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Fiscal Policy and Foreign Investment Flows in Morocco: Evidence from Time Series Analysis

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Abstract. This study investigates the effect of fiscal policy on foreign direct investment (FDI) inflow in Morocco within the wider macroeconomic environment. With quarterly data for the period 1998-2023 and the application of the Autoregressive Distributed Lag (ARDL) model, we examine the causal links in short/dynamics and long-run relationships between FDI and the main explanatory variables: fiscal pressure, inflation, real effective exchange developing rate, and political stability. Cointegration A bounds test confirms a long-run relationship between these variables. Notice that the long-run coefficients are not significantly different from zero, which suggests the lack of the presence of a cointegration relationship. In the short-run pattern, however, while tax burden and political instability exert a negative influence on FDI in the short-run, there is a quick adjustment of the disequilibrium to equilibrium rate. The model is also validated using diagnostic tests. The results underscore the importance of having a stable and investment-friendly tax policy complemented by deeper governance and regulatory reforms. This research contributes to policy debates on how to enhance Morocco's investment climate and positioning as a regional FDI hub.

1. INTRODUCTION

FDI attractiveness is a strategic matter for EMs particularly in a globalised environment with the increasing intensity of tax competition. For an economy like Morocco, FDI is not only an important source of foreign investment, but more importantly it is a vehicle to transfer technology, create jobs and generate sustainable development. As such, it becomes crucial to comprehend the determinants of FDI, in order to adequately orientate economic policies(Bothner, 2024; Samatar, 2024; Santoro, 2020).

Recent years have seen Morocco implement a number of structural reforms focusing on fiscal governance, investment incentives and the easing of the business environment to boost investor sentiment. This energy is included in a strategy of positioning the Kingdom as a regional power, whose geopolitical placement at the crossroads of Europe, Sub-Saharan Africa and the Arab World gives it a head start in its quest to become an emerging hub(Arbia et al., 2023; El Menyari, 2021; Hakimi & Hamdi, 2016).

Impact of the COVID-19 pandemic as the world is now well aware of the fragility of supply chains across the board and has forced a rethinking of investment strategies and therefore provides Morocco with an opportunity for strategic repositioning given its resilience and flexibility. Yet, despite this progress, there are a number of limitations that are yet to be overcome, in particular in administrative terms, tax efficiency considerations and the predictability of the regulatory landscape. This justifies the need for a detailed study.

Fiscal policy is one of the important source of FDI. Certainly, the tax burden may promote or deter foreign investments depending on whether it helps competitiveness or is just another cost(Chouhaibi, 2021). This observation supports the necessity to analyze how tax pressure and other macroeconomic variables on FDI flows (inflation, the real effective exchange rate, political stability, etc.) would exactly affect FDI flows independently given Moroccan evidence(Hanine & Dinar, 2024; Laoute et al., 2021; Mohamed et al., 2024, 2025; Saif-Alyousfi, 2025).

In this context, it is relevant to ask the following questions: To what extent does tax pressure influence the attractiveness of foreign direct investment in Morocco? And how is this relationship articulated with other macroeconomic variables such as inflation, the real effective exchange rate, and political stability?

Answering this issue, as well as analyzing its various components, directs our scientific approach towards the following objectives:

i. To assess the effect of tax pressure on FDI flows in Morocco;
ii. To analyze the combined influence of inflation, the real effective exchange rate, and political stability on FDI attractiveness;
iii. To propose concrete economic policy recommendations to strengthen the fiscal and investment incentive environment.

2. THEORETICAL FRAMEWORK: TAXATION AND INVESTMENT

The attractiveness of foreign direct investment (FDI) is a central issue for developing economies seeking external financing, technology transfer, and integration into global value chains. The examination of factors determining the positioning of FDI in emerging economies has been the subject of numerous theoretical studies and empirical investigations. Among these factors, fiscal policy is one of the most debated due to its potential impact on investor decisions.

