in the country's 63 provinces and supports local socio-economic advancement by evaluating various factors affecting the ease of doing business for the private sector. These factors include entry costs for new businesses, land use rights, transparency, regulatory compliance time, informal fees, provincial leaders' commitment, policy preferences, business support services, workforce training, and legal institutions. Developed in 2005 with collaboration from international and local experts and USAID's support, the PCI annually surveys around 11,000 domestic private enterprises and 2,000 foreign companies operating in Vietnam, providing crucial insights for policymaking.

The PCI has evolved from a monitoring tool for local governments to a respected diagnostic instrument government officials utilize to pinpoint issues and implement strategies for enhancing economic governance and fostering a more conducive business environment. Through regular diagnostic workshops held in provinces nationwide, the PCI project facilitates direct feedback from the private sector to provincial leaders, fostering a constructive policy dialogue and prompting local governments to introduce plans for improving the business environment. The annual release of the PCI index has motivated reforms and boosted Vietnam's competitiveness globally, resulting in enhanced economic governance performance across all provinces. This progress is evidenced by the development of improvement plans by all provinces, score enhancements in 62 provinces, and the promulgation of over 300 legal documents aimed at PCI enhancement. Notably, in 2014, the Prime Minister of Vietnam incorporated PCI as a key goal to elevate national competitiveness, urging ministries to further enhance the business and investment environment. Similarly, in January 2019, the Vietnamese government issued Resolution No.2 to continue advancing the business environment, emphasizing the importance of the PCI as a significant measure in this endeavor.

Table 1. Summary of variables (2018–2022).

Main Variable	Description (Source)	N	Mean	Std. Dev
FDI	Foreign direct investment (GSO)	235	694.308936	1354.475297
PCI	Provincial Competitiveness Index (VCCI)	235	64.986691	2.976253
GDP per capital	Gross Domestic Product per capita (GSO)	235	7596.123404	4815.579708
CSTP1	Time to market: Includes indicators related to market entry (VCCI)	235	7.237532	
CSTP2	Land use rights indicators: Covers indicators related to land use rights (VCCI)	235	6.889957	0.526989
CSTP3	Transparency: Includes transparency-related indicators (VCCI)	235	6.115149	0.559520

In Table 1, The dataset contains various indicators in different worksheets. Includes the overall score of each indicator and the investment value in millions of US dollars. CSTP1 Time to Market: Contains indicators related to market entry, such as registration time, ease of obtaining permits, and related costs. CSTP2 Land Tenure Indicators: Covers indicators related to land tenure, including land registration, lease duration, and related costs. CSTP3 Transparency: Includes transparency-related indicators, such as regulations and public availability of information4.

4. Result

In Table 2, R-squared is 0.788. This means that the model explains approximately 78.8% of the factors in FDI. Adjusted R-squared: 0.733, which explains the number of predictors in the model, indicating a good fit of 73.3%. F-statistic shows high value combining with the very low p-value indicates that the overall model is statistically significant. Intercept is the expected mean of FDI when all predictors are zero. However, the high standard error and nonsignificant p-value (0.900) indicate that the intercept is not significantly different from zero. The regional effect is significant in Binh Duong, Bac Ninh, Hanoi, Hai Phong, and urban areas. Ho Chi Minh City has a significant positive coefficient, indicating higher FDI compared to the baseline region. TP. Ho Chi Minh has the largest positive impact on FDI (Coefficient = 6537.6730, p < 0.0001). Hanoi also showed a strong positive effect (Coefficient = 4849.3128, p < 0.0001). Binh Duong (Coefficient = 2995.5591, p < 0.0001) and Haiphong (Coefficient = 2900.4152, p < 0.0001) are also significant contributors. Bac Ninh, Bac Giang, Bac Lieu, and other regions also showed significant positive effects.

Table 2. Regression Outputs (Province, FDI, Provincial Competitiveness Index, GDP per capita).

