# “The impact of free trade agreements on foreign direct investment inflows: Evidence from next-generation agreements in Vietnam”


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# THE IMPACT OF FREE TRADE AGREEMENTS ON FOREIGN DIRECT INVESTMENT INFLOWS: EVIDENCE FROM NEXT-GENERATION AGREEMENTS IN VIETNAM

## Abstract

Free Trade Agreements (FTAs) are widely recognized as instruments for enhancing economic integration and attracting Foreign Direct Investment (FDI). This study examines the impact of FTAs, particularly next-generation agreements such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the European Union-Vietnam Free Trade Agreement (EVFTA), on FDI inflows to Vietnam. Using a Gravity Model and a panel dataset of 48 trading partners covering the period 2007–2023, this study quantifies the extent to which FTAs influence FDI attraction. The empirical results reveal that FTAs significantly contribute to increased FDI inflows. The overall effect of FTA participation is estimated at 5.64% (coefficient = 0.0549, $p < 0.05$), reinforcing the positive relationship between trade liberalization and investment attraction. However, the impact varies across agreements. The CPTPP has a stronger effect, increasing FDI inflows by approximately 9.47% (coefficient = 0.0905, $p < 0.05$), while the EVFTA does not exhibit a statistically significant impact. These findings highlight the effectiveness of next-generation FTAs in attracting investment, particularly when agreements include deeper commitments beyond tariff reductions. For Vietnam and other emerging economies, maximizing the benefits of FTAs requires complementary structural reforms, including institutional improvements, regulatory enhancements, and investment-friendly policies to sustain FDI inflows and strengthen global economic integration.

**Keywords** economic integration, emerging economies, foreign investment, gravity model, international trade, investment policy, regional agreements, trade liberalization

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## INTRODUCTION

Globalization and economic integration have fundamentally reshaped the international economic landscape, creating unprecedented opportunities for trade, investment, and cooperation among nations. At the core of this transformation, Free Trade Agreements (FTAs) play a pivotal role in reducing trade barriers, harmonizing regulations, and fostering economic connectivity. Beyond traditional trade liberalization, FTAs are increasingly recognized as key drivers of Foreign Direct Investment (FDI), particularly in emerging markets. However, the extent of their impact on FDI inflows varies depending on the depth, scope, and institutional provisions embedded in the agreements.

The evolving nature of FTAs has brought new dimensions to the investment landscape. While traditional agreements primarily focused on tariff reductions and trade facilitation, next-generation FTAs in-

corporate broader commitments such as regulatory transparency, labor standards, environmental protections, and investment dispute mechanisms. These deeper provisions aim to reduce investment risk and improve institutional predictability, thereby strengthening the attractiveness of host economies to foreign investors.

Vietnam offers a relevant empirical context for examining these dynamics. As one of Southeast Asia's fastest-growing economies, the country has actively pursued trade liberalization through multiple FTAs. With 16 agreements currently in effect, Vietnam has become a leading FDI destination. However, despite significant FDI inflows, Vietnam faces increasing competition among FTA member countries and must navigate structural challenges to sustain investment growth. The effectiveness of its FTA participation, particularly under next-generation frameworks, in shaping FDI inflows remains an important and underexplored issue within the broader context of emerging markets.

## 1. LITERATURE REVIEW AND HYPOTHESES

FTAs have become a key instrument in international economic policy, shaping trade flows, investment patterns, and economic integration. By reducing trade barriers and creating predictable regulatory environments, FTAs facilitate cross-border economic activities and attract FDI (Baier & Bergstrand, 2007; Medvedev, 2012; Péridy, 2024). The role of FTAs in stimulating FDI is particularly relevant for emerging economies, where these agreements can serve as catalysts for structural reforms and institutional improvements (Petri & Plummer, 2020; Bruno et al., 2021). However, the effectiveness of FTAs in driving FDI inflows remains a subject of debate, influenced by factors such as agreement depth, institutional quality, and macroeconomic conditions.

The relationship between FTAs and FDI has been widely analyzed through various economic theories. Dunning's eclectic paradigm (1980) suggests that FDI decisions are driven by ownership, location, and internalization advantages. FTAs can enhance location advantages by reducing trade costs, improving market access, and fostering economic stability, making host countries more attractive to investors (Büthe & Milner 2008; Baier et al., 2014). The Gravity Model has become the dominant framework for assessing FDI flows, emphasizing that investment levels between two countries depend on their economic size and geographical distance (Anderson & van Wincoop, 2003). Recent applications of the Gravity Model to FDI highlight the role of institutional quality and trade agreements in shaping investment flows (Egger & Merlo, 2007; Fernandes et al., 2021). FTAs mitigate geographical disadvantages by reducing uncertainty, strengthening investor protections, and harmonizing regulatory frameworks (Frankel & Rose, 2002). Zeng et al. (2025) further demonstrate that deep FTAs enhance participation in global value chains, which in turn reinforces FDI flows.

