The Investment Climate and the Attractiveness of Foreign Direct Investment in Algeria (Empirical Study for the Period 2000-2019)

Fatima Zohra KHELIFA*

Mustafa Stambouli University, Mascara, Algeria

fatima.khelifa@univ-mascara.dz

Fatima TALEB

Mustafa Stambouli University, Mascara, Algeria

taleb.fatima@univ-mascara.dz

Received: 11/03/2021 *Accepted*: 10/10/2021 *Published*: 16/12/2021

Abstract:
This study aims to analyze the relationship between the investment climate and foreign direct investment in Algeria by estimate the relationship between the FDI (as a dependent variable) and other three variables: GDP (per capita), Openness index and Political stability (as independent variables) by using a Half-logarithmic model for the period (2000-2019). The results of the study showed that there is a positive effect of the Gross domestic product per capita on the Foreign Direct investment, a strong positive effect of openness index on the FDI has been confirmed, technically (a change increase or decrease) by one unit of the Openness Index of the Algerian Economic, ceteris paribus, should make a change of the FDI by 2.55%. We confirmed the existence of the causality (in Granger sense) of political stability to the FDI during the study period.
***Key Words*:** Investment climate, Foreign direct investment, Openness index, Political stability, Half –logarithmic model, Attractiveness.

JEL Classification: F21**.**

* Corresponding author: Khelifa Fatima Zohra (fatima.khelifa@univ-mascara.dz).

Introduction

Attracting foreign direct investment is an economic policy of great importance for most developing and developed countries, as it is the driving force to raise economic growth rates as well as its effective contribution to bridging the gap between savings rates and domestic investment, and it is also an important source for transferring administrative skills and technology, increasing competition in the local market, Job creation and easy access to global markets (Rahim, 2007, p. 01).

Due to this importance, competition between countries intensified to attract it, and this matter became a source of concern for a number of countries in order to benefit from its positive effects and transfer them to local companies. Algeria is one of the countries that always seeks to attract this type of investment despite its availability of a set of advantages that can draw the attention of foreign investors, such as its geographical location that overlooks the Mediterranean, the diversity of natural resources, the market size of more than 42 million consumers and the availability of labor. Etc., but the decision of foreign companies depends on several factors, the most important of which are: the availability of an appropriate

investment climate and a stimulus to continue investment without any risks or obstacles, that is, the political, economic, social and legal environment must be appropriate for foreign direct investment in the country the host.

On this basis, we will try, through this research paper, to address the following problem:

Is the investment climate in Algeria capable of attracting foreign direct investment?

The aim of this study is addressing the concepts of foreign direct investment, the attractiveness of foreign direct investment, the investment climate and indicators of foreign direct investment, analyzing the relationship between the investment climate and foreign direct investment through an empirical study of incoming foreign direct investment flows to Algeria (2000-2019).

Literature review:

There are several studies that dealt with the issue of direct foreign investment, as well as the most important factors affecting its attractiveness. We mention for instance (Root & Ahmed, 1979) who tested the economic, social and political impact on direct foreign investment. They found out that the economic variables (per capita gross domestic product, gross domestic product, growth rate economic integration, transport, trade and communication importance), social variables (degree of urbanization) and political variables (number of constitutional changes in government leadership) havean impact on direct foreign investment, (Vittorio & Klaus, 1991) stated that political instability creates an uneconomic environment, having risks on long-term planning. This would reduce economic growth and investment opportunities. For (Shigeru & Tadayuk, 1995), they emphasized in their study that the location of the country is of great importance for investment decision-making. (Asiedu, 2002) noted that sub-Saharan African countries are viewed as inherently risky, which is likely to keep foreign investors away from that region. Also, the infrastructure and rate of openness to trade have a positive effect on direct foreign investment. (Quazy, Economic Freedom and Foreign Direct Investment in East Asia., 2007) found out that economic freedom is an important and powerful determinant of direct foreign investment.

Other recent studies focused on several other factors, including inter alia social and cultural ones, and factors related to the institution’s environment. Numerous researchers, such as: (Jolanta & Rolf H, 2000), note that social and cultural differences are the ones that influence positioning decisions, as culture has become a significant factor in determining location, and a key factor to enhance the local and regional attractiveness. Another study by (Javier & Óscar, 2006) demonstrates the importance of the institution's environment, whether internally or externally, as it is considered an important factor in determining the institution's region.

