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The rise of the geopolitical tensions and its impact on FDI flow in Morocco

La montée des tensions géopolitiques et son impact sur les flux d'IDE au Maroc

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Abstract:

Morocco has attempted to attract FDI (Foreign Direct Investment). However, geopolitical tensions are contributing to changes in the economy worldwide. These flows start to shrink globally, and Morocco is marked lately by fluctuations in FDI and changes in their country of origin. Moreover, the resilience capabilities are important in attenuating these risks and taking advantage of the fragmentation of FDI. From this perspective, Morocco attempts to attract more FDI from different regions to invest in new sectors. The country has several advantages. Nevertheless, some inadequacies, such as geopolitical tensions and vulnerabilities, threaten its efforts. In this study, we examine the extent to which geopolitical risks are reshaping FDI in Morocco in the backdrop of the recent rising geopolitical tensions. We also analyze the role of vulnerability factors and resilience capabilities of Morocco in FDI fragmentation. To address these issues, we use a correlation test between geopolitical tensions and FDI, and we use the multidimensional index of vulnerability to determine the structural aspects that threaten FDI in Morocco and the manifestations of FDI fragmentation. Our results confirm that Morocco is not immune to the impact of geopolitical tensions on FDI. This requires policy adjustment to attenuate these risks and take advantage of the actual situation.

Key words: Attraction of FDI, geopolitical risks, vulnerabilities, fragmentation of FDI.

Résumé:

Le Maroc tente d'attirer les IDE (Investissement direct étranger). Cependant, les tensions géopolitiques contribuent aux changements dans l'économie mondiale. Ces flux commencent à se réduire à l'échelle mondiale, et le Maroc est marqué ces derniers temps par des fluctuations des IDE et changements de leur pays d'origine. Néanmoins, les capacités de résilience sont importantes pour atténuer ces risques et tirer parti de la fragmentation des IDE. Dans cette perspective, le Maroc s'efforce d'attirer davantage d'IDE de différentes régions pour investir dans de nouveaux secteurs. Le pays dispose de plusieurs atouts. Cependant, certaines insuffisances, telles que les tensions et vulnérabilités géopolitiques, menacent ses efforts. Dans cette étude, nous examinons dans quelle mesure les risques géopolitiques remodèlent les IDE au Maroc dans le contexte de la récente montée des tensions géopolitiques. Nous analysons également le rôle des facteurs de vulnérabilité et des capacités de résilience du Maroc dans la fragmentation des IDE. Pour répondre à ces questions, nous utilisons un test de corrélation entre les tensions géopolitiques et les IDE, et nous utilisons l'indice multidimensionnel de vulnérabilité pour déterminer les aspects structurels qui menacent les IDE au Maroc et les manifestations de la fragmentation des IDE. Nos résultats confirment que le Maroc n'est pas à l'abri de l'impact des tensions géopolitiques sur les IDE. Il est donc nécessaire d'ajuster ses politiques pour atténuer ces risques et tirer profit de la situation actuelle.

Mots clés: attraction des IDE, risques géopolitiques, vulnérabilités, fragmentation des IDE.

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1 . Introduction

In the era of geopolitical tensions, the role of the state in making or orienting its public policies is becoming more relevant and manifest in order to adapt to new constraints that are reshaping the world today. Although public policies have been complex actions marked by conflicts and interests, these conflicts are becoming more acute and destabilize the world economy.

In this new context, economic policies are oriented to face a more acute and complex problem that threatens the existence of communities, countries, and nations, and not only to correct social and economic problems. This shift in the aim of economic policies is starting to change in favor of protectionism and nationalism, and they are directing the economy to face new geopolitical tensions.

Many countries, especially Europe, are redirecting their economies toward an economy of war. In that sense, the capacity of the state to direct the economy affects the investment of the private sector, which has to follow what the states are aiming to realize in terms of developing their military capabilities and reinforcing its economic independence. This shift has been conducted despite many restrictions determined by international agreements or fiscal policies.