Empirical studies provide mixed evidence regarding the effects of FTAs on FDI inflows. Using a Gravity Model, Baier and Bergstrand (2007) find that FTAs increase bilateral FDI flows by an average of 27%, emphasizing the role of market access in driving investment. Similarly, Jaumotte (2004) employs panel data from 71 developing countries and highlights that larger FTA markets create economies of scale and enhance the profitability of foreign investments. Medvedev (2012) extends this analysis to 153 countries and confirms the significant impact of FTAs in fostering FDI inflows, particularly in regions with robust institutional frameworks. Zeng et al. (2025) find that deep FTAs contribute significantly to participation in global agricultural value chains. Bruno et al. (2021) also show that economic integration under the European Union leads to substantial increases in bilateral FDI flows. However, other studies challenge the notion that FTAs consistently lead to higher FDI inflows. Eicher and Henn (2011) find no significant relationship between FTAs and FDI in certain contexts, while Páez (2008) and Jang (2011) report negative impacts in South America and OECD countries, respectively. This variation underscores the importance of institutional quality in determining the effectiveness of FTAs in attracting investment. Moreover, not all FTA-driven investments are equally beneficial.


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Büthe and Milner (2008) show that comprehensive FTAs with investment chapters, such as the EU-Japan Economic Partnership Agreement, are more effective in enhancing investor confidence. Furthermore, studies such as Egger and Merlo (2007) suggest that intra-FTA investment flows may be less significant than those from non-member states, particularly when infrastructure or governance disparities exist within member countries. Petri and Plummer (2020) argue that next-generation FTAs, which include deeper commitments to investment protection, dispute resolution, and regulatory transparency, have a stronger positive impact than traditional agreements focused solely on tariff reductions. Kim et al. (2024) show that deeper FTAs have encouraged investment in service and manufacturing industries, especially in economies with integrated digital and logistics infrastructure.

The effect of FTAs on FDI is influenced by several key factors, including macroeconomic conditions, geographical characteristics, and regulatory frameworks. Regarding macroeconomic conditions, Gross Domestic Product (GDP) levels are an important determinant of FDI attraction. Jaumotte (2004) and Medvedev (2012) highlight that countries with higher GDP levels tend to derive greater benefits from FTA-driven FDI inflows, as large markets provide better opportunities for revenue generation and long-term investment returns. Additionally, recent studies reaffirm this link between economic growth and FDI. For example, Khan et al. (2022) and Rao et al. (2023) find a positive relationship between economic expansion and FDI inflows, with GDP growth serving as a critical signal of market potential and investment viability. Similarly, trade openness is another critical factor shaping the association between FDI and FTAs. Open economies engaging in substantial trade flows generally benefit more from FTAs, as these agreements further liberalize trade, reduce barriers, and create environments conducive to foreign investment (Frankel & Rose, 2002). Petri and Plummer (2020) find that countries with higher levels of trade openness attract more FDI after signing FTAs because open trade regimes enhance market access and enable foreign investors to participate in export-oriented value chains. Hashmi et al. (2020) and Le et al. (2023) provide evidence that trade openness significantly and positively affects FDI across Asia-Pacific countries, with a greater impact in politically stable economies. Conversely, restrictive trade policies can limit the benefits of FTAs, as such policies reduce a country's ability to capitalize on market liberalization. Lee and Kim (2022) support this by showing that countries with strong bilateral tax and trade treaties see consistently higher FDI inflows, especially in the manufacturing sector. Exchange rate fluctuations also play a crucial role in the relationship between FTAs and FDI, particularly for export-oriented sectors. Stable and competitive exchange rates attract FDI by reducing the risk of currency volatility and enhancing the profitability of foreign investments (Froot & Stein, 1991; Klein & Rosengren, 1994). Klein and Rosengren (1994) found that the real exchange rate plays a significant role in determining FDI inflows into the U.S., with both relative wealth and relative wage effects influencing investment decisions.

Geographical distance between trading partners significantly affects FDI inflows and interacts with the impacts of FTAs. According to Yeyati et al. (2003), greater distances raise transportation costs and complicate supply chain management, potentially deterring FDI. However, FTAs can mitigate these negative effects by facilitating regional trade agreements and improving trade logistics (Egger & Merlo, 2007). For instance, countries within the same region often benefit more from FTAs due to proximity, which reduces costs and simplifies market access. Nonetheless, this relationship depends heavily on the development of transportation and logistics infrastructure, underscoring the need for investments in these areas to maximize FDI benefits.

The level of infrastructure development is a key mediating factor in the impact of FTAs on FDI. Countries with well-developed transportation networks, communication systems, and energy infrastructure are better positioned to attract FDI, as they reduce operational costs and facilitate efficient market access (Aschauer, 1989). Recent studies, such as Kim et al. (2024), emphasize that infrastructure quality significantly enhances the benefits of FTAs by enabling foreign firms to integrate into regional supply chains. The ASEAN Economic Community (AEC) has identified improving cross-border infrastructure as a prior-

ity for maximizing FDI inflows across member states (UNCTAD, 2022). Zeng et al. (2025) emphasize that countries with robust digital and logistical infrastructure see stronger integration into global value chains and greater benefits from deeper FTAs, especially in agri-food sectors.

