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Partnerships



**Vietnam's New Industrial policy – the Role of the Sub-  
national Business Environment in Facilitating foreign  
Direct Investment**

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**Abstract**

A large and growing literature suggests that the quality of a country's "investment climate" or "business environment" is a key factor in determining investment, job creation and private sector economic activity.

Taking sub-national data from Vietnam's 64 provinces, this paper tries to measure the importance of business environment variables in determining the spatial distribution of foreign direct investment. While Vietnam has been very successful in attracting inward investment, the author finds only very weak evidence to suggest that the standard "costs of doing business" variables are the main factors that drive choice of location by investors. Factors such as the location of existing foreign investment, the quality of infrastructure and the size of the local market appear to be more important.

## 1. The new Asian tiger

In recent years, Vietnam has emerged as one of the most talked-about developing countries in the world. Reforms began in 1986 and accelerated in the years following. Shrugging off the effects of the Asian financial crisis, Vietnam has seen GDP growth of around 7-8 percent for much of the last ten years, and second only to China in the East Asian region.

From a closed economy with no real private sector in the 1980s, the country has moved from food insecurity to food surplus, and is now one of the world's leading exporters in a number of sectors ranging from rice, coffee and pepper, to footwear and garments, and increasingly in electronics and light manufactured products. Poverty reduction has been very impressive, dropping from 58 percent of the population in 1992 to 19 percent in 2004 (according to national measures). Vietnam's growth story has been remarkably *pro-poor* with an almost unparalleled elasticity of poverty reduction with respect to growth of greater than one.

Foreign Direct Investment (FDI) has played an important role throughout Vietnam's growth story<sup>1</sup>, with commitments now reaching as much as 5 percent of GDP in 2006 (World Bank 2005). Fortunate geography, strong economic growth rates, political stability, together with a youthful and well-educated but low-cost labour force have all helped in attracting FDI. Many investors also see Vietnam as the "plus one" in a "China plus one" investment strategy (KPMG 2007). However, even 5 percent does not represent a critical level and it would be fair to say that in Vietnam FDI has been more of a growth accelerant, rather than the source of growth. Anh and Thang (2007) provide a good discussion on the literature attempting to show the effects of FDI in Vietnam on growth.

As can be seen in Figure 1 below, FDI inflows to Vietnam grew steadily following in the 1986 Law on Foreign Investment<sup>2</sup> before peaking in 1996 at just over USD 10 billion. FDI dropped sharply following the 1997-98 Asian crisis and took volumes only really began to recover after 2004. However, while the volume of capital committed fell after the late 1990s, the number of projects rose significantly. This reflected the changing nature of FDI as the earlier larger projects in sectors such as oil and gas, and property gave way to smaller investment projects, frequently in light manufacturing, from mostly regional investors.

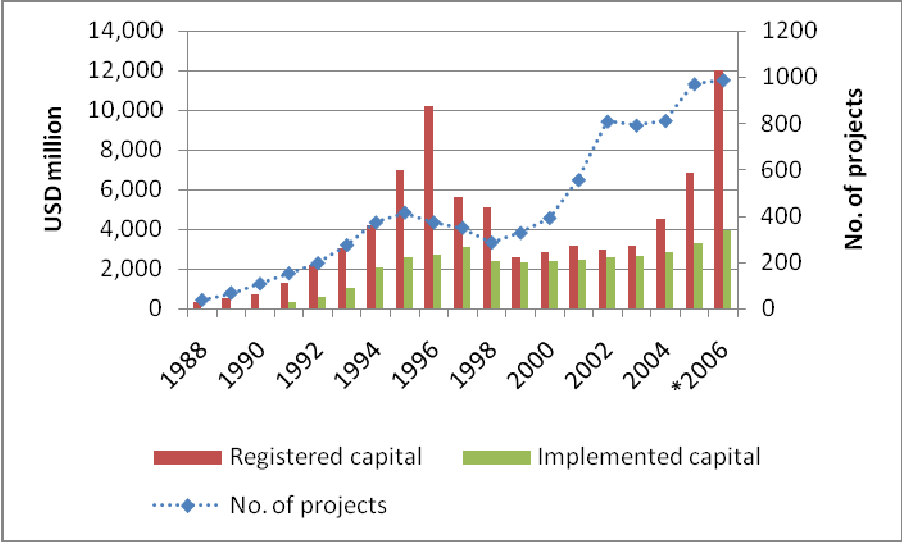
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<sup>1</sup> See Athukorala and Tran (2008) for a very good overview of Vietnam's FDI experience, and te Velde (2006) for a more general discussion on the links between FDI and development.

<sup>2</sup> In 2006, foreign and domestic investment was brought together within one legal framework under the Unified Investment Law.

Vietnam is currently in the midst of a second FDI boom with new highs being reached in both volumes and the number of projects.