(Bayraktar, 2013) indicated that countries characterized by ease of business have the ability to attract direct foreign investment. In another study by (Elhasbi, Barkaouia, Bouksoura, & kamach, 2014), it is confirmed that the geographical location factor of the country and its proximity to industrial areas, in addition to

social, cultural, economic and technological factors have a positive effect on investment decisions. The results of the study by (Papadopoulos, Ibrahim, De Nisco, & Napolitano, 2018) ,showed that the currency exchange rate, market openness and the branding effect of a given country from the buyer's perspective has a great impact on the flow of foreign direct investment. the study by (TIR, Okba, & Boularbah, 2019) showed that the corruption variable has a negative impact on the flow of direct foreign investment, that is, the greater the size of corruption by 1%, the lower the volume of direct foreign investment flow in Arab countries by 1.479%.

Through these previous studies, we notice a variety of factors that affect the decisions of foreign investors, they were generally economic, social, political, legal and technological.

I. The theoretical framework of the study:

1. Meaning and Importance Direct Foreign Investment.

1.1 Direct Foreign Investment:

Several researchers and international organizations provided different definitions of direct foreign investment. The International Monetary Fund defined it as *any investment in capital greater than or equal to 10% outside national borders (establishing companies, investments shares, invested profits, and loans between affiliated companies)* (IMF, 1993, p. 86) While the Organization for Economic Cooperation and Development defined it as *every natural person, public or private institution, government, group of related natural persons, group of institutions that have a legal personality and related to each other, who are a foreign direct investor possessing a direct investment institution, It also means a branch or subsidiary that conducts investment operations in a country other than the country in which the foreign investor resides* (OECD, 1983).

According to Grosse and Kujawa (1995), it is a *company ownership and control of assets in a foreign country * (Douglas E & Grosse, 2001, p. 60).

1.2 Importance of Direct Foreign Investment.

Direct foreign investment is of great importance, most of which are as follows:

- Transferring knowledge and technology to the host country in light of the availability of human capital (Bouoiyour, Hanchane, & Mouhoud, 2009).
- Leading to the acquisition of new methods of production and management, resulting in improvement of quality and productivity.
- Further improving human capital through training and on-the-job learning.
- Significantly boosting economic development by stimulating competition at the local level, which could ultimately lead to improve productivity, lower prices, and more efficient resource allocation (OCDE, 2002, p. 18).
- Exerting important impact on human capital including the acquisition of additional skills, improvement and accumulation of knowledge capital,

helping to accumulate human capital and ensuring the growth of companies and countries in general (Bannour, 2013).

- Growing commercial transactions, capital formation, entry of international companies specializing in related services and increasing the demand for local business which can lead to lower average costs (Iloiea, 2015, p. 627).

2. Investment Climate and Attractiveness of Direct Foreign Investment:

According to the report issued by the World Development Organization, investment climate it is a set of elements specific to a particular location, that constitute the opportunities and incentives attracting companies to invest in a productive way, create jobs and expand (WDR, 2005).

Dollar consider it the institutional, political, regulatory and environment factors in which companies operate; that is, whether the local government is too bureaucratic and corrupt, or the government's provision or regulation of infrastructure and financial services is so ineffective that it is impossible to rely on corporate services (Dollar, Hallward-Driemeier, & Mengistae, 2005, p. 02).

The attractiveness of direct foreign investment can be defined as all economic, tax, customs and institutional policies and arrangements set by the authorities in order to make the national lands attractive to investors. These policies obey international agreements in order to respect the main articles of international trade practices in the world

The attractiveness it is *the ability of a given country to attract and retain companies* (Benoît, Rabaud, & Thierry, 2003, p. 98) ,and can be defined it as the set of policies put in place by the public authorities to attract FDI (Kambou & Khariss, 2020, p. 22).

The attractiveness of investments is the region's ability to provide investors with the necessary conditions to establish their activities and the incentives that drive them to be in this region.

According to UNCTAD, this attractiveness depends mainly on three factors:

- Host country policies (economic and political stability, market access rules, international agreements on direct foreign investment and financial policies, etc.).
- Characteristics of its economy (size and structure of the market, growth rate, technology and infrastructure... etc).
- Effective measures taken by the host country to encourage and facilitate investment.

