

Determinants of Foreign Direct Investment Inflows in Algeria An Analytical Econometric Study (1980-2017).

محددات الاستثمار الأجنبي المباشر في الجزائر

1980_2017 قياسية تحليلية دراسة

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Abstract:

The study aims to determine the factors that affect the foreign direct investment inflows in Algeria, using a sample of 38 observation for the period 1980-2017. Rely on annual time series and multiple linear regression model to examine the relationship between foreign direct investment inflows as a dependent variable, and market size, trade openness, economic stability, credit provided by financial sector, human capital, political stability, quality of infrastructure as independent variables.

The results show that market size, trade openness, human capital have a positive and significant effect on foreign direct investment inflows in Algeria.

Keywords: FDI Inflows, Determinants of FDI, Algeria.

JEL Classification: C25, F21

ملخص:

تهدف هذه الدراسة إلى تحديد العوامل التي تؤثر على تدفقات الاستثمار الأجنبي المباشر نحو الجزائر، تم الاعتماد على نموذج انحدار خطي متعدد وسلسلة زمنية تحوي 38 مشاهدة سنوية تغطي الفترة من 1980-2017، اعتمدت الدراسة على المتغيرات التالية: تدفقات الاستثمار الأجنبي المباشر كمتغير تابع،

أما كمتغيرات مستقلة أو المفسرة فقد تم الاعتماد على حجم السوق، درجة الانفتاح الاقتصادي، الاستقرار الاقتصادي، الائتمان المقدم من القطاع المالي رأس المال البشري، الاستقرار السياسي، نوعية البنى التحتية. توصلت الدراسة إلى أن حجم السوق، درجة الانفتاح الاقتصادي، رأس المال البشري لها تأثير موجب ومعنوي على تدفقات الاستثمار الأجنبي المباشر في الجزائر.

كلمات مفتاحية: تدفقات الاستثمار الأجنبي المباشر، محددات الاستثمار الأجنبي المباشر، الجزائر.

تصنيفات JEL: F21، C25

1. Introduction

In the last few years, FDI has an important role in several countries, contributes to realizing economic growth, creates jobs, as a result, reduces unemployment, and provides finance, transfer technology, skills and so. Accordingly, countries attempt to attract the larger part of foreign direct investment inflow by improving the investment climate, which requires economic and political stability, unchanging macroeconomic policies, protection of property rights, get better infrastructure, facility access to credit.

Algeria as one of several countries efforts to improve the conditions (economic and policy reforms) to attract big part of foreign direct investment inflow, Algeria has a lot of advantages to draw many investors (proximity to Europe, low cost of energy...), but also has a range of disadvantage such as it is complicated to acquire industrial property, administrative procedures take a long time and slowly, tax law is very complex.

In view of that, the study looks for the following question:

What are the main determinants of FDI inflows in Algeria?

To answer the question we will test the following hypotheses:

- GDP per capita is foreign direct investment determinant.
- Merchandise trade is foreign direct investment determinant.
- Inflation is foreign direct investment determinant.
- Credit provided by financial sector is foreign direct investment determinant.

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- School enrollment secondary is foreign direct investment determinants.
- Military expenditure is foreign direct investment determinant.
- Air transport is foreign direct investment determinant.

There are several studies tried to explain the determinants of foreign direct investment, recall the most recent:

Behrooz Shahmoradi, Mostafa Baghbanyan (2011), "Determinants of Foreign Direct Investment in Developing Countries: A Panel Data Analysis", based on a sample of 25 developing countries and used panel data techniques to determine the main factors that affect foreign direct investment inflows to this countries for 18 years (1990-2007), the FDI inflows were used as explained variable and FDI outflow, GDP per capita, balance of payment, (export+import)/ GDP, population, mobile telephone per 1000 people, internet users per 1000 people, workforce, technology, ODA(Total Official Development Aid, and inflation as explanatory variables. The results achieved that openness of the economy, market size, workforce, ODA, mobile technology, and the internet had a significant and positive effect on FDI inflows, the population had a significant and negative effect, and the other variables did not significantly at any level. (Behrooz Shahmoradi, 2011, pp. 49-56)