**Figure 1: FDI inflows to Vietnam, 1998-2006<sup>3</sup>**



Source: GSO (2007)

Foreign-invested companies now account for almost 100 percent of production in oil and gas and 84 percent in automobile assembly. The share is much less dominant in other sectors such as electronics (45 percent), textiles and garments (41 percent), chemicals (38 percent), steel (32 percent), and 25-20 percent in cement, rubber and plastics, and food and beverages (World Bank 2005).

**2. Vietnam’s sub-national business environment**

Since the 2005 World Development Report (titled “A Better Investment Climate for Everyone”), there has been an increased focus throughout the development literature on the importance of the business environment. The theory draws closely upon the earlier institutions (“rules of the game”) literature, and proposes a causal chain from the investment climate, through to investment, economic growth, and therefore higher living standards and poverty reduction.

Dollar, Hallward-Driemeier and Mengistae (2003) analyse enterprise data from four countries (Bangladesh, China, Ethiopia and Pakistan) and find that investment climate matters for the level of productivity, wages and profit rates at the firm level. So, where hassles and bottlenecks are greater, then firms exhibit lower productivity and profitability. Taking

<sup>3</sup> \* indicates provisional data.

enterprise data from port cities across eight developing countries, the same authors (Dollar, Hallward-Driemeier and Mengistae 2004) find evidence to suggest that cities with a better investment climate – taken to mean low customs clearance times, reliable infrastructure and good financial services – attract more foreign investment. Then, the authors find that foreign firms generally bring superior technology and management and so raise average productivity in the private sector. The authors do rightly caution that other factors such as geography and national policy matter as well, but it is interesting to try and account for the large differences in foreign investment across major port cities in different developing countries.

More recently the World Bank's "Doing Business" project has attracted significant attention. Countries are ranked annually according to the costs and time taken to carry out standardised business activities (such as starting a business). In essence, the argument goes that countries which can provide a low cost and time efficient business environment, will see greater private sector investment and activity.

Altenburg and von Drachenfels (2006) have emerged as leading critics of what they term the "new minimalist" or "neoclassical" investment climate / business environment literature, implying that much more is required in order to accelerate investment and growth. Altenburg and von Drachenfels disaggregate the overall business environment into a series of feasible interventions illustrated by a series of three concentric circles. The innermost circle is termed the "regulatory business environment" and concerns the standard *Doing Business* issues such as licensing, business start-up costs etc. For the authors, the "investment climate" includes this inner circle, but also a wider series of issues covering areas such as skills, trade policy, and geography. Finally they add an additional set of issues termed "the neo-structural approach" in a third and outermost circle covering a menu of more interventionist policies and themes such as cluster policy, strategic trade, embedded knowledge etc.

A more fundamental critique is made by Moore and Schmitz (2007) who contend that the basic premise of the investment climate literature is based on an overly optimistic and unrealistic "institutional gap paradigm" and that merely transferring business environment models and practices from wealthy countries fails to take into account the more complex relationships between political and economic power. The authors go on to argue that there is little evident connection between actual levels of private investment, and the extent to which international best practice is adopted in the investment climate.

One of the greatest problems when it comes to trying to test the importance of business environment variables is being able to control effectively for outside effects. As in many other policy areas, cross-country regressions often produce disappointing results. Hence the debate is beginning to move on to look at the business environment at the sub-national level, that is across jurisdictions within one country.

Vietnam represents as especially interesting case in this regard. The country is large enough, and with enough separate jurisdictions (provinces) to make real sub-national comparisons. Although still quite a centrist state, there is a decentralisation agenda and provinces do have growing powers. Perhaps more interestingly, a number of commentators have pointed to the extent to which Vietnamese provincial authorities have *de facto* powers to influence the business environment, if not *de jure* powers. A recent UNDP study revealed that as many as half of Vietnam's provinces were "fence-breaking" and offering additional incentives to attract foreign direct investment (FDI) that were strictly beyond the remit of provincial authorities to offer (Anh, Thai and Thang 2007). In a similar fashion, Mallon (2006) describes how Vietnamese sub-national authorities have acted as "laboratories of reform" in testing out business environment advances that the centre is perhaps unwilling to try until proven. Malesky (2004, 2008) goes further, suggesting that the additional revenue, employment generation and economic activity that FDI brings, actively encourages provincial authorities to "fence break" and risk censure by the central government.

