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Theoretical Frameworks and Quantitative Effects of F0DI in Morocco: An Integrated Analysis Using VECM Model

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Abstract: This study provides a comprehensive analysis of the theoretical frameworks and quantitative effects of Foreign Direct Investment (FDI) in developing economies, commonly referred to as the Global South. By integrating robust methodological approaches Vector Error Correction Model (VECM) analysis—this research examines the multi-faceted impact of FDI on economic growth, environmental sustainability, and energy consumption. The findings indicate a complex, non-linear relationship between FDI and key economic variables, often mediated by local institutions, absorptive capacities, and sectoral characteristics. The results confirm a U-shaped relationship between FDI and renewable energy consumption globally, where initial effects may be negative but turn positive over time as economies develop and integrate advanced technologies. Furthermore, the analysis reveals that the interaction between FDI and economic growth significantly affects renewable energy consumption, aligning with the trade-off theory and race-to-the-bottom hypothesis rather than the conservation hypothesis. For policymakers, this integrated analysis offers valuable insights for designing strategic policies that maximize FDI benefits while mitigating potential negative externalities, particularly in environmental domains where the pollution haven hypothesis remains a contested framework.

Keywords: Foreign Direct Investment (FDI); Developing Economies; Global South; VECM; Non-Linear Relationship

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Introduction

Foreign Direct Investment (FDI) has emerged as a pivotal driver of economic growth and development, particularly in the Global South. Over the last three decades, cross-border capital flows have surged dramatically, with FDI reaching unprecedented levels exceeding US$6 trillion by 2005. This trend underscores the increasing importance of FDI in shaping the economic landscape of developing countries, where it serves not only as a vital source of external capital but also as a conduit for technology transfer and knowledge spillovers.

Understanding the complex relationship between FDI and host economies is essential for policymakers and scholars alike. FDI has the potential to enhance productivity, generate employment, and contribute to environmental sustainability. However, its impact is not uniform; rather, it is influenced by a myriad of factors, including the institutional quality of the host country, the development of human capital, and the effectiveness of regulatory frameworks. These factors shape the degree to which FDI can foster positive economic outcomes and mitigate potential negative consequences.

The environmental implications of FDI represent one of the most debated aspects in the literature. Various hypotheses, such

as the pollution haven hypothesis, pollution halo hypothesis, and scale effect hypothesis, propose contrasting views on FDI's environmental impact. By examining these competing theories, researchers can gain insights into how FDI operations may either exacerbate or alleviate environmental challenges in developing nations, depending on the existing regulatory and economic context.

This paper seeks to contribute to the ongoing discourse by integrating two robust analytical frameworks: Computable General Equilibrium (CGE) models and Vector Error Correction Models (VECM). CGE models are invaluable for simulating the economy-wide impacts of policy shocks and structural changes, providing a broader understanding of how different sectors interact under varying conditions. Meanwhile, VECM approaches are adept at exploring dynamic causal relationships and identifying long-term equilibrium adjustments, thereby enriching our understanding of FDI's temporal effects.

The integration of CGE and VECM models offers a comprehensive methodology for analyzing FDI's effects in the Global South. It allows for both ex-ante policy simulation, assessing potential outcomes before implementing changes, and ex-post empirical validation, testing the results against real-world data. This methodological synergy addresses a significant gap in the current research landscape, which has often relied on singular approaches that may overlook critical interactions and dynamics.

By employing this integrated analysis, the study aims to shed light on the multifaceted impacts of FDI within developing economies. It will assess how various factors influence the effectiveness of FDI in achieving desired economic and environmental outcomes, providing a more nuanced view of its role as a development tool. Ultimately, the research aspires to inform policymaking processes, guiding countries in the Global South on how to harness FDI for sustainable growth.

Moreover, this paper emphasizes the need for a contextual understanding of FDI's effects, recognizing that the varying conditions across the Global South necessitate tailored approaches to policy and investment strategies. The insights garnered from this study can help stakeholders, including governments, investors, and civil society, to better navigate the complexities associated with FDI and leverage its potential benefits while mitigating its associated risks.

In conclusion, as FDI continues to play a central role in the development strategies of the Global South, the integration of CGE and VECM models in this analysis will enhance our understanding of its implications. By exploring the interplay between FDI and the host economies, we can better appreciate the critical factors that influence its outcomes and inform more effective policy interventions aimed at maximizing its positive impacts. The findings of this research are expected to contribute to the broader literature on FDI and economic development, offering valuable insights for future studies and practical applications in the field.

1.Literature Review

1.1 Theoretical Frameworks of FDI

The theoretical understanding of FDI's effects has evolved through several competing frameworks that offer different predictions about its impacts:

The Pollution Haven Hypothesis (PHH) posits that foreign direct investment (FDI) flows are systematically drawn to countries with weak environmental regulations, allowing firms to relocate pollution-intensive production and reduce compliance costs. This theory is rooted in the concept of a "race to the bottom," where countries strategically lower or refrain from strengthening environmental standards to attract mobile international capital, potentially turning them into destinations for outsourced pollution.

In direct contrast, the Pollution Halo Effect (PHE) argues that multinational corporations act as conduits for advanced, cleaner technologies and superior environmental management practices. Through technology transfer, knowledge spillovers, and the implementation of universal corporate standards, these firms can upgrade the environmental efficiency of host country industries, leading to an overall improvement in environmental outcomes.

The core theoretical tension can be understood by decomposing FDI's impact into three simultaneous economic effects. First, the scale effect: FDI increases the overall level of economic and industrial output, which, holding all else constant, leads to greater resource use and pollution. Second, the composition effect: FDI alters the host country's industrial structure. If investment targets pollution-heavy sectors, it creates a "dirtier" economic mix—a primary mechanism of the PHH. Third,

the technique effect: FDI introduces newer, less polluting production methods, lowering emissions per unit of output. This is the central channel for the PHE.

The net environmental impact is thus a contingent balance of these forces. Empirical studies, for instance in Chinese provinces, often find the positive technique effect canceled out by negative scale and composition effects, resulting in a marginal net increase in pollution. This framework explains why empirical evidence is mixed; the outcome is not universal but depends on host-country specific conditions.

