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Political Risk Impacts on Foreign Direct Investment in Vietnam

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Abstract

The research explores the impact of political risk on foreign direct investment in Vietnam. The dataset for political risk employed in this research consists of twelve factors from the International Country Risk Guide, offering a comprehensive assessment of Vietnam's political landscape. The research utilises Principal Component Analysis to consolidate twelve political risk items, examining their influence alongside GDP growth, inflation rate and trade openness. With data spanning from 1994 to 2021, ARIMA models are employed due to non-stationarity issues from secondary data set. The findings indicate that while economic factors contribute to FDI, political risk variables like governance quality, military involvement, and economic stability have profound impacts. The study suggests that enhancing governance and reducing military politics are key to attracting FDI, offering insights for policymakers and investors to navigate Vietnam's investment landscape.

Keywords: Political Risk, Foreign Direct Investment, Vietnam, International Country Risk Guide, Governance Quality, Military Involvement, Economic Stability

1. Introduction

Foreign direct investment (FDI) has emerged as a lifeblood for economic growth, especially in an increasingly interconnected global economy. It is a vital source of external financing for countries, offering more than just capital infusion; it brings in technological advancements, managerial expertise, and opens up new avenues for international trade (UNCTAD, 2019). FDI is essential for developing nations as it supplements domestic investment, often leading to higher productivity and job creation (Moosa, 2002).

The drivers of FDI are both diverse and complex, typically categorised into internal factors, such as economic stability, market size, and political condition, and external factors, which include global financial conditions and the economic performance of investor countries (Dua, 2015). Within these factors, political risk stands out as a

critical consideration. It encompasses the uncertainty that investors face due to the political environment in the host country, which can significantly affect the viability and profitability of investment projects (Kim, 2010).

In developing countries and particularly in Asia, the flow of FDI has been a testament to the region's dynamic economic development. Asian countries have been actively improving investment climates to attract more FDI, which is often seen as a stamp of economic credibility (Sahoo, 2006). Vietnam, in particular, has made significant strides in this arena. It has evolved from a war-torn nation to a rising star in the Asian economic landscape, attracting substantial FDI inflows (Hoang, 2014). With a rapidly growing market and a strategic location in Southeast Asia, Vietnam presents a unique case for studying the impact of PR on FDI.

This research endeavors to examine the nuanced relationship between political risk and foreign direct investment (FDI) inflows in Vietnam. The remainder of this paper is organised as follows. Section 2 reviews the theoretical analyses and literature review. Section 3 specifies the methodology employed in the study along with the estimation techniques. Section 4 provides the regression results with interpretations, and section 5 concludes the paper.

2. Literature Review

2.1. Political Risk and FDI inflow

The intersection of PR and FDI is a focal point of inquiry within the realm of international business and economic development literature. PR refers to the probability of disruptive political events affecting the investment climate and, consequently, the returns on investment in a particular country (Gobinda, 2014). The concept of FDI pertains to investments made by a firm or individual in one country into business interests located in another country, typically in the form of establishing business operations or acquiring business assets (Busses, 2007).

The academic landscape presents a mosaic of perspectives on the impact of PR on FDI, reflecting a spectrum of empirical findings and theoretical standpoints. The majority of empirical research reinforces the notion that heightened PR can elevate the cost of doing business internationally and diminish the attractiveness of a host country to foreign investors (Harms, 2002; Lee, 2012; Howell, 2001). While a significant portion of literature posits a negative correlation, other studies present more nuanced views. Some research indicates that certain forms of PR do not uniformly discourage FDI; instead, the effect may vary depending on the industry, investment type, and investors' risk appetite (Hoang, 2012; Asiedu, 2006). These varied results emphasise the complex interplay between PR and FDI, suggesting that a nuanced analysis of PR factors is necessary.

