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**FDI AND VIETNAM'S LIBERALIZATION ON
INVESTMENT IN FREE TRADE AGREEMENTS**

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FDI AND VIETNAM’S LIBERALIZATION ON INVESTMENT IN FTAs

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LIST OF ABBREVIATIONS

ASEAN	Association of South East Asian Nations
FTA	Free Trade Agreement
FDI	Foreign Direct Investment
WTO	World Trade Organization
UNCTAD	United Nations Conference on Trade and Development
AFTA	ASEAN Free Trade Agreement
AKFTA	ASEAN – Korea Free Trade Agreement
AANZFTA	ASEAN – Australia/New Zealand Free Trade Agreement
ACIA	ASEAN Comprehensive Investment Agreement
AFAS	ASEAN Framework Agreement on Services
OECD	Organization for Economic Cooperation and Development

Abstract

Being active in international economic integration, Vietnam not only promotes trade but also attracts a lot of foreign investment. Over the past 20 years, FDI into Vietnam has increased dramatically and Vietnam has gained considerable success in joining the FTA and liberalizing investment. By early 2018, it has signed 12 FTAs, one is planned to be signed and are negotiating three other FTAs. However, the degree of liberalization on investment in Vietnam's commitments is not the same under each FTA. The objective of this study is to assess the FDI inflows and the extent of liberalization on investment in AFTA, AKFTA and AANZFTA. Although Korea has the highest FDI inflows, Vietnam's commitments in AFTA are the highest in terms of investment and investment in services. In general, the level of investment liberalization in services is lower than that in manufacturing industries regulated by investment agreements. There are still a large number of sectoral reservations and sectors/subsectors with restrictions. This reflects the fact that the FDI inflow into service is very limited compared to the investment flow in the manufacturing sector.

I. Introduction

International integration and the attraction of foreign investment are considered as two of the most important resources for the growth of Vietnam's economic since the reform "Doi Moi" in 1986 (Le, 2002). For over two decades, from 1996, when Vietnam joined its first free trade agreement - ASEAN FTA, till early 2018 Vietnam has signed 12 FTAs, planned to sign one FTA and negotiated 3 others, both individually and as member of ASEAN (WTO Center, 2018). Besides that, Vietnam has achieved impressive success in attracting FDI. Since becoming a member of the WTO, FDI inflows into Vietnam have increased about five times compared to previous period and have made Vietnam as one of the largest FDI recipients in ASEAN. It also became one of the five most attractive foreign investment destinations in 2016 in the world, according to UNCTAD (2017).

Participation in FTA plays an important role not only in enhancing international trade but also in attracting FDI. Through FTA, market access are provided, stable and non-discrimination environment are ensured, and investment and interests of foreign investment are protected. However, the commitments and the degree of liberalization of Vietnam, like other countries, are different in each FTA and therefore have different influence on the attraction of FDI inflows.

The aim of this study is to clarify the content of Vietnam's commitment to investment in some FTAs, compares the extent of the liberalization of investment, and from there, identify how it might affect the FDI inflows into Vietnam. The impact of the FTA investment agreements on perceptions and decision of investor is not only by opening market for foreign investors, creating opportunities and protecting them and their investments in host countries, but also by creating a favorable environment, promoting investment and securing investor's interests in disputes. However, the scope of study limits only to principles of investment liberalization that Vietnam has committed to foreign investors. For services, the effectiveness of investment liberalization are usually imposed in Mode 3 (Commercial presence) but also in other modes, especially Mode 4 (Presence of natural persons), the coverage of persons who are eligible to enter the market which is often strictly regulated. However, this paper is also limited only to Vietnam's commitments in market access under Mode 3 in specific schedules.

ASEAN FTA (AFTA), Asean – Korea FTA (AKFTA) and Asean – Australia/New Zealand FTA (AANZFTA) are selected to be assessed in this study. While ASEAN and Korea are the two largest investors of Vietnam in 2016, Australia is one of the FTA partners which have low investment capital in Vietnam. Both agreements of AKFTA and AANZFTA came into force during the period 2009 to 2010. For ASEAN, ASEAN Comprehensive Investment Agreement (ACIA) was signed in 2009 and came into effect in 2012. In term of services, although the ASEAN Framework Agreement on Services (AFAS) was signed in 1995, from the 1st to 7th Package of Commitments under AFAS the level of service openness in Vietnam's commitments is just equal or even lower compared to that in WTO. Until 2010, when the 8th Package came into force, higher commitments were made for some subsectors and some new subsectors were opened for trade and investment (WTO Center, 2015). Particularly, this study are based on the text of investment and services agreement/chapters as following:

- For ASEAN-Korea FTA:
 - o Agreement on investment
 - o Agreement on trade in services
 - o Schedule of Specific Commitments of Vietnam – Annex of Agreement on trade in services
- For ASEAN - Australia – New Zealand FTA