Institutional quality, including governance, legal frameworks, and regulatory efficiency, is another vital factor moderating the relationship between FTAs and FDI. High-quality institutions create a stable and transparent investment environment, reduce transaction costs, and foster investor confidence (North, 1991). Fernandes et al. (2021) demonstrated that countries with robust institutions benefit more from FTA-driven FDI, as transparent rules and effective enforcement mechanisms encourage long-term investments. Conversely, weak institutions may undermine the positive effects of FTAs by increasing risks associated with corruption, bureaucratic inefficiencies, and political instability (Alemu, 2012). Freytag et al. (2024) echo this by identifying legal enforceability, anti-corruption measures, and procedural transparency as vital FDI enablers under modern FTAs.

The emergence of next-generation FTAs, characterized by commitments beyond traditional trade liberalization, has introduced new dynamics in FDI attraction. Agreements like the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) include provisions related to intellectual property, environmental standards, labor protections, and dispute resolution mechanisms. These elements create more predictable and transparent investment environments, thereby attracting higher-quality FDI (Petri & Plummer, 2020).

Sectoral analyses reveal that next-generation FTAs have disproportionate impacts on specific industries. Kim et al. (2024) demonstrate that the Regional Comprehensive Economic Partnership (RCEP) significantly boosted FDI in the manufacturing and services sectors by reducing non-tariff barriers and facilitating deeper regional integration. Similarly, González and Ferencz (2018) highlight that FTAs with environmental clauses attract green investments, particularly in renewable energy projects. These findings suggest that tailored provisions within FTAs play a critical role in directing investment to strategic sectors. Despite these positive impacts, challenges remain in realizing the full potential of FTAs. Infrastructure disparities and governance inefficiencies often hinder the ability of member states to capitalize on FTA provisions. For instance, Ismail et al. (2009) noted that weaker economies within ASEAN, such as Laos and Myanmar, struggled to attract FDI despite participating in FTAs, due to structural and institutional challenges.

Despite extensive research on FTAs and FDI, gaps remain in understanding how next-generation FTAs impact FDI inflows, particularly in emerging economies. While prior studies have examined the general relationship between FTAs and investment, limited research systematically differentiates between traditional FTAs, which primarily focus on tariff reductions, and next-generation FTAs, which incorporate deeper commitments such as investment protection, regulatory transparency, and labor and environmental standards. Furthermore, the effectiveness of these agreements in enhancing FDI inflows remains context-dependent, influenced by factors such as economic conditions, agreement depth, and implementation timelines.

This study aims to analyze the impact of FTAs on FDI inflows, with a particular focus on next-generation FTAs. Using a Gravity Model and a panel dataset covering 48 trading partners from 2007 to 2023, the research quantifies the extent to which FTAs influence investment patterns. The analysis distinguishes between the broad effects of FTAs and the specific impacts of next-generation agreements such as the CPTPP and the European Union-Vietnam Free Trade Agreement (EVFTA). To achieve these objectives and empirically test the relationship, the following hypotheses are developed:

*H1: The presence of an FTA between Vietnam and a partner country positively affects FDI inflows.*

*H2: Next-generation FTAs (e.g., CPTPP, EVFTA) have a stronger positive impact on FDI than FTAs in general.*


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## 2. METHODOLOGY

This study employs a Gravity Model framework to analyze the impact of FTAs on FDI inflows into Vietnam. The dataset consists of quarterly panel data covering Vietnam and 48 of its trading partners from 2007 to 2023. The selection of countries is based on Vietnam's FTA participation, ensuring that the sample represents the majority of FDI inflows into the country. According to the Ministry of Planning and Investment, these countries collectively accounted for over 85% of total FDI into Vietnam over the past decade. The dataset is collected from various sources. FDI inflow data are obtained from the Foreign Investment Agency under the Ministry of Planning and Investment, while information regarding Vietnam's participation in FTAs is sourced from the World Trade Organization (WTO). Data on distances between Vietnam and its trading partners are collected from the Centre d'Études Prospectives et d'Informations Internationales (CEPII). Real GDP, exchange rates, and internet user rates for each country are retrieved from the World Bank's World Development Indicators (WDI). Institutional quality indicators are obtained from the World Bank's World Governance Indicators (WGI).

To achieve the objective of this study, the Gravity Model is employed, which has become a standard tool for studying bilateral trade and investment flows in international economics. Originally developed to explain trade patterns, the Gravity Model is rooted in Newton's Law of Gravitation, where the gravitational force between two objects is proportional to their masses and inversely proportional to the square of the distance between them. In an economic context, this model posits that trade or investment flows between two countries are positively correlated with their economic sizes and negatively correlated with the distance between them, which represents trade costs or barriers (Tinbergen, 1963; Anderson & van Wincoop, 2003). The Gravity Model is particularly well-suited for this study as it accommodates a wide range of factors influencing bilateral flows, including economic size, geographical distance, population, exchange rates, and policy variables such as trade barriers and FTAs. It has been extensively applied in empirical research to evaluate and quantify the impact of these factors on both trade and FDI flows (Egger & Pfaffermayr, 2004; Anderson & van Wincoop, 2003), demonstrating its versatility and reliability in the field.

