INSTITUTIONS, VOLATILITY AND INVESTMENT

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Abstract
Countries with strong executive constraints have lower growth volatility but similar average growth to those with weak constraints. This paper argues that this may explain the relationship between executive constraints and inflows of foreign investment. It uses a a novel dataset of Dutch sector-level investments between 1983 and 2012 to explore this issue. It formulates an economic model of investment and uses data on the mean and variance of productivity growth to explain the relationship between investment inflows and executive constraints. The model can account for the aggregate change in inflows when strong executive constraints are adopted in terms of the reduction in the volatility in productivity growth. The data and model together suggest a natural way of thinking about country-level heterogeneity in investment inflows following the adoption of strong executive constraints. (JEL: O43, F21, D72, O11)

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