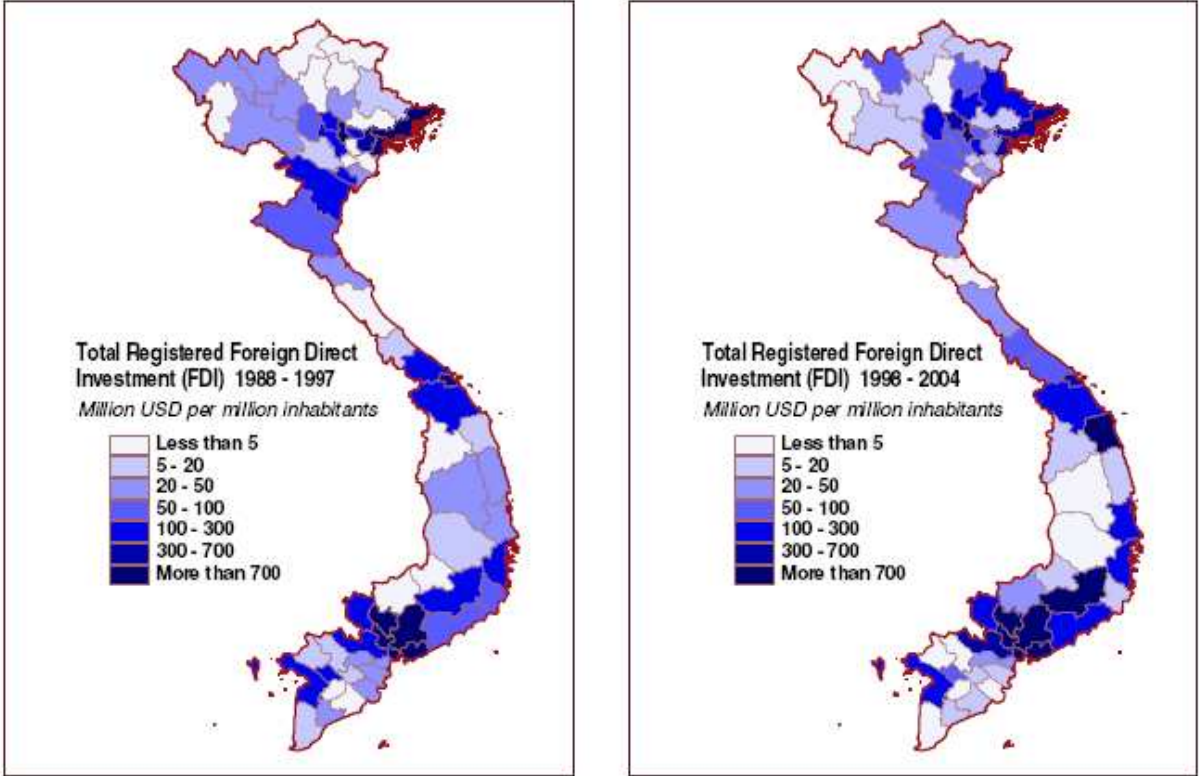
While much of the wider investment climate literature attempts to link changes in the business environment with resultant private sector activity, contrasting differences in the sub-national business environment in Vietnam with the distribution of foreign direct investment is a useful means of measuring the importance of the local business environment.

### **3. The business environment – what matters most in determining FDI inflows?**

Figure 2 shows the spatial distribution of FDI inflows to Vietnam between 1988 and 2004 across provinces. Clearly the centre of focus is the southern hub of provinces surrounding Ho Chi Minh City, and to a lesser extent a northern hub surrounding Hanoi. The more rural, the inland and the mountainous provinces have clearly attracted less inward investment. The differences are quite stark too. While some provinces have received more than US\$ 700 per

capita in FDI (seven provinces during the 1996-2004 period), a number of provinces received less than US\$ 5 per capita (twelve provinces during the same period).

**Figure 2:** FDI commitments by province, 1988-97 and 1998-2004



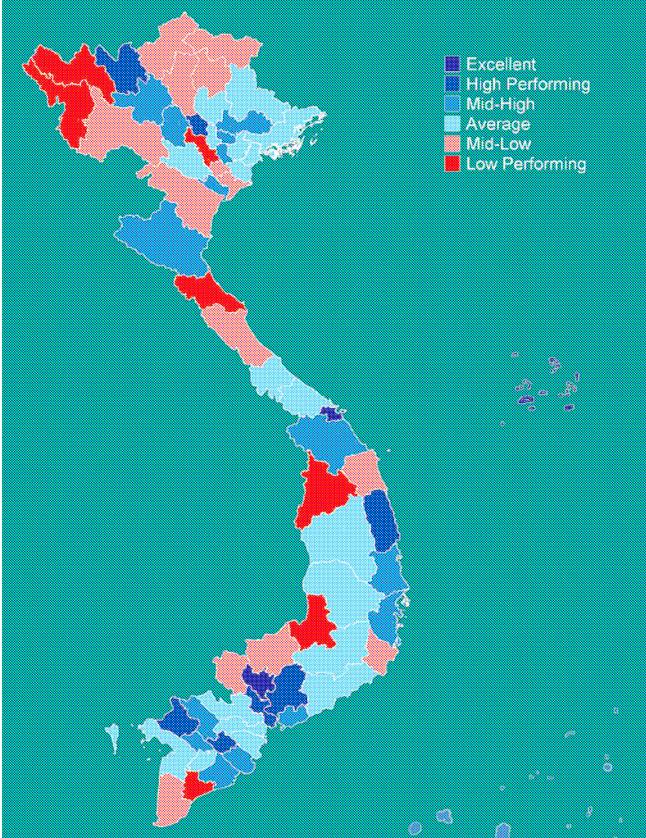
Source: World Bank (2005)