Yapatake kossele Thales Pacific, Riti Joshua Sunday, Anning Lucy 2015, "Determinants of Foreign Direct Investment Flows to Francophone African Countries: Panel Data Analysis", to look at the factors that determine foreign direct investment inflows to Francophone African Countries, they relied on panel data analysis from 25 countries for the period of 9 years(2004-2012) which had 158 panel observations, used FDI inflows as dependent variable and the growth rate of Gross Domestic Product, exports in goods and services, official exchange rate, domestic credit to private sectors, information and communication technology defined by the number of internet users, political stability and absence of violence as independent variables. The main results showed that most important determinants of FDI Francophone African Countries were: exports in goods and services, internet's users, exchange rate, political stability and absence of violence

estimate, the time required to start a business in the country. (Yapatake kossele Thales Pacific, 2015, pp. 4-9)

Sobir Shukurov. 2016, "Determinants of FDI in Transition Economics: The Case of CIS Countries." Used panel data models to determine the factors affecting (share of FDI inflows in GDP as dependent variable, and GDP per capita, inflation rate, external balance on goods and services, infrastructure reform, trade and exchange rate restriction, competition policy; banking reforms, natural resources as independent variables) FDI inflows to CIS (Commonwealth Independent States) countries (Uzbekistan, Ukraine, Turkmenistan, Tajikistan, Russia, Moldova, Kazakhstan, Belarus, Azerbaijan, Armenia) for the period of 1995-2010. The results indicated that market size, abundance in natural resources were positively affected FDI inflow, where fiscal imbalance and inflation had a negative influence on FDI inflows. (Shukurov, 2016, pp. 75-94)

The study structured as follows: The first part is the introduction to the study. Part two has some background information about foreign direct investment inflow in Algeria. Part three includes the data collection and sources, variable definition, and economic analysis methods. Last part introduces the results of the study. The conclusion and the recommendations discussed at the end of the study.

2. Overview

Investment is a vital element in development economics and has an important role in several countries alike local or foreign. In recent years nations undertake to care for foreign direct investment since its advantages. Algeria regards as one of the countries that attempt to attract a lot of FDI inflows, thus it seeks to create a favourable and motivate investment climate. Algeria has many potentials to be an attractive country to foreign investments, it riches in natural resources which are competitive factors costs(natural gas 0.21 to 0.40 Euros/therm, electricity 1 to 4 euro certs/kwh on average, gasoline super 0.3euros/ L, gas oil 0.17euros/L) (<http://www.andi.dz/index.php/en/raisons-pour-investir.>), has young and a qualified labor force , modern infrastructure, encouragement for investment for example: when foreign company recruits young job seekers, benefits for reduction of charges of contribution to social security (North 56%to

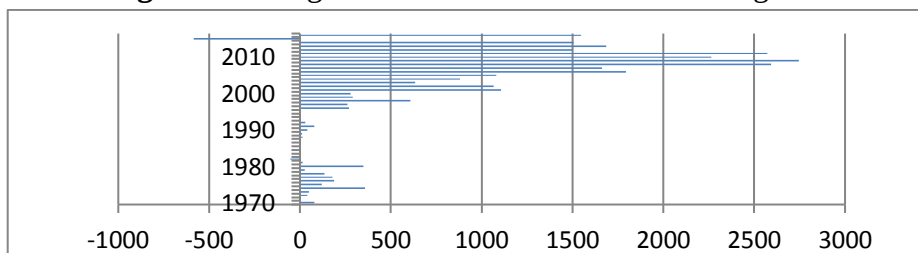
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80, Highlands and South 72% to 90%) (<http://www.andi.dz/index.php/en/raisons-pour-investir.>), and so on...

To attract great part of FDI inflows will have identified the mains factors that influence the FDI inflows to Algeria, but before that, we will take a general idea about foreign direct investment in Algeria.

Table and Figure (01) represent foreign direct investment inflows to Algeria from 1970 to 2017, during this period the FDI inflows are increasing, after the independence Algeria did not welcome foreign investments, but now it is realizing its importance as a financing source, so is striving to improve its investment climate to attract more foreign investments. The 1970s showed that FDI inflows during this period have been volatile, but are certainly weak compared to other international sources of finance, in 1971 FDI flows declined to \$ 0.6 million compared with 1970 \$ 80.12 million (as a result of the liquidation of FDI due to nationalization). The 1980s characterized by the significant decline in foreign direct investment, which reached \$ 348.67 million in 1980 to arrive at -53.57 in 1982. In the 1990s, there was a near total absence of foreign direct investment, particularly the period from 1993 to 1995 due to the complex situation in Algeria, As well as the lack of political stability, which had a negative impact on foreign direct investment inflows. From 1996 to 1999 foreign investment inflows had raised, which ranged between 270(1996) and 606.6(1998) million dollars, most of them went to the hydrocarbons sector. Recently the volume of FDI inflows are growing, which reflect the polarization conditions available in Algeria, especially political and institutional stability, improving the macroeconomic framework, and strengthening of infrastructure, as well as government incentives such as finance, fiscal and customs exemption.

