Abstract
Based on a panel data analysis of 164 countries from 1996 to 2006, we examine the impact of institutional quality on foreign direct investment (FDI) levels and volatility. We find that good institutional quality matters to FDI. We provide evidence that institutional quality has a positive and significant effect on FDI. More specifically, we find that a one standard deviation change in institutional quality improves FDI by a factor of 1.69. Ceteris paribus, institutional quality is negatively and significantly associated with FDI volatility which may have an adverse effect on economic growth per Lensink and Morrisey (2006). Thus, our results suggest that if there are institutional determinants of FDI volatility and if such volatility is associated with lower economic growth, then the usual policy prescription of attracting FDI into countries by offering the “correct” macroeconomic environment would be ineffective without an equal emphasis on institutional reform.

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