Besides, attracting and retaining companies in a particular region is linked to certain goals, and the most frequent ones are as follows:

- Enhancing competitiveness.
- Developing high-tech sectors.
- Searching for a better international specialization in high value-added activities (Mansouri & Berjaoui, 2020, p. 413). Attractiveness depends

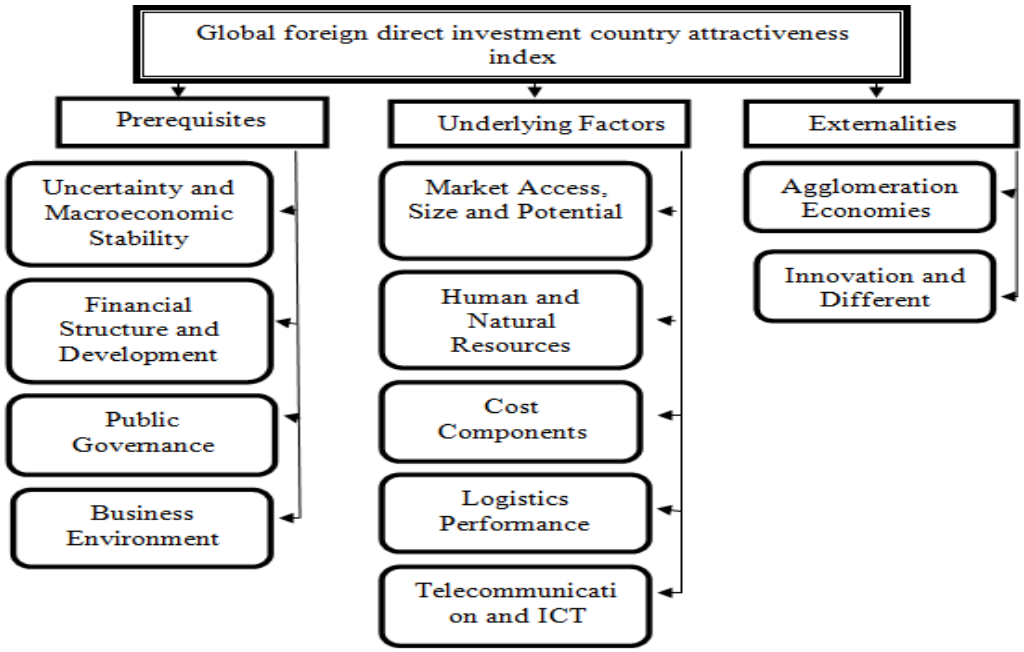
on the dynamics of the area. Regional stakeholders, authorities, residents, economic actors and civil society seek to bring life back to Earth, establish regional projects and attract juveniles of all kinds on an ad hoc and long-term basis (Vuignier, 2018, p. 16).

3. Investment Climate Indicators:

The company investing in a country evaluates the investment climate either by using its own capacities or by relying on external study offices. The evaluation process is based on information, laws and government statements in the host country, in addition to studies, publications and reports submitted by some specialized international and regional institutions and organizations. The latter issue some indicators that address one or more aspects of the business climate that are a stimulus and attractive to foreign direct investment, and classify countries according to these indicators.

These indicators can be summarized in the following figure (Riad, 2020, p. 7):

Fig 1: «Global foreign direct investment country attractiveness index»



Source: Riadh Ben Jelili, 2020, http://www.fdiattractiveness.com/

II. The Empirical Study:

1. Methodology:

1.1. Variables:

It is necessary to present the economic variables before the study and define the model for attracting foreign direct investment, these variables fall into two parts:

- The dependent variable: it is the variable that is tested and measured in a study.
- Independent variables: they are the ones that have the ability to influence the dependent variable through the nature of the relationship between them.

The variables for this study are:

The dependent variable:

- FDI: foreign direct investment.

The independent variables:

- GDP per capita: gross domestic product (one person).
- PS: political stability.
- OI: openness index.

And from it, the relationship between the dependent variable and the independent variables is as follows:

FDI= f(GDP ,PS, OI).

The Study hypotheses:

H1: Political stability has a positive effect on the attractiveness of foreign direct investment.

The following table gives the measures used for our variables:

Table 1: «Study variables»

Variables	The mesure chosen
FDI	Foreign direct investment, net inflows (% of GDP)
GDP	GDP per capita (current US$)
PS	Political Stability and Absence of Violence/Terrorism: Estimate
OI	Exports and Imports of goods (current US$) divided by GDP (current US$)

Source: Prepared by author.