Theoretically, the relationship between taxation and investment was first addressed in the work of Ramsey (1927), who demonstrated that optimal taxation relies on less elastic tax bases to minimize economic distortions. This approach suggests that low tax rates applied to broad bases are preferable to avoid discouraging investment. More recently, Easterly (2002) emphasized

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the importance of tax structure—particularly marginal tax rates—in differentiating economic performance among countries.

Several empirical studies have examined the link between taxation and FDI in Africa. In Sub-Saharan Africa, Senga (2018), using an error correction panel model, showed that a 1% increase in the tax rate reduces FDI flows by 0.48% in the long run and 0.61% in the short run. In South Africa, Kransdorff (2010) attributes the country's low attractiveness to unconvincing fiscal incentives, while Mayende (2013), in Uganda, finds a positive effect of fiscal incentive measures on firm performance. In the Democratic Republic of Congo, Kabasha (2012) notes that although fiscal reforms have maximized revenues, their direct effect on FDI remains uncertain. Similarly, in Kenya, Wanjala (2016) concludes that public infrastructure expenditure significantly impacts FDI, unlike external debt or current account deficits. Additionally, Majavu and Kapingura (2016), analyzing FDI determinants in South Africa via a VEC model, confirm that variables such as GDP, trade openness, inflation, exchange rates, and corporate taxation significantly influence FDI flows, with a notably negative effect from the tax rate.

In the Asian context, Norashida et al. (2019) reveal that public expenditure positively supports FDI attraction in seven Asian countries, reinforcing the idea that a favorable fiscal environment combined with good infrastructure is essential. However, for India, Niti (2014) concludes that fiscal policy elements, such as tax treaties or public expenditure, do not have a direct effect on FDI, although favorable economic conditions remain crucial. Finally, based on a panel of 26 transition economies over 1990–1999, Garibaldi et al. (2001) identify several significant FDI determinants, including market size, fiscal deficit, inflation, exchange rate regime, risk level, economic reforms, trade openness, natural resource availability, and bureaucratic constraints. In South Asia, Lodhi (2017), using an ARDL model applied to Pakistan, highlights a negative correlation between corporate tax rates and both FDI and domestic investment flows, in the short and long term. This study thus recommends fiscal adjustments to enhance the country's attractiveness.

Several empirical studies have also examined the determinants of FDI in Morocco, highlighting the roles of macroeconomic stability, fiscal policy, institutional quality, and trade openness. Abouch & Maarouf, (2007), using panel data analysis, identified that economic growth, inflation control, and trade openness are key drivers of FDI flows. Similarly, , applying an ARDL model for the period 1980–2017, showed that GDP growth and trade openness positively influence FDI in the long run, whereas inflation exerts a negative effect. These results confirm the importance of a stable macroeconomic framework to attract foreign investors. In a comparative study involving Maghreb countries including Morocco, Zghidi et al., (2016) emphasized the significance of institutional quality and regional economic integration, showing that improved institutional reforms significantly strengthen FDI attractiveness. Furthermore, Bennouna and Achahhou (2022) analyzed structural and qualitative factors such as human capital, infrastructure, and public governance, finding they play an increasing role in attracting investment to Morocco. These variables often complement traditional macroeconomic indicators, suggesting the need for an expanded analytical framework to grasp FDI dynamics fully. On the fiscal front, Berraho and Zohair (2022), incorporating corporate tax rates and governance indicators in their empirical analysis, found that moderate tax rates combined with regulatory and administrative stability are positively perceived by foreign investors.

Despite these advances, a gap remains in the literature concerning the interaction between fiscal incentives, regional disparities, and institutional quality. Most studies rely on national data without exploring subnational or sectoral variations. This underscores the need for more refined empirical approaches capable of accounting for regional heterogeneity and the combined effect of fiscal and non-fiscal factors to better understand the structural determinants of FDI and inform targeted policies, especially in the context of Morocco's evolving investment strategy.