The rise of public expenditure beyond the restriction of Maastricht will affect other public policies, especially social policy and some sectorial policies. Moreover, the reinforcement of sovereign reserves obliges states to change their latest policies to meet domestic needs. The comparative advantages are no longer in service of exportation, but to reinforce external resilience in the face of vulnerabilities, especially the shortage of foreign supply. This affects the flow of FDI worldwide and these fluxes are becoming subject to fragmentation.

This change is going to affect more of the other countries that depend not only on FDI but also on importation in order to satisfy their internal need for agricultural or manufactured goods. Morocco is among the countries that are faced by this probable prepared shift; however, it is not a menace to the Moroccan economy, but it could be an opportunity to adjust the structure of its economy to meet this change.

The policy of attracting FDI in Morocco is part of a large investment policy that includes the rise of private investment in total investment. The ultimate goal is to contribute to the socioeconomic development of the country. To realize this goal, Morocco has sub-goals that will contribute to the acceleration of the transformation of the country; it passes by integrating its economy, especially the industry within global value chains (GVN). Thus, attracting FDI became a priority for Morocco.

The adjustment of this policy holds the premise of creating a less dependent economy not only for Morocco but also for similar countries. This adjustment would help create a more balanced world where the disparities are not destabilizing; therefore, the main question of this paper is how geopolitical tensions affect FDI in Morocco, its manifestation in the economy, and how the latest is going to benefit from this shift.

To answer these questions, we analyze the manifestations and effects of geopolitical tensions on FDI and the vulnerabilities that are going to exacerbate the situation in Morocco. This study aims to trace the risks of correcting them through policy adjustment.

In this perspective, the hypotheses of this paper are:

H1: The GPR negatively affects the FDI in Morocco,

H2: The vulnerabilities in Morocco threaten the FDI,

H3: Morocco might benefit from the FDI fragmentation.

To verify these hypotheses, we use a correlation test between geopolitical tensions and FDI and use the multidimensional index of vulnerability to determine the structural aspects that threaten FDI in Morocco and the manifestations of FDI fragmentation in Morocco.

In addition, this study is based on a literature review that demonstrates how geopolitical risks affect macro-financial stability. It emphasizes the role of major geopolitical events in the increase of economic and financial uncertainty, which undermines investment decisions, and how political alignment might favor FDI.

2. Literature review

This literature review aims to understand how GPR affects FDI and the economy.

First, we need to understand the channels through which geopolitical risks affect FDI. To do so, we compile a literature review that is large and features different aspects in a different disciplinary framework in order to apprehend the relationship between GPR and economic aggregate, and its impact on FDI.

Different approaches have been used to assess the relationship between GPR and FDI. It first started with an analysis of the impact of political and economic risks on FDI, especially the work of Ramcharran (1999), who used Euromoney's Country Risk Data index to measure political and economic risks and their impact on FDI; his findings on 26 countries over the period 1992-1994 affirmed a negative impact on FDI in case of an increase in political and economic risks.

Recently, inward-looking policies have become more manifest to adjust inequalities in the past gain of globalization (Colantone and Stanig, 2018; Rodrik, 2018; Autor et al., 2020; Pastor and Veronesi, 2021). Multilateralism is threatened by the rise of conflict worldwide. This situation created what qualifies as the “slowbalisation, ” particularly after the financial crisis (Antràs, 2020; Baldwin, 2022). This situation created a slowdown on FDI with global FDI declining from 3.3 percent of GDP in the 2000s to 1.3 percent between 2018 and 2023(Shekhar Aiyar, Davide Malacrino, and Andrea F. Presbitero 2023).

However, Blonigen(2005) and Piger(2014) emphasize that one of the most important determinants of FDI is geographic proximity, which is not always the only reason. Morocco has managed to attract investment from many distant countries characterized by promising opportunities, such as China and Usa.

Diplomatic and political relations played a crucial role in attracting FDI from those countries, as confirmed by (Desordes, 2010) and the work of (Li, Meyer, Zhang and Ding,2018). Moreover, geopolitical alignment is associated with larger aid flows and favors FDI flux (Shekhar Aiyar, Davide Malacrino, and Andrea F. Presbitero 2023).

