THE IMPACT OF TRADE OPENNESS AND FDI ON GROWTH AND FINANCIAL STABILITY IN VIETNAM: OVERVIEW OF EMPIRICAL EVIDENCE AND POLICY IMPLICATIONS

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Abstract: ***As Vietnam continues to integrate deeply into the global economy, trade openess and foreign direct investment (FDI) flows are often seen as two key drivers of growth. However, empirical evidence shows that the impact of trade openness and FDI is not uniform, but strongly depends on macroeconomic conditions (inflation, exchange rates), the level of financial development, the quality of institutions, and the absorption capacity of the domestic business sector. This paper provides a policy-oriented review based on representative research on Vietnam and the Asia/ASEAN region, synthesizing evidence across four transmission channels: (i) the growth and productivity channel; (ii) the financial-monetary and macroeconomic stability channel; (iii) the business and microeconomic efficiency channel; (iv) the distribution-household welfare channel. The results show that: (1) trade openness and FDI generally have a positive relationship with growth, but there is a nonlinearity/threshold effect; (2) trade and financial integration can increase exchange rate volatility and macroeconomic stability risks in the absence of supporting policies; (3) trade benefits are unevenly distributed, with rural group and poor households bearing higher risks after shocks such as the 2008 crisis; (4) business efficiency is affected by market risk, financial distress, and governance mechanisms. Based on this, the article proposes a package of financial policy implications, including: selectively attracting FDI linked to technology absorption capacity; coordinating monetary and fiscal policies to stabilize inflation and exchange rates in conditions of high openness; developing the domestic financial market to increase resilience; upgrading the capacity of domestic SMEs to participate in value chains; and designing distribution policies to reduce "integration-related damage".***

• Keywords: *trade openess, FDI, growth, financial stability, exchange rate, household welfare, Vietnam.*

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1. Introduction

Vietnam has chosen a growth strategy heavily reliant on trade integration and attracting FDI since its Doi Moi reforms. Increased trade openness has helped expand markets, boost production and exports; FDI has supplemented capital, technology, and management capabilities. However, deep integration also brings challenges: fluctuations in the effective real exchange rate, inflationary pressures, the risk of dependence on FDI, capability gaps between domestic enterprises and foreign-invested enterprises, and the risk of income inequality among population groups.

Recent empirical results on Vietnam suggest that the impact of integration is not uniform. Some studies find threshold effects of openness and inflation in the transmission channel from banking development to growth. Others point to a long-term relationship between FDI, trade openness, and GDP per capita, while warning of the adverse impact of currency depreciation on long-term growth. At the micro level, trade liberazation can improve household income and spending through the export and labor market channels, but the benefits differ between urban - rrual areas and declined after the 2008 shock.

Meanwhile, existing studies often take a fragmented approach: some focus on growth; others on exchange rates and macroeconomic stability; still others on enterprises or welfare. The gap is the lack of an integrated overview for the Vietnamese context that both systematizes the evidence and draws coherent macroeconomic and financial policy implications.

The objectives of this paper are: (i) to systematically synthesize empirical evidence on the impact of trade openness and FDI on growth and financial stability; (ii) to identify transmission

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channels and points of conflict/nonlinearity; (iii) to propose a feasible framework of financial policy implications for the deep integration phase.

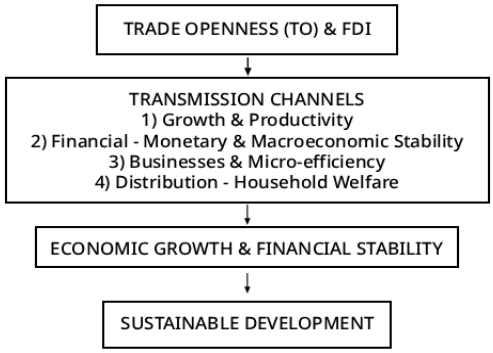
2. Integrated theoretical framework and overview methodology

2.1. Integrated Theoretical Framework

This paper draws on four clusters of theory to interpret the evidence: (1) Growth theory (neoclassical and endogenous) emphasizes that trade openness increases competition, expands markets, and boosts productivity; FDI can generate technology spillovers if domestic absorption capacity is sufficiently strong. (2) Financial development theory argues that openness can promote financial depth, but benefits depend on institutions and the quality of capital allocation. (3) The macro-financial stability approach emphasizes that high openness increases sensitivity to external shocks, particularly through exchange rates, inflation, and capital flows. (4) Distribution/welfare theory points to uneven distribution of integration benefits; impacts depend on labor structure, region, and mobility.