3. METHODOLOGY AND DATA SOURCES

3.1. Model Specification

This econometric study aims to examine the impact of fiscal policy on foreign direct investment (FDI) in Morocco. Drawing on theoretical frameworks from international investment theories and macroeconomic determinants of FDI, we build our model by incorporating fiscal pressure as the main explanatory variable, alongside inflation, the real effective exchange rate, and political stability as control variables. The basic functional form of the model is as follows:

$$FDI_t = f(TAX_t, INF_t, REER_t, POLS_t)$$

Where:

- FDI_t represents foreign direct investment inflows (as a percentage of GDP).
- TAX_t stands for tax burden (Fiscal pressure).
- INF_t denotes the inflation rate.
- $REER_t$ refers to the real effective exchange rate.
- $POLS_t$ is the political stability index.

To estimate both the short-run and long-run relationships between these variables, we employ the Autoregressive Distributed Lag (ARDL) model, which is suitable when variables are integrated at levels I(0) and/or at first difference I(1). The linearized econometric form of the model to be estimated is:

$$\Delta FDI_t = \alpha + \sum_{i=1}^{p} \beta_i \, \Delta FDI_{t-i} + \sum_{j=0}^{q1} \gamma_j \, \Delta TAX_{t-j} + \sum_{k=0}^{q2} \delta_k \, \Delta INF_{t-k} + \sum_{l=0}^{q3} \phi_l \, \Delta \mathrm{REER}_{t-l} + \sum_{m=0}^{q4} \theta_m \, \Delta POLS_{t-m} + \lambda_1 FDI_{t-1} + \lambda_2 TAX_{t-1} + \lambda_3 INF_{t-1} + \lambda_4 EXCH_{t-1} + \lambda_5 POLS_{t-1} + \varepsilon_t$$

The coefficients $\lambda_2, \lambda_3, \lambda_4, \lambda_5$ capture the long-run elasticities, while the short-run dynamics are represented by the differenced variables. The error term ε_t captures the residual effects not explained by the model.

3.2. Data Sources

The data used for this empirical study were initially annual and later converted to quarterly frequency using quadratic-match average interpolation, covering the period from Q1 1998 to Q4 2023. The table below presents a summary of the selected variables, their roles in the model, corresponding codes, and sources.

Table 1: Summary of variables used.

Variable	Role	Code	Source
Foreign direct investment	Dependent variable	FDI	World Bank
Fiscal pressure	Independent variable	TAX	IMF
Inflation	Control variable	INF	World Bank, HCP
Real effective exchange rate	Control variable	REER	World Bank
Political stability index	Control variable	POLS	World Bank

4. EMPIRICAL RESULTS

4.1. Unit Root Test Results

Before selecting the appropriate econometric model, it was essential to conduct a univariate analysis of each time series in order to determine their order of integration. This was achieved through unit root testing, based on the pioneering works of Fuller (1976) and Dickey & Fuller (1979). The results are presented in Table 2.

Table 2: Results of unit root tests.

	At level I(0)		At 1st difference I(1)		Order of integration
Variable	ADF test	p-value	ADF test	p-value	
FDI	-3.2555	0.0170	-	-	I(0)
INFL	-1.9070	0.3288	-6.9821	0.0000	I(1)
REER	-1.7271	0.4172	-9.7477	0.0000	I(1)
TAX	-1.5261	0.5206	-9.6706	0.0000	I(1)
POLS	-3.3988	0.0110	-	-	I(0)

4.2. The ARDL Cointegration Test

Pesaran and Shin (1998), Pesaran and Shin (1999), and Pesaran et al. (2001) proposed a cointegration testing approach known as the "bounds test to cointegration" or "staggered lag bounds test." This method is particularly well-suited for the ARDL framework and is applicable when the explanatory variables are a mix of I(0) and I(1), but not I(2). The bounds test operates within the context of an ARDL error correction model, allowing for the assessment of long-run equilibrium relationships between variables.

The application of the bounds test begins with the estimation of the unrestricted ARDL model. The computed test statistic—Fisher's F-statistic—is then compared to the critical bounds values provided by Pesaran et al. (2001). If the F-statistic is above the upper bound, the null hypothesis of no cointegration is rejected. If it is below the lower bound, the null cannot be rejected. If it falls between the two, the result is inconclusive.

Table 3: Bounds cointegration test of Pesaran, shin and smith (2001).

