# Provincial Governance and Foreign Direct Investment in Vietnam: An empirical study at sub nation level

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**Abstract**:

***Purpose****-This paper explores the role of provincial governance in attracting Foreign Direct Investment (FDI) in Vietnam across provinces*

***Methodology****-This study uses unbalanced panel data for a period of 9 years (2006-2014) in order to examine the significance determinants of Provincial Governance Index (PCI) in attracting FDI in Vietnam at sub nation level. The research takes into account Entry Costs, Land Access and Security of Tenure, Transparency and access to information, Time Costs of Regulatory Compliance, Informal charges, Proactivity, Business Support Services, Labor &Training, Legal Institutions, which are 9 indices of Provincial Competitive Index as potential determinants of FDI.*

***Findings****-The empirical results show what Transparency, Time costs of regulatory compliance, and Business Support Services are significant determinants of FDI inflow across provinces in Vietnam.*

***Research limitations/implications****-The paper does not take into consideration cultural and historical factors at the province level which may play a role in encouraging inward FDI. Furthermore, reverse causality between FDI inflows and governance quality is not discussed.*

***Values****- Our results have significant implications for policy, given the assumption that the changes in the quality of local economic governance will improve economic performance.*

**Keywords: Foreign Direct Investment, Provincial Competitive Index, Provinces, Determinants, Economic Provincial Governance.**

## 1. Introduction:

### *1.1 FDI in Vietnam:*

Analysts of the Vietnamese economy have highlighted the important contributions of foreign direct investment (FDI) to economic growth, trade, employment growth, and poverty alleviation throughout the country. Since Vietnam first opened up to global capital flows in 1987, FDI has averaged about 5 percent of gross domestic product (GDP), accounting for nearly $49 billion in implemented investment (World Bank 2010). Even before entry into the World Trade Organization (WTO), Vietnam was among the most attractive developing countries for FDI projects, but after WTO entry in 2006, FDI attraction exploded, with inflows increasing to 10 percent of GDP (World Bank 2010). To put this number in comparative perspective, as a share of GDP, Vietnam is the third largest recipient of FDI in the Association of Southeast

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Asian Nations (ASEAN) region. To this end, the 2010 PCI research team decided to supplement its regular analysis of the domestic private sector with a survey of 1,155 foreign investors throughout Vietnam, which, according to the GSO Enterprise Census (2009), represents 21 percent of the total current FIEs currently active in the country. Foreign firms were invited to complete a survey instrument that was similar to the standard PCI questionnaire, but tailored to address the unique needs of foreign investors. In particular, we probed the motivations behind locational decisions, the obstacles faced in entering the Vietnamese market, and the post registration business environment.

There are several competitive advantages to explain for this success, including strategic location, stable economic and political environment, and young labor force large and growing domestic market. Inward FDI benefits the economy by transferring technology and management skills, increasing investment capital and creating jobs for local people. Accordingly, there has been an increasing number of research on the determinants of FDI and its impacts on the economy of Vietnam, but this topic is still under- researched.

### *1.2 Regional distribution of FDI:*

According to official statistics by the Government Statistical Office (GSO) and the Ministry of Planning and Investment (MPI), all 64 provinces in Vietnam have received FDI. However, the distribution of FDI across provinces is very much uneven. As shown in Figure 1, the South East region (covering Ho Chi Minh City and its surrounding provinces) and Red River Delta (including Hanoi and neighboring provinces) account for the largest shares of FDI, leaving a very small proportion for other regions. This pattern is due to the fact that Hanoi and Ho Chi Minh City are the two main economic hubs of the country. The concentration of FDI in Hanoi and Ho Chi Minh has been attributed to the increased cost of living and doing business in the two cities. This has led to a tendency that foreign investors are looking elsewhere for the investment location. In addition, the local governments in other provinces have now realized the importance of FDI and are actively attracting inward FDI in their respective provinces.