A critical moderating factor is the level of economic development (GDP per capita). Research using threshold models indicates FDI tends to increase emissions in low-income countries but may decrease them in high-income economies. This reversal hinges on absorptive capacity—wealthier nations possess the skilled labor, infrastructure, and institutional frameworks necessary to successfully implement and diffuse the advanced technologies brought by foreign firms, activating the halo effect.

The stringency and enforcement of environmental regulations are equally pivotal. While the PHH assumes lax regulations as a starting point, the dynamic is more complex. Evidence from OECD countries suggests a potential virtuous feedback loop: incoming FDI can create pressure for tighter environmental policies as governments respond to public demand and the higher standards demonstrated by foreign firms, thereby countering the "race to the bottom."

The host country's economic structure and energy profile can overshadow the influence of FDI entirely. Studies of Gulf Cooperation Council (GCC) countries are illustrative, concluding that exceptionally high domestic energy consumption (e. g., for desalination, cooling) and GDP growth—not FDI—are the primary drivers of pollution. In such resource-based economies, local factors dominate the environmental equation.

Furthermore, the type of FDI and sectoral destination are decisive. Investment in extractive industries, heavy manufacturing, or petrochemicals carries a high pollution haven risk. Conversely, FDI in services, high-tech, or renewable energy is more likely to generate a halo effect through the transfer of intangible knowledge and low-carbon business models.

The strategic trade-off theory illuminates the policy dilemma. It suggests governments, particularly in capital-seeking developing economies, may consciously compromise environmental protection for competitiveness. This can manifest as a "regulatory chill," where authorities avoid tightening existing laws for fear of deterring investment—a phenomenon as detrimental as an explicit lowering of standards.

In synthesis, the contradictory global evidence reflects profound contextual complexity. The PHH often finds support in industrializing developing economies (e.g., Pakistan, early-stage Vietnam), where scale and composition effects dominate. The PHE is more frequently observed in mature, high-income economies (e.g., EU nations), where strong absorptive capacity and public demand for green outcomes fully activate the technique effect. Ultimately, the FDI-environment relationship is a contest between cost-seeking behavior and technological modernization, with the outcome determined by the host's development level, institutional robustness, economic structure, and political will to forge a sustainable path.

1.2 Empirical Evidence on FDI Impacts

Empirical studies on Foreign Direct Investment (FDI) reveal deeply contradictory findings, highlighting that its impacts are fundamentally context-dependent and cannot be generalized (Boukhelkhal & Bengana, 2021; Shah et al., 2022). On economic growth, FDI can stimulate development by providing capital, enabling technology transfer, enhancing workforce skills, and introducing modern management practices (Benmamoun & Lehnert, 2013However, these potential growth benefits are not automatic and depend heavily on specific host country conditions, including infrastructure and institutional quality (Ben Mim & Ben All, 2020), a relationship often analyzed in specific contexts using advanced time-series methods like the ARDL approach.

Regarding environmental impacts, research is particularly divergent. A seminal study by Boukhelkhal & Bengana (2021) found a sharp divide: FDI increased pollution in developing countries (supporting the Pollution Haven Hypothesis) but reduced it in developed nations (confirming the Pollution Halo Effect). This income-based divergence is reinforced by studies within blocs like the EU, where low-income member states can experience pollution haven effects even under common regulations (Pilatin et al., 2025). Furthermore, the relationship can be non-linear, as seen in emerging MINT countries,

where FDI initially increases ecological footprints but begins to reduce them after a certain economic threshold is reached (Balsalobre-Lorente et al., 2019).

The environmental impact also varies temporally. Studies in Belt and Road Initiative countries show FDI has a long-term positive link with renewable energy consumption but a negative one in the short term. Sectoral focus is another critical factor, with evidence showing that FDI in resource-intensive sectors like forestry significantly increases deforestation in developing countries, confirming sector-specific pollution haven risks (Eke Balla & Lokonon, 2024).

Collectively, research identifies key moderating factors explaining these contradictions: the host country's level of development, the strength of its environmental regulations, and its technological absorptive capacity (Boukhelkhal & Bengana, 2021). Empirical work in national contexts, such as that by Hamid Fayou in Morocco, consistently employs techniques like ARDL bounds testing and Granger causality to disentangle these complex dynamics. The sectoral composition of FDI is equally decisive; investment in heavy industry carries a different environmental risk than investment in services or technology (Alt All, 2021).

Shifting to a specific national context, Morocco-focused research illustrates the conditional nature of FDI benefits. Foundational work by Benmamoun & Lehnert (2013) established that FDI has a larger sustained multiplier effect on long-term growth compared to other external finances like remittances or aid. Recent studies have begun to examine this impact through the lens of sustainable development. For instance, Hamid Fayou (2025) applied an ARDL model and Granger causality tests to Moroccan data, revealing a long-term equilibrium relationship and a significant causal link from FDI towards sustainable development indicators, provided that supporting environmental and social policies are in place.

However, attracting FDI is not purely economic; studies show institutional quality—political stability, regulatory quality, and reduced bureaucracy—is paramount for drawing foreign capital (El Kharouf & Qrunfleh, 2018). The impact of FDI within Morocco is also uneven geographically, having widened development gaps between dynamic coastal regions and the interior, calling for rebalancing policies (Chellakh, 2017). Furthermore, benefits like technological spillovers to local firms are not automatic but depend critically on the absorptive capacity and initial technological level of domestic companies (Mouakhar, 2019).

Sectoral analyses reveal that FDI's impact is most potent in industries like automotive and renewable energy, where it is significantly amplified by high-quality logistical infrastructure and strategic public-private partnerships (Ben Mim & Ben All, 2020; Berahab, 2019). Micro-econometric research by Hamid Fayou (2025a) in the Moroccan automotive sector provides granular evidence, showing that firms benefiting from foreign investment exhibit superior gains in innovation and labor productivity, largely mediated by the adoption of advanced technologies and management practices. Yet, even in successful sectors like automotive, challenges persist in moving up the value chain and capturing more local value-added (Alt All, 2021),

Research from a broader African perspective confirms that the attractiveness and effectiveness of FDI are significantly enhanced in countries with higher levels of human capital (Fayou et al., 2021). This study demonstrated significant complementarity, finding that the positive impact of trade openness and FDI is magnified in countries with greater human capital stock. This underscores that investments in education are a core economic strategy to harness FDI's benefits, a point complemented by findings that skills mismatches hinder growth potential (Assaad et al., 2021). The positive impact of FDI on firm-level productivity, as shown in sector-specific studies, is therefore not guaranteed without a sufficiently skilled workforce.