- Chapter 8: Trade in services
- Chapter 11: Investment
- Vietnam's Schedule of specific services commitments
- For AEC
 - ASEAN Comprehensive Investment Agreement (ACIA)
 - ASEAN Framework Agreement on Services (AFAS)
 - Vietnam's schedule of specific commitments – The 8th Package of Commitments under AFAS (2010)
 - Vietnam's schedule of commitments on Air transport services under AFAS – The 7th Package (2011)
 - Vietnam's schedule of commitments on Financial services under AFAS – The 5th Package (2011)

The next sections of this paper will be organized as follows. Section 2 will give a brief literature review of the impacts of FTAs on FDI. Section 3 then provides an overview of Vietnam's economy and FDI regulation framework. Following is section 4 which refers to methodology. Section 5 analyze on Vietnam's inward FDI and Vietnam's commitments in FTAs. Section 6 follows this by giving a discussion. The final section are conclusion and recommendations.

II. A brief literature review of the impacts of FTAs on FDI

FDI is considered as one of the importance source of economic development, especially for developing countries. According to OECD (2002), generating technology spillovers, promoting international trade integration, generating production and employment, especially skilled labor, management know-how are the benefits of FDI for host country. In addition, FDI also helps to create a more competitive business environment, plays as a mean for enterprise development and brings an access to international markets and to production network (UNCTAD, 1999). All of these help host countries to advance economic growth, increase welfare and reduce poverty. Despite the fact that empirical studies support for the impact on economic growth of FDI is mixed (Walsh & Yu, 2010) and there is different between developed and developing countries, global FDI flows have grown rapidly in recent years, particularly into emerging markets.

The attractiveness of country for FDI is attributed by a number of determinants. According to Walsh and Yu (2010), effective macroeconomic management, such as high growth, low inflation, openness; more independent judiciary and good infrastructure are important factors to explain the growth of FDI. In addition, developing country also should to develop a flexible labour market and strong and deep financial market in order to attract more FDI. By comparison successful countries in attracting FDI with others using panel data from 68 low-income and lower-middle income developing countries, Mottaleb and Kalirajan (2010) found that beside the large market and the high GDP growth rate, the business friendly environment and the openness of economy are the crucial factors for developing countries to attract FDI.

Among those, openness is one of the key determinant for the attractiveness of developing countries (Mottaleb & Kalirajan, 2010; Sekkat, 2007; Liargovas & Skandalis, 2012). In particularly, other studies (Daude, Stein & Yeyati, 2003; Kreinin & Plummer, 2008; Bütthe & Milner, 2008) stresses that international trade agreement which has a positive and significant impact on FDI and developing countries are enable to increase FDI inflow by joining regional integration agreement. In more recent work, although Medvedev (2012) found the relationship between preferential liberalization and FDI in only from late 1990s to early 2002, his study also concludes that preferential trade agreement significantly impact on increase the net FDI inflows of country members and “this relationship is driven by the developing countries”. Notably, by analyzing the bilateral data of 30 OECD and 9 ASEAN countries from 2000 to 2009, Thangavelu & Narjoko (2014) observes that FTAs also resulted in the increase of FDI in ASEAN countries and they can expect a larger FDI inflows by developing infrastructure, human capital and technologies.

There are several channels that joining the trade agreements may promote the attractiveness of a country toward foreign investors. According to Nguyen & Cao (2016), the increase of FDI by trade liberalization is caused by signaling effect, commitment effect, commerce expansion and efficiency gain. By joining free trade agreement, country want to show its desire to create a friendly investment environment and pursue policy for economic development, therefore, to become appealing to foreign investors. In addition, under its commitment in FTAs, on the one hand, government reduces concern of investors about the inconsistency problem, such as change in regulation, a higher tax rate or political conflict which

might lead to significant loss of investors. In other words, key policies and regulations would be ensured the same after FTA came into effect as governments bound. On the other hand, country members also committed to open their market and facilitate investment and investors from other countries in FTAs. Investors, therefore, have the opportunity to expand their commerce and increase their investment. By taking advantages of preferential treatments from FTAs, they would not only reduce their costs, gain the productivity and efficiency but also expand their market. Besides, Daude et al. (2003) also indicates that capital flow liberalization, legal harmonization and cooperation in cross-border disputes between countries members help to reduce transaction cost for investors, while they can get more profit thank to the tariff reduction and economies of scale through the increase size of market as a result of FTAs.

In the context of Vietnam, openness and joining the FTAs are also ones of the important factors which lead to the high growth of FDI inflows. Pham (2010) indicates that the effect of WTO accession on the dynamic of FDI into Vietnam is significant during the period from 1990 – 2008. The same result is founded in the period 2006 -2010 by Nguyen, Zhong & Tran (2012), although that study observed that law factor is considered as the stronger determinant. With regards to FTAs, both Hoang, Tran & Dong (2015) and Nguyen and Cao (2016) found that being a member of FTAs has a “strong and significant” impact on attracting FDI inflow, however individual FTA have not equal effects. While AFTA, ASEAN – China FTA, ASEAN – Japan FTA have not affected, AKFTA significantly facilitated FDI inward flows in Vietnam. By contrast, AANZFTA is shown in negative side. It might be explained by the tariff reduction which help investors to export directly to Vietnam at lower rate.