This analysis in this paper uses the “Provincial Competitiveness Index” (PCI) dataset as a means of measuring the quality of the localised investment climate. The PCI represents an effort to quantify the business environment in which private sector firms operate across the entire country, and has been collected annually since 2005 jointly by the Vietnam Chamber of Commerce and Industry and the Asia Foundation, under a USAID funded project. The data is collected via an anonymous mail-out survey and the analysis in this paper is based on the 2006 round of the survey which covered some 6,300 private sector firms across all of Vietnam’s 64 provinces.

The PCI is composed of ten sub-indices with questions covering entry costs (business establishment costs); land access and security of tenure; transparency and access to information; time costs of regulatory compliance; informal charges; state-sector bias (the competitive environment); pro-activity of provincial leadership; private sector development

services; labour training; and legal institutions.<sup>4</sup> Firm responses are grouped according to home province and then averaged and weighted in order to calculate aggregate scores and ranks for each of the 64 provinces in the ten sub-indices. Similarly the sub-indices are then weighted in order to calculate an overall PCI score and ranking. In 2006, Binh Duong was the top ranked province with a score of 76.23 and Lai Chau was the bottom ranked province with a score of 36.76. Figure 3 shows a map of Vietnam where provinces are shaded according to their respective PCI scores in 2006.

**Figure 3:** PCI map of scores, 2006



Source: VNCI (2006)

The basic thesis of the PCI, along with most of the standard investment climate literature is, in its simplest form, that a better investment climate should lead to greater investment. Since Vietnam now has an open economy that is fully receptive to Foreign Direct Investment, the aim of this paper is therefore to test how important the investment climate really is (as measured by the PCI) when it comes to determining the spatial (provincial) distribution of FDI inflows into Vietnam.

<sup>4</sup> See [www.pcivietnam.org](http://www.pcivietnam.org) for further information on the PCI.



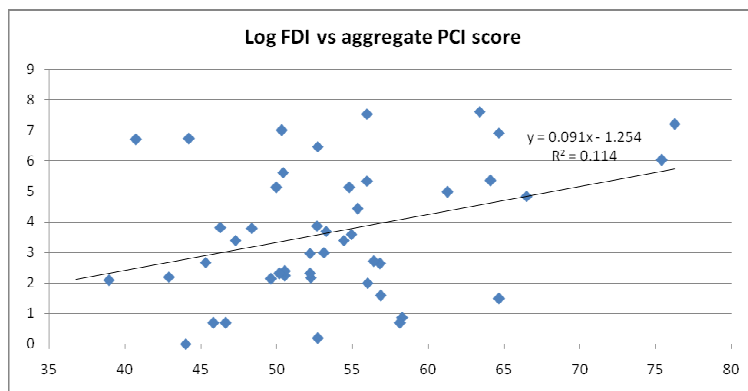
### **3.1 Basic causal analysis**

The first part of the causal analysis consists of basic two-way scatter plots of FDI inflows against business environment variables. Figure 4 to Figure 13 show a series of plots of the log of FDI against firstly a province's aggregate score according to the Provincial Competitiveness Index, and then against provincial scores for each of the eight PCI sub-indices for 2006. Throughout, the unit of analysis is the province. FDI is taken as the total registered capital in US dollars that a province received during 2006, with figures provided by the Vietnamese General Statistics Office (GSO 2007).

The aggregate plot (Figure 4) is broadly as one would expect. There is a general pattern with a trend from bottom left to top right with provinces with higher PCI scores (measured on the  $x$  axis) seeing higher FDI (measured on the  $y$  axis). However, there are clearly a number of outliers with several provinces with very low relative PCI scores, seeing high FDI inflows (the dots in the top centre and top left of the figure). In contrast the bottom right section of the plot is empty, with almost no provinces that have high PCI scores seeing low FDI inflows. This might suggest that provinces may be able to attract significant FDI if well-endowed with factors outside those measured by the PCI (good transport communications, close to the major cities of Hanoi and Ho Chi Minh, fortunate geography, availability of valuable natural resources etc...), but otherwise a good investment climate does provide some return in terms of FDI.

Although the trend line has a good positive slope, is not an especially good fit with an  $R^2$  of just 0.114, implying that the business environment (as measured by the PCI) "explains" just over 11 percent of FDI spatial distribution. This would suggest that the business environment is a factor affecting FDI, but perhaps not the key determining factor. This is not so surprising. The best provincial legal institutions and lowest times to register a business etc, cannot totally offset the disadvantages that may come from being far from the key sea or airports, or from key suppliers etc.