1.2 Model:

In order to estimate the relationship between foreign direct investment (as a dependent variable) and the other three variables: GDP (per capita), openness and political stability index (as independent variables). The semi-logarithmic model was estimated by taking the statistical equation:

$$\log(FDI_t) = \alpha + \beta_1 * \log(GDP_t) + \beta_2 * OI_t + \beta_3 * PS_t + \varepsilon_t$$

With t: 2000 to 2019 ($T = 20$), and ε_t is an error term (corresponds to all other variables which are not integrate into the model).

We chose this model because it has better statistical indicators than other models in representing data in terms of several criteria, including the statistical significance of the milestones

1.3 Data:

We obtained the statistical data relating to the study variables from the World Bank database, where:

- Statistical data for FDI, GDP per capita, Exports and Imports: world development indicators.
- Statistical data for PS: world governance indicators.

2. Results and discussion:

Table 2: « Summary statistic of the time series»

	FDI	GDP/capita	OI	PS
Mean	1.44E+09	3805.158	0.568621	-1.206889
Maximum	2.75E+09	5592.257	0.6946	-0.826592
Minimum	-5.38E+08	1740.642	0.457432	-1.753627
Std. Dev	7.98E+08	1280.09	0.06	0.24
Skewness	-0.41	-0.28	0.12	-0.63
Kurtosis	3.39	2.04	2.23	3.12
Jarque-Bera	0.70	1.04	0.54	1.25
Probability	0.70	0.60	0.76	0.54
Observations	20	20	20	**19 (**)**

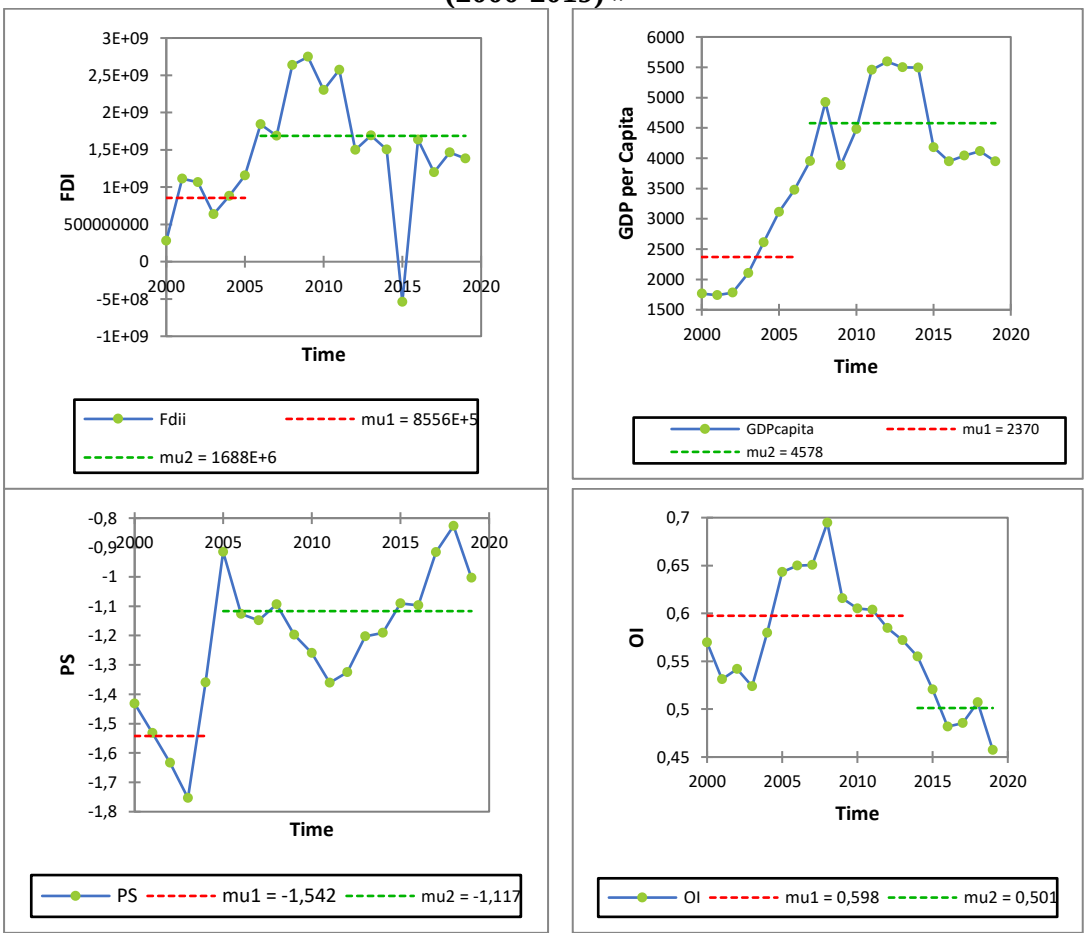
Source: Estimated using Eviews (V 10) program, based on World Bank datasets.