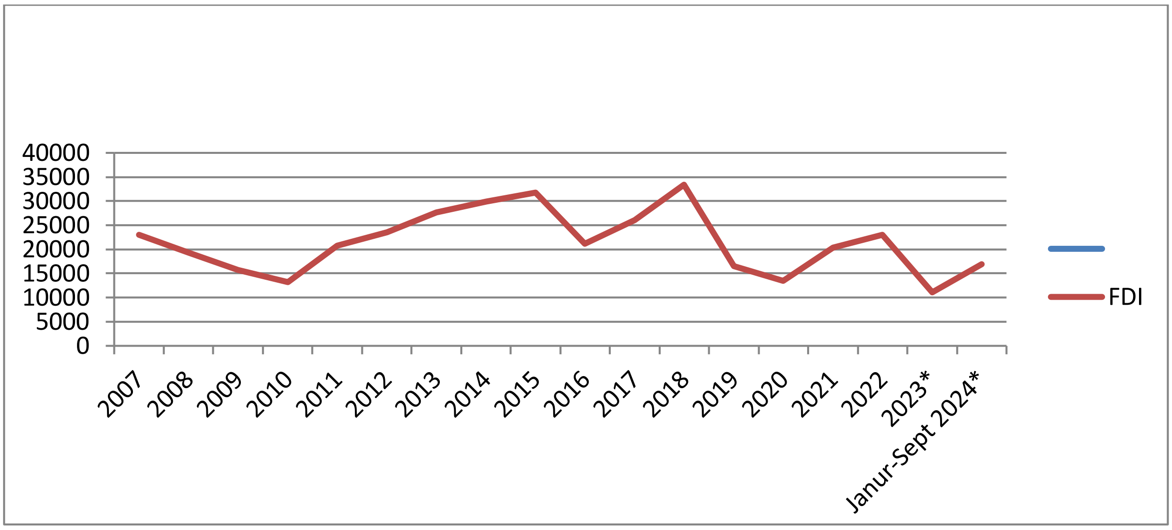
3. Methodology

To Measure the correlation between geopolitical tension risks and the flow of Foreign Direct Investment (FDI) to Morocco, we use data from 2007 to 20024. The main objective of this study is to confirm or deny what has been announced in the literature review concerning the impact of geopolitical tension on FDI. After this test, we apply the multidimensional index of vulnerability to FDI to the case of Morocco to examine its vulnerabilities and resilience that threaten FDI. This is followed by an examination of how Morocco is affected by the fragmentation of FDI, which concerns many economic sectors and different regions worldwide because of the rise of geopolitical tensions.

4. Tests and results

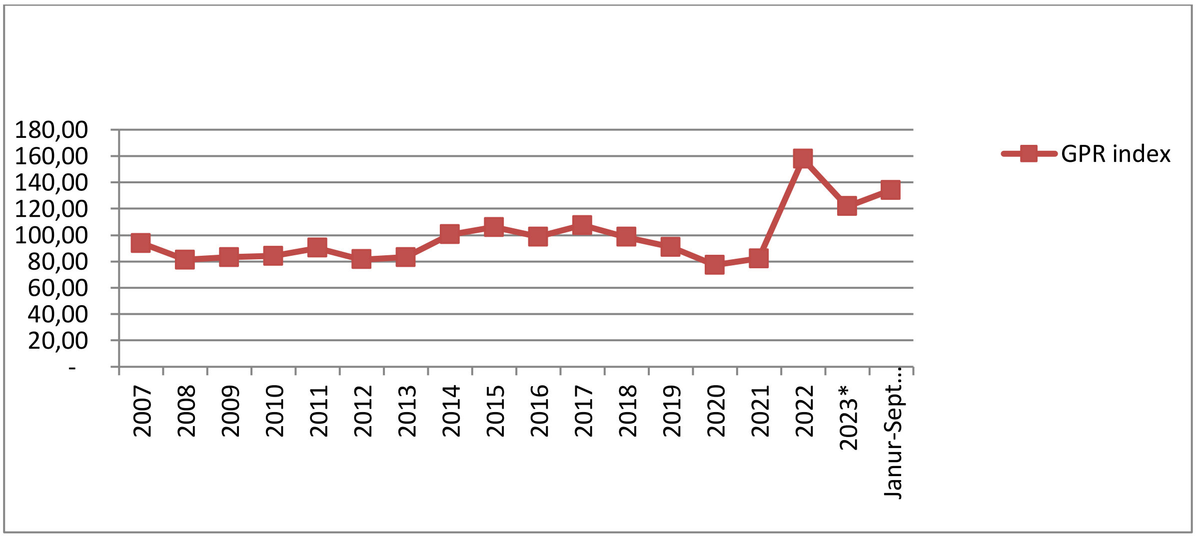
H1: The GPR negatively affects the FDI in Morocco.