Figure 1. Analytical framework for the impact of trade openness and FDI

The integrated conceptual framework illustrated 4 transmission channels from TO/FDI to growth and financial stability.



2.2. Policy-oriented review methodology

This paper uses a policy-oriented review: selecting representative quantitative studies on Vietnam and directly relevant regions (ASEAN, Asia), prioritizing studies with clear data/estimates (ARDL, VECM, NARDL, VAR/Granger, dynamic GMM, threshold regression, Bayesian model averaging). Results are synthesized across four transmission channles and conclude with a policy implication framework for fiscal policy.

3. Synthesis of empirical evidence across transmission channels

This section synthesizes evidence across four transmission channels: (i) growth & productivity; (ii) finance - monetary & macroeconomic stability; (iii) enterprises & microeconomic effiency; (iv) distribution & welfare.

3.1. Growth and productivity channel

"Conditional integration": The first group of evidence generally affirms the growth-driving role of FDI and trade openness, but emphasized conditionally and non-linearity.

At the macro level, ARDL results show that FDI and trade openness may have a positive impact in the short term, but the long-term impact may depend on the economic structre (intermediate imports, technology content, absorption capacity of domestic enterprises). This suggests that trade liberalization does not automatically guarantee high-quality growth without complementary policies on macroeconomic stability, industrial development, and competitiveness enhancement.

Notably, evidence of non-linearity/threshold effects emerges in the relationship between financial development and growth when trade openness and inflation are present: below the opennness threshold, banking development does not contribute significantly; above the threshold, the impact becomes positive. At the same time, inflation also has a threshold that changes the transmission channel through capital costs and credit allocation.

On the FDI side, VECM results for Vietnam indicate that FDI and trade openness support GDP per capita in the long term, while suggesting a causal relationship from growth and openness to FDI and exchange rates. The NARDL study adds that the impact may be asymmetric depending on the direction of the fluctuation, particularly with the FDI → trade openness channel. These findings emphasize that policy should not assume linearity; it is neccessary to identify the state of the economy and the quality of capital flows.

The growth channel conclusion: openness and FDI tend to support growth, but effectiveness depends on integration thresholds, macroeconomic stability, and technology absorption capacity.

3.2. Financial - monetary channel and macroeconomic stability:"The price of openness

The second group of evidence shows that integration can increase macroeconomic volatility, particularly through exchanges rates and inflation.

A key finding is the bidirectional relationship between trade openness and real effective exchange rate (REER) volatility. VAR/Granger estimates show that trade openness and REER volatility have bidirectional causality; openness may increase REER volatility at some lags, while REER volatility reduces trade openness at short lages. This implies that when openness is high, exchange rate management is not only a stability objective but also a condition for maintaining trade momentum.

Regional evidence on economic stability shows that trade openness may be negatively associated with growth stability in some cases, while being linked to exchange rate stability in the short term. For Vietnam, the role of inflation is particularly prominent: there exists an inflation threshold, and when this threshold is exceeded, the quality of credit allocation deteriorates, weakening the financial development - growth channel.

In terms of financial integration, evidence for Vietnam indicates that financial integration has a long-term co-integration relationship and a positive impact on growth; at the same time, there is a two-way causality. This suggests that developing the financial channel plays a "shock absorber" role in transforming the benefits of integration into growth, but also increases sensitivity to shocks if risk management is weak.

Conclusion on the financial - monetary channel: high openness increases the demand for macroeconomic management capacity; lack of policy coordination can amplify exchange rate/ inflation volatility and reduce growth benefits.

3.3. The corporate channel and micro-level effiency:

"Who benefits, who bears the risk?" This channel clarifies that even when macroeconomic growth improves, efficienty at the enterprise level can be strongly differentiated by governance, risk, and financial status.