	Province	Coefficient	Std. Error	t-Statistic	P>|t|	[0.025	0.975]
1	Binh Duong	2993.9299	656.838	4.558	0.000	1698.120	1778.835
2	Bac Lieu	893.0484	449.000	1.989	0.048	7.262	1955.418
3	Bac Giang	1064.9691	451.363	2.359	0.019	174.520	3085.741
4	Bac Ninh	1782.4270	660.642	2.698	0.008	479.113	5979.124
5	Hanoi	4848.0670	573.326	8.456	0.000	3717.010	4100.072
6	Hai Phong	2899.0077	608.812	4.762	0.000	1697.944	7817.844
7	Ho Chi Minh	6536.0327	649.742	10.059	0.000	5254.222	2968.775
8	Dong Nai	1890.2303	546.708	3.457	0.001	811.685	1778.835

In Table 3, CSTP1 (coefficient = 299.3829, p = 0.003) is statistically significant, indicating that it has a positive impact on FDI. CSTP2 (coefficient = 101.5254, p = 0.392) CSTP3 (coefficient = -148.6024, p = 0.248) This shows that the model explains a higher proportion of the variation in FDI and has a significant positive impact on FDI compared to CSTP1. The regression results once again confirm that specific regions, especially TP, Ho Chi Minh City, and Hanoi, are the main factors attracting FDI to Vietnam. The time variable (year) has no significant impact on FDI, suggesting that regional characteristics and possibly policy or infrastructure factors are more influential. Furthermore, CSTP1 had a significant positive effect on FDI, whereas CSTP2 and CSTP3 had no significant effect.

Table 3. Regression Outputs (Province, FDI, CSTP1, CSTP2, CSTP3).

Variable	Coefficient	Std. Error	T	P>|t|	[0.025	0.975]
CSTP1	299.3829	100.897	2.967	0.003	100.298	498.468
CSTP2	101.5254	118.315	0.858	0.392	-131.929	334.979
CSTP3	-148.6024	128.187	-1.159	0.248	-401.535	104.330

Investment reasons for why the time to enter the market and related indicators (such as registration time, ease of obtaining a license, and related costs) have a greater impact on foreign direct investment (FDI) can be explained from the following aspects. In a country or region, the shorter the time required to set up a business, the lower the barriers to entry for investors. This convenience attracts more foreign investment, as a quick registration process means investors can start operations and earn profits faster. If obtaining the licenses and approvals required to operate is complex and time-consuming, investors may be attracted to other markets where procedures are simpler. Simplifying and expediting the license approval process can reduce investors' time and costs and increase market attractiveness. The lower the fees and taxes associated with market entry, the lower the initial costs for investors, thereby increasing the return on investment. This is particularly important for SMEs, as the resources and finances are more limited. Reducing time-to-market means businesses can start operations sooner, thereby generating revenue earlier. This has a direct impact on ROI, especially in highly competitive industries were getting to market quickly can capture market share. An efficient market entry process reduces the opportunity cost for investors because they do not need to wait long for business operations to begin and can profit from the investment earlier. In the context of globalization, competition among countries to attract foreign investment is fierce. Countries that can provide more convenient market entry conditions are more likely to have an advantage in attracting FDI. Improving the timing and conditions of market entry can improve a country's competitiveness in global investment markets. The World Bank's Doing Business report states that the report annually evaluates countries' ease of starting and operating businesses, including registration time, license processing, and other indicators. Countries with easy market entry are generally able to attract more FDI. Research shows that simplifying administrative procedures and reducing barriers to market entry significantly increases FDI inflows. Through data analysis and case studies, these studies verify the importance of efficient market entry processes in attracting foreign investment.

5. Discussion

The results show that among these eight provinces, CPI has the most significant impact on FDI. They all have unique economic advantages, with per capita GDP ranging from high to low. Ho Chi Minh (Ho Chi Minh City) is the largest city and economic center in Vietnam. Its economic characteristics include Ho Chi Minh City has a large number of industrial areas and is a major center for manufacturing and exports. Finance, banking, retail, and tourism are very developed. It is one of the major cities in attracting foreign investment.