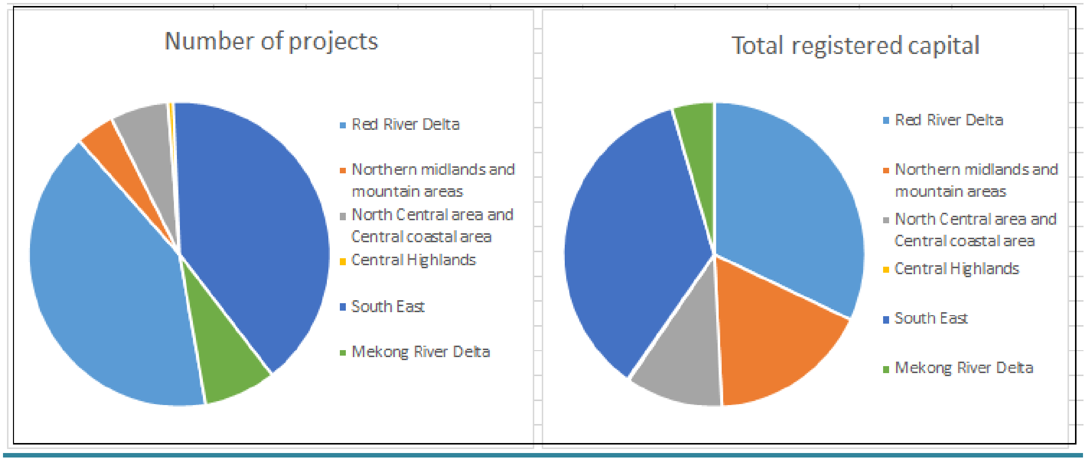


*Figure 1: Regional FDI by number of projects and register capital in 2014*

Le (2007) provides a comprehensive analysis of the sub national determinants of FDI and finds that agglomeration economies play a key role in attracting investors in Vietnam. Similarly, Nguyen Phuong Hoa (2002), Meyer and Nguyen (2005), Nguyen Phi Lan (2006), and Nguyen Ngoc Anh and Nguyen Thang (2007) point to conventional determinants of FDI including economic growth, market size, human capital, labor costs and the quality of infrastructure. Interestingly, this literature does not point to the quality of local economic governance as a determinant of FDI. Although Malesky (2007) shows that there is a positive correlation between local economic governance and FDI, and Huynh (2010) argues that the quality of local post-registration services played a key role in attracting FDI. Vo Hung Dung (2011) points out that productivity, income and investment does not increase in line with improvements in the business environment in the Mekong delta, and Nguyen (2007) find no relationship between the quality of local economic governance and FDI.

Although there has been a great deal of work on FDI in Vietnam, most contributions have depended on aggregate economic data. What has been missing from these discussions is the voice of the Foreign Invested Enterprises (FIEs). What are their needs, how do they perceive economic policy, and where do they see the Vietnamese economy going over the next few years? To this end, the 2010 Provincial Competitive Index (PCI) research team decided to supplement its regular analysis of the domestic private sector with a survey of 1,155 foreign investors throughout Vietnam, which, according to the GSO Enterprise Census (2009), represents 21 percent of the total current FIEs currently active in the country. Foreign firms were invited to complete a survey instrument that was similar to the standard PCI questionnaire, but tailored to address the unique needs of foreign investors. In particular, we probed the motivations behind locational decisions, the obstacles faced in entering the Vietnamese market, and the post registration business environment.

In this research, we employ the Provincial Competitiveness Index (PCI) which has been jointly developed by the Vietnam Chamber of Commerce and Industry (VCCI) and USAID since 2005. The PCI is an aggregate indicator that measures and assesses the conditions of economic governance toward business sector development for 64 provinces in Vietnam. The PCI is good tool for examining how each province initiates policies to facilitate institutional changes or governance reforms, how the changes affect development of the business sector, and which of governance reform package is the most effective toward business sector.

