



**FOREIGN CAPITAL COMPOSITION, PRODUCTIVITY AND GROWTH IN G7  
COUNTRIES: THE ROLE OF INSTITUTIONAL QUALITY**

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*Abstract*

The central role of international capital transactions during the financial and sovereign debt crisis in the EU has encouraged policy discussions, also in the G7 framework, on the benefits and costs associated to capital mobility. International capital transactions might potentially support long-term growth and convergence among countries, but at the same time they might also determine policy challenges associated with adverse consequences of exchange-rate appreciation, asymmetric shocks among countries, sudden stops and moral hazard behaviors (Kirabaeva and Razin, 2009 and De Gregorio 2013).

In the last two decades, international investments position's components, namely, foreign direct investments, portfolio debt investments, and portfolio equity investments, in G7 countries experimented different paths.

While in some countries there has been a change of the composition towards international sources of financing that are usually seen as more stable and productive (i.e. a larger component of foreign direct investments and a smaller share of portfolio debt investments) in the others, on average, the opposite has occurred.

As for EU countries following the introduction of the euro, so-called imbalances

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emerged across countries Europe. Countries in the periphery received large capital inflows. During this period productivity diverged, with peripheral countries experiencing on average slower productivity growth than core countries. Economists and policymakers often conjecture that the decline in productivity resulted from a misallocation of financial resources across firms or sectors in the South of Europe.

According to the literature, the composition of foreign capitals in a given country, is strictly related to its economic characteristics, macroeconomic fundamentals, financial regulatory settings and institutional quality.

The aim of this paper is to analyse the joint dynamics of institutional quality, foreign capital flows and growth in G7 countries in the period 1996-2015.