This study applies the Gravity Model to examine how FTAs influence FDI inflows into Vietnam. Building on its theoretical foundation, the model is extended to capture the role of FTAs in shaping bilateral FDI flows, highlighting the importance of trade policies and agreements that reduce barriers and enhance investor confidence. Specifically, the model is adapted as follows:

$$FDI_{ivt} = \beta_0 + \beta_1 FTA_{ivt} + \beta_j C_{ivt} + \theta_t + \varepsilon_{ivt}, \quad (1)$$

where the superscript $v$ denotes Vietnam, $i$ denotes the partner country, and $t$ denotes the year; $\beta$ denotes slope, $\varepsilon_{ivt}$ is the error term; $\theta_t$ represents time-fixed effects to control for unobserved time-specific shocks.

$LnFDI_{ivt}$ is the dependent variable, representing the natural logarithm of the FDI value from partner country $i$ to Vietnam in year $t$.

The main independent variable of interest, $FTA_{ivt}$, captures the presence of FTAs between Vietnam and country $i$ during year $t$, with a value of 1 if an FTA is in effect, and 0 otherwise. To further differentiate the effects of next-generation *FTAs*, two additional variables are included: $CPTPP_{ivt}$ and $EVFTA_{ivt}$, which capture Vietnam's participation in the *CPTPP* and the *EVFTA*, respectively.

$C_{ivt}$ is a set of control variables. Market size is measured by the natural logarithm of Gross Domestic Product (GDP) of both Vietnam and its partner countries $(LnGDP_{it}\ and\ LnGDP_{vt})$, and reflects the economic scale and investment potential of each economy. The model also incorporates geographical distance $(LnDIST_{iv})$, which captures trade costs and investment barriers associated with physical distance between Vietnam and its trading partners. Exchange rate stability is controlled for by including the real exchange rate between the Vietnamese Dong and the currency of each partner country $(ER_{ivt})$. A stable exchange rate environment is expected to reduce uncertainty and facilitate investment decisions. Economic openness $(OPEN_{it}\ and\ OPEN_{vt})$,

is another key determinant, indicating the degree of economic integration with global markets. Infrastructure development is proxied by the percentage of internet users in the partner country and Vietnam $(INT_{it}\ and\ INT_{vt})$ serving as an indicator of digital infrastructure and connectivity, which are increasingly relevant in attracting foreign investment. Additionally, the model includes a binary variable $WTO_{ivt}$, which takes the value of 1 if both Vietnam and the partner country are members of the World Trade Organization in year *t*, and 0 otherwise.

Institutional quality is another important factor in investment decisions. To capture this, the study incorporates governance indicators from the World Bank's World Governance Indicators (WGI). These include the Government Effectiveness Index for partner country and Vietnam $(GE_{it}\ and\ GE_{vt})$, which measures the quality of public services and policy implementation; the Control of Corruption Index for the partner country and Vietnam $(CC_{it}\ and\ CC_{vt})$, which assesses the extent to which corruption affects economic transactions; and Political Stability and Absence of Violence Index for the partner country and Vietnam $(PS_{it}\ and\ PS_{vt})$, which reflects the likelihood of political instability affecting investment. All variables used in this study are described in Table 1.

This study employs panel data techniques to analyze the impact of free trade agreements on FDI inflows to Vietnam. Panel data combining time-series and cross-sectional observations offer a more comprehensive analysis by capturing both temporal and country-specific variations. To estimate the relationship between FTAs and FDI inflows, three widely used econometric models are considered: the Pooled Ordinary Least Squares (Pooled OLS) model, the Fixed Effects Model (FEM), and the Random Effects Model (REM).

To determine the most appropriate model, this study applies the Breusch-Pagan Lagrange Multiplier