Among nine packages of provincial governance changes, the empirical results show what Transparency and access to information, Time costs of regulatory compliance, and Business Support Services are significant determinants of FDI inflow across provinces in Vietnam. Firstly, the result suggests that improvement in transparency and access to information will bring attract more inward FDI. Secondly, the result highlights the importance of provincial government assist private entrepreneurs in the acquisitions and use of new technologies. Thirdly, the result also implies that reduction in time costs of regulatory compliance can serve as a motivation for foreign investments. All together, the results of this study provide insights on policy implications and directions for local governance to give better market-supporting mechanism and institutions to attract more FDI into their provinces.

In this context, this paper studies on the determinants of FDI across provinces in Vietnam. The main purpose of this paper is to collect and review determinants of FDI related papers in Vietnam and to provide an updated analysis of the determinants of distribution of FDI across provinces in Vietnam during 2006-2014. This paper is structured in five sections. Section 2 review previous studies on issues related determinants of FDI in Vietnam. Section 3 describes data and model specification. Section 4 shows the empirical results and section 5 concludes our paper.

## 2. Literature review: A REVIEW OF FDI-RELATED LITERATURE IN VIETNAM:

Even though there are numerous reports on FDI in Vietnam, the number of research is still limited due to the shortage of data availability. The unavailability of data has long been an obstacle for researcher doing empirical research on the determinants of FDI. Though data is becoming accessible recently, it is still not in good quality. At the provincial level, the data is not systematically available and has measurement problems (Phan and Ramstetter 2006, Nguyen and Xing 2006). Government Statistical Office (GSO) in Vietnam has recently released several enterprise level dataset available for research. We believe this will lead to a surge of research work on the important topics of FDI for Vietnam.

In this section of our paper, we attempt to provide an updated literature review on FDI determinants research at both the national and sub national levels in Vietnam (Mirza and Giroud 2004, Nguyen and Haughton 2002, Pham 2002, Nguyen Phuong Hoa 2002, Hsieh 2005, Meyer and Nguyen 2005). Dunning (1993) argues that firms invest abroad because of O (ownership), L (locational) and I (internalization) advantages. First, multinationals must have some firm specific ownership advantage to compete with their rivals. Second, they are willing to invest in one host country to take advantage of location-specific characteristics of that host country rather than in others. Finally, multinationals must have the ability to internalize the O and L advantages. Mirza and Giroud (2004) have identified several country specific characteristics that attract FDI into Vietnam. According to their survey results, Vietnam is chosen as a destination of investment because of its political stability, government policies, size of the local market and quality of the labor force. Their result is quite interesting because given Vietnam's small local market, 40 percent of the output for FDI firms are for local market. A number of studies have investigated the regional distribution of FDI in Vietnam including Pham (2002), Meyer and Nguyen (2005), Nguyen Phuong Hoa (2002) and Nguyen Phi Lan (2006). In general, the findings from studies on the distribution of FDI in Vietnam are quite consistent with studies for other countries. Common factors such are the market potential, labor factors, and infrastructure are found to be important determinants of FDI location. Nguyen Phuong Hoa (2002) estimated a cross-sectional regression model for the locational determinants of accumulated FDI to the year 2000 across provinces in Vietnam. She found that market size represented by provincial GDP, human capital (measured by the percentage of worker having certificates in the total labor force, electricity, GDP per capita and the number of industrial zones are important determinants of FDI across provinces in Vietnam. Pham (2002) examined the distribution of FDI across provinces Vietnam during the period 1988-1998 and found that local market, wage rate, labor force; infrastructure and government policies are important factors determining the location of FDI in Vietnam. Similar to Pham (2002), Meyer and Nguyen (2005)19 examined the distribution for both newly registered FDI in 2000 and cumulative FDI upto 2000.

## 3. Model and data description:

### *3.1 Data description:*

The source of information on the dependent variable FDI is taken from the GSO and MPI. The data on the PCI including 9 sub-indices are obtained from VNCI. During the period from 1988 to 2006, the number of provinces has increased from 54 to 63. Due to the integration of Hatay province into Hanoi capital in the late 2008, there is no data on Hatay province after 2008. We thus exclude data on this province from our sample. We collected data of FDI and PCI across 63 provinces from 2006 to 2014. However, conducting empirical research in Vietnam is seriously limited by the availability and consistency of data. Therefore, we obtained unstructured panel data.