Figure 1. Foreign Direct Investment inflows to Algeria.



urce: Prepared by researchers, based on data in table N°1.

Table 1. Foreign Direct Investment inflows to Algeria.

Unit: million dollars

years	FDI inflows	years	FDI inflows
1970	80,12	1994	0.001
1971	0,6	1995	0.001
1972	41,49	1996	270
1973	51	1997	260
1974	358	1998	606,6
1975	119	1999	291,6
1976	187	2000	280,1
1977	178,45	2001	1113.106
1978	135,15	2002	1065
1979	25,69	2003	637.88
1980	348,67	2004	881,85
1981	13,21	2005	1145.33
1982	-53,57	2006	1888.165
1983	0,42	2007	1743.331
1984	0,8	2008	2631.711
1985	0,4	2009	2753.755
1986	5,32	2010	2301.226
1987	3,71	2011	2580.354
1988	13,02	2012	1499.21
1989	12,09	2013	1684
1990	40	2014	1506.733
1991	80	2015	-584
1992	30	2016	1546
1993	0.001	2017	1203

Source : <http://unctadstat.unctad.org/wds/TableViewer/tableView.asp /30-6-2018>.

Table 2. The most important countries investing in Algeria (January 2013 – December 2017)

country	Amount (million dollars)	Number of projects	Number of companies
China	3539	10	5
Singapore	3151	3	1
Spain	2565	10	6
Turkey	2313	4	4

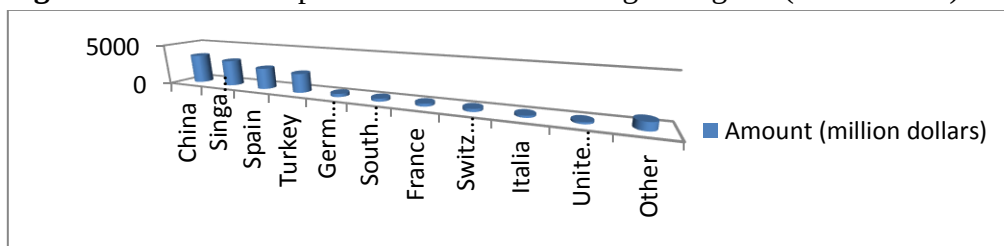
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Germany	380	7	7
South Africa	350	1	1
France	330	12	10
Switzerland	330	4	4
Italia	232	1	1
United Kingdom	212	2	2
Other	892	28	28
Total	14293	82	69

Source: The Arab Investment and Export Credit Guarantee Corporation, Quarterly Bulletin of Investment Guarantee, Features of Foreign Direct Investment in Arab Countries 2017, N°2, 2018, p13.

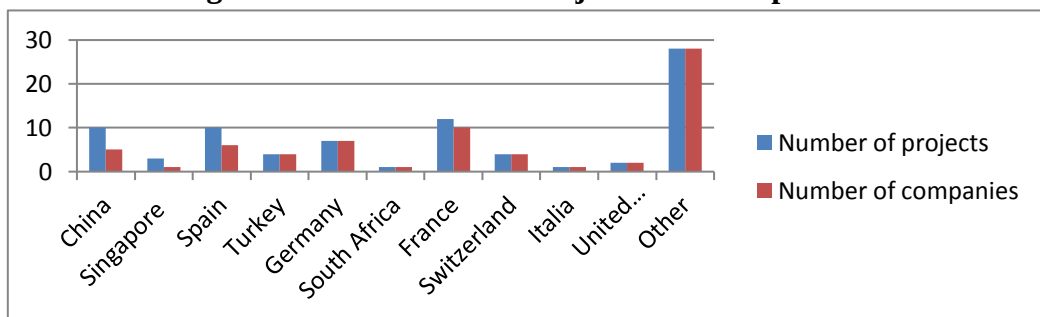
Figure 2. The most important countries investing in Algeria (2013 - 2017).