The relationship between PR and FDI is multifaceted, with studies highlighting various factors that influence investor decisions. Political instability and governance quality, including voice and accountability, have been identified as significant determinants of FDI inflows (Rios-Morales, 2010; Rajan and Hattari, 2009). While global research indicates that lower corruption and better contract enforcement encourage FDI (Gastanaga, 1998; Wei, 2000), findings also suggest the complexity of PR's components, such as policy volatility and cultural conflicts, which can dissuade investment (Hermes and Lensink, 2001; Goswami and Haider, 2014). In Vietnam specifically, the impact of corruption negatively affects FDI inflow (Vo and Nguyen, 2015), yet improved institutional quality has been seen to have a positive influence (Nguyen and Cao, 2015). These insights underscore the importance of nuanced approaches in both global and Vietnamese contexts to understanding PR's diverse impacts on FDI.

2.2. Macro-economic Factors and FDI Inflow

Gross domestic product (GDP) serves as a broad indicator of a country's economic health and market size, often linked to the potential for FDI inflow. A larger GDP growth is indicative of a more substantial market, potentially

offering greater opportunities for investors (Campos, 2002, Chowdhury, 2003). Within the context of Vietnam, research has underscored the positive correlation between the country's escalating GDP and FDI attraction, suggesting that economic growth fosters a conducive investment environment (Nguyen, 2023). However, contrary viewpoints caution that a higher GDP does not automatically equate to increased FDI, particularly in markets nearing saturation where the marginal benefit of additional investment diminishes, or in highly competitive markets where the entry of new players is met with significant barriers to success (Alshamsi, 2015; Nupehewa, 2022).

Trade openness refers to a country's willingness to engage in international trade, measured by the ratio of total trade to GDP. It is posited that a higher level of trade openness correlates with increased FDI, as it reflects fewer restrictions and a welcoming attitude towards foreign investment (Klein, 1998; Chakrabarti, 2001). This is evident in Vietnam, where progressive trade liberalisation has been a key factor in the surge of FDI inflows (Hanh, 2020). However, some analysts caution that excessive openness may leave economies vulnerable to global fluctuations, potentially impacting FDI negatively by introducing greater economic risks (Raf, 2004; Seim, 2009).

Inflation is a pivotal economic indicator, measuring the average price increase of goods and services and suggesting the loss of purchasing power within an economy (Mason, 2017). Traditionally, high inflation is viewed unfavorably by foreign investors due to its potential to signal economic instability and unpredictability, leading to a negative impact on FDI inflow (Buckley et al., 2007, Ahmad, 2014). In Vietnam, persistently high inflation rates have raised concerns about economic management, which can adversely affect investor confidence and FDI (Hoang, 2020; Cung, 2020). Conversely, some economists argue that a certain level of inflation is characteristic of dynamic, developing economies, and can be perceived as a sign of an active, growing market. Under this premise, moderate inflation could potentially attract FDI as it may promise higher returns on investment in an expanding economy (Mason, 2017).

2.3. Research Gaps

While there has been considerable research on the relationship between PR and FDI, the literature on the Asian region, and particularly Vietnam, remains limited (Nguyen and Cao, 2015; Hoang, 2020). Existing studies tend to focus on isolated aspects of PR without considering the overall panorama of PR factors (Vo and Nguyen, 2015; Wei, 2000). This study aims to address these gaps by conducting a comprehensive investigation into the impact of PR on FDI in Vietnam, considering the influence of macroeconomic factors such as trade openness, inflation, and market size.

2.4. Main Research Question

Given the identified research gaps, the main research question for this study is: *“How does political risk, in combination with macroeconomic factors, influence the inflow of foreign direct investment in Vietnam from 1994 to 2021?”*. This question is pivotal as it will enable an exploration of the specific impacts of PR on FDI inflows in Vietnam. The insights garnered from this research could offer valuable guidance for policymakers and investors in formulating strategies to optimise FDI inflows while mitigating the adverse effects of PR. This framework delineates the exploration of factors affecting FDI into Vietnam, focusing on the crucial role of political risk, GDP growth, inflation, and trade openness, to encapsulate the comprehensive economic landscape.