Studies on corporate governance for Vietnamese listed companies show that certain governance characteristics are associated with business efficiency; also emphasize that governance reforms need to be tailored to the institutional context and ownership structure.

Regarding financial distress and cash policy, evidence shows that cash holdings vary across the business life cycle, with financially distressed firms tending to hold less cash; the relationship differs across life cycle stages.

Specifically, the results on market risk and financial distress (2012-2021) indicate that increased market risk reduces business efficiency; lower financial distress improves efficiency; but when market risk increases, the efficiency of businesses with good financial health also declines sharply. This is an important implication: in an open economy, risk shocks can spread rapidly through financial markets and simultaneously impact capital costs, expectations, and operational efficiency.

Conclusion on the corporate channel: the benefits of integration do not automatically translate into micro-level efficiency; resilience must be enhanced through governance, risk management, and the development of healthy financial markets.

3.4. Distribution channel - household welfare

"Integration has winners and losers" This channel emphasizes the uneven distribution of integration benefits.

Micro evidence from VHLSS shows that trade liberalization generally improves household income and spending through the export channel and expanded labor demand; however, the impact weakened after the 2008 crisis, and rural households became more vulnerable, with poor households benefiting less. This implies that integration needs to be 'cushioned' by social protection and skills upgrading policies.

A political economy perspective on distributional alliances shows that tariff schedules and opening designs can be influenced by interest groups; this strategy may be effective in the short term but less effective in promoting structural transformation for sustainable long-term growth. Business evidence also shows that the local business environment and institutional reforms determine the extent to which businesses can take advantage of trade benefits.

Conclusion on distribution channels: integration creates growth but also risks polarization; the lack of distribution policies and institutional reforms may undermine the sustainability of growth strategies.

4. Contradictions, non-linearity and policy gaps

The summary highlights three prominent issues.

First, there are contradictions regarding the sign and magnitude of the impact (short- term vs. long-term) of trade openness. This may stem from changes in the structure of intermediate imports, supply chain dependencies, and structural adjustment costs. The implication is that policy should focus on increasing domestic value added and absorption capacity.

Second, threshold and non-linear effects appear in many relationships (openness growth; inflation - growth; financial development - growth). This emphasizes the need to optimize the 'effective level of openness' rather than simply expanding it.

Third, shocks (especially in 2008) weakened the welfare benefits of integration and increased the vulnerability of disadvantaged groups. Therefore, financial stability and buffer policies should be considered the backbone of the integration strategy.

Policy gap: lack of coherence between trade - FDI - finance - distribution. This paper proposes a framework in the following section to connect the four channels in a financial policy package.

5. Financial policy implications

- Attract selective FDI, increasing "quality" rather than "quantity." Policies should shift from scale-based incentives to those based on technology content, R&D, domestic linkages, and green standards; design mechanisms to encourage skill transfer, develop domestic suppliers, and mitigate "outsourcing" risks.

- Coordinate monetary and fiscal policies to control inflation and stabilize exchange rates. Maintain inflation within the target range to support growth; design a flexible, managed exchange rate framework linked to foreign exchange reserves and policy communication mechanisms; develop exchange rate risk hedging tools for import-export businesses.

- Develop the domestic financial market as a "shock absorber" for openness Expand the depth of the capital market, enhance transparency, and standardize corporate governance in line with the context; increase market risk and liquidity risk monitoring capabilities.

- Upgrading domestic SMEs to participate in the value chain and reduce benefit disparity Combine preferential credit policies with technology innovation/digital transformation KPIs; implement supplier development programs to enable SMEs to become tier 1-2 suppliers for FDI; support compliance with quality and ESG standards.

- Distribution and social security policies as conditions for sustainable integration Increase investment in skills training and labor mobility; design targeted support for groups heavily impacted by import competition; assess distribution impacts prior to new integration commitments.

Conclusion: Trade openness and FDI are important drivers of Vietnam's growth, but their impact is conditional and comes with macroeconomic stability costs as well as distributional costs. Policy needs to shift from 'expanding openness' to 'optimizing effective openness', based on a coordinated macroeconomic-financial policy package: selective FDI; inflation and exchange rate stability; developing financial markets as shock absorbers; upgrading domestic SMEs; and distribution policies to reduce integration-related vulnerabilities.

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