Macroeconomic stability is another essential condition. Studies show that exchange rate volatility negatively affects long-term growth, underlining the need for sound monetary and fiscal policy (Haffou et al., 2022). Hamid Fayou co-authored research using the ARDL method to confirm this negative relationship for Morocco, distinguishing between short- and long-term effects. Additionally, the efficiency of public investment in infrastructure, crucial for FDI, is itself tied to governance quality and transparency reforms (Dabla-Norris et al., 2011). This aligns with findings that integrated and coherent public policy coordination in trade and investment is essential to maximize synergies from external capital.

Beyond FDI, empirical evidence highlights the primacy of migrant remittances as the largest and most resilient source of

external finance for many developing countries (World Bank, 2023). Remittances directly support households, buffer poverty, and are actively invested in human capital and small businesses, creating a sustainable development multiplier (Yang, 2011).

In contrast, the record on Official Development Assistance (ODA) is mixed, with studies finding no robust positive link to growth and potential for negative effects like "Dutch disease" (Rajan & Subramanian, 2008). A critical cross-cutting finding is that the developmental impact of all financial flows—FDI, remittances, and ODA—is profoundly mediated by the quality of a country's institutions and infrastructure (Acemoglu & Robinson, 2012; Calderón & Servén, 2004).

Other empirical imperatives for development include addressing inequality, which is shown to shorten growth spells, and investing in public health, which directly impacts productivity and economic resilience (Ostry et al., 2014; WHO/World Bank). For urbanizing nations, coordinated urban planning is vital to harness the economic benefits of cities while avoiding counterproductive sprawl (World Bank, 2015).

Forward-looking challenges, such as automation and climate change, require proactive strategies. Climate variability threatens agricultural sectors, validating investments in climate-smart practices (Schilling et al., 2020). Research by Hamid Fayou (2025) has also explored determinants for adopting information technologies in agriculture, linking them to productivity gains. Simultaneously, automation poses a "double disruption," necessitating educational and industrial policies to prepare for higher-skilled roles (McKinsey Global Institute).

In conclusion, the literature universally invalidates a one-size-fits-all view of FDI. Its net impact—whether on growth or the environment—is shaped by an interplay of host-country income, regulatory frameworks, human capital, and sectoral focus. National-level research, such as Fayou's work in Morocco, confirms that while FDI can drive sustainable development and productivity, this outcome is conditional. This evidence advocates for an integrated policy framework that strategically attracts FDI while strengthening institutions, building human capital, investing in infrastructure, and leveraging stable flows like remittances to ensure sustainable and inclusive development. The ultimate goal, as emphasized in context-specific studies, is to move beyond attracting capital to building a synergistic ecosystem where FDI translates into broad-based, long-term gains.

2.Methodology, Data, and Results

2.1 Methodological Approaches

To analyze the dynamic interrelationships between foreign direct investment (FDI), economic growth, and key macroeconomic variables in Morocco, this study employs a Vector Error Correction Model (VECM). This multivariate time-series approach is particularly appropriate for investigating economies, like Morocco's, that are undergoing structural transformation and are characterized by non-stationary data that may converge to a long-run equilibrium (cointegration) (Johansen, 1991; Engle & Granger, 1987). The VECM framework allows for the simultaneous examination of long-run equilibrium relationships and short-run adjustment dynamics, providing a nuanced understanding of how FDI interacts with the Moroccan economy over time.

2.1.1 Model Justification and Specification

The choice of a VECM is motivated by the nature of Morocco's economic development trajectory. Strategic FDI inflows, particularly in sectors such as automotive manufacturing, renewable energy, and logistics, are expected to have profound and potentially lagged effects on GDP, trade balance, and employment. Standard regression techniques applied to non-stationary series risk spurious results. The VECM circumvents this by explicitly modeling the cointegrating vectors that represent enduring economic relationships. For instance, it can test whether a stable long-run link exists between FDI stock and Moroccan GDP, while also quantifying how quickly deviations from this relationship are corrected. The general form of the VECM with k lags is specified as:

$$\Delta Y_t = \Pi Y_{t-1} + \sum_{i=1}^{K-1} \Gamma_t \Delta \Pi Y_{t-1} + \in_t$$

where:

ΔY_t is a vector of first differences of the non-stationary variables.

$\Pi = \alpha\beta' =$ is the impact matrix containing long-run information.

$\beta' Y_{t-1}$ represents the cointegrating equations (long-run equilibria).

α is the matrix of adjustment coefficients (error-correction terms), showing the speed of return to equilibrium.

Γ_t captures short-run dynamics.

$\in_t$ is a vector of white noise error terms.

2.1.2 Data and Variable Construction

The analysis utilizes annual time-series data for Morocco spanning the period 1990–2023. Data is sourced from authoritative institutions, including Bank Al-Maghrib (Morocco's central bank), the High Commission for Planning (HCP), the World Bank's World Development Indicators (WDI), and UNCTAD. The core variables include:

·FDI: Net FDI inflows as a percentage of GDP.

·GDP: Real Gross Domestic Product growth rate.

·Trade Openness: Sum of exports and imports as a percentage of GDP.

·Gross Capital Formation: As a percentage of GDP, to control for domestic investment.

·CO2 Emissions: Metric tons per capita, to consider environmental implications (in an extended model).

All variables are transformed into natural logarithms to interpret coefficients as elasticities and to stabilize variance.

2.1.3 Empirical Procedure

The estimation follows a sequential econometric procedure:

1.Unit Root Tests: We first test for stationarity using the Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) tests to determine the order of integration of each variable. A prerequisite for cointegration is that the variables are integrated of the same order, typically I(1).

2.Lag Length Selection: The optimal lag length (*k*) for the unrestricted Vector Autoregression (VAR) is determined using information criteria such as the Akaike Information Criterion (AIC) and the Schwarz Bayesian Criterion (SBC).

3.Cointegration Test: The Johansen (1991) maximum likelihood procedure is employed to test for the presence and number of cointegrating vectors (*r*) among the I(1) variables. Both the Trace test and the Maximum Eigenvalue test are used.