Hanoi (Hanoi) is the capital of Vietnam and one of the political, cultural, and economic centers. Its economic characteristics include Government agencies and educational and cultural centers. Industry and manufacturing: Although not as good as Ho Chi Minh City, it still has a considerable industrial base. Real estate and infrastructure have developed rapidly in recent years.

Binh Duong (Binh Duong Province) is an important industrial province in southern Vietnam. Its economic characteristics include being Vietnam's industrial powerhouse with numerous industrial parks and manufacturing companies. It has attracted many foreign-invested enterprises, especially in the manufacturing field. Due to its geographical location, the logistics and warehousing industry is developing rapidly.

Hai Phong (Haiphong City) is an important port city in northern Vietnam. It has the largest deep-water port in northern Vietnam and is an important logistics and transportation center. It has multiple industrial zones and has attracted a large amount of foreign investment. It has a relatively developed shipbuilding and ship repair industry.

Dong Nai (Dong Nai Province) is an important industrial province in southern Vietnam. It has many industrial parks and is a manufacturing center. Traditionally there is an agricultural base, mainly growing rubber, coffee, and tropical fruits. It has attracted many foreign-invested enterprises, especially in the industrial field.

Bac Ninh (Bac Ninh Province) is an emerging industrial province in northern Vietnam. Home to many world-renowned electronics manufacturing companies, such as Samsung. There are many modern industrial parks. It is one of the popular provinces for attracting foreign direct investment, especially in high-tech manufacturing.

Bac Giang (Bac Giang Province) is a developing province. Its economic characteristics include Traditionally an agricultural province, growing mainly vegetables and fruits. The pace of industrialization has accelerated in recent years, attracting some manufacturing companies. Due to its proximity to major traffic arteries, the logistics industry is also gradually developing.

Bac Lieu (Bac Lieu Province) is a coastal province in southern Vietnam. Its economic characteristics include mainly aquaculture, especially shrimp farming. Rice and other crops are mainly grown. There have been certain developments in the fields of wind and solar power generation in recent years. The economic characteristics of these provinces and cities reflect the diversity and complementarity of Vietnam's economic development in different regions. From industrial manufacturing to agriculture and aquaculture, each province and city has its own unique advantages and economic priorities.

6. Conclusion

Time to market and related administrative and cost indicators have a significant impact on FDI because they are directly related to investor convenience, risk control, cost management, and speed of returns. Improving efficiency and transparency in these areas can significantly increase a country or region's attractiveness for foreign investment. This paper uses the latest panel data set of provinces and cities in southeastern Vietnam to study the impact of the overall assessment of market entry, access to land, transparency, fair competition, etc. on foreign direct investment (FDI).

Practical research results show that market entry has a significant impact on FDI. The reasons can be summarized as follows. Simplifying and accelerating the registration and license approval process can reduce investors' barriers to market entry, allowing them to start operations faster and increase return on investment. Reducing fees and taxes associated with market entry can reduce investors' initial costs and increase willingness to invest. Efficient administrative processes reduce investment uncertainty, enhance investor confidence, and attract more foreign capital inflows. Reducing time to market allows businesses to generate revenue earlier, thereby increasing ROI. In the context of globalization, countries that provide convenient market entry conditions have a competitive advantage in attracting FDI. Improving the timing and conditions of market entry can significantly enhance a country's international competitiveness. Research shows that market entry time and related administrative and cost indicators directly affect investor convenience, risk control, cost management, and revenue speed. Improving efficiency and transparency in these areas can significantly increase a country or region's attractiveness for foreign investment. This has been verified in the specific case of Vietnam. The impact of PCI on foreign direct investment has been significant in some regions. In the 2018-2022 data, the significant effect of PCI on most regions is that cities with high economic rankings have a greater impact.

It can be inferred that FDI is also affected by other supporting models, or the impact of these indicators in other aspects (e.g. policy, infrastructure) may be more complex. Economically developed provinces and cities (such as Ho Chi Minh City and Hanoi) are significantly attractive to FDI. It is recommended that to further attract foreign investment, the government should continue to simplify the market entry process, reduce administrative and tax costs, improve transparency, and ensure fair competition. These measures will help improve the investment environment and enhance competitiveness in the global market.

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