It should be noted that studies on the effects of FTAs on FDI inflows usually treated FTA as "black boxes", while in practice FTAs vary in their own provisions and the commitments of each member country. This can be considered as one of the reasons that the effects of FTA on FDI in each country and the results in the studies are open to discussion.

III. Background

Over the past 20 years, macroeconomics and regulation framework have seen significant development and became the essential conditions for increasing FDI inflows into Vietnam. Before analysis the level of liberalization in Vietnam as committed in its FTAs, this section will

provide an overview of Vietnam's economy, integration process and important milestones in FDI regulatory of Vietnam in recent years.

3.1. Macroeconomics

Vietnam is considered as one of the most impressive, dynamic and stable economies in South East Asia. GDP growth has averaged over 6% in the last 20 years and is forecasted to remain at 6.4% in the period from 2017 – 2020 (World Bank, 2017). Despite the difficulties and challenges in the global economy, especially the global economic crisis in 2009, Vietnam has demonstrated its resilience with growth drivers coming from strong domestic demand, increasing investment, greater integration and export oriented manufacturing (KPMG, 2016). After peaking at 22.9% in 2008, the Vietnamese government made great effort and was successful in controlling inflation by contractionary fiscal and monetary policies. While the average price increase in 2011-2015 was about 7%, in the next five years it is projected to be lower, at 4% (World Bank, 2017). In addition, the high level of political stability¹ (World Bank, 2018a) along with the commitment to pursue economic development of government has made the macroeconomic environment steadily improved in recent years.

3.2. Integration to global economy

While the first and important step in trade integration of Vietnam is joining ASEAN in 1995 and ASEAN Free Trade Agreement in 1996, becoming the 150th WTO's member from January 2007 is considered as the biggest milestones. Since then, Vietnam has been actively pursuing the further integration into the world economy. In addition to entering into FTAs as a member of ASEAN with other countries in the Asia Pacific region, Vietnam also negotiated and signed its own bilateral FTAs. The year of 2015 is considered as a successful year of Vietnam as 4 agreements with its important trading partners was signed, including Korea, Eurasian Economic Union, EU and TPP². Up to now, Vietnam has signed 12 FTAs, planned to sign one FTA in 2018 (see Annex 1) and 3 FTAs³ are under negotiation.

¹ Political Stability Index is indicator developed by World Bank in order to assess the potential of government for instability or being overthrown by unconstitutional or violent means, including political violence and terrorism. It ranges from -2.5 to 2.5. The higher indicator is better. (Kaufmann, Kraav & Mastruzzi (2010). The score of Vietnam in 2016 is 0.2 which is higher than almost scores of ASEAN countries.

² Now is CPTPP

³ Including Regional Comprehensive Economic Partnership (RCEP), Vietnam – Israel and Vietnam – EU.

Vietnam's FTA partners are mainly countries in the Asia Pacific region. However, in recent years, Vietnam has entered into negotiations and signed FTAs with countries from Europe and the Middle East. The extent of commitments of Vietnam in FTA is also higher and more comprehensive. Most recently, Vietnam has joined and negotiated the very deep and comprehensive agreements, which are considered as 'new generation' FTAs, including CPTPP, EVFTA RCEP, and even Free Trade Area of the Asia-Pacific among APEC economies (World Bank, 2016). These agreements cover not only traditional trade in goods, trade in services, investment but also other trade-related areas, such as intellectual property, labor, environment, competition, state enterprises, public procurement, e-commerce, etc. With the signing of these agreements, Vietnam has expanded its market to foreign investors not only in manufacturing, real estate but also in services. Active participation and success in Vietnam's economic integration over the years has made Vietnam as a FTA hub in South East Asia and became an attractive investment destination.

Before signing the CPTPP, ASEAN was the FTA that Vietnam had joined with the highest and most comprehensive commitments among Vietnam's FTAs. Currently, Vietnam is close to completing the tariff reduction and elimination schedule as it committed in the agreement. Nine packages of commitments under AFAS have been signed and implemented, with higher commitments and higher number of service sectors that Vietnam bound to open for trade and investment. A comprehensive investment agreement that was in place since 2012 has created more investment opportunities for countries in the region. Domestic regulations on investment also provide a friendlier environment for investors to access Vietnam market. In 2016, as a group, ASEAN is the second largest investor in Vietnam.

The Framework Agreement on Comprehensive Economic Cooperation between ASEAN and Korea was signed in 2005 but it was not until 2007 that the Agreement on Trade in Goods was signed and came into effect. Trade in Service and Investment reached an agreement later and came into force in mid-2009. With the aim of promoting trade and economic cooperation between Korea and ASEAN countries, the agreement has reduced and eliminated up to 90 % of tariff lines as well as important barriers to trade in goods, and most of the sectors and subsectors important to trade in services are covered in agreement on services. Creating a liberal, transparent and competitive investment environment are the goal of the ASEAN-Korea FTA.