(**) For political stability index, there is a missing value in 2001; we proceed to impute it by the mean values of 2000 and 2002.

The descriptive statistics of the time series showed in Table 1, suggested that average of Foreign Direct investment in Algeria over the period (2000 to 2019) is approximately 1.44 billion dollars, the max value is recorded in 2009 by a 2.75 billion dollars. For GDP per capita, the mean value was 3805 dollars, this indicator witnessed a remarkable development during the period from 2000 to 2011, which witnessed an improvement in oil prices. For the economic openness indicator- which is estimated as the ratio of the sum of export and import to the GDP- the average of this ratio is 0.568, with a range value of [0.457 to 0.694] during the period (2000-2019), where the min value is recorded in 2019; this is caused mainly by the drop in oil prices, which in turn led the Algerian Government to attempt to lower the country's sizable import bill. For political stability indicator, the statistics in Table1 reported that the average value during the study period was -1.206 points with a range of -1.75 to -0.826 points. Noticed that Algeria is far from the World average (which is estimated to -0.05 points in 2019), Despite the remarkable progress and development achieved by Algeria, it needs additional efforts to improve the political climate and security stability in general.

For the form distribution of the time series, all the variables approximately follow a normal distribution, this is well tested by the Skewness, Kurtosis and Jarque-Bera statistical tests; for the Skewness are all different from zero, the Kurtosis statistics also are all different from 3, and the P-value of Jarque-Bera test also is greater than 0.05, so we accept the null hypothesis of Normal distribution.

Figure 2: «Plots showing dynamics of the time series over the period (2000-2019) »



Note: the red and green lines depict the homogeneity of these time series.

Looking at plots of the four time series, we can confirm (*a prior*) that they are no stationary over the study period, among them; we see that foreign direct investment was the high volatile compared with other variables. To test the stationary assumptions of these time series, three statistical tests have been used: the Augmented Dickey-Fuller (ADF), Kwiatkowski-Phillips-Schmidt-Shin (KPSS, 1992) and Phillips-Perron (PP).

Table 3: « Results of Augmented-Dickey-Fuller (ADF), Phillips-Perron(PP), and KPSS unites roots tests»

	Tests					
	ADF(*)		PP		KPSS(**)	
Variables	Constant	Constant & Trend	Constant	Constant & Trend	Constant	Constant & Trend
FDI	-2.89 (0.064)	-2.73 (0.234)	-2.85 (0.069)	-2.67 (0.254)	.0164 (0.463)	0.149 (0.146)
GDP/capita	-1.686 (0.421)	-0.874 (0.938)	-1.688 (0.421)	-0.801 (0.947)	0.402 (0.463)	0.151 (0.146)
OI	-0.550 (0.860)	-1.12 (0.897)	-0.624 (0.843)	-1.107 (0.901)	0.264 (0.463)	0.148 (0.146)
PS	-2.22 (0.205)	-2.276 (0.423)	-2.19 (0.213)	-2.10 (0.506)	0.439 (0.463)	0.081 (0.146)

Source: Own estimation using Eviews(v10).

The testing results are reported in Table2, where we conclude that all time series are not stationary at level, without trend, otherwise they are integrated of order 1 :I(1); so the best method to make them stationary it to generate the first difference of these time series (i.e.) we should work on a new time series $X_t^{'}$ which is calculated as follows: $\Delta(X_t) = X_t - X_{t-1}$. After transformation, all time series became stationary.

Before model estimation, we analyzed the correlation among the variables, and we tested also a potential existence of multicollinearity among explanatory variables. The most signaled result is that all explanatory variables have a positive linear correlation with the foreign direct investment in Algeria over the period (2000-2019), where the Gross domestic product per capita has the strongest relationship with FDI by a correlation coefficient equals: 0.655.