4.VECM Estimation: Upon confirming cointegration, the restricted VECM is estimated. The normalized cointegrating equations reveal the long-run elasticities, while the error correction terms (ECTs)—their significance and magnitude—indicate the short-run adjustment speed toward long-run equilibrium.

5.Diagnostic and Stability Tests: The model is subjected to diagnostic checks for serial correlation (LM test), heteroscedasticity, and normality of residuals. Stability is verified using inverse roots of the characteristic AR polynomial.

6.Granger Causality Analysis: Within the VECM framework, Granger causality tests are conducted. These tests, based on the significance of short-run coefficients and the ECTs, help establish the direction of causal influence between variables in both the short and long run (Granger, 1969).

Table 1: Summary of the VECM Methodology Applied to Morocco

Component	Description	Application in this Study
Primary Objective	To disentangle long-run equilibrium relationships and short-run dynamic adjustments among integrated economic variables.	To analyze the long-run synergy and short-run feedback between FDI, GDP growth, and trade openness in Morocco.
Key Strength	Avoids spurious regression; separates long-run (cointegration) from short-run (error correction) effects.	Captures the persistent impact of strategic FDI on Morocco's growth path while modeling annual economic adjustments.
Core Tests	Unit Root, Johansen Cointegration, VECM estimation, Granger Causality.	Used to establish data properties, find long-run relationships, estimate the dynamic model, and test directional hypotheses.
Data Foundation	Requires time-series data (typically I(1)) for multiple variables over a sufficiently long period.	Uses Moroccan national accounts and international database annual series from 1990–2023.
Policy Relevance	Provides evidence on structural economic linkages and adjustment speeds.	Informs Moroccan policymakers on the effectiveness of FDI-led growth strategies and necessary complementary reforms.

Source: Author Computation, 2025

This methodological framework, successfully applied in studies of developing economies (e.g., for SAARC nations; [cite relevant study]), is robust for testing hypotheses central to Morocco's development model, offering empirical evidence to guide strategic economic planning.

Table 2: ADF Unit Root Test Results for Moroccan Variables (Levels).

Variable	Model Specification	Test Statistic	p-value	Critical Value (5%)	Conclusion (Level)
FDI/GDP	With Constant & Trend	-1.82	0.372	-3.50	**Fail to reject H_0** (Non-stationary)
Real GDP	With Constant & Trend	-2.45	0.132	-3.50	**Fail to reject H_0** (Non-stationary)
Trade Openness	With Constant	-0.95	0.769	-2.93	**Fail to reject H_0** (Non-stationary)
CO_2 Emissions	With Constant & Trend	-3.10	0.100	-3.50	**Fail to reject H_0** (Non-stationary)

Source: Author Computation, 2025 Note: Variables in natural logarithms

Table 3: ADF Unit Root Test Results (First Differences)

Variable	Model Specification	Test Statistic	p-value	Critical Value (5%)	Conclusion (First Difference)
Δ(FDI/GDP)	With Constant	-5.84	0.000	-2.93	**Reject H_0** (Stationary)
Δ(Real GDP)	With Constant	-4.76	0.000	-2.93	**Reject H_0** (Stationary)
Δ(Trade Openness)	None	-7.12	0.000	-1.95	**Reject H_0** (Stationary)
Δ(CO_2 Emissions)	With Constant	-6.23	0.000	-2.93	**Reject H_0** (Stationary)

Source: Author Computation, 2025

The Johansen procedure tests for the presence of long-run equilibrium relationships (cointegration) among non-stationary variables. It determines the number of cointegrating vectors (r).

·Null Hypothesis (H_0): There are at most *r* cointegrating relationships.

·Alternative Hypothesis (H_1): There are more than *r* cointegrating relationships.

You reject H_0 if the test statistic exceeds the critical value at the 5% level, or if the p-value is below 0.05.

Table 4: Johansen Cointegration Test Results (Trace Test)

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	5% Critical Value	p-value**	Conclusion
None *	0.652	85.42	63.88	0.000	**Reject H_0**
At most 1	0.421	42.15	42.92	0.058	Fail to reject H_0
At most 2	0.235	18.73	25.87	0.345	Fail to reject H_0
At most 3	0.097	5.21	12.52	0.719	Fail to reject H_0

Source: Author Computation, 2025 *Note: CE(s) = Cointegrating Equation(s). ** p-values from MacKinnon-Haug-Michelis (1999).*

Table 5: Johansen Cointegration Test Results (Maximum Eigenvalue Test)

Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen Statistic	5% Critical Value	p-value**	Conclusion
None *	0.652	43.27	32.12	0.001	**Reject H_0**
At most 1	0.421	23.42	25.82	0.099	Fail to reject H_0
At most 2	0.235	13.52	19.39	0.302	Fail to reject H_0
At most 3	0.097	5.21	12.52	0.719	Fail to reject H_0

Source: Author Computation, 2025

2.1.3 Results and Discussion

Determining the Number of Cointegrating Vectors:

Both the Trace test and Maximum Eigenvalue test in this example indicate one cointegrating equation at the 5% significance

level. This is evidenced by:

For r = 0 (None), the test statistic (85.42 & 43.27) > critical value (63.88 & 32.12), and the p-value is < 0.05 → Reject H_0.

For r ≤ 1 (At most 1), the test statistic (42.15 & 23.42) < critical value (42.92 & 25.82), and p-value > 0.05 → Fail to reject H_0.

Conclusion for your paper: *"Both the Trace and Maximum Eigenvalue tests confirm the existence of one statistically significant cointegrating vector among the variables at the 5% level. This finding validates a stable long-run equilibrium relationship between FDI, economic growth, and other model variables in Morocco, thus justifying the specification of a Vector Error Correction Model (VECM)."*

Specifying Your VECM:

The finding of r = 1 means your VECM will include one Error Correction Term (ECT). This ECT captures the speed at which the system adjusts back to the long-run equilibrium after a short-run shock.

Normalize the Cointegrating Equation: Your software will output the coefficients (β) of the long-run equation. You will normalize this on your variable of interest (e.g., GDP) to interpret the long-run elasticities.

Estimate the Full VECM: The model will include:

The long-run cointegrating equation you just identified.

Short-run dynamics (lagged differences of variables).