Source: Prepared by researchers, based on data in table N°2.

Table and figure (02) display the most important countries investing in Algeria from January 2013 to December 2017 (China, Spain, Turkey, Germany, South Africa, France, Switzerland, Italy, United Kingdom), note that China owns the biggest amount of investment which achieves to 3539 million dollars, however the United Kingdom has the lowest amount of investment 212 million dollars during this period.

Figure 3. The Number of Projects and Companies.



Source: Prepared by researchers, based on data in table N°2.

Figure N°3 Shows the number of projects and companies for each country (China, Spain, Turkey, Germany, South Africa, France,

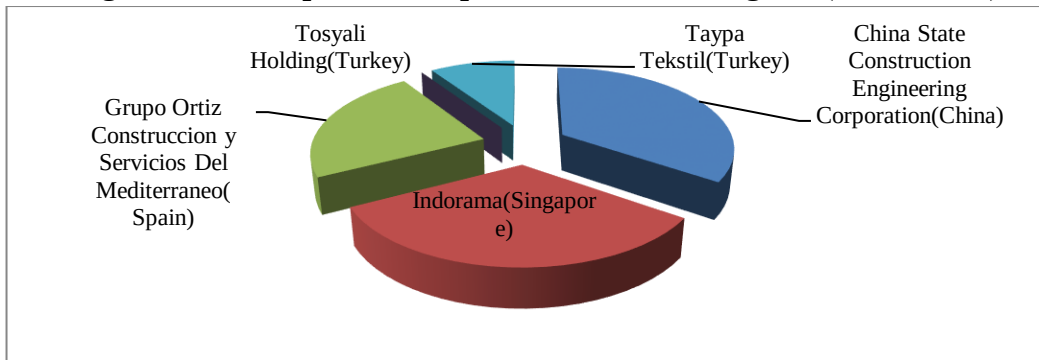
Switzerland, Italia, United Kingdom) during the period of fourth years from 2013 to 2017, France has biggest number of projects (12 projects) and companies (10 companies), China and Spain have the same number of projects (10 projects), and 6 companies for Spain and 5 for China, Germany owns 7 projects and companies, when Italia has the lowest number of projects and companies during this period.

Table 3. The Top Five Companies Investing in Algeria (January 2013 and December 2017)

Company	Country	Amount (Million Dollars)
China State Construction Engineering Corporation	China	3.300
Indorama	Singapore	3.151
Grupo Ortiz Construcccion y Servicios Del Mediterraneo	Spain	2.209
Tosyali Holding	Turkey	1.397
TaypaTekstil	Turkey	900

Source: The Arab Investment and Export Credit Guarantee Corporation, Quarterly Bulletin of Investment Guarantee, Features of Foreign Direct Investment in Arab Countries2017, N°2, 2018, p13.

Figure 4. The Top Five Companies Invested in Algeria (2013 - 2017)



Source: Prepared by researchers, based on data in table N°3.

Table (03) represents the top five companies investing in Algeria from 2013-2017, China State Construction Engineering Corporation(CSCEC) which is china's company invests 3300 million dollars, CSCEC Algeria's business has centered on housing, public works, and infrastructure, Indorama company from Singapore spends 3151 million dollars, Grupo Ortiz

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Construccion y Servicios Del Mediterraneo(in 2013 the Ortiz Group signed a memorandum of understanding (The contract includes: a train Algerian workers, an architectural and engineering contract for the housing, technology transfer of building systems, construction of concrete panels and slabs in Algiers.) with the Algerian public company OLA to build 5,000 homes using the INDAGSA construction system of precast concrete panels) from Spain its investment arrives at 2209 million dollars, and Turkish company Tosityali Holding invests 1397 million dollars(the ingot produced at Tosityali Algeria is used for the production of wire rod, construction steel, hollow sections, and merchant bars), and Taypa Tekstil 900 million dollars(textile production facility).