Table 4: «The correlation among the variables»

Variables	**OI**	**PS**	**GDP/capita**	**FDI**
OI	**1**	-0.0462	0.1559	**0.4634**
PS	-0.0462	**1**	0.3922	**0.2722**
GDP/capita	0.1559	0.3922	**1**	**0.6559**
FDI	0.4634	0.2722	0.6559	**1**

Source: Own estimation using Eviews(v10).

For the multicollinearity statistics, the tolerance and variance inflation factor (VIF) were calculated and reported in table 3. The rule to detect multicollinearity among variables is: If the value of tolerance statistics is less than 0.2 or 0.1 and, simultaneously, the value of VIF will be 10 and above. In our case, the tolerance is nearly equals 1 for the three variables and the VIF is approximately equal 1, so we reject the existence of multicollinearity among explanatory variables.

Table 5: « multicolinearity statistics»

Statistic	OI	PS	GDP/capita
Tolerance	0.9621	0.8344	0.8158
VIF	1.0394	1.1985	1.2257

Source: Estimated by author based on Eviews (V10) software.

Table 6: «Estimation results of the semi-logarithmic model»

Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
Log(GDP/capita)	0.822438	0.232685	3.534558	0.0028
Openness Index	2.549167	1.318001	1.934116	0.071
Political Stability	-0.132737	0.453217	-0.292878	0.7734

Source: Output of Eviews(V10) program. ***Note***: R^2=0.594, Durbin-Watson=1.667, Prob(Fisher-Test)=0.0019.

Table 4 reported that the changes of all explanatory variables (GDP/capita, Political stability, Openness Index) have different kind of effects on the variations or the dynamic of the Foreign Direct Investment in Algeria during the study period (2000-2019), the GDP/capita and openness index are statistical significant, in contrast the parameter of political stability was not significant.

We interpret the estimation results as follow:

- For the log GDP (per capita), for each 1% increase in the Gross Domestic Product in Algeria, *ceteris paribus*, the Foreign Direct Investment should increase by 0.82%.
- For the Commerce Openness, a change (increase or decrease) by one unit of the Openness Index of the Algerian Economic, *ceteris paribus*, should make a change of the FDI by 2.55%.
- For the Political Stability, the corresponding coefficient is not statistically significant.

For the estimated model, the regression seems to be acceptable, where the three independent variables explain $R^2 = 59.4\%$ of the FID variations; this impression is confirmed by the Fisher test, $Prob(F - test) = 0.0019$; the model is very significant. After estimation, different diagnostic tests (based mainly on error distribution) have been calculated, see Table5.

3. Causality analysis

We analyze the causality among the selected variables, where a main focus was about the causality between the political stability and the Foreign Direct Investment. Table (6) summarizes the testing results.

Table 7: «Granger causality analysis»

Null Hypothesis:	F-Statistic	Prob.
LGDP does not Granger Cause LFDI	1.5741	0.2276
LFDI does not Granger Cause LGDP	1.46855	0.2432
PS does not Granger Cause LFDI	4.07971	**0.0605**
LFDI does not Granger Cause PS	0.08689	0.772
CO does not Granger Cause LFDI	8.45144	**0.0103**
LFDI does not Granger Cause CO	0.81168	0.381

Source: Estimated by the author using Eviews(V10).

The findings reveal that, we cannot reject the hypothesis that Foreign Direct Investment does not Granger cause the Commerce Openness, but we do reject the hypothesis that Commerce Openness does not Granger cause FDI. Same result for the political stability and FDI (i.e.), we cannot reject the hypothesis that Foreign Direct Investment does not Granger cause the Political Stability, but we do reject the hypothesis that Political Stability does not Granger cause FDI (here we are worked on a level of significance $\alpha = 0.1$). Therefore it appears that Granger causality runs one-way from Political Stability and Commerce Openness to FDI and not the other way. Last result, there is no causality between GDP(per capita) and FDI.

Table 8: «Diagnostic tests of the estimated model»

Tests	Statistics	Probability
Normality Test(Jarque-Bera)	2.961	0.227
ARCH test	0.124	0.454
REST test of Ramsey	0.636	0.608

Source: Estimated by author.

Note: for ARCH effect testing, different lags have been included, we found the same result. Here, the Ramsey test is based on the Likelihood ratio statistics.

For the model specification, based on the Ramsey test, the reset F statistic is equal to 0.636 and the corresponding p-value is 0.608. There is no evidence to reject the null hypothesis of linearity at the 5% significance level. For the autocorrelation and partial correlation of residuals, we conclude that all coefficients are not significant (see Prob in the Figure1), furthermore, all coefficients are into the confidence intervals, see Figure1.