**Table 1.** Variables description

| Category | Variable | Description | Symbol |
|---|---|---|---|
| Dependent Variable | Foreign Direct Investment | Natural logarithm of the FDI inflow value from partner country *i* to Vietnam in year *t*. | $LnFDI_{ivt}$ |
| Explanatory Variables | Free Trade Agreement | Takes the value of 1 if partner country *i* and Vietnam have an active FTA in year *t*, 0 otherwise. | $FTA_{ivt}$ |
| | CPTPP Agreement | Takes the value of 1 if partner country *i* and Vietnam are part of an active CPTPP agreement in year *t*, 0 otherwise. | $CPTPP_{ivt}$ |
| | EVFTA Agreement | Takes the value of 1 if partner country *i* and Vietnam are part of an active EVFTA agreement in year *t*, 0 otherwise. | $EVFTA_{ivt}$ |
| Control Variables | Gross Domestic Product (GDP) | Natural logarithm of the GDP of partner country *i* in year *t*. | $LnGDP_{it}$ |
| | | Natural logarithm of the GDP of Vietnam in year *t*. | $LnGDP_{vt}$ |
| | Distance | Natural logarithm of the distance (in kilometers) between Vietnam and partner country *i*. | $LnDIST_{iv}$ |
| | Exchange Rate | Natural logarithm of the real exchange rate of the Vietnamese Dong relative to the currency of partner country *i* in year *t*. | $ER_{ivt}$ |
| | Economic Openness | Economic openness of partner country *i* in year *t*. | $OPEN_{it}$ |
| | | Economic openness of Vietnam in year *t*. | $OPEN_{vt}$ |
| | World Trade Organization membership | Takes the value of 1 if partner country i and Vietnam are both members of the World Trade Organization in year t, 0 otherwise. | $WTO_{ivt}$ |
| | Infrastructure Development | Percentage of internet users in partner country *i* in year *t*, representing infrastructure and technological development. | $INT_{it}$ |
| | | Percentage of internet users in Vietnam in year *t*. | $INT_{vt}$ |
| | Institutional Quality | Government Effectiveness Index for partner country *i* in year *t*. | $GE_{it}$ |
| | | Government Effectiveness Index for Vietnam in year *t*. | $GE_{vt}$ |
| | | Control of Corruption Index for partner country *i* in year *t*. | $CC_{it}$ |
| | | Control of Corruption Index for Vietnam in year *t*. | $CC_{vt}$ |
| | | Political Stability and Absence of Violence Index for partner country *i* in year *t*. | $PS_{it}$ |
| | | Political Stability and Absence of Violence Index for Vietnam in year *t*. | $PS_{vt}$ |


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(LM) test, which evaluates whether the REM is preferable to the Pooled OLS model. The null hypothesis of the LM test states that the cross-sectional variance is zero, implying that the Pooled OLS model is sufficient. The test results in Table 2 indicate that the Chi-squared statistics for the three models are 136.46, 140.14, and 141.79, respectively, all statistically significant at the 1% level. Consequently, the null hypothesis is rejected in all three cases, confirming that the REM is more effective than the Pooled OLS model.

**Table 2.** Breusch-Pagan Lagrange Multiplier test

| | Model 1 | Model 2 | Model 3 |
|---|---|---|---|
| | FTA | CPTPP | EVFTA |
| chi2 | 136.46 | 140.14 | 141.79 |
| Prob > chi2 | 0.0000 | 0.0000 | 0.0000 |

Additionally, the Hausman test is conducted to compare the FEM and REM models, testing whether country-specific effects are correlated with the independent variables. The results of the Hausman test are presented in Table 3. The results reveal that the Chi-squared statistics for the three models are 20.88, 24.76, and 22.53, none of which are statistically significant. Consequently, the null hypothesis, "The differences in coefficients are not systematic," is not rejected. This implies that the REM is more effective than the FEM in this case.

Based on these diagnostic tests, the REM is selected as the most suitable estimation method for analyzing the impact of FTAs on FDI inflows to Vietnam. This approach allows for efficient estimation while accounting for unobserved heterogeneity across countries, ensuring robust empirical results.

**Table 3.** Hausman test

| | Model 1 | Model 2 | Model 3 |
|---|---|---|---|
| | FTA | CPTPP | EVFTA |
| chi2 | 20.88 | 24.76 | 22.53 |
| Prob > chi2 | 0.1409 | 0.1533 | 0.1946 |

Descriptive statistics for the variables used in this study are presented in Table 4. The mean value of LnFDI is 3.2869, with a standard deviation of 3.2586, indicating moderate variation in FDI levels across trading partners. The FTA variable has a mean value of 0.4411, reflecting that FTAs were active for nearly half of the observations during the study period. Specific agreements, including CPTPP and EVFTA, have lower mean values of 0.0306 and 0.1446, respectively, given their relatively recent implementation. Macroeconomic factors such as LnGDP and openness exhibit interesting trends. The average LnGDP of partner countries is 26.4008 (log-transformed), slightly larger than Vietnam's mean LnGDP (26.1287). This discrepancy highlights the economic asymmetry between Vietnam and its trading partners, most of whom are developed or rapidly developing economies. The openness index, which measures the ratio of trade to GDP, shows that Vietnam has a higher mean value compared to its partners, reflecting Vietnam's strong reliance on trade and its export-oriented growth strategy.