To measure the quality of local economic governance, we draw on Vietnam provincial competitiveness index (PCI). It is an indicator which measures the attitude and the practice of laws and regulations issued by the central government at provincial level is the. This index was developed at the first time in 2005 by the Vietnam Chamber of Commerce and Industry (VCCI) and the U.S. The PCI is an effort to explain the reasons why some parts of the country perform better than others in terms of private sector dynamism and growth. The analysis of the PCI highlights the importance of good economic governance for attracting investment and generating growth, and identifies opportunities for better practices at the provincial level. The PCI methodology has proven to be remarkably robust, consistently identifying top performers among Vietnam's provinces, while allowing room for other provinces to improve and achieve higher PCI scores in subsequent years.

The PCI is constructed in a three step sequence, referred to as the "3 Cs": 1) collect business survey data and published data sources, 2) calculate nine sub indices and standardize to a 10-point scale, and 3) calibrate the composite PCI as the weighted mean of nine sub indices with a maximum score of 100 points. It is based upon a mail out survey to a random sample of firms in each province. A high index shows a competitive local government. The survey asks a range of questions about firms' perceptions of local economic governance, as well as concrete measures of their experience of local governance. A particular strength of the PCI is that it focuses on aspects of local governance which are under the control of the provincial administration. It therefore excludes factors such as the quality or availability of national roads, airports and ports which would bias the index in favor of larger cities or provinces. Firm responses to the questions are combined into a set of nine sub indices reflecting provincial performance on:

- ***Entry Costs:*** A measure of time it takes firms to register, acquire land, and receive all the necessary licenses to start business, the number of license required and the perceived degree of difficulty to obtain all licenses / permits.

- ***Land Access and Security of Tenure:*** A measure combining two dimensions of the land problems confronting entrepreneurs: how easy it is to access land and the security of tenure once land is acquired. The first dimension comprise whether firms possess their official land use rights certificate, whether they have enough land for their business expansion requirements, whether they are renting from SOEs and an assessment of land conversion efforts. The second dimension includes perceptions of various tenure security risks (such as expropriation, unfair compensation values, or changes in the lease contract) as well as the duration of tenure.

- ***Transparency and Access to Information*:** A measure of whether firms have access to the proper planning and legal documents necessary to run their business, whether those documents are equitably available, whether new policies and laws are communicated to firms and predictably implemented, and the business utility of the provincial web page.

- ***Time Costs of Regulatory Compliance:*** A measure of how much time firms waste on bureaucratic compliance as well as how often and how long firms must shut their operations down for inspections by local regulatory agencies.

- ***Informal Charges*:** A measure of how much firms pay in informal charges, how much of an obstacle those extra fees pose for their business operations, whether payment of those extra fees results in expected results or 'services', and whether provincial officials use compliance with local regulations to extract rents.

- ***Pro-activity of Provincial Leadership*:** A measure of the creativity and cleverness of provinces in both implementing central policy, designing their own initiatives for private sector development, and working within sometimes unclear national regulatory frameworks to assist and interpret in favor of local private firms.

- ***Business Support Services (Private Sector Development Services)*:** A measure of provincial services for private sector trade promotion, provision of regulatory information to firms, business partner matchmaking, provision of industrial zones or industrial clusters, and technological services for firms.

- ***Labor Training*:** A measure of the efforts by provincial authorities to promote vocational training and skills development for local industries and to assist in the placement of local labor.

- ***Legal Institutions*:** A measure of the confidence of the private sector in the provincial legal institutions, whether firms regard provincial legal institutions as an effective vehicle for dispute resolution or as an avenue for lodging appeals against corrupt official behavior.