Graph 1: FOREIGN DIRECT INVESTMENT IN MOROCCO In millions of dirhams



Source: Prepared by us using data from the Moroccan Foreign Exchange Office

Graph 2: The annual Geopolitical Risk Index



Source: Prepared by us using GPR Index elaborated by Dario Caldara and Matteo Iacoviello

The correlation between GPR and FDI shows that there is a weak correlation between the two tins in the case of Morocco; the correlation coefficient is around 0.06 between 2007 and 2024.

However, since 2022, the increase in geopolitical risk that reached 157.78 is followed in the same year by a drop of FDI in 2023 to reach only 11090 million dirhams[1] after it was 22 964 million dirhams; though the impact of the GPR risk is marked by a one-year lag effect, which was not remarked in 2017 when the GPR reached 107.38, and FDI in Morocco reached a

[1] Moroccan Dirham to USD average Exchange Rate is 9.00 between 2007 and 2023

peak of 33404 million dollars, before it dropped in 2019 to 16541 millions dirhams, a year that preceded the Covid 19 sanitary crisis marked by a drastic full on FDI.

However, the effect of the sanitary crises did not affect FDI as the GPR risk on 2022 marked by Russia invading Ukraine on February 24, 2022, and the effects of this war lagged until 2023 when it reached its lowest level, a drop of more than 50% compared to 2022. This geopolitical crisis has negatively affected the evolution of FDI, despite the evolution of 2024 FDI, which reached 17200 million dirhams.

H2: The vulnerabilities in Morocco threaten the FDI

Table 1: Structural vulnerability index and lack of resilience index

Structural Vulnerabilities	Manifestation of vulnerability	Structural vulnerability index	Lack of structural resilience index
Economic vulnerability	Dependence on agriculture	28.8	25.3
	Reliance on imports(especially energy)		
	the part of tourism on export		
	MRE remittance		
	FDI inflows		
Environmental vulnerability	Water scarcity	53.2	68.8
	Climate change		
Social vulnerability	Youth unemployment	4.2	45.1
	Persistent inequality		
	regional disparities		

Source: Prepared by us using the Multidimensional Vulnerability Index (United Nations 2024)

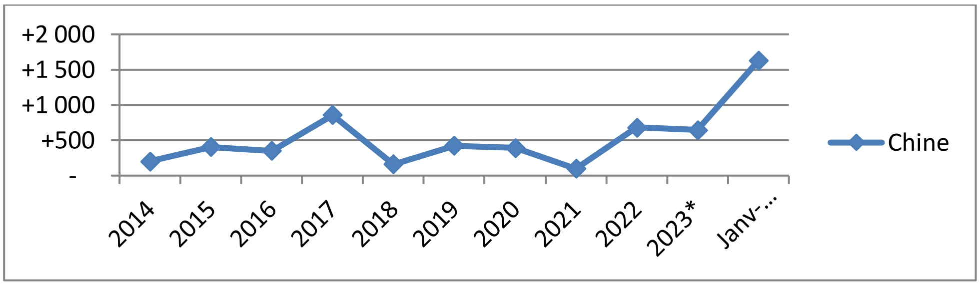
The scores of Morocco classify it as the country least vulnerable and resilient, with a score of MVI that reaches 43 and a score of lack of structural resilience index of 49,7. Even if Morocco has realized a lower vulnerability index in the economy of 25,3; the environment vulnerability reaches 68,8; which is a high score. For social vulnerability, it was close to the median of 45. The correlation between vulnerability and resilience confirmed that a lack of resilience affects vulnerability in Morocco. This is especially relevant to the economy.