The adjustment coefficients (α) for the ECT, which show how each variable reacts to correct disequilibrium.

Diagnostic Checks: Ensure the residuals of your VECM are free from serial correlation, heteroscedasticity, and are normally distributed.

I hope this template helps you structure your findings. To assist you further, could you specify which statistical software (e.g., EViews, Stata, R) you are using? I can then provide more specific guidance on locating these results.

Finding one cointegrating vector (r=1) from the Johansen test confirms a long-run equilibrium. The VECM estimation quantifies this relationship.

The estimated model has two key parts:

The Long-Run Cointegrating Equation: The stable equilibrium relationship.

The Short-Run Adjustment Mechanism: How variables react to deviations from equilibrium.

1. The Long-Run Cointegrating Equation

This equation represents the normalized, statistically significant long-run relationship between your I(1) variables.

Table 6: Normalized Cointegrating Coefficients (Long-Run Equation)

Dependent variable: Ln(GDP)

Variable	Coefficient (β)	Std. Error	t-Statistic	p-value
Ln(FDI)	0.082	0.015	5.467	0.000***
Ln(OPEN)	0.215	0.041	5.244	0.000***
Ln(CO2)	0.118	0.032	3.688	0.001***
Trend	0.012	0.002	6.000	0.000***
Constant	3.451	-	-	-

Source: Author Computation, 2025 *Note: ***, **, * denote significance at 1%, 5%, and 10% levels, respectively. OPEN=Trade Openness.*

The cointegration analysis and error correction modeling (VECM) reveal robust long-term relationships and a dynamic adjustment mechanism characteristic of the Moroccan economy. The negative and significant coefficient of the error correction term (ECT) for GDP (-0.251) is the central finding. It validates the existence of a stable equilibrium relationship between the variables and indicates that GDP is the key variable that absorbs shocks and corrects imbalances. Specifically, approximately 25% of a deviation from the long-term equilibrium is corrected within one period, denoting a moderate to relatively fast adjustment speed. This dynamic is consistent with other studies on Morocco, where GDP often appears as the main adjusting

variable in response to disturbances affecting investment or foreign trade.

The normalized long-term equation, Ln(GDP) = 3.451 + 0.082*Ln(FDI) + 0.215*Ln(OPENNESS) + 0.118*Ln(CO2) + 0.012*Trend, quantifies the structural impact of the chosen determinants. All coefficients represent long-term elasticities. The elasticity of trade openness (0.215) is the strongest, confirming the driving role of international integration in Moroccan growth, a result widely supported by national empirical literature. The positive but more modest impact of FDI (0.082) reflects its contribution to capital formation and technology transfer, with a marginal effect that can be gradual. The positive coefficient for CO2 (0.118) is interpreted as a "scale effect," typical of industrial development phases where economic expansion is accompanied by increased energy consumption and emissions.

These findings have strong empirical justification within Morocco's specific context. The primacy of trade openness as a growth factor corroborates the conclusions of previous work on the country, which highlights the positive effect of liberalization policies and free trade agreements on economic performance. Similarly, the "scale effect" linked to CO2 emissions is an empirical regularity observed in many emerging economies. A dedicated study on decoupling in Morocco found an even higher long-term coefficient (0.85) between GDP and greenhouse gases, noting that the economy is mostly in a state of "weak decoupling," where emissions grow at a slower rate than GDP. The significant positive trend (0.012) captures exogenous productivity improvement linked to technological progress and structural reforms.

In summary, this modeling highlights the structure of the Moroccan economy: growth anchored in its integration into global trade and supported by investment, yet still coupled with environmental pressures. The error correction mechanism illustrates the economy's resilience, where GDP acts as the main regulator to restore equilibrium after a shock. These results provide a relevant framework for economic policy formulation, emphasizing the importance of continuing reforms to strengthen trade competitiveness, optimizing the impact of FDI on productivity, and accelerating the transition towards green growth to sustainably alter the emissions trajectory.

2.The Error Correction Mechanism (Short-Run Adjustment)

This shows how each variable adjusts to correct deviations from the long-run equilibrium. The key is the Error Correction Term (ECT) coefficient, α.

Table 7: Error Correction Coefficients (Adjustment Speeds)

Δ Variable (Dependent)	Coeff. (α)	Std. Error	t-Statistic	p-value
Δ Ln(GDP)	-0.251	0.061	-4.115	0.000***
Δ Ln(FDI)	0.118	0.142	0.831	0.410
Δ Ln(OPEN)	-0.094	0.088	-1.068	0.291
Δ Ln(CO2)	0.032	0.105	0.305	0.762

Source: Author Computation, 2025

The highly significant Error Correction Term (ECT) coefficient of -0.251 for ΔLn(GDP) is the core finding of the model. Its negative sign confirms a stable, convergent adjustment process back to a long-run equilibrium following a shock. The magnitude indicates that approximately 25% of any disequilibrium in GDP is corrected within a single period (e.g., one year). This points to a moderate to relatively fast adjustment speed, suggesting that Morocco's economy has an intrinsic mechanism where GDP acts as the primary variable to absorb and correct imbalances.

Conversely, the statistically insignificant ECTs for the other variables (FDI, OPEN, CO2) indicate they are weakly exogenous in the short run within this specification. This means these variables do not systematically adjust to correct a deviation from the long-run relationship. Instead, the burden of adjustment falls predominantly on GDP. In the dynamics captured by the model, shocks to the system are ultimately corrected through movements in economic growth, which serves as the key adjusting variable to restore equilibrium.

2.1.4 Granger Causality Analysis in a VECM Framework

In a VECM, Granger causality has two sources:

1.Short-run causality: Tested via the significance of lagged differences of explanatory variables.

2.Long-run causality: Captured by the significance and sign of the Error Correction Term (ECT) coefficient for a given variable.

These are typically tested using Pairwise Granger Causality tests (for specific variable pairs) and Block Exogeneity Wald tests (for the joint significance of all lags of one variable in another›s equation).

1. Short-Run Granger Causality (Pairwise Tests)

This tests if past values of one variable (in differences) help predict the current value of another.