As we can see in Figure 2, *Policy Bias*- Provinces give privileges to state owned economic group, corporations, causing difficulties to your business is a new sub index just recently appeared in 2013 and 2014. To merge the panel data from 2006 to 2014, we did not include this new sub index in the final data.

Therefore, PCI in this study only includes 9 sub-indices. Figure 2 illustrates the annual scores in governance sub indices, by depicting the score of the median province on each sub index over time. More detail on the specific survey questions and indicators used in the index construction is available in the annual reports.


*Figure 2: Changes in Scores of sub-indices from 2006 to 2014*

Figure 2 illustrates the annual scores in governance sub-indices, by depicting the score of the median province on each sub-index over time. In 2014, as previously mentioned, the most significant improvements were observed in the area of Entry Costs (by 0.95 points), followed by Transparency (0.42 points), Business Support Services (0.43 points), Labor Training (0.4 points) and Time Costs (0.33 points). Compared with last year, there is a decline in the scores of the median province on four sub-indices, of which three were significant drops: Informal Charges (down 1.4 points), Proactivity (1.02 points) and Land Access (1.01 points). Finally, the sub index on Policy Bias dropped 0.5 points. Legal Institutions had no change compared to 2013.

### *3.2 Model specification:*

Panel regression model is used in the study as the data is a combination of times series and cross section. The following is the panel model estimation:

$$\mathbf{LnFDI}_{it}=\alpha+\beta_1 V_{1it} + \beta_2 V_{2it} + \beta_3 V_{3it} + \beta_4 V_{4it} + \beta_5 V_{5it} + \beta_6 V_{6it} + \beta_7 V_{7it} + \beta_8 V_{8it} + \beta_9 V_{9it} \quad (1)$$

The dependent variable $\mathbf{LnFDI}_{it}$ is the natural log of investment in a given year, indexed by the firm id ($i$) and year ($t$). Independent variables include 9 sub-indices of PCI from 2006 to 2014: $\mathbf{V}_{1it}$ Entry cost, $\mathbf{V}_{2it}$ Land access & Security of Tenure, $\mathbf{V}_{3it}$Transparency and access to information, $\mathbf{V}_{4it}$ Time costs of Regulatory Compliance, $\mathbf{V}_{5it}$Informal charges, $\mathbf{V}_{6it}$ Proactivity, $\mathbf{V}_{7it}$ Business support services, $\mathbf{V}_{8it}$Labor policies and $\mathbf{V}_{9it}$Legal Institutions.

**Table 1: Descriptive statistics**

| Variables | Indicators | Obs. | Mean | Std. | Min | Max |
|---|---|---|---|---|---|---|
| **Dependent variables** | LnFDI | 471 | 4.038 | 2.336 | -2.303 | 9.190 |
| **Independent variables** | | | | | | |
| Entry cost | $V_1$ | 471 | 7.925 | 0.923 | 4.955 | 9.600 |
| Land access & Security of Tenure | $V_2$ | 471 | 6.332 | 0.891 | 3.040 | 8.840 |
| Transparency & access to information | $V_3$ | 471 | 5.885 | 0.833 | 2.154 | 8.850 |
| Time costs of Regulatory Compliance | $V_4$ | 471 | 6.100 | 1.112 | 2.638 | 8.930 |
| Informal charges | $V_5$ | 471 | 6.379 | 0.936 | 3.770 | 8.940 |
| Proactivity | $V_6$ | 471 | 5.120 | 1.418 | 1.390 | 9.999 |
| Business support | $V_7$ | 471 | 5.255 | 1.405 | 1.750 | 9.620 |
| Labor Policies | $V_8$ | 471 | 5.216 | 0.957 | 1.920 | 9.597 |
| Legal Institutions | $V_9$ | 471 | 4.886 | 1.181 | 2.130 | 7.910 |

## 4. Empirical results and discussion:

As the data also contains the time series, so stationarity is checked. In order to investigate the possibility of non-stationary in the data set, the paper uses Augmented Dicky-Fuller (ADF) and Phillips-Perron (PP) tests and result is reported in Table 2. The result of the ADF and PP test panel unit root test at level indicating that all variables are I(0). It clearly shows that the null hypothesis of a panel unit root (non-stationary) in the level of the series can be rejected.