Table 4. Distribution of FDI inflows to Algeria by regions invested (2013-2017)

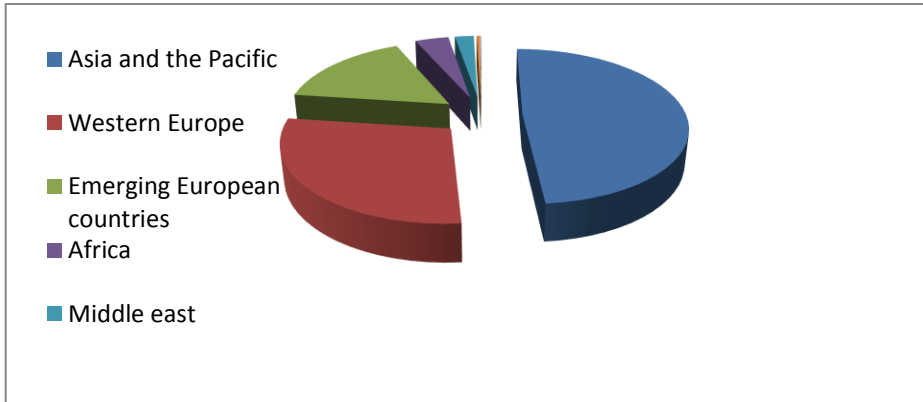
Investedregions	Amount (million dollars)	%
Asia and the Pacific	6.965	48.7
Western Europe	4.056	28.4
EmergingEuropean countries	2.328	16.3
Africa	554	3.9
Middle east	317	2.2
NorthAmerica	59	0.4
Latin America and the Caribbean	13	0.1

Source: The Arab Investment and Export Credit Guarantee Corporation, Quarterly Bulletin of Investment Guarantee, Features of Foreign Direct Investment in Arab Countries2017, N^o2, 2018, p13.

From table (04) which represents the distribution of FDI inflows to Algeria by regions invested from 2013 to 2017, note that Asia and the Pacific have the biggest part of the investment in Algeria 48.7% as well Western Europe, Emerging European countries(28.4%,16.3%). When Latin America and the Caribbean have the little part of investment 0.1%, also Africa, Middle East, North America doesn't have a big contribution for FDI inflows (3.9%,

2.2%, and 0.4%).

Figure 5. Distribution of FDI inflows to Algeria by regions invested (2013-2017)



Source: Prepared by researchers, based on data in table N°4.

3. The Methodology and Data Description

3.1 Methodology

3.1. Nature and sources of data

To determine the main factors that affect foreign direct investment in Algeria and test the hypotheses, the annual data were collected from the [National Agency of Investment Development](#) (ANDI), United Nations Conference on Trade and Development (UNCTAD), **The Arab Investment & Export Credit Guarantee Corporation (Dhaman)** for the period 1980 to 2017. The study uses annual time series data consists 38 observation, including foreign direct investment inflows, GDP per capita, Merchandise trade, inflation, credit provided by financial sector, School enrollment secondary, Military expenditure, Air transport.

Table (05) represents the determinants of FDI inflows, their name, definition and the expected effect on FDI inflows.

Table 5. Variables Description

Variables name	definition	Expectedsing
GDP per capita (market size)	GDP per capita is gross domestic product divided by total population.	Positive
Merchandise trade (openness of economy)	Export plus import divided by the value of GDP.	positive

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Inflation (economic stability)	Inflation as measured by the consumer price index reflects the annual percentage change in the cost to the average consumer of acquiring a basket of goods and services that may be fixed or changed at specified intervals.	Negative
Domestic credit provided by financial sector	Domestic credit provided by the financial sector includes all credit to various sectors on a gross basis, with the exception of credit to the central government, which is net.	Positive
School enrollment secondary(human capital)	The ratio of total enrolment, regardless of age, to the population of the age group that officially corresponds to the level of education shown.	Positive
Military expenditure(political stability)	Military expenditures include all current and capital expenditures on the armed forces.	Positive
Air transport(quality of infrastructure)	Registered carrier departures worldwide are domestic takeoffs and takeoffs abroad of air carriers registered in the country.	Positive

Source: Prepared by the researchers, based on <https://data.worldbank.org/products/wdi/> 25/07/2018.

4. Hypothesis and model specifications

The study attempts to test the following hypotheses:

GDP per capita, Merchandise trade, Inflation, credit provided by financial sector, School enrollment secondary, Military expenditure and Air transport are foreign direct investment determinants.

