Referee Report on the Manuscript:
"Capital Account Openness, Political Institutions and FDI in MENA Region"

This paper revisits the issue of the threshold effect of financial liberalization on FDI inflows. More specifically, the authors investigate how capital account openness can affect FDI inflows interactively with, i.e., conditionally upon, the level of institutional development/conditions. Applying the GMM methodology to a sample of 17 Middle East and North Africa (MENA) countries from 1985 through 2009, the authors find that, while the level of capital account openness alone may discourage the inflows of foreign direct investment, if it is coupled with higher levels of institutional development or political stability, capital account openness can have a net positive impact on the volume of FDI inflows.

Below are a few comments and suggestions, which may help the authors improve the paper.

General Comments

1 What makes the authors focus on the MENA region? The authors argue that it is meaningful to focus on the region because many of the countries in the region have implemented financial liberalization while they also tend to have weak institutions. However, the combination of relatively high levels of financial openness and weak institutions is quite commonly observed among many emerging market economies. Unfortunately, the paper has an impression that a methodology used in other papers is merely being reapplied to MENA countries. Is there any particular hypothesis, ideally pertaining to some characteristics of the MENA region, tested in this study?

2 In addition to above, even if the authors are interested in investigating on the MENA region, having a sample composed only of MENA countries would not let them get insights on the peculiarity of the regional economies. It is better to try to focus on the region in a cross-country or panel context. For example, showing the average effect of MENA countries or individual countries using the estimates based on the sample composed only of MENA countries is not greatly insightful.

3 How are the correlations among all the institutional variables? One would instinctively imagine that they must be high. If that is the case, trying to identify which of the individual institutional variables is affecting the results of the composite index (Table 3) does not present so much information.

4 The explanations on the negative coefficient on the interaction terms between bureaucratic quality or anti-corruption measures and capital account openness (reported in columns 11 and 12 of Table 2) do not seem to make sense. What does "foreign investors value the quality of institutions more than the level of corruption in the location selection" mean? A country with higher levels of bureaucratic quality or anti-corruption measures tends to receive smaller volumes of FDI inflows when it opens its capital markets to foreign investors? Why so?

5 The authors conclude that "high levels of democracy and property rights protections increase FDI inflows to the MENA region (p. 10)." While the positive (interactive) effect of property

rights is understandable, why can a more democratic country receive more FDI when it opens itself financially? A more democratic developing country can often be more politically unstable (e.g., Latin American countries).

Specific/Minor Comments

1. Figures 1 and 3 do not convey much information. They can be removed.
2. First line on page 2: Do you mean “2014” or “2004”? If it is the latter, why do you focus on the year 2004?
3. The first sentence of the third paragraph on page 9 starting with “The total effect of a one-unit increase in …” is not clear. What does it mean? The whole paragraph seems quite redundant.