H3: Morocco might benefit from the fragmentation

The evidence of FDI fragmentation is clear based on an analysis of the change in FDI flow after the 2008 financial crisis. This change is due to technological changes. This means that FDI seems to invest in aligned countries that represent advantages in new technologies.

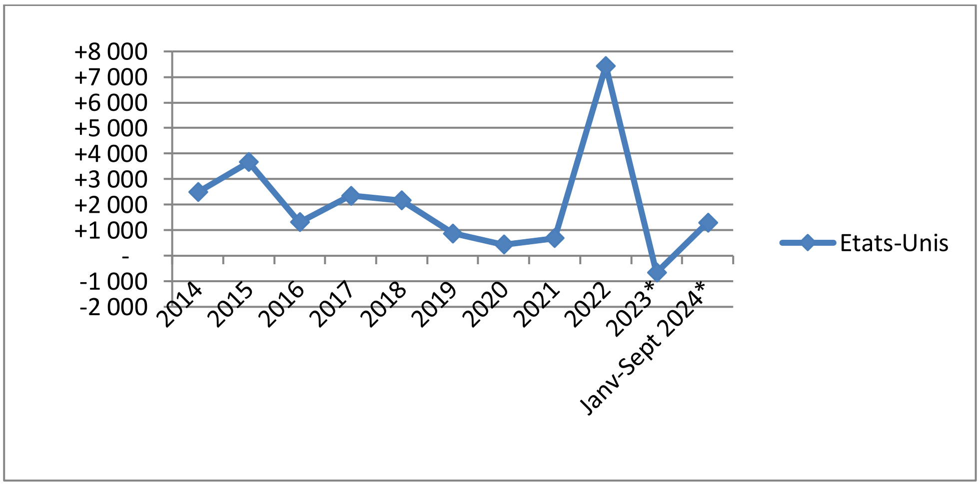
This fragmentation is seen in the case of Morocco in two dimensions: the first concerns the country origin of the FDI that Morocco attracts, and the second concerns the sectors that benefit from FDI. The following graphs trace the evolution of those changes:

Graph 3: The evolution of FDI from China to Morocco



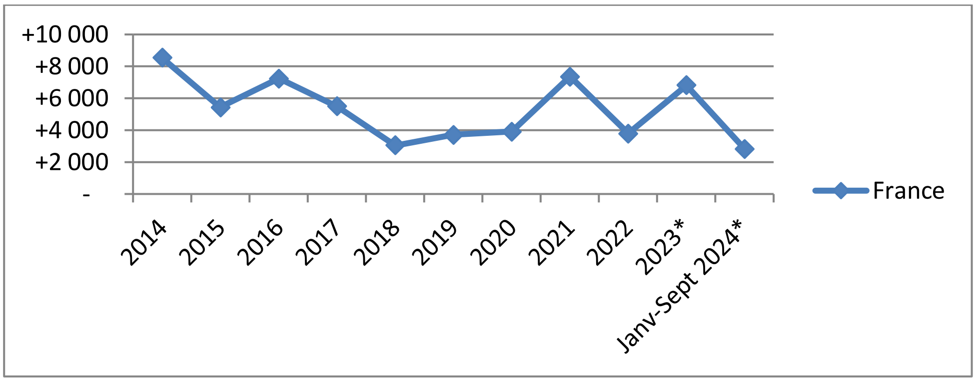
Source: Prepared by us using data from the Moroccan Foreign Exchange Office

Graph 4: The evolution of FDI from USA to Morocco