Multiple regression model is used to find the main determinants of foreign direct investment inflows in Algeria, according to the prevision studies and Literature Review we develop the following basic model:

$FDI = f(\text{market size, openness of economy, economic stability, domestic credit provided by financial sector, human capital, political stability, quality of infrastructure})$

$$\text{FDI} = B_0 + B_1X_1 + B_2X_2 + B_3X_3 + B_4X_4 + B_5X_5 + B_6X_6 + B_7X_7$$

Where:

FDI: foreign direct investment inflows, **X₁:** GDP per capita (market size), **X₂:** Merchandise trade (openness of economy), **X₃:** Inflation (economic stability), **X₄:** credit provided by financial sector, **X₅:** School enrollment secondary (human capital), **X₆:** Military expenditure (political stability), **X₇:** Air transport (quality of infrastructure)

4. Results and Discussion

4.1 unit of root test

The stationary time series require that:

The mean of Y_t is constant over time:

$$E(Y_t) = \mu_Y$$

The variance of Y_t is constant over time:

$$\text{VAR}(Y_t) = (Y_t - \mu_Y)^2$$

The covariance of time series does not vary over time and depend on the factor of time only. But sometimes the non stationary is obtained because of the changes that face economic environment as the result of the economic fluctuations (business cycle fluctuation between expansion and recession), in this case the test statistics may often show a significant relationship between variables in the regression model even though no such relationship exists between them and this creates incorrect regression even when the value of R^2 is high. To investigate this problem, the ADF (Augmented Dickey-Fuller) test of stationary is used which is the most widely used unit root test. After computed the value of Dickey-Fuller, we compared this value with the critical value tabulated by Dickey-Fuller (the Dickey-Fuller test), if the value of the former is greater than the value of later the null hypothesis is rejected which mean that times series is stationary, if not the null hypothesis is accepted, that is times series is nonstationary. In this case, the first difference of data is taken and retesting, even the times series is stationary. (Dickey, 1979, p. 429)

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Table 6. Unit Root Test

variables	level		1 st difference	
	ADF test statistic	Result	ADF test statistic	Result
y	-1.190294	not stationary	-2.335862^{**}	stationary
X ₁	0.311196	not stationary	-5.491112 [*]	stationary
X ₂	-0.639835	not stationary	-4.659536[*]	stationary
X ₃	-1.313836	not stationary	-5.615609 [*]	stationary
X ₄	-0.935965	not stationary	-6.762456 [*]	stationary
X ₅	0.450111	not stationary	-5.399564 [*]	stationary
X ₆	1.541792	not stationary	-4.974985 [*]	stationary
X ₇	1.055931	not stationary	-7.030029 [*]	stationary

Source: Prepared by the researchers, based on Eviews output.

*1% significant level.

** 5% significant level.

This work started with the null hypothesis that the variables of interest in the study have a unit root (that is nonstationary) against the alternative hypothesis that the variables are stationary. The test for this null hypothesis has represented in a table **(06)**, we can see that all variables are not stationary at the level so they have a unit root, thus we accept the null hypothesis. After taking first difference they became stationary at 1% and 5% significant level.

4.2 Johansen Cointegration Test

Cointegration analysis is used to investigate the long-term relationship between the variables (FDI, market size, openness of economy, economic stability, credit provided by financial sector, human capital, political stability, and quality of infrastructure) of the study. Economically speaking two variables will be cointegration if they have long-term or equilibrium relationship between them. To look for this relationship Johansen test is used to test the null hypothesis that says there is no cointegration between the variables of the study against the alternative that says there is cointegration between the variables of the study.(Johansen, 1992, p. 230)

Table N7. Cointegration Test

Hypothesized No.of CE(s)	Trace Statistic	0.05critical value	prob
None*	199.950	159.5297	0.0000
At most 1*	133.9974	125.6154	0.0139
At most 2*	99.90256	95.75366	0.0251
At most 3	67.54941	69.81889	0.0748
At most 4	40.87110	47.85613	0.1928
At most 5	22.04305	29.79707	0.2961
At most 6	10.09333	15.49471	0.2736
At most 7	0.244073	3.841466	0.6213

Source: Prepared by the researchers, based on Eviews output.

*denote rejection of the hypothesis at the 0.05 level

Table(07) represents the Cointegration test results, as we see there are three Cointegration at a level of 5%, which means there is a long-term relationship between the FDI, market size, openness of economy, economic stability, credit provided by financial sector, human capital, political stability, and quality of infrastructure. Thus we reject the null hypothesis that says there is no cointegration between the variables of the study, and accept the alternative hypothesis that says there is cointegration between the variables of the study.