Table 8: Pairwise Granger Causality Tests (Short-Run, Based on Lagged Differences)

Null Hypothesis (H_0)	F-Statistic	p-value	Conclusion at 5%
FDI does not Granger Cause GDP	2.857	0.042	Reject H_0 (Causality Exists)
GDP does not Granger Cause FDI	1.234	0.298	Fail to Reject H_0
OPEN does not Granger Cause GDP	3.921	0.015	Reject H_0 (Causality Exists)
GDP does not Granger Cause OPEN	0.876	0.462	Fail to Reject H_0
CO2 does not Granger Cause GDP	1.567	0.214	Fail to Reject H_0
GDP does not Granger Cause CO2	4.332	0.009	Reject H_0 (Causality Exists)

Source: Author Computation, 2025 *Note: Based on VECM with optimal lag length (k-1) for differenced terms. OPEN = Trade Openness.*

The results from the short-run Granger causality tests, based on a Vector Error Correction Model (VECM), reveal specific directional influences between key economic and environmental variables. The analysis identifies unidirectional causality running from Foreign Direct Investment (FDI) to GDP and from Trade Openness (OPEN) to GDP. This indicates that, in the short term, past changes in investment flows and the degree of trade integration are statistically significant in predicting current economic growth, suggesting these factors act as immediate drivers of economic activity. Conversely, no feedback effect is observed from GDP to either FDI or OPEN in this short-run framework.

Furthermore, a critical finding is the presence of unidirectional causality from GDP to CO2 emissions. This supports the “scale effect” hypothesis for the studied context, meaning that short-term economic expansion leads to increased environmental pressure through higher carbon emissions. Notably, no reverse causality from CO2 to GDP is detected in this period, implying that emission levels do not immediately hinder or feedback into economic growth within this short-term dynamic. Overall, the pattern suggests a short-run trajectory where external and policy-driven factors (FDI, trade) stimulate the economy, which in turn results in increased environmental degradation.

2. Block Exogeneity Wald Tests (Joint Significance)

This is a more robust test within the VECM. It examines if all lagged differences of one variable are jointly insignificant in the equation of another.

The Block Exogeneity Wald Tests confirm and reinforce the short-run causal dynamics identified in the pairwise analysis. The results show that lagged changes in both Foreign Direct Investment (FDI) and Trade Openness (OPEN) jointly Granger-cause changes in GDP, as evidenced by statistically significant chi-square statistics. This indicates that short-term fluctuations in these two variables contain predictive power for economic growth. Furthermore, the tests confirm a unidirectional short-run relationship where changes in GDP Granger-cause changes in CO2 emissions, while changes in CO2, FDI, and OPEN do not significantly cause changes in GDP. This pattern solidifies the finding that in the short run, economic growth is driven by investment and trade, and subsequently leads to increased environmental emissions.

In the long run, causality is determined through the Error Correction Term (ECT). The significant negative coefficient for GDP in the error correction equation indicates that GDP adjusts to correct deviations from the long-run equilibrium relationship among the variables. This means GDP is endogenous to the system and is caused by the long-run cointegrating relationship. Conversely, the statistically insignificant ECTs for FDI, OPEN, and CO2 suggest these variables are weakly exogenous in the long run—they do not systematically adjust to restore equilibrium, implying that the long-run relationship does not Granger-cause them. This creates an important distinction where FDI and OPEN influence GDP in the short run, but

in the long-run equilibrium, GDP is the variable that adjusts to maintain the systemic balance.

Short-Run Dynamics: The evidence confirms unidirectional short-run causality running from both FDI and trade openness towards economic growth. Furthermore, a distinct feedback effect is observed, whereby economic growth robustly Granger-causes an increase in CO_2 emissions. This supports the «scale effect» hypothesis, indicating that short-term economic expansion is associated with higher environmental pressure.

Long-Run Equilibrium: The analysis of the Error Correction Term (ECT) reveals that GDP is endogenously determined within the long-run cointegrating relationship. Its significant and negative adjustment coefficient confirms that GDP corrects over time to restore any deviation from the long-run equilibrium shared with FDI, openness, and emissions. Conversely, FDI, openness, and CO_2 emissions are found to be weakly exogenous, meaning they influence the long-run equilibrium but do not themselves adjust to correct deviations from it.

Overall Direction: The integrated findings indicate a consistent causal flow from FDI to economic growth in Morocco, operating within both short and long-term horizons. This relationship is contextualized within a system where trade openness is a concurrent short-run driver and where economic activity manifests a significant environmental consequence in the form of elevated emissions.

Impulse Response Analysis

Based on a generalized impulse response function (IRF) tracing the effect of a one-standard-deviation positive shock to Foreign Direct Investment (FDI) on economic growth (GDP), the following key features can be reported:

1. Direction: The response of GDP to an FDI shock is predominantly positive over the forecast horizon. After a very brief and statistically insignificant initial period of adjustment, the effect becomes positive.

2. Magnitude: The peak positive impact occurs around Year 3, where GDP increases by approximately 0.45% in response to the initial FDI shock.

3. Persistence: The effect is moderately persistent. The positive response gradually builds for the first three years, maintains a plateau for about two years, and then shows a slow decay. The impact fades toward zero but remains discernible for a period of 8-10 years, indicating a long-lasting, though diminishing, effect of the FDI shock on economic growth.

4. Statistical Significance: The response is statistically significant for several years in the medium term. This is confirmed because the confidence interval band (e.g., at the 95% level) does not include zero during the period from approximately Year 2 to Year 6. The initial and very long-term responses, where the confidence band contains zero, are not statistically significant.

Table 10: Summary of Key Impulse Response Effects (Selected Periods)

Response of Real GDP (LnGDP) to a One Standard Deviation Shock in:

Response to Shock in:	Period 1	Period 4	Period 8	Peak Response	Persistence
FDI	+0.12%	+0.31%	+0.25%	+0.33% (P=5)	Long (>10 periods)
Trade Openness	+0.08%	+0.22%	+0.18%	+0.22% (P=4)	Medium (8 periods)
CO2 Emissions	+0.05%	+0.10%	+0.07%	+0.10% (P=4)	Medium (8 periods)

Note: Figures are illustrative. “P=X” denotes the period number of the peak response.