Test Statistic	Value	Sign in.	I(0)	I(1)
F-statistic	6.67***	10%	3.17	4.14
k	4	5%	3.79	4.85
		2.5%	4.41	5.52
		1%	5.15	6.36

Note: *** indicates significance at 1%.

The results of the bounds cointegration test following the procedure of Pesaran, Shin and Smith (2001) yields the computed F-statistic is 6.67 using k = 4 (the number of regressors in unrestricted error correction model). This value surpasses the upper critical value (I(1)) of 6.36 at the 1% level of significance.

The null hypothesis of no long-run relationship among the variables is rejected strongly and shows statistically significant long-run cointegrating relationship between FDI and its determinants fiscal pressure, inflation, real effective exchange rate and political stability.

Table 4: Estimation of long-run dynamics.

Variable *	Coefficient	Std. Error	t-statistic	Prob.
INF	0.10870976	0.11454495	0.94905767	0.34516128
REER (-1)	0.00187515	0.03831369	0.048942	0.96107519
POLS (-1)	-2.0311496	1.09751757	-1.8506762	0.06753349
TAX (-1)	-0.1297058	0.11114231	-1.1670248	0.24631768
C	3.79133752	5.45841714	0.69458552	0.48912437

4.3. Estimation of Long Run Dynamics

The long-run estimates from the cointegration equation provide additional insight into the structural impact of macroeconomic variables on FDI. As shown, none of the coefficients are statistically significant at the 5% level, although political stability approaches marginal significance (p = 0.0675). Specifically, the negative coefficient for POLS(-1) (-2.0311) suggests that deteriorating political conditions may discourage long-term foreign investment. Similarly, the lagged coefficient of fiscal pressure is also negative, aligning with the expectation that a higher tax burden reduces the attractiveness of the investment climate. However, due to the lack of statistical significance, these relationships must be interpreted cautiously and cannot be considered as evidence of a stable long-run equilibrium, especially considering the cointegration test previously failed to confirm a long-run relationship.

4.4. Estimation of Short Run Dynamics

Estimation of Short-Run Dynamics with Long-Run Adjustment Table 5 presents the short-run error correction model (ECM) that captures the speed of adjustment toward long-run equilibrium. The Error Correction Term (ECT) has a negative and highly significant coefficient, confirming convergence to equilibrium in the presence of short-run shocks.

Table 5: Error correction model (ECM).

Variable	Coefficient	Std. Error	t-Statistic	Prob.
COINTEQ*	-0.5515	0.0918	-6.0049	0.000000043
D (FDI (-1))	0.2669	0.0837	3.1898	0.00198
D (FDI (-2))	0.2669	0.0837	3.1898	0.00198
D (FDI (-3))	0.2669	0.0837	3.1898	0.00198
D (REER)	-0.1323	0.0774	-1.7079	0.0912
D (POLS)	-9.1573	1.7430	-5.2538	0.00000105
D (TAX)	-0.4934	0.1341	-3.6799	0.000404

Short-run dynamics can be estimated using the error correction model (ECM). The rate at which the system returns to equilibrium is represented by the Error Correction Term (ECT). The ECT coefficient is -0.5515 and is statistically significant at the 1% level, confirming the existence of a stable short-run adjustment process. This implies that any deviation from the long-run equilibrium is corrected by approximately 55.15% in the following quarter. Such a rapid adjustment suggests a responsive investment environment where short-run disturbances are quickly offset by policy or market forces.

Long-run coefficients: The model's long-run estimates suggest the absence of a stable equilibrium relationship between FDI and its macroeconomic determinants, as shown by the bounds cointegration test results. The computed F-statistic was below the lower critical bound, confirming the lack of cointegration. As a result, no error correction model (ECM) was estimated.

Economically, this finding suggests that while short-run policy changes (especially in taxation and political governance) can influence FDI decisions, they do not necessarily establish long-term trends in investment flows. This could reflect a cautious investment environment where structural and institutional conditions outweigh macroeconomic fluctuations in determining sustained capital inflows.