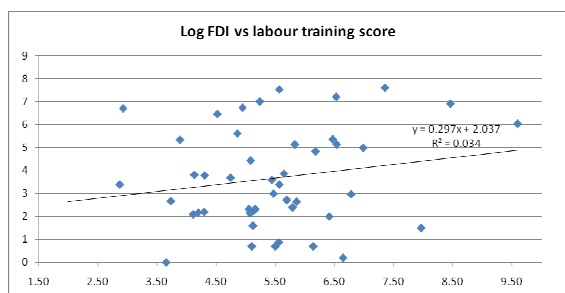
**Figure 4:** Plot of log FDI against province's aggregate PCI score



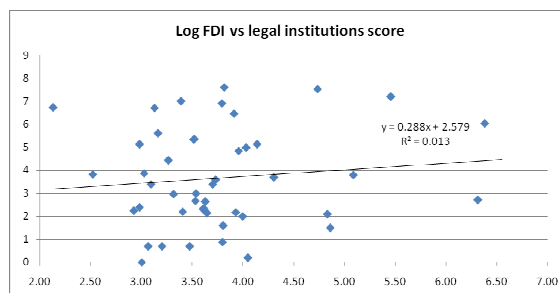
The following figures show the same plot of the log of FDI across provinces, but plotted against the eight constituent subindices within the PCI. This allows us to better understand which specific business environment variables make a difference.

Figure 5 and Figure 6 show the plot of log FDI versus measures of labour training and legal institutions. In the PCI methodology, the “labour training” sub-index is an attempt to measure the extent to which provincial authorities promote vocational training and skills development for local industries. The “legal institutions” sub-index is a measure of the degree of confidence that firms have in the provincial authorities when it comes to dispute resolution or when lodging appeals against corrupt official behaviour. Such issues are frequently cited as being of critical importance when it comes to attracting FDI. While the analysis shows a slight positive slope, and therefore a positive relationship between better labour training or legal institutions and FDI, the relationship is a very weak one. The  $R^2$  figures imply that the quality of provincial labour training explains just over 3 percent of FDI distribution, while the quality of provincial legal institutions explains just over 1 percent of FDI distribution.

**Figure 6:** Plot of log FDI against province’s labour training score



**Figure 5:** Plot of log FDI against province’s legal institutions score

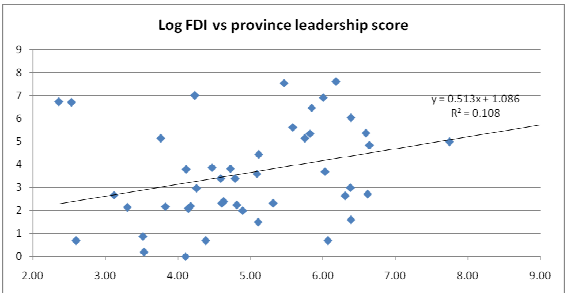
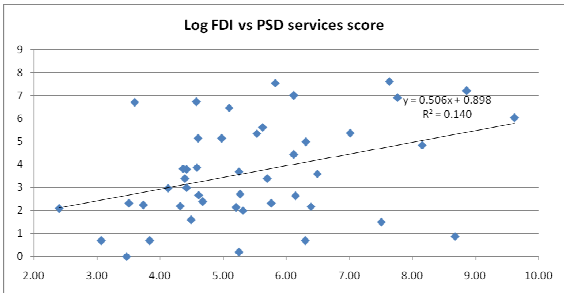


These results might not be entirely implausible. The bulk of foreign investment into Vietnam is still focused at low-skill, low value addition processes such as garments and footwear assembly. This, coupled with the country’s comparatively liberal migration rules and a large stock of migrant labour in rural areas, perhaps means that foreign firms that have decided to invest in Vietnam are for the most part confident that they can source sufficient labour. Similarly, firms that have decided to invest in Vietnam will almost certainly be aware of the limited opportunities available for redress in the legal system in general, and hence see little difference between one province and another in this area.

The next two plots, Figure 7 and Figure 8 show the log of FDI plotted against measurements of a province’s private sector development (PSD) services and a province’s leadership. “PSD services”, as defined by the PCI methodology, covers such areas as local services for trade promotion, the provision of regulatory information, business partner matchmaking, and the provision of services for industrial zones and industrial clusters. “Provincial leadership” is a measure of the creativity and cleverness of provinces in both implementing central policy, designing their own initiatives and working within sometimes unclear national regulatory frameworks to support the development of locally based firms. Both of these plots show stronger relationships with positive slopes. The quality of PSD services explains 14 percent of the dsitribution of FDI, while provincial leadership differentials explain just under 11 percent of the cross-province FDI distribution. However, there are a number of outliers in both cases.