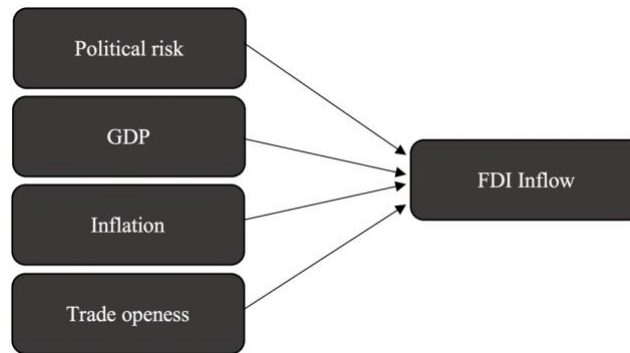


Figure 1: Research framework

3. Methodology

3.1. Research Paradigm

The study is anchored in a positivist research paradigm, emphasising objectivity and the quantifiable aspects of social phenomena (Jean, 1992). Quantitative methods are the cornerstone of the research strategy, combining with deductive approach, facilitating the measurement and analysis of variables and their relationships (Schutt, 2019). The longitudinal design of the study allows for the observation of changes over time, combining the exploratory research question can provide a dynamic view of the situation (Saldan, 2003). By prioritising statistical analysis and empirical evidence, the positivist and deductive stance enhances the study's rigor and replicability, aligning with the quantitative strategy to deliver conclusive and generalisable findings (Schutt, 2019). This approach is particularly suitable for understanding trends in FDI in response to changing economic policies and market dynamics.

3.2. Scope of the Research

The temporal scope of this study is selectively set from 1994 to 2021, despite data availability since 1986 after Vietnam initiated the Reform Policy (Lipworth, 1993). The study spans from 1994 to 2021, a timeframe chosen for its significance in Vietnam's economic journey post-trade embargo lifted in 1993 by the USA, marking a critical juncture in international trade relations (Goodman, 1993). This period witnessed substantial legislative shifts, including the Land Law in 1993, which facilitated foreign land ownership and spurred investment, reflecting a radical transformation in Vietnam's economic policies (Marsh, 2002). Analysing from 1994 allows for an exploration of FDI patterns amidst Vietnam's rapid economic integration and legislative changes, offering a rich analytical backdrop for understanding FDI's evolution in the country.

3.3. Data Collection

For data collection, the study employs World Bank's Databank for macroeconomic variables—FDI, GDP growth, inflation rate, and trade openness—to evaluate the economic climate and investment attractiveness of Vietnam. This robust dataset ensures an accurate reflection of the country's economic state over the study period. Political risk factors are drawn from the ICRG dataset; this dataset encompasses twelve detailed items, including government stability, socioeconomic conditions, investment profile, internal conflict, external conflict, corruption, military in politics, religious tensions, law and order, ethnic tensions, democratic accountability, and bureaucracy quality. High scores indicate favorable conditions for investors, while low scores denote risk areas. The ICRG indices are favored due to their comprehensive coverage across multiple dimensions of PR and their extensive country and yearly coverage, outperforming other available measures of institutional quality (Rafat, 2019).

3.4. Data analysis

The initial stage involves preparing the dataset to facilitate Principal component analysis (PCA). This process aims to reduce the number of PR factors from the initial twelve items, thus avoiding multicollinearity (Kurita, 2019). Before implementing PCA, the dataset undergoes evaluation through the Kaiser-Meyer-Olkin (KMO) test and Bartlett's test, ensuring adequacy for the reduction of dimensions. Successful PCA leads to the use of correlation tests to establish the strength and significance of the components, also scree plot can inform the number of reduced components (Kurita, 2019). A pivotal aspect of methodology is Stationarity testing for time series data. The Augmented Dickey-Fuller (ADF) test is employed to assess the stationarity of the data (Dolado, 2002). If the data proves to be stationary, Ordinary Least Squares (OLS) regression is employed for analysis. Conversely, if the data exhibits non-stationary characteristics, Auto Regressive Integrated Moving Average (ARIMA) model is utilised as they are better suited for non-stationary data. Following regression analysis, statistical tests such as the Portmanteau, Skewness, and Kurtosis tests validate the model's accuracy (Kinney, 1978). The results section then interprets the findings, providing a narrative that connects statistical outcomes with the literature context.

