

Abstract

In this thesis we provide an updated empirical evidence on the linkage between an exchange rate and foreign direct investments (FDI). On the sample of 40 developing countries receiving FDI flows from five developed OECD economies, we analyse how the strength of exchange rates, exchange rate volatility and currency regime affect FDI. Applying the Hausman-Taylor instrumental variable approach over the analysed period from 1991 to 2010, we have not found unanimous support on the role of exchange rates in influencing FDI. In the thesis, we document that over the last two decades, bilateral exchange rate volatility decreased and this can be assigned to its less-likely influence on FDI. In addition, based on the results of the analysis, we cannot confirm the wealth effect hypothesis that supposes an increase of FDI after real depreciation of developing country's currency. We ascribe this outcome to the development of average real exchange rates of developing countries that exhibited considerable strengthening during the analysed period. We also find that de facto bilateral fixing of the currencies might be beneficial for FDI flows. The reasoning might lie in the reduction of transaction costs that is linked to credible exchange rates.