**Figure 8:** Plot of log FDI against province’s PSD services score

**Figure 7:** Plot of log FDI against province’s leadership score

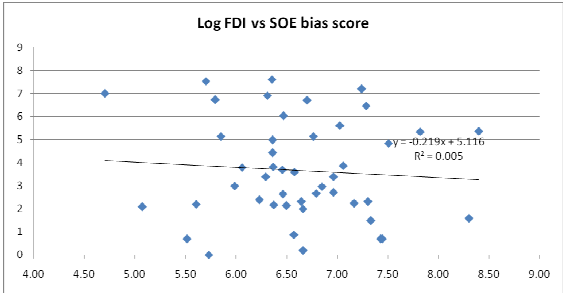


These results are quite intuitive, as both areas reflect the extent to which provincial authorities probably can make a real difference to investors.

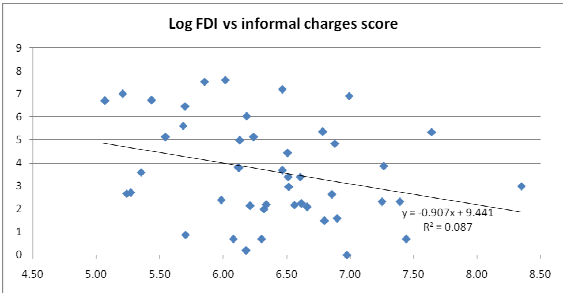
Figure 9 and Figure 10 show plots of the log of FDI against a measure of bias in favour of state-owned enterprises (SOEs) and against the extent of informal charges in a given

province. The “SOE bias” sub-index provides a measure of the perceived bias shown by provincial authorities towards favoured SOEs (or recently equitised SOEs) in terms of incentives, policy and access to capital. The “informal charges” sub-index is a measure of how much firms have to pay rent seeking charges, how much such extra fees act as an obstacle to business operations, and whether such fees resulted in the expected “services”. In both cases the plot shows a negative slope, implying (somewhat unrealistically) that provinces that demonstrate either greater SOE bias or rent seeking see more FDI. However, the results are not strong ones and hence from an econometric point of view, it is safer to say that there is no evidence to suggest that SOE bias or rent seeking at the provincial level plays a determining role in the provincial distribution of FDI in Vietnam.

**Figure 10:** Plot of log FDI against province’s SOE bias score



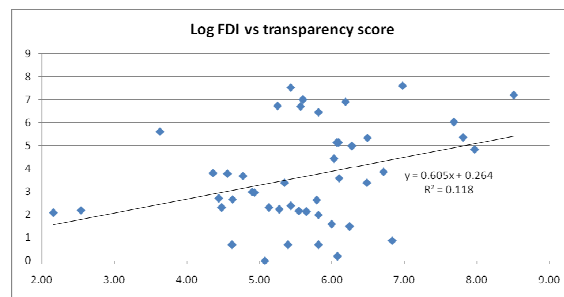
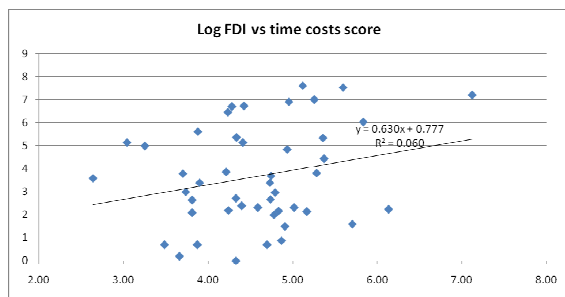
**Figure 9:** Plot of log FDI against province’s informal charges score



The next two plots, Figure 11 and Figure 12, show the log of FDI versus province’s time costs and transparency respectively. According to the PCI methodology, “time costs” is a measure of how much time firms waste on bureaucratic compliance applying for permits, receiving inspections etc. The “transparency” sub-index is a measure of the extent to which provinces provide firms with access to proper planning and legal documents, and whether new policies and laws are communicated and predictably implemented by provincial authorities. Both plots have a clear positive slope, implying that lower time costs and greater transparency results in greater FDI. However as in the other plots, the relationship is not especially strong. Differentials in the time costs score explain just 6 percent of provincial FDI. The transparency result is slightly stronger, with differentials accounting for almost 12 percent of the provincial distribution of FDI. Similarly, the general interpretation would be that these factors help when it comes to determining FDI, but are almost certainly not the key factors when a given firm makes its investment location decision.