**Table 2: Unit root tests**

| Variables | Indicators | ADF | PP |
|---|---|---|---|
| | | **Levels** | **Levels** |
| Foreign Direct Investment | LnFDI | 178.548*** | 368.697*** |
| Entry cost | $V_1$ | 204.697*** | 487.167*** |
| Land access & security of tenure | $V_2$ | 167.449*** | 277.471*** |
| Transparency & access to information | $V_3$ | 121.27** | 261.898*** |
| Time costs of regulatory compliance | $V_4$ | 115.402* | 490.508*** |
| Informal charges | $V_5$ | 119.961** | 253.138*** |
| Proactivity | $V_6$ | 149.061*** | 247.019*** |
| Business support service | $V_7$ | 129.262** | 238.604*** |
| Labor training | $V_8$ | 154.648*** | 162.292*** |
| Legal Institutions | $V_9$ | 160.566*** | 327.579*** |

****,*,* denotes values significant at 1%, 5% and 10%, respectively*

We estimate Panel data analysis including OLS pooled regression, Fixed effects method and Random effects method for the selected study period. A Hausman test is performed in order to decide between a country fixed and random effects regression. The choice for country random effects estimation requires that the constant and error term of each independent variable should not be correlated with those of other independent variables **(**Dougherty, 2007). The result of the Hausman test clearly cannot rejects the null-hypothesis and therefore we will use random effects regression. In order to determine the exact influences of the governance indicators on inward FDI, it is important to control for the presence of heteroskedasticity in the regression model. Heteroskedasticity occurs when there is no constant variance of the error terms and its presence causes biased standard errors and therefore invalid t-statistics (Wooldridge, 2006). We tested for the presence of group wise heteroskedasticity in the random effects regression model. We cannot reject the null-hypothesis, which indicates there is no presence of heteroskedasticity. The estimation results of Random effects are presented in Table 3.

**Table 3: Random effects regression model the effects of economic governance at province level in Vietnam**

| **Explanatory variables** | **Indicators** | **Random effects** | |
|---|---|---|---|
| | | *Coefficients* | *t-values* |
| Entry cost | $V_1$ | 0.154 | 1.618 |
| Land access & Security of Tenure | $V_2$ | -0.125 | -1.008 |
| Transparency & access to information | $V_3$ | 0.216* | 1.692 |
| Time costs of Regulatory Compliance | $V_4$ | 0.174** | 1.977 |
| Informal charges | $V_5$ | 0.064 | 0.583 |
| Proactivity | $V_6$ | -0.106 | -1.229 |
| Business support | $V_7$ | 0.197*** | 2.931 |
| Labor Policies | $V_8$ | 0.063 | 0.598 |
| Legal Institutions | $V_9$ | -0.036 | -0.459 |
| $R^2$ | 0.655 | | |

*Notes: ***,**,* denote significance at 1%, 5% and 10%*

The table 3 provides the regression coefficients from a series of regression equation using the sub-indices as independent variables. Stars denote whether or not a particular sub- index has a statistically significant relationship with the dependent variable in the model. Table 3 shows the results of Random effects model for the explaining variables included in the model is fairly good explanation for the dependent variable ($R^2$=0.655 means that the variable FDI is explained of about 65% by the independent variables in the model). The result confirms the significance of Transparency & access to information at 10%, Time costs of regulatory compliance at 5% and Business Support service at 1%. Confirming this finding, the strongest result for the individual sub-indices is Business support service. The substantive effect of improving the quality of business support service is particularly large. A one point change in the sub index is associated with 2.931 percentage increase in inward FDI across provinces.