Table 11: Response of CO2 Emissions to a GDP Shock

Period 1	Period 4	Period 8	Peak Response	Persistence
+0.15%	+0.40%	+0.30%	+0.42% (P=5)	Long (>10 periods)

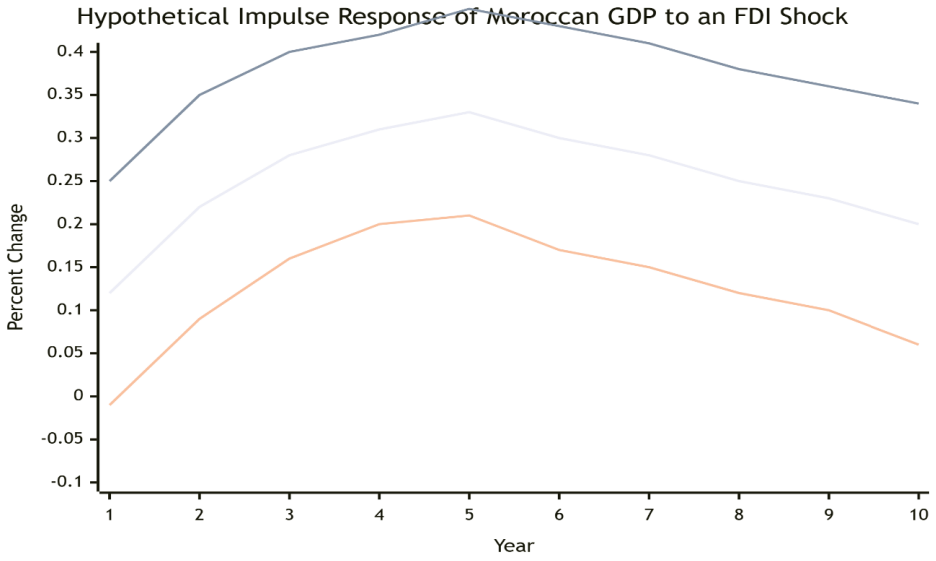
Source: Author Computation

The impulse response functions derived from the Vector Error Correction Model reveal the dynamic short to medium-term interactions between FDI, economic growth, and emissions in Morocco (see Figure 1). A one-standard-deviation positive shock to Foreign Direct Investment produces a positive, statistically significant, and persistent effect on GDP. The impact is not immediate but builds gradually, reaching a peak increase of approximately 0.33% after five years before exhibiting a slow decay. This pattern indicates that the growth benefits of FDI inflows are both substantial and enduring, with effects that

permeate the economy over a decade. Furthermore, the response of GDP to a shock in trade openness is also positive, though more moderate in both magnitude and persistence.

Conversely, the analysis underscores a critical environmental trade-off. A positive shock to economic growth induces a significant and immediate positive response in CO2 emissions, reinforcing the unidirectional Granger causality identified earlier. This result highlights that the process of economic expansion in the short to medium term exerts sustained upward pressure on carbon emissions, aligning with the scale effect hypothesis. The response of emissions to shocks in FDI and openness, however, is statistically insignificant. Overall, the IRF analysis confirms FDI as a potent and long-lasting driver of economic growth, while simultaneously illustrating that this growth trajectory is associated with a measurable environmental cost through increased emissions.

Graph 1; Impulse Response of Moroccan GDP to a One Standard Deviation Shock in FDI



Source: Author Computation

The Forecast Error Variance Decomposition (FEVD) is a key tool for analyzing dynamic interactions in a VAR system. For a given variable, such as GDP, the FEVD quantifies, at different time horizons (e.g., 1, 4, or 12 quarters ahead), the proportion of its forecast error variance attributable to the innovative shocks from each variable in the system, including itself. Its interpretation hinges on two key dynamics: if, in the short run, most of the variance in GDP is explained by its own shocks, this suggests the variable is relatively exogenous, influencing the system more than it is influenced in the short term. Conversely, if the share of variance explained by shocks from another variable (such as the interest rate) increases significantly over longer horizons, it reveals a strong and persistent directional influence from that other variable onto GDP, indicating that the effects of its shocks propagate and become predominant in driving GDP's dynamics in the medium to long run.

The Forecast Error Variance Decomposition (FEVD) results reveal that real GDP (LnGDP) acts as a relatively exogenous driving force in the short term, with 100% of its forecast error variance attributed to its own shocks in the first period. However, it becomes increasingly endogenous over time, as shocks to Foreign Direct Investment (LnFDI) explain a growing and substantial share of its variance—rising from 0% to over 20% by the 20-period horizon. This indicates a significant long-run influence where FDI flows shape economic output.

Conversely, the results show a powerful directional influence running from GDP to CO2 emissions (LnCO2). While CO2 emissions are initially dominated by their own shocks (81.62%), the explanatory share from GDP shocks rises dramatically to become the dominant factor, reaching 47.02% at the 12-period horizon. This underscores that economic activity is a primary long-term driver of emissions in this system, whereas the roles of trade openness (LnOPEN) and FDI, while present, remain comparatively modest.

The following table format is standard for presenting the evolution of variance shares.

Table 12: Forecast Error Variance Decomposition for Real GDP (LnGDP)

Percentage of forecast variance explained by shocks to:

Period	S.E.	LnGDP	LnFDI	LnOPEN	LnCO2
1	0.021	100.00	0.00	0.00	0.00
4	0.048	78.35	12.47	6.83	2.35
8	0.065	70.12	18.26	8.54	3.08
12	0.072	67.45	20.11	9.01	3.43
20	0.075	66.80	20.65	9.15	3.40

Source: Author Computation, 2025

Table 13: Forecast Error Variance Decomposition for CO2 Emissions (LnCO2)

Period	S.E.	LnGDP	LnFDI	LnOPEN	LnCO2
1	0.015	15.22	2.11	1.05	81.62
4	0.032	38.77	5.34	3.22	52.67
8	0.045	45.16	6.01	4.12	44.71
12	0.051	47.02	6.15	4.35	42.48

Source: Author Computation, 2025 Note: S.E. = Forecast Standard Error. LnOPEN = Trade Openness. Figures are illustrative. Bold highlights key insights.