3.5. Limitations

While the study employs a quantitative and deductive framework, it recognises that this approach may not capture all the complexities of FDI influences. Specifically, the reliance on numerical analysis may overlook some qualitative factors that could provide additional insight into the behaviors influencing economic investment (Ochieng, 2009). Another significant limitation arises from the use of secondary data, which often encounters non-stationarity issues, making time-series analysis challenging (Cheng, 2014). Moreover, the dataset spanning from 1994 to 2021, while extensive, offers limited annual observations due to data access constraints, potentially impacting the robustness of statistical inferences (Cheng, 2014).

4. Results and Findings

4.1. Principal Component Analysis

Table 1: KMO and Bartlett's test

| KMO Measure | | | |
|--|---------------|---------------------------|--------|
| Government Stability | 0.4523 | Military in Politics | 0.7115 |
| Socioeconomic Conditions | 0.7333 | Religious Tensions | 0.7064 |
| Investment Profile | 0.5609 | Law and Order | 0.5542 |
| Internal Conflict | 0.6602 | Ethnic Tensions | 0.7253 |
| External Conflict | 0.2934 | Democratic Accountability | 0.6101 |
| Corruption | 0.5486 | Bureaucracy Quality | 0.3059 |
| Overall KMO | 0.6044 | | |
| Bartlett's Test of Sphericity: | | | |
| Chi-Square (χ^2): 415.81 | | | |
| Degrees of Freedom (df): 66 | | | |
| Significance (Prob>χ^2): < 0.0001 | | | |

The PCA conducted in the study begins with an assessment of the data's adequacy through the KMO and Bartlett's test (Table 1). With an overall KMO value of 0.6044, the dataset is considered marginally suitable for PCA, while

Bartlett's test confirms significant correlations among variables, indicating the dataset's appropriateness for the analysis (Dunteman, 1989).

Table 2: Correlation Matrix

| | GS | SE | IP | IC | EC | CO | MP | RT | LO | ET | DA | BQ |
|----|-----------|-----------|------------|------------|----------|----------|------------|-----------|-----------|-----------|-----------|-------|
| GS | 1.000 | | | | | | | | | | | |
| SE | 0.0809 | 1.000 | | | | | | | | | | |
| IP | 0.0306 | -0.2421 | 1.000 | | | | | | | | | |
| IC | 0.1183 | 0.7052** | -0.6990** | 1.000 | | | | | | | | |
| EC | 0.4201* | -0.3872* | -0.1425 | -0.2003 | 1.000 | | | | | | | |
| CO | -0.2460 | -0.0133 | 0.1306 | 0.0774 | -0.1041 | 1.000 | | | | | | |
| MP | -0.2910 | -0.5439** | 0.7566*** | -0.7120*** | -0.0725 | 0.2894 | 1.000 | | | | | |
| RT | 0.4030* | 0.4190* | -0.7188*** | 0.6361*** | 0.0825 | -0.3887 | -0.9607*** | 1.000 | | | | |
| LO | 0.1994 | 0.5269** | -0.8011*** | 0.9159*** | -0.1356 | 0.0110 | -0.7644*** | 0.7432*** | 1.000 | | | |
| ET | 0.0341 | 0.6712*** | -0.6478*** | 0.7820*** | -0.0810 | 0.0934 | -0.8331*** | 0.6829*** | 0.7461*** | 1.000 | | |
| DA | -0.5403** | 0.3671* | -0.0633 | 0.2396 | -0.3327* | 0.4483** | -0.0990 | -0.1209 | 0.1148 | 0.5684** | 1.000 | |
| BQ | 0.2843 | -0.3518* | 0.2538 | -0.3217 | -0.0338 | -0.2102 | 0.2576 | -0.0861 | -0.0463 | -0.4607** | -0.4671** | 1.000 |