Vietnamese government acknowledged the importance of information openness to investors and issued policies to encourage provinces to set up agencies and centers to provide market information and trade promotion. However, information transparency to firms is implemented differently by provinces. The impacts of information access investment decision by foreign firms are investigated through two sub indices, transparency and access to information and business support services. Transparency is a measure of whether firms have access to the proper planning and legal documents necessary to run their business, whether those documents are equitably available, whether new policies and laws are communicated to firms and predictably implemented, and the business utility of the provincial web page. Foreign firms clearly benefit from access to these provincial materials. In fact, one point (10%) improvement in transparency is associated with 26.1% increase in FDI flows across provinces. One critical source of this information for foreign investors is provincial web pages. Many Vietnamese provinces have highly sophisticated web pages, detailing provincial regulations, the location of industrial zones, and charting investment incentives. In 2015, The Ministry of Planning and Investment has introduced a new tool for foreign investors: *Vietnam.eregulation.org*. This portal is an online step by step guide on procedures to set up a business in Vietnam and promotes awareness of rules and procedures and stimulates public private dialogue.

Business support services, used to be named “Private Sector development services”, is a measure of provincial services for private sector trade promotion, provision of regulatory information to firms, business partner matchmaking, provision of industrial zones or industrial clusters, and technological services for firms. The index is designed specially with the private sector in mind, but also has very strong implications for the foreign sectors as well. A one point increase in the index of Business support services links with 19.7 % increase in the flow of foreign investment. The result reveals that foreign firms are particularly attracted to locations where provincial government assists private entrepreneurs in the acquisitions and use of new technologies. It is noted that this variable has the strongest effect on investment of foreign firms in provinces compared with the other sub indices.

Time Costs of Regulatory Compliance is a measure of how much time firms waste on bureaucratic compliance as well as how often and how long firms must shut their operations down for inspections by local regulatory agencies. A one point shift yields a 17.4 % increase in additional investment relative to other provinces. Waiting periods for business registration and procedures for startup have declined significantly throughout the country (as shown in Figure 3), largely attributable to the creation and operation of one stop shops.

## 5. Conclusion:

We use panel data to investigate the effect of economic governance by local authorities on inward FDI across provinces in Vietnam over the period 2006-2014. The paper shows that recent FDI attraction is correlated with economic governance, even if the governance measure itself is derived from domestic private sector perceptions. Transparency and access to information, Business support services and Time costs of Regulatory Compliance are strongly associated with investment attraction. It appears that foreign investment enterprises are willing to invest in the regions or provinces where they can easily access necessary information at the lowest costs relating to relating to legal documents, provincial master socio-economic plans and market information such as information about inputs, outputs, alternative suppliers, buyers, price and price trends, spend less time on bureaucratic compliance and receive incentive support from local governance to assist and interpret in favor of local private firms can increase attractiveness of provinces toward foreign firms. Compared with domestic investors, foreign firms may always have disadvantages in accessing information about local business environment due to differences in language, culture and business manners. Yet, these disadvantages will reduce if firms locate in regions where local authorities can create the ways to make necessary information transparent and easy to access for investors. Reducing the regulatory compliance burden is also a matter of concern. Provinces should diligently review administrative procedures in order to cut and simplify the cumbersome paperwork for firms. The empirical findings suggest that the government should encourage provinces to exchange information and experience as well as facilitate cross provincial communication and learning.

The research still has some limitations that future study can address. First, we did not take into consideration cultural and historical factors at the province level which may play a role in encouraging inward FDI. In

Vietnam, the North's and South's different history with capitalist business activity is a particular concern. It is believed that politicians in the South may have had more experienced with entrepreneurial activity and therefore are more likely to construct institutions conducive to its development (Turley and Womack 1998; Nguyen et al. 2004). The second drawback is that we did not address the reverse causality. It means that provinces with better governance capacity will attract more inward FDI. As a result, the causal arrow may run from high level of FDI flows to economic governance quality. A fundamental dilemma facing all of these studies is the difficulty of showing a causal relationship between institutions and economic performance.

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