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DOES FOREIGN DIRECT INVESTMENT AFFECT INCOME INEQUALITY? A THRESHOLD REGRESSION ANALYSIS IN VIETNAM

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Abstract

The benefits of FDI consist of being as an important source of capital, contributing to employment, transferring technology, increasing competition and generating spillover effects to domestic companies. However, the literature on equality argued that while FDI may bring many benefits to the host economy, it does not mean that everyone in the country could benefit in the same way. According to Figini & Gorg (2011); Herzer & Nunnenkamp (2011); Kyriacou & Roca-Sagales (2012), the growth of host economies and FDI inflows have been widening the income gap between rich and poor segments of population, between high and low skilled labours, which leads to the increase in income inequality. This paper aims to explore the relationship between FDI and income inequality in Vietnam using Panel Threshold Regression for a recent period (2006-2015), and examine the existence of FDI threshold(s) at which the impact of FDI on income inequality is minimal. By using a panel data of cities and provinces in Vietnam in the period of 2006 – 2015, this paper examines the relationship between regional income inequality and FDI growth using fixed effect threshold model developed by Hansen (1999). The findings indicate that FDI directly has a negative effect on income equality. Furthermore, the results show that FDI can influence on inequality indirectly through its impact on GDP. We found strong evidence that there are two threshold levels of FDI in the regression relationship. They are 4.38% and 11.96% of GDP with asymptotic 95% confidence interval. These thresholds divide the observations into three regimes, in which the relationship between GDP and inequality has an inverted U-shape. This finding is consistent with the previous studies on other countries such as Figini & Gorg (2011) and Kyriacou & Roca-Sagales (2012). It implies the tradeoffs of the country when trying to attract FDI. The fact in Vietnam shows that the competition among regional governments for the inward FDI generally deepens the gap between the rich and poor resource regions in the country. In the context that Vietnam has been putting so much efforts to attract FDI, this is a warning of an increase in region income inequality in the near future.

Keywords: Economic Growth, FDI, Income Inequality, Threshold Effect, Panel Threshold Regression (PTR), Vietnam.