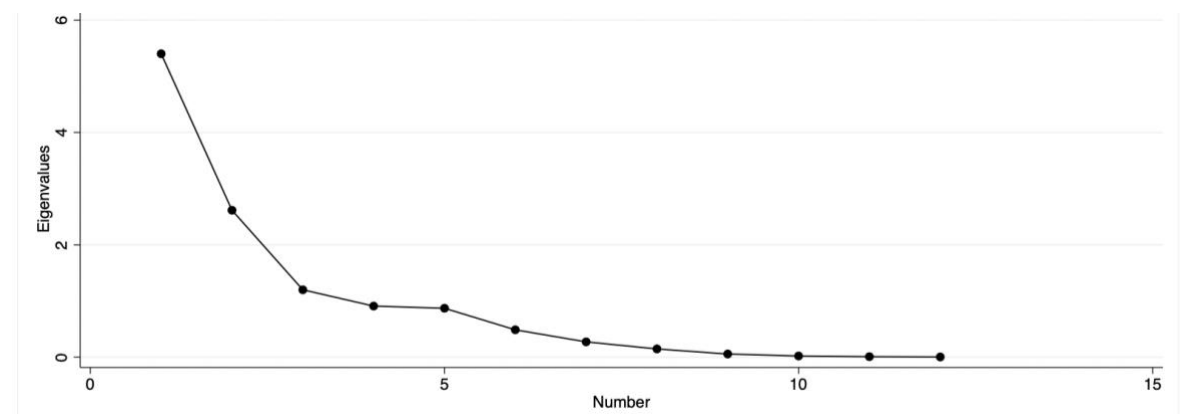


Figure 2: Scree Plot after PCA

Looking at the correlation matrix (Table 2), the PCA identifies significant interconnections among the PR indicators. The scree plot (Figure 2) is crucial as it informs the subsequent retention of three principal components based on their eigenvalues, which surpass the accepted one unit threshold (Lansangan, 2009). This PCA process helps simplifying the dataset while retaining the most significant variables for further analysis.

Table 3: Pattern Matrix

| Variable | Comp1 | Comp2 | Comp3 |
|---------------------------|----------------|----------------|----------------|
| Government Stability | 0.1376 | -0.4192 | -0.1397 |
| Socioeconomic Conditions | 0.2123 | 0.0575 | 0.4179 |
| Investment Profile | -0.3861 | -0.0400 | 0.1707 |
| Internal Conflict | 0.3530 | 0.0521 | 0.2019 |
| External Conflict | 0.1263 | -0.0169 | -0.7756 |
| Corruption | -0.0655 | 0.4339 | -0.0561 |
| Military in Politics | -0.4224 | 0.0792 | 0.0306 |
| Religious Tensions | 0.3946 | -0.2235 | -0.0075 |
| Law and Order | 0.3641 | -0.0758 | 0.1833 |
| Ethnic Tensions | 0.3784 | 0.2172 | 0.0311 |
| Democratic Accountability | 0.0462 | 0.5286 | 0.1254 |
| Bureaucracy Quality | -0.1733 | -0.4894 | 0.2826 |

Extraction Method: Principal Component Analysis.

Rotation Method: Varimax with Kaiser Normalization.

In the pattern matrix (Table 3), a threshold of 0.4 helps isolate the most representative variables for each component (Lansangan, 2009). Although the original twelve PR factors are reduced to three principal components, only seven are explained due to the limitations imposed by the limited yearly data. This strategic condensation allows for a focused analysis, each component reflects a distinct influence on PR as it pertains to governance and policy-making in Vietnam (Table 4).

Table 4: Factor Names and Component Variables

| Military Influence (MI) | Governance Quality (GQ) | Economic Equilibrium (EE) |
|-------------------------|---------------------------|---------------------------|
| | Government Stability | |
| | Corruption | Socioeconomic Conditions |
| Military in Politics | Democratic Accountability | External Conflict |
| | Bureaucracy Quality | |

The first component, reflecting MI, is significantly influenced by "Military in Politics," demonstrating the military's substantive role in governance and policy-making. The second component, denoting GQ, includes variables such as "Government Stability" and "Corruption," which collectively indicate the level of bureaucratic efficiency and integrity. The third component, representing "EE," captures elements like "Socioeconomic Conditions" and "External Conflict," encapsulating both the country's internal economic health and its external geopolitical relationships.