**Table 4.** Descriptive statistics

| Variable | Obs | Mean | Std. Dev | Min | Max |
|---|---|---|---|---|---|
| $LnFDI$ | 816 | 3.2869 | 3.2586 | –5.4672 | 9.6232 |
| $FTA$ | 816 | 0.4411 | 0.4968 | 0 | 1 |
| $CPTPP$ | 816 | 0.0306 | 0.1724 | 0 | 1 |
| $EVFTA$ | 816 | 0.1446 | 0.3519 | 0 | 1 |
| $LnGDP_{it}$ | 816 | 26.4008 | 1.8113 | 22.1638 | 30.9532 |
| $LnGDP_{vt}$ | 816 | 26.1287 | 0.4964 | 25.0724 | 26.7863 |
| $LnDIST$ | 816 | 8.6223 | 0.8455 | 5.9712 | 9.5316 |
| $ER$ | 816 | 1.7911 | 2.6925 | –1.1657 | 9.7806 |
| $OPEN_{it}$ | 816 | 112.299 | 68.6630 | 23.0797 | 437.3267 |
| $OPEN_{vt}$ | 816 | 150.1797 | 20.3146 | 113.9777 | 186.6758 |
| $WTO$ | 816 | 0.9656 | 0.1821 | 0 | 1 |
| $INT_{it}$ | 816 | 0.6999 | 0.2480 | 0 | 1 |
| $INT_{vt}$ | 816 | 0.4994 | 0.1959 | 0.2075 | 0.7859 |
| $GE_{it}$ | 816 | 0.9015 | 0.8202 | –1.7528 | 2.4696 |
| $GE_{vt}$ | 816 | –0.0527 | 0.1681 | –0.2481 | 0.2434 |
| $CC_{it}$ | 816 | 0.6992 | 1.0140 | –1.6728 | 2.4354 |
| $CC_{vt}$ | 816 | –0.5055 | 0.1143 | –0.7115 | –0.2872 |
| $PS_{it}$ | 816 | 0.5748 | 0.9751 | –2.2134 | 1.6903 |
| $PS_{vt}$ | 816 | –1.4034 | 0.0773 | –1.5269 | –1.2418 |

# 3. RESULTS

Table 5 reports the main findings regarding the relationship between FTAs and FDI inflows into Vietnam. Column (1) presents the general effect of FTAs on FDI inflows using the independent variable FTA. The coefficient for the FTA variable is 0.0549 and statistically significant at the 5% level, implying that the signing and implementation of FTAs positively influence FDI inflows to Vietnam. This translates into an approximate

5.64% (exp(0.0549) - 1) increase in FDI flows following the implementation of an FTA. This supports Hypothesis 1 (*H1*), which posits that FTAs positively influence investment attraction. The results are consistent with the findings by Le (2017), who examined the impacts of the ASEAN-Korea and Vietnam-Japan FTAs, and Ismail et al. (2009), who analyzed the influence of AFTA on FDI inflows to Vietnam. The results also reaffirm the findings of Duong et al. (2021), who reported that Vietnam's participation in FTAs led to an average FDI increase of 159%.

However, the magnitude of the impact varies across agreements. Column (2) and Column (3) analyze the impact of next-generation agreements, CPTPP and EVFTA, respectively, on LnFDI. The coefficient for CPTPP is 0.0905 and significant at the 5% level, suggesting that CPTPP increases FDI inflows by approximately 9.47% (exp(0.0905) - 1). This result supports Hypothesis 2 (*H2*), which suggests that next-generation FTAs exert a stronger effect on FDI inflows compared to traditional agreements. The stronger impact of CPTPP is likely attributed to its comprehensive commitments, which include investment liberalization, intellectual property protections, and dispute resolution mechanisms, thereby improving investor confidence. In contrast, the EVFTA coefficient of 0.0598 is not statistically significant, likely due to its recent implementation and overlap with the global economic disruptions caused by the COVID-19 pandemic.

**Table 5.** Regression results on the impact of FTAs on FDI inflows

| Variables | Dependent variable: LnFDI | | |
|---|---|---|---|
| | (1) | (2) | (3) |
| *FTA* | 0.0549** | | |
| | (0.0191) | | |
| *CPTPP* | | 0.0905** | |
| | | (0.0870) | |
| *EVFTA* | | | 0.0598 |
| | | | (0.0189) |
| $LnGDP_{it}$ | 0.1557*** | 0.1556*** | 0.1535*** |
| | (0.0976) | (0.1068) | (0.1028) |
| $LnGDP_{vt}$ | 0.2218** | 0.2902*** | 0.2110** |
| | (0.2210) | (3.06) | (2.05) |
| *LnDIST* | −0.2283*** | −0.2086*** | −0.2046*** |
| | (0.0522) | (0.0530) | (0.0508) |
| *ER* | 0.125 | 0.118 | 0.114 |
| | (0.106) | (0.112) | (0.105) |
| $OPEN_{it}$ | 0.0131*** | 0.0127*** | 0.0133*** |
| | (0.0365) | (0.0384) | (0.0389) |
| $OPEN_{vt}$ | 0.0257** | 0.0301*** | 0.0252** |
| | (0.0227) | (0.0270) | (0.0221) |
| *WTO* | 0.2007** | 0.2169* | 0.2118* |
| | (0.0160) | (0.0174) | (0.0170) |
| $INT_{it}$ | 0.5820*** | 0.1153*** | 0.7120*** |
| | (0.5600) | (0.1160) | (0.7012) |
| $INT_{vt}$ | 0.7918 | 0.9986 | 0.7795 |
| | (0.2880) | (0.3861) | (0.2793) |
| $GE_{it}$ | −0.1581 | −0.0053 | −0.1792 |
| | (0.1033) | (0.0111) | (0.1238) |
| $GE_{vt}$ | 0.0383 | 0.0006 | 0.0428 |
| | (0.0313) | (0.000) | (0.0354) |
| $CC_{it}$ | 0.5925 | 0.4526 | 0.5897 |
| | (0.1368) | (0.1099) | (0.1390) |
| $CC_{vt}$ | −0.0522 | −0.3990 | −0.0628 |
| | (0.0411) | (0.3212) | (0.0513) |
| $PS_{it}$ | 0.2539 | 0.2098 | 0.2740 |
| | (0.0664) | (0.1605) | (0.1776) |
| $PS_{vt}$ | −0.2175 | −0.3618 | −0.1999 |
| | (0.1392) | (0.1460) | (0.1583) |
| *Constant* | −0.8054*** | −1.0240*** | −0.7907*** |
| | (0.2078) | (0.3177) | (0.2269) |
| *N* | 816 | 816 | 816 |
| *F*–Stat | 177.34 | 216.18 | 204.67 |
| Prob>*F* | 0.0000 | 0.0000 | 0.0000 |