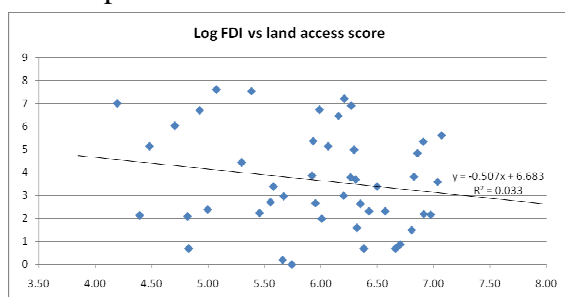
**Figure 12:** Plot of log FDI against province’s time costs score

**Figure 11:** Plot of log FDI against province’s transparency score

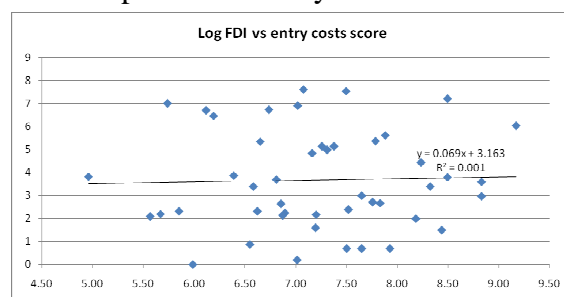


The final two sub-index plots (Figure 13 and Figure 14) show log FDI versus sub-indices for access to land and business entry costs at the province level. The “land access” sub-index is a measure of how easy it is for firms to access land, and how secure tenure is once land is acquired. “Entry costs” is a measure of the time it takes a firm (and complexity) to register, acquire land, and receive all the necessary licences to start a business. As with the plots for SOE bias and informal charges, the plot for land access has a counter-intuitive negative slope, while the plot of log FDI against entry costs is a horizontal line, thus implying no relationship at all. Again, an explanation for these results might be that it foreign firms choose to locate an investment in a given province for reasons other than land access and availability, and start-up costs. Perhaps firms prefer to locate facilities in provinces with better transport communications and infrastructure, or closer to supplier firms or in same-industry clusters, even if land is more difficult to access in such locations. With regard to business entry costs, it may well also be the case that greater start-up impediments are more of a binding obstacle for domestic firms rather than foreign firms.

**Figure 14:** Plot of log FDI against province’s land access score



**Figure 13:** Plot of log FDI against province’s entry costs score



### 3.2 Regression causal analysis

The basic analysis carried out above suggests that the quality of the business environment matters when it comes to the spatial distribution of FDI, but is perhaps not the most important determining factor. Hence, it makes sense to surmise a regression model with some additional

explanatory variables as a means of establishing what effect the quality of the local investment climate has on the distribution of FDI as follows:

$$FDI = f(\text{business environment, domestic market, infrastructure, existing stock of FDI})$$

where: *FDI* is the registered capital in US\$ received by a province in 2006; the *business environment* in a province is measured by scores under the Provincial Competitiveness Index for 2006; the size of the local *domestic market* is measured by retail sales of goods and services in billions of dong in 2006; the quality of the local *infrastructure* is measured as the average number of telephone lines per person<sup>5</sup>; and the *existing stock of FDI* is measured as FDI registered capital over the period 1988 to 2006. This final explanatory variable is included in order to take account of clusters and path dependence among investors.

The model assumes that investors choose to invest in Vietnam for a given set of reasons (perhaps including labour costs, productivity, market access etc.), then choose where to locate their investment within Vietnam. It is this second distributional decision that the model is attempting to estimate.

Table 1 shows the results of this first model. There appears to be limited evidence to suggest that the local business environment (*pci2006*) has an impact on the amount of FDI received by a province. The coefficient on the business environment variable is only significant in a simply twoway regression. Once the other variables are added, the coefficient becomes insignificant.

Similarly, the coefficients for the domestic market (*dommar*) and infrastructure (*telden*) are only significant (and then only weakly) if the existing stock of FDI (*logfdicum*) variable is excluded from the model. The highly significant coefficients found for the existing stock of FDI suggest that it is this variable that has the strongest influence on new foreign direct investment.

**Table 1:** OLS: Independent variable: *logfdi*

Model	1	2	3	4	5	6	7
Dependent							

<sup>5</sup> The density of telephone lines is assumed to be a good proxy for infrastructure (including transport infrastructure) in general.

variables							
pci2006	0.091** (0.038)	0.038 (0.039)	0.004 (0.026)	0.005 (0.026)	0.010 (0.025)		0.006 (0.025)
dommar		0.000* (0.000)	0.000 (0.000)		0.000 (0.000)	0.000 (0.000)	
telden		5.693* (2.938)	1.218 (2.035)	1.077 (1.952)		1.337 (1.883)	
logfdicum			0.892*** (0.120)	0.879*** (0.110)	0.913*** (0.114)	0.896*** (0.117)	0.980*** (0.141)
logdommar							-0.428 (0.307)
logtelden							0.382 (0.402)
Intercept	-1.2548 (2.0857)	0.459 (1.980)	-1.767 (1.343)	-1.731 (1.323)	-2.019 (1.266)	-1.567** (0.589)	2.339 (3.050)
N	46	46	46	46	46	46	46
R <sup>2</sup>	0.11	0.30	0.70	0.70	0.70	0.70	0.72
F	5.68	6.13	24.26	33.04	32.73	33.10	25.95

(*t*-ratios in brackets; \*, \*\* and \*\*\* indicate significance at 10%, 5% and 1% level respectively)

Given that the results in Table 1 would suggest that the existing cumulative stock of FDI is the most important determinant of incremental FDI, the next logical step would be to assess what factors determine the cumulative stock of FDI.