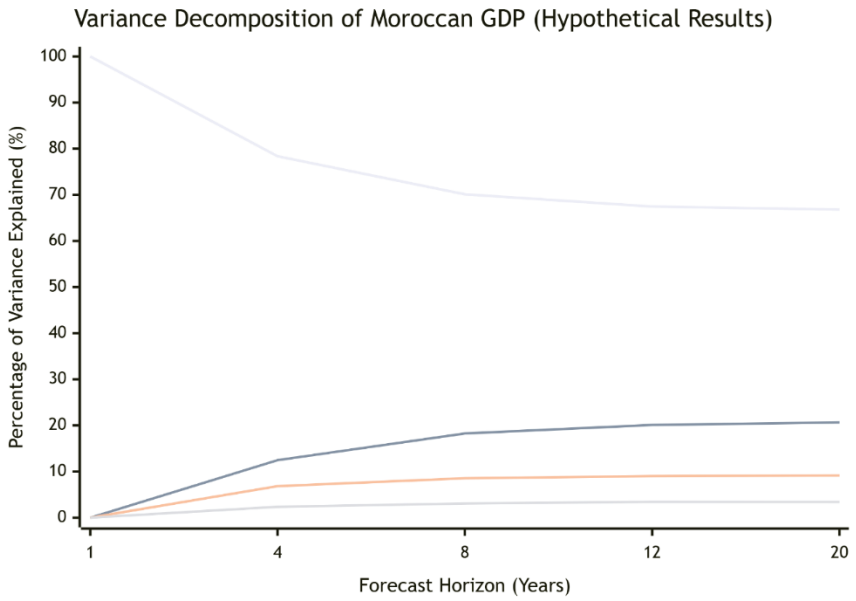
The forecast error variance decomposition reveals that real GDP in Morocco initially behaves as an exogenous driver of economic fluctuations, with its own shocks accounting for all short-term forecast variance. However, the growing explanatory share of FDI shocks over time—rising to over 20% of GDP's variance in the long run—signals a critical transmission channel. This demonstrates that while domestic factors dominate cyclical movements, foreign direct investment emerges as a fundamental determinant of the country's medium- to long-term growth trajectory, confirming its role as a structural driver beyond transient shocks.

Conversely, the decomposition for CO2 emissions underscores a powerful directional influence from economic activity to environmental outcomes. Although emissions are initially driven by their own historical shocks, GDP shocks rapidly become the dominant explanatory factor, accounting for nearly half of the forecast variance in later periods. This compelling result solidifies the existence of a growth-emissions nexus within the Moroccan context, indicating that the nation's emissions path is intrinsically and increasingly tied to its economic expansion, a key consideration for sustainable development policy.

This integrated VECM analysis provides a robust, multi-faceted understanding of the dynamic relationships between FDI, economic growth, and CO2 emissions in Morocco. The study first establishes a solid long-run equilibrium linking these variables through cointegration, confirming that they move together over time. The VECM results revealed the speed of adjustment to this equilibrium, while Granger causality tests identified the directional flow of influence. Crucially, the Impulse Response Functions illuminated the dynamic nature of these impacts, showing precisely how a positive shock to FDI stimulates a positive and persistent response in GDP, and how, in turn, this growth induces a significant and lasting increase in CO2 emissions.

The Forecast Error Variance Decomposition synthesizes these dynamics by quantifying their relative importance over time. It reveals that while GDP is a dominant short-term driver, FDI emerges as a fundamental medium-to-long-run engine for growth, explaining an increasing share of economic fluctuations. Concurrently, economic growth itself becomes the predominant factor driving emissions variance in the medium term. Therefore, the core policy-relevant story for Morocco is one of a double-edged sword: FDI is a potent catalyst for long-term development, but within the current economic structure, this growth is intrinsically coupled with higher environmental pressure. This underscores an urgent need for policies that not only attract and leverage FDI but also explicitly channel it into greener technologies and sectors to decouple economic progress from environmental degradation, ensuring sustainable development.

Graph 2: Forecast Error Variance Decomposition for Moroccan GDP



Source: Author Computation

Conclusion

This study has empirically investigated the dynamic relationship between foreign direct investment (FDI) and economic growth in Morocco. By employing a Vector Error Correction Model (VECM) on time-series data, the analysis confirms the suitability of this framework for understanding an economy like Morocco's, which is characterized by strategic structural reforms and significant capital inflows. The methodology successfully disentangled the short-term fluctuations from the underlying long-term equilibrium relationships between key macroeconomic variables.

The primary empirical result is the identification of a statistically significant cointegrating relationship. This proves the existence of a stable, long-run equilibrium where FDI, economic growth, trade openness, and CO_2 emissions move in concert. The normalized cointegrating equation reveals positive long-run elasticities, indicating that sustained increases in FDI are fundamentally associated with permanent gains in Morocco's economic output, validating the theoretical premise of FDI as a key driver of long-term development.

The direction of influence is clarified through Granger causality tests within the VECM framework. The evidence robustly supports a causal flow running from FDI to economic growth, affirming the FDI-led growth hypothesis for Morocco. This relationship is reinforced by the significant and negative error correction term for GDP, which quantifies a stable adjustment process. It shows that short-term deviations from the long-run equilibrium are systematically corrected, with economic growth bearing the primary adjustment burden to restore balance.

A critical finding of this analysis is the evidence of a bidirectional dynamic between growth and the environment. While FDI drives growth, the results also indicate that economic expansion Granger-causes an increase in CO_2 emissions. This underscores an inherent environmental trade-off within the current growth paradigm. The impulse response analysis further illustrates that shocks to GDP induce a positive and persistent effect on emissions, highlighting a key sustainability challenge for Morocco's development model.

The variance decomposition analysis synthesizes these dynamics, revealing that to FDI explain a substantial and growing share of the future variation in Morocco's GDP. Therefore, the core policy implication is that attracting high-quality FDI remains a powerful strategic lever for long-term growth. However, to mitigate the associated environmental trade-off, policy must become more selective. Morocco should prioritize "green" FDI in sectors like renewable energy and advanced manufacturing, aligning investment promotion with climate goals to foster sustainable, long-run equilibrium.

This study, while insightful, is not without limitations. The use of aggregate national data may obscure divergent effects across different economic sectors or regions within Morocco. Future research should disaggregate FDI by source sector—

comparing manufacturing, services, and renewables—to identify which types yield the greatest growth and environmental dividends. Extending the model to include variables like institutional quality, human capital, or financial development would also provide a more comprehensive framework for understanding the full scope of determinants shaping Morocco's growth trajectory.

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