Table 8. Regression Result

Dependent variable : y			
variable	Coefficient	t- statistic	prob
c	-2239.682	-2.468621	0.0195
X₁	0.300808	3.181898	0.0034
X₂	34.95256	3.145034	0.0037
X₃	-20.85225	-1.600169	0.1200
X₄	-0.001734	-0.034345	0.9728
X₅	15.57672	2.729320	0.0105
X₆	-246.0105	-1.685805	0.1022
X₇	0.004695	0.257049	0.7989
F-statistic	11.92350	R-squared	0.735600
Prob (F-statistic)	0.000000	Adjusted R-squared	0.673907

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Source: Prepared by the researchers, based on Eviews output.

The results show that market size, openness of economy, capital human have a positive and significant (1%, 1%, 5%, respectively) effects on foreign direct investment inflows in Algeria, where inflation, credit provided by financial sector, Military expenditure have negative effects on FDI inflows, but are not significant at any level, also Air transport as a proxy of infrastructure has a positive effect on FDI inflows but is not significant at any level. GDP per capita as an indicator for market size has a positive and significant effect on foreign direct investment inflows at a level of 1%, this means that Algeria foreign direct investment inflows will increase by 0.300808 if GDP per capita raises by a unit. So market size is an important determinant of FDI inflows in Algeria, a higher GDP per capita means higher effective demand and purchasing power, the literature confirms that market size is an important determinant of FDI inflows in the host country(Singh, 1995, p. 14),(Culem, 1988, pp. 885-904), (Liargovas & Skandalis, 2012, p. 327).

Merchandise trade as proxy for openness of economy has a positive and significant relationship with Algeria foreign direct investment inflows at a level of 1%, this result is consistent with previous studies(Moosa, 2006, pp. 199-211), (Chantasasawat, 2010, p. 533). (Srinivasan, 2011, p. 26), thus trade openness is an essential determinant of FDI inflows in Algeria, foreign investors are more attracted to countries that opened up to the outside world, a high value indicates openness to trade, and it is a motivating factor for foreign investors.(Caves, 1996). Capital human has positive and significant relationships with Algeria foreign direct investment inflows at level 5%, which means that well-informed labor force in host country attracting more FDI inflows.(Asiedu, 2006, p. 63). Air transport indicates the quality of infrastructure is found to be insignificant, this means that quality of infrastructure is not determinant of Algeria foreign direct investment inflows, this result is supported by Quazi(Quazi, 2007, p. 329), in addition inflation(Elijah, 2008, p. 22; Asiedu, 2006; Asiedu, 2006), credit provided by financial sector (Yapatake kossele Thales Pacific, Riti Joshua Sunday,

Anning Lucy2015) and military expenditure have negative and non-significant impact on FDI inflows in Algeria.

5. Conclusions

Currently, the countries compete to attract great part of foreign investment inflows for the reason that it makes jobs, improve economic growth, provides stable finance and so. Algeria also aims to attract more foreign investment inflows by improving its investment climate. The first part in this study was an overview on foreign direct investment inflows in Algeria from 1970 o 2017, during this period the FDI inflows are increasing as result of improving its investment climate, the most important countries investing in Algeria from 2013 to 2017 are China, Spain, Turkey, Germany, South Africa, France, Switzerland, Italia, and United Kingdom, while the top five companies investing in Algeria from 2013-2017are China State Construction Engineering Corporation(CSCEC, Indorama company from Singapore , Grupo Ortiz Construcción y Servicios Del Mediterraneo from Spain, and Turkish companies Tosyali Holding. and Taypa Tekstil, the distribution of FDI inflows to Algeria by regions invested from 2013 to 2017, note that Asia and the Pacific have the biggest part of the investment in Algeria when North America has the lowest contribution for FDI inflows. In the second part, we investigated whether the GDP per capita, Merchandise trade, inflation, credit provided by financial sector, School enrollment secondary, Military expenditure and Air transport affect foreign direct investment inflows in Algeria, rely on time series include a sample of 38 observation from 1980 to 2017.

Finally, the results showed that GDP per capita as a proxy of market size, Merchandise trade as an indicator of economic openness, and School enrollment secondary as a proxy of capital human are important attracting factors of FDI inflows in Algeria.

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