Figure 3: «The Auto-correlation and partial correlation functions of the residuals; the Output are for the Box-Pierce and the Ljung-Box Tests (Q test)»

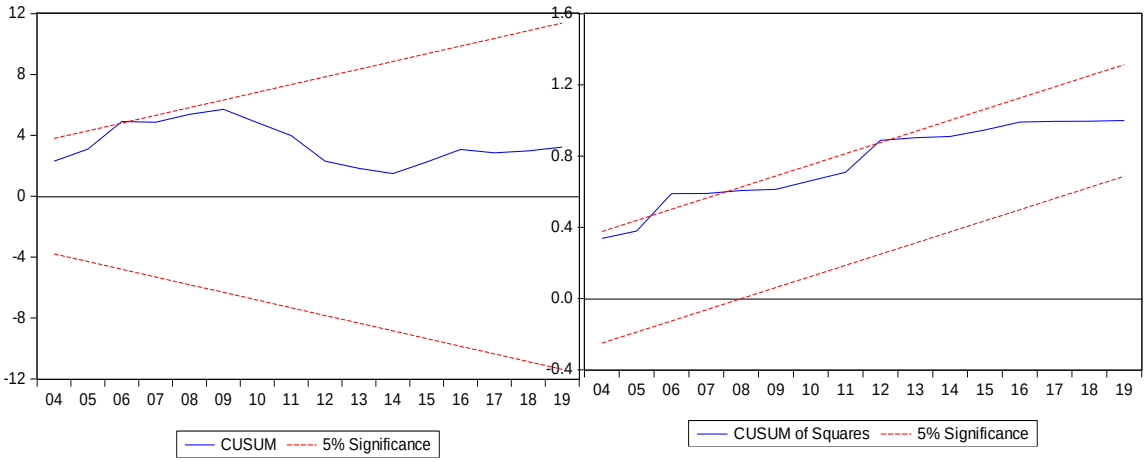
Sample: 2000 2019
Included observations: 20

Autocorrelation	Partial Correlation		AC	PAC	Q-Stat	Prob
		1	0.264	0.264	1.6092	0.205
		2	0.104	0.037	1.8726	0.392
		3	-0.023	-0.063	1.8861	0.596
		4	-0.073	-0.061	2.0334	0.730
		5	-0.088	-0.051	2.2615	0.812
		6	-0.110	-0.072	2.6406	0.852
		7	-0.079	-0.033	2.8536	0.898
		8	-0.030	0.002	2.8859	0.941
		9	0.162	0.178	3.9348	0.916
		10	-0.045	-0.158	4.0222	0.946
		11	-0.027	-0.025	4.0573	0.968
		12	0.069	0.111	4.3213	0.977

Source: Plotted by the authors using Eviews(V10).

For the model statbility, Figure2 shows the CUSUM and CUSUMSQ tests, accordingly see that the coefficients of the model are stable over time, because the plots are inside the 5% boundary lines.

Figure 4: «Stability test (CUSUM and CUSUM of Squares) of the estimated model»



Source: Plotted by the authors using Eviews(V10).

As a final result of this study, and based on the modeling findings, we conclude that there is a positive effect of the Gross domestic product per capita on the Foreign Direct investment, a strong positive effect of openness index on the FDI has been confirmed, technically (a change (increase or decrease) by one unit of the Openness Index of the Algerian Economic, *ceteris paribus*, should make a change

of the FDI by 2.55%. We confirmed the existence of the causality (*in Granger sense*) of political stability to the FDI during the study period.

Conclusion

Different countries in the world seek to attract foreign direct investment in order to accelerate the growth of their economies and this by taking full advantage of the characteristics and advantages specific to each country, whether in terms of location, natural resources belonging to the country, the regulatory and legal aspect, the country's policy, the culture of the people.

Therefore, in this study, we have dealt with an analysis of the relationship between the investment climate and foreign direct investment in Algeria by estimating the relationship between foreign direct investment and the other three variables: GDP (per capita), the openness and stability index.
we found the following results:

- that there is a positive effect of the Gross domestic product per capita on the Foreign Direct investment.
- there is a positive effect of the opening index on FDI.
- The existence of the causality (in the sense of Granger) of political stability to FDI during the study period.

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