*Note*: This table reports the regression estimates examining the impact of FTAs on FDI inflows to Vietnam, using the Random Effects Model (REM). Robust standard errors are in parentheses. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

Regarding control variables, the regression model reveals some noteworthy findings. Both the GDP of partner countries $(LnGDP_{it})$ and Vietnam's GDP $(LnGDP_{vt})$ are positively and statistically significantly associated with FDI inflows, supporting the expectation that larger and more dynamic economies attract greater investment. The geographical distance variable $(LnDIST)$ is negative and significant, confirming that greater distance reduces FDI, consistent with the findings of Sahoo et al. (2010) and Narayanamoorthy et al. (2008). Meanwhile, the exchange rate variable $(ER_{ivt})$ does not show a significant relationship with FDI inflows in any of the models.

Economic openness also plays a significant role. The coefficient for partner countries' openness $OPEN_{it}$ is positive and statistically significant, indicating that more open economies tend to engage in higher levels of bilateral investment.


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Likewise, Vietnam's openness $OPEN_{vt}$ is also positive and significant, suggesting that its trade liberalization efforts are associated with increased FDI inflows.

Similarly, the WTO variable is positive and significant across all columns, suggesting that WTO membership correlates with stronger FDI inflows, likely due to improved policy credibility and international investor confidence.

In terms of infrastructure, internet penetration in partner countries $INT_{it}$ shows a positive and statistically significant relationship with FDI, highlighting the importance of digital infrastructure in facilitating investment. In contrast, Vietnam's internet penetration $INT_{vt}$ does not exhibit a statistically significant effect.

Lastly, the study evaluates institutional quality through three governance indicators: *GE*, *CC*, and *PS*. None of these variables exhibits statistically significant coefficients across the models.

## 4. DISCUSSION

The results provide robust evidence of the positive effects of FTAs on FDI inflows into Vietnam, reinforcing the broader argument that trade liberalization enhances investment attractiveness. The statistically significant coefficient for FTAs in Model (1) supports the existing literature suggesting that trade agreements reduce entry barriers, improve market access, and enhance investor confidence (Medvedev, 2012; Bruno et al., 2021; Péridy, 2024). This aligns with the theoretical expectations of the Gravity Model, which suggests that stronger trade and economic linkages promote greater investment flows.

A key finding of this study is the stronger impact of CPTPP compared to general FTAs. The broader commitments embedded in next-generation FTAs, particularly in areas such as investment protection, intellectual property, labor standards, and dispute resolution mechanisms, provide greater assurances to investors (Petri & Plummer, 2020; Kim et al., 2024). The regional nature of CPTPP, involving a diverse set of economies across Asia-Pacific and the Americas, also increases Vietnam's attractiveness as a hub for intra-regional investment. This result is consistent with previous research highlighting that agreements with deeper commitments tend to generate higher-quality and more stable investment flows (Baier & Bergstrand, 2007; Zeng et al., 2025).

In contrast, the insignificant impact of EVFTA suggests that the agreement's investment-enhancing effects have yet to materialize fully. One potential explanation is that EVFTA remains in the early stages of implementation, and investment responses often take time to adjust to new regulatory frameworks. This is consistent with the findings of Fernandes et al. (2021), who noted that the full benefits of FTAs, particularly in terms of FDI, depend on gradual legal and institutional adjustments in the host country. Another possible factor is the overlapping effect of the COVID-19 pandemic, which created economic uncertainty and delayed investment decisions worldwide. Compared to CPTPP, which had a longer period of post-ratification adaptation, EVFTA was implemented during a period of global disruption, potentially limiting its immediate impact on investment flows.