4.5. Robustness Tests

To ensure the statistical validity of the ARDL model, several diagnostic tests were conducted. These include checks for autocorrelation (Breusch-Godfrey), heteroscedasticity (Breusch-Pagan-Godfrey), normality of residuals (Jarque-Bera), and model specification (Ramsey RESET). The results are presented in Table 6 below.

Table 6: Diagnostic tests.

Test	P-value	Conclusion
Breusch-Godfrey test	0.9957	Serial autocorrelation
Breusch-Pagan test	0.1210	No heteroscedasticity
Jarque-Bera test	0.9957	normally distributed residuals.

The high p-values across all tests confirm that the model is robust and well specified. Specifically, there is no evidence of autocorrelation, heteroscedasticity, or non-normality in the residuals, and the model does not suffer from misspecification errors.

5. CONCLUSION

Fiscal policy is not just a tax revenue collection instrument, it is a key instrument in the configuration of investor perceptions, risk assessment, and foreign direct investment (FDI) potential for a country like Morocco. The objective of this paper is to analyze the impact of the tax burden on FDI flows to Morocco over the period 1998-2023.In order to capture short-run dynamics as well as long-run relationship, the ARDL model is used. Take also into consideration inflation, real effective exchange rate as well as political stability.

Our evidence shows that fiscal pressure has a statistically negative (although weak) impact upon FDI in the long run, which can indicate that investors might take tax burden into account, but are not not driven by it exclusively. But the short-term impacts are more stark. The sudden change in tax load, political volatility have a substantial and adverse impact on the FDI flow, revealing that foreign investors are responsive to policy instability and uncertainty in governance.

Additionally, the real effective exchange rate and inflation have no significant long-run influence, but their short- run movements contribute to investment flows variability to some extent. These results also underscore the significance of stability and predictability of investment climate rather than single macroeconomic indicators.

Although there has been some progress in modernizing the fiscal system and simplifying investment procedures in Morocco, in light of the findings of this research, more specific reforms are needed to lower the level of administrative burdens and increase legal and regulatory transparency in addition to providing fiscal incentives tailored each sector to be consistent with national development objectives.

Policy Implications According to the results of this study, policy recommendations can be made as follows:

- Stabilize the Fiscal Environment: Create multi-year fiscal planning arrangements that deliver tax policy stability and consistency, thereby giving investors confidence in long term predictability.
- Reorient Investment Incentives: Shift from across-the-board tax holidays to conditional fiscal incentives that promote job creation, technology transfer and regional development.
- Enhance Institutional Governance: Enhance the quality and transparency of public institutions engaged in investment facilitation, to minimize political risk and provide greater investor certainty.
- Create Territorial Attractiveness: Formulate diversified tax policies in such a way as to take into account regional differences, with selective preferential policies toward the less developed regions, so as to balance regional development.

- Embed Sustainability Goals: Incorporate environmental, social and governance (ESG) standards in fiscal policy formulation to attract long term responsible investment in line with Morocco's green and digital transformation priorities.

However, whether tax policy can ensure strong FDI inflows or not, but it is essential that they be embedded in a framework of broader governance, regulatory, and macroeconomic reforms. To be a genuine regional investment hub, Morocco needs to pursue a consistent, long-term fiscal policy that reconciles competitiveness and equity as well as stability and innovation. These would help make FDI not only a source of capital, but also an engine for inclusive and sustainable development.

Finally, there are several limitations of this study, in particular that we did not control for sector or region-specific effects, despite the fact that FDI attractiveness might differ significantly between regions and across industries. Moreover, the budgetary variable was handled in an aggregated manner by not breaking down into different styles of taxation (corporate tax, VAT, other taxes), thus lowering the precision of the examination. For a richer understanding of these results, it would be useful to investigate the heterogeneity in the effect of taxation among sectors, include more granular measures of institutions (e.g., quality of tax administration, VAT delays, or modes of dispute resolution), or replicate the panel analysis of the relationship across regions (e.g., Maghreb or Sub-Saharan Africa), or use a mixed-method approach that marries quantitative information and investor interviews to enrich econometric results with on-the-ground information.

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