Port Econ J (2013) 12:215–250
DOI 10.1007/s10258-013-0093-z

ORIGINAL ARTICLE

Foreign direct investment and institutional reform: evidence and an application to Portugal

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Received: 26 September 2011 / Accepted: 1 October 2013 / Published online: 19 October 2013

Abstract We examine the role of geographic, economic, and institutional factors in attracting Foreign Direct Investment (FDI) in Europe, using a cross-section of inward bilateral investments. We estimate and assess the expected benefits, the required reform efforts, and the efficiency of reform options corresponding to a convergence of Portuguese institutions to EU standards. We conclude that improving home institutions is likely to have a quantitatively very significant role in attracting FDI. Geographical and market size factors also play a role. Reforms promoting the independence of financial institutions and a leaner bureaucracy, lowering political

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risk and corruption, and improving the investment code may significantly affect the amount of bilateral inward FDI that is targeted to Portugal.

Keywords Foreign direct investment · Institutions · Institutional reform · Portugal · European union

JEL Classification F30 · H00