The control variables offer additional insights into the determinants of FDI inflows. Both the GDP of partner countries and Vietnam's GDP are consistently positive and significant, reaffirming the view that larger economies with greater purchasing power are more likely to invest abroad (Khan et al., 2022; Rao et al., 2023).

Geographical distance exerts a negative influence on FDI inflows, consistent with the Gravity Model's predictions. Countries farther from Vietnam are less likely to invest due to higher transportation costs and logistical challenges, echoing findings from Sahoo et al. (2010) and Narayanamoorthy et al. (2008).

Exchange rate volatility, which has no significant effect on FDI inflows in this study, contrasts with prior research emphasizing the importance of stable exchange rates in attracting foreign investment (Abbott et al., 2012). The insignificant result may reflect the State Bank of Vietnam's efforts to maintain a relatively stable exchange rate during the study period, minimizing its impact on FDI decisions.

Trade openness shows a significant positive effect for both Vietnam and its partner countries. This indicates that not only does openness in source economies facilitate outbound FDI, but Vietnam's own liberal trade regime also plays a direct role in attracting investment. This finding reinforces the importance of export-oriented development strategies and supports prior research by Petri and Plummer (2020) and Le et al. (2023), which emphasized the symbiotic relationship between trade integration and investment flows in Asia-Pacific economies.

The WTO variable also demonstrates a positive and statistically significant relationship with FDI, suggesting that WTO membership contributes to Vietnam's international credibility and enhances investor confidence through predictable trade and legal frameworks. This finding is consistent with prior research by Medvedev (2012), who highlighted that WTO accession often serves as a signal of institutional reliability and trade policy transparency, thereby fostering long-term investment. Similarly, Bruno et al. (2021) found that WTO membership positively influenced FDI inflows across EU member states, particularly when accompanied by regulatory reforms.

The results for infrastructure underscore the growing importance of digital connectivity in attracting FDI. Internet penetration in partner countries significantly contributes to FDI inflows, reflecting the increasing relevance of digital infrastructure in facilitating investment, particularly in technology-driven and services sectors (Kim et al., 2024; Zeng et al., 2025).

Lastly, the study evaluates institutional quality through three governance indicators: government effectiveness (GE), control of corruption (CC), and political stability (PS). None of these variables exhibits statistically significant coefficients across the models. This result suggests that, in the context of Vietnam, these governance factors may not play a decisive role in influencing FDI inflows when compared to macroeconomic variables and trade-related factors. While prior literature has often emphasized the importance of institutional quality (Fernandes et al., 2021; Freytag et al., 2024), the current findings imply that structural reforms and economic fundamentals may currently carry greater weight in shaping investor decisions.

## CONCLUSION

This study examines the impact of FTAs, particularly next-generation FTAs such as the CPTPP and EVFTA, on FDI inflows to Vietnam. Using a Gravity Model and a balanced panel dataset of 48 trading partners from 2007 to 2023, the findings highlight the significant positive influence of FTAs on FDI inflows. The results indicate that FDI from partner countries increases following the implementation of FTAs, with the CPTPP demonstrating a stronger positive effect compared to general FTAs. In contrast, the EVFTA's impact remains statistically insignificant, likely due to its recent implementation and the overlap with global disruptions caused by the COVID-19 pandemic.

Control variables such as partner countries' GDP, Vietnam's GDP, geographical distance, openness, infrastructure, WTO membership, and institutional quality provide additional insights. Larger partner economies, as well as Vietnam's growing economy, greater openness in both home and host countries, improved digital infrastructure in source countries, and multilateral trade credibility through WTO accession are all associated with higher FDI inflows. Meanwhile, institutional quality indicators such as government effectiveness, control of corruption, and political stability do not show significant direct effects on FDI. The findings suggest that while trade liberalization enhances a country's attractiveness to investors, complementary reforms in governance, infrastructure, and economic policy are essential to maximize FDI benefits.

These results offer important implications for Vietnam and other emerging economies seeking to leverage FTAs as a tool for investment attraction. While FTAs provide improved market access and investor protections, their effectiveness depends on broader structural conditions. Countries aiming to attract FDI should not only pursue trade agreements but also implement institutional and economic reforms


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that strengthen investor confidence. Addressing regulatory inefficiencies, enhancing infrastructure, participating in credible multilateral frameworks such as the WTO, and ensuring policy transparency will be critical for sustaining long-term investment inflows. By adopting a holistic approach that integrates trade liberalization with domestic reforms, emerging economies can improve their competitiveness and accelerate economic integration in an increasingly globalized world.

## AUTHOR CONTRIBUTIONS

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Formal analysis: Huong Giang Mai.
Investigation: Huy Trung Bui, Huong Giang Mai.
Methodology: Huy Trung Bui.
Resources: Huy Trung Bui.
Software: Huy Trung Bui.
Supervision: Huong Giang Mai.
Validation: Huong Giang Mai.
Visualization: Huong Giang Mai.
Writing – original draft: Huy Trung Bui, Huong Giang Mai.
Writing – review & editing: Huy Trung Bui, Huong Giang Mai.

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