4.2. Stationarity Testing

The stationarity of the time-series data is a prerequisite for many time-series analyses (Dickey & Fuller, 1979). The application of the ADF test and subsequent differencing suggests that the initial data exhibited non-stationary characteristics, necessitating transformations to achieve stationarity before further analysis. The results lead to the rejection of OLS regression due to the data's limited stationary observations, prompting the use of ARIMA models suitable for non-stationary data (Jong, 1994). Comprehensive details and results of the stationarity testing are documented in the *Appendix section* of this report.

4.3. ARIMA Modeling

Table 5: Variables List

| Variable | Label | Interpretation |
|---------------------------|-------|--|
| Foreign Direct Investment | FDI | Foreign Direct Investment Inflow (Billion USD) |
| GDP Growth | GDP | Logarithm of annual GDP growth (percentage) |
| Inflation Rate | INF | Logarithm of annual Inflation rate (percentage) |
| Trade Openness | OPN | Logarithm of the trade openness index |
| Military Influence | VPCA1 | Generated by the result of Component 1 after PCA |
| Governance Quality | VPCA2 | Generated by the result of Component 2 after PCA |
| Economic Equilibrium | VPCA3 | Generated by the result of Component 3 after PCA |

In the context of macroeconomic variables, logarithmic transformations are applied to stabilize the variance, which is particularly beneficial for data that may exhibit exponential growth patterns or skewed distributions, thus facilitating a more accurate econometric evaluation (Kirui, 2014). The ICRG's PR scales are designed to directly quantify the aspects of a nation's political environment without the need for logarithmic transformation, ensuring the data's original structure is maintained for time-series analysis.

Table 6: KMO and Bartlett's test before ARIMA

| KMO Measure | | | |
|--------------------|---------------|----|--------|
| FDI | 0.5972 | MI | 0.4903 |
| INF | 0.6619 | GQ | 0.3204 |
| GDP | 0.6032 | EE | 0.2628 |
| OPN | 0.6237 | | |
| Overall KMO | 0.5253 | | |

Bartlett's Test of Sphericity:
Chi-squared (χ^2): 118.82
Degrees of Freedom (df): 21
Probability (Prob> χ^2): < 0.0001

The ARIMA model's variables undergo a second KMO and Bartlett test, ensuring that the new variables derived from the PCA are suitable for time-series modeling. Despite the lower overall KMO score of 0.5253, Bartlett's test indicates some relationships between the variables are strong enough to proceed with the ARIMA modeling (Dunteman, 1989).

Table 7: ARIMA Regression

| Sample: 1994 to 2021 | | Wald chi2: 668.58 | | | | |
|----------------------------|-------------|--------------------|-------|--------|--------------------|------------|
| Number of observations: 26 | | Prob > chi2: 0.000 | | | | |
| | Coefficient | S.E. | z | P > z | 95% conf. Interval | |
| GDP | -3.25e+0.9 | 1.48e+0.9 | -2.20 | 0.025 | -6.15e+0.9 | -1.15e+0.8 |
| INF | -9.18e+0.8 | 4.10e+0.8 | -2.24 | 0.028 | -1.72e+0.9 | -3.55e+0.8 |
| OPN | 2.56e+0.9 | 5.74e+0.8 | 4.46 | 0.000 | 1.44e+0.9 | 3.69e+0.9 |
| MI | -1.60e+0.9 | 2.22e+0.8 | -7.20 | 0.000 | -2.03e+0.9 | -1.16e+0.9 |
| GQ | 9.66e+0.8 | 2.34e+0.8 | 4.13 | 0.000 | 5.07e+0.8 | 1.42e+0.9 |
| EE | 1.55e+0.9 | 2.79e+0.8 | 5.56 | 0.000 | 1.00e+0.9 | 2.09e+0.9 |

In the ARIMA regression analysis, all six variables demonstrate a significant impact on FDI in Vietnam, as evidenced by the robust Wald χ^2 statistic of 668.58 and significant p-value. The ARIMA model's robust standard errors address the potential heteroscedasticity, providing more reliable coefficient estimates for the time-series analysis (Bianco, 1996). This approach compensates for irregularities in the error term's variance, which is essential when the dataset does not fulfill the homoscedasticity assumption (Mansournia, 2021).

Table 8: Statistical Test

| |
|---|
| Portmanteau Test for White Noise (Q-test): |
| Portmanteau (Q) Statistic: 17.7025 |
| Prob > chi2(11): 0.0887 |
| Skewness and Kurtosis Test for Normality of Residuals: |
| Adjusted Chi-Squared (2 df): 2.74 |
| Prob > chi2: 0.2538 |

Following the ARIMA regression, statistical tests are conducted to validate the reliability of the model. The Portmanteau test suggests that the ARIMA model's residuals, while not perfectly random, capture a substantial portion of the data's variability, indicating a satisfactory fit (Ljung & Box, 1978). Concurrently, normality tests on residuals, such as Skewness and Kurtosis, confirm adherence to the model's assumptions (Thode, 2002). Moreover, the AIC/BIC test for model selection and MSE/RMSE for predictive accuracy will add depth to the model evaluation, detailed discussions and results are reserved for the Appendix to maintain focus on the main findings (table 10).

4.4. Analysing Regression Output

Table 9: Relationship between variables

| Relationships | Coefficient | S.E. | P-Value | Results |
|---------------|-------------|-----------|---------|----------|
| GDP → FDI | -3.25e+0.9 | 1.48e+0.9 | * | Negative |
| INF → FDI | -9.18e+0.8 | 4.10e+0.8 | * | Negative |
| OPN → FDI | 2.56e+0.9 | 5.74e+0.8 | *** | Positive |
| MI → FDI | -1.60e+0.9 | 2.22e+0.8 | *** | Negative |
| GQ → FDI | 9.66e+0.8 | 2.34e+0.8 | *** | Positive |
| EE → FDI | 1.55e+0.9 | 2.79e+0.8 | *** | Positive |

Note: *** $p < 0.001$, ** $p < 0.01$, * $p < 0.05$

Overall, all six variables have a significant impact on FDI. Specifically, the variables INF, GDP and MI indicate a negative relationship with FDI. Conversely, OPN, GQ and EE have positive coefficients, signifying a favorable effect on FDI inflows. Among these, GDP presents the strongest negative influence, underscoring the critical impact of economic growth in attracting foreign investment. Whereas, OPN and GQ present as the two most impactful factors, with OPN showing the most substantial positive influence on FDI, the underpinnings of political stability and governance are equally vital, demonstrating that PR exerts a substantive effect on FDI inflows.

Macroeconomic Factors Impacting FDI: The macroeconomic environment of Vietnam significantly influences FDI. Higher inflation rates correspond with decreased foreign direct investment, which aligns with the theory that inflation creates economic uncertainty and can deter investors (Ahmad, 2014; Hoang, 2020). Conversely, a more open trade environment has a favorable effect on FDI, supporting the idea that policies promoting trade and economic integration can attract foreign investors by providing access to larger markets and the opportunity to join global supply chains (Klein, 1998; Hanh, 2020). Interestingly, an inverse relationship between GDP growth and FDI suggests that during periods of economic expansion, Vietnam might be less reliant on foreign investment, or FDI might be directed towards sectors that do not directly contribute to immediate GDP growth (Nuphehwa, 2022).

Military Influence: Investors typically shy away from significant military control in governance, as indicated by the negative coefficient for military involvement (Wisniewski, 2014). This apprehension is exemplified by countries, where military interventions have resulted in economic sanctions and political instability, undermining investor confidence and creating a volatile environment for FDI (Alesina & Perotti, 1996).

Governance Quality: The positive impact of governance quality on FDI inflows suggests investors' preference for reliable and transparent institutions. Countries exemplifying high governance quality, like Singapore, tend to draw more investors, who view these attributes as indicators of a lower-risk business environment (Nguyen and Cao, 2015). Good governance is associated with predictability and fairness in business regulations, which are critical for long-term investment strategies (Dinh et al., 2019).

Economic Equilibrium: A stable macroeconomic environment, as denoted by the positive association with the EE component, is crucial for attracting FDI. For example, nations that manage to maintain economic stability even during global crises are seen as safe havens for investors seeking to minimise exposure to financial volatility, offer a predictable and secure investment climate, which is a significant determinant for investors when allocating capital (Levchenko & Mauro, 2007).

5. Conclusion and Recommendation

This study sheds light on the nuanced impact of political risk (PR) on foreign direct investment (FDI) in Vietnam, emphasizing governance quality, military involvement, and economic stability as significant factors alongside traditional macroeconomic indicators. It suggests that robust governance and minimal military interference in politics are essential for attracting FDI. The research calls for more comprehensive future studies to refine these findings further. For Vietnam's policymakers, the path to increased FDI lies in strengthening institutional integrity

and ensuring political stability. Investors, in turn, should closely evaluate Vietnam's political and economic environment to capitalize on its integration into the global market. Overall, this study highlights the critical convergence of economic and political dynamics in formulating effective investment strategies in Vietnam.

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Appendix

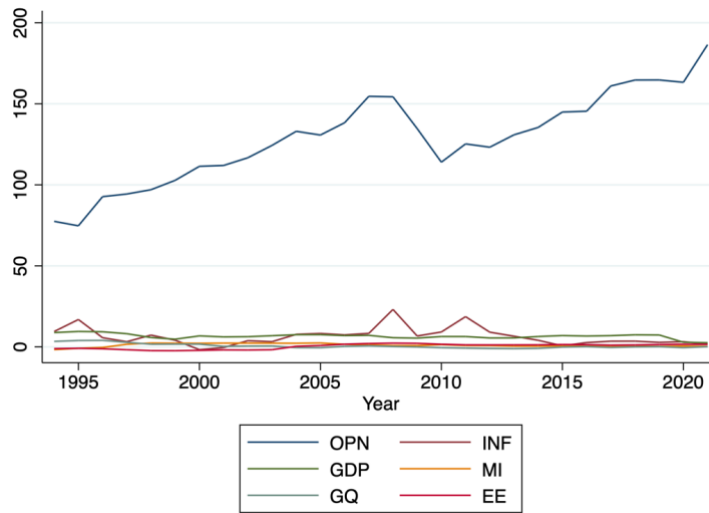


Figure 3: Stationary testing raw data

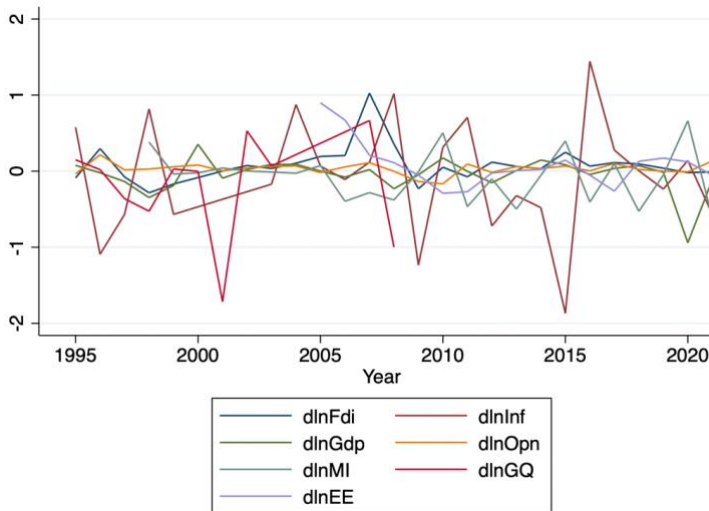


Figure 4: Stationary testing differencing data

Table 10: Statistical test ARIMA

Akaike's Information Criterion (AIC) and Bayesian Information Criterion (BIC):

AIC: 1198.443

BIC: 1207.25

Mean Squared Error (MSE) and the Root Mean Square Error (RMSE)

MSE: 3.565e+18

RMSE: 1.888e+09

Variance FDI: 2.924e+19