Table 2 (next page) presents the result of regressing the cumulative stock of FDI in a given province (*logfdicum*) on the aggregate business environment (*pci2006*) and then the ten individual components of the PCI, as well as the quality of infrastructure (*logtelden*) and the size of the domestic market (*logdommar*). The results suggest that the size of the domestic market and the quality of infrastructure are important determinants of cumulative FDI with coefficients consistently significant. As with the earlier analyses, it is difficult to find strong evidence that the business environment (as measured by the PCI) has a major influence on FDI. Of the ten business environment variables that form the PCI, only the variable for bias towards state-owned enterprises (model 6) displayed a significant and positive coefficient (implying that provinces where the authorities are less biased towards state enterprises have seen greater FDI inflows). The composite PCI coefficients were entered separately to avoid problems associated with multicollinearity between variables.

These results match those found by Meyer and Nguyen (2004, 2005) who similarly found that new FDI followed strong path dependence, but cumulative FDI was strongly influenced by infrastructure. Anh and Thang (2007) also struggle to find evidence to suggest that the localised investment climate has a major impact on FDI.

**Table 2:** OLS: Independent variable: *logfdicum*

Model Dependent variables	1	2	3	4	5	6	7	8	9	10	11
pci2006	0.019 (0.027)										
entcost		-0.072 (0.208)									
landac			-0.076 (0.233)								
transp				0.155 (0.161)							
regul					0.187 (0.238)						
soebias						0.544** (0.263)					
infch							-0.861 (0.235)				
psds								0.222 (0.145)			
labour									0.123 (0.149)		
legal										0.093 (0.233)	
provlead											-0.111 (0.141)
logtelden	1.576*** (0.391)	1.649*** (0.384)	1.597*** (0.400)	1.599*** (0.381)	1.593*** (0.384)	1.700*** (0.371)	1.576*** (0.346)	1.572*** (0.377)	1.535*** (0.399)	1.578*** (0.409)	1.682*** (0.385)
logdommar	1.059*** (0.241)	1.092*** (0.235)	1.130*** (0.240)	1.025*** (0.244)	1.065*** (0.238)	1.185*** (0.226)	1.121*** (0.208)	0.929*** (0.255)	1.082*** (0.231)	1.127*** (0.235)	1.134*** (0.232)
Intercept	-1.604 (2.727)	-0.217 (3.253)	-0.743 (2.598)	-1.121 (2.534)	-1.481 (2.631)	-5.020 (3.160)	4.302 (2.706)	-0.676 (2.501)	-1.561 (2.647)	-1.565 (3.011)	-0.481 (2.592)
N	64	64	64	64	64	64	64	64	64	64	64
R <sup>2</sup>	0.60	0.60	0.60	0.60	0.60	0.63	0.67	0.61	0.60	0.60	0.60
F	30.20	29.91	29.90	30.59	30.32	33.36	40.95	31.75	30.38	29.95	30.33

(*t*-ratios in brackets; \*, \*\* and \*\*\* indicate significance at 10%, 5% and 1% level respectively)



#### **4. Conclusions**

The analysis carried out in this paper suggests that the business environment is perhaps not the major determining factor when it comes to the distribution of FDI across Vietnam's 64 provinces. While there is some evidence of a positive relationship between better provincial governance and greater foreign direct investment, the link is a weak one. This suggests that it is "other factors" which have the greatest influence on choice of investment location.

An important caveat is that one major weakness of business environment surveys such as the PCI is that perceptions can be slow to adjust, even after reforms have been implemented. Gonzalez *et al* (2007), using the World Bank's enterprise surveys data for 33 countries, find that firms' experience with corrupt officials can be an imperfect proxy for the true incidence of corruption, precisely for this reason. Hence, there may be lags between policy improvements at the province level, and firms noticing and reacting to such changes. Only a more detailed survey of actual foreign investors would reveal the real reasons as to why firms chose to invest in a given location. Similarly, it may well be the case that domestic investors respond differently to foreign investors when it comes to the nature of the local business environment.

A further issue is that causality may run from FDI inflows to better local economic governance, as Malesky (2004, 2008) argues, as well as from the quality of the local business environment to FDI. Hence, as a province receives FDI, this may encourage further reform of the business environment, this in turn stimulates further foreign investment etc. in a virtuous circle. The key question here is how provinces get started in the first place, and what is required for the underperforming provinces to catch up.

Finally, while the evidence found in this analysis linking the sub-national investment climate with FDI distribution is weak, this does not mean that Vietnam's provinces should abandon efforts to improve local governance. Provincial authorities in rural, landlocked provinces cannot completely offset the disadvantages of poor geographical location, underdeveloped infrastructure, or the lack of an investment hub that might draw in other investors, but they can at least partially offset such disadvantages through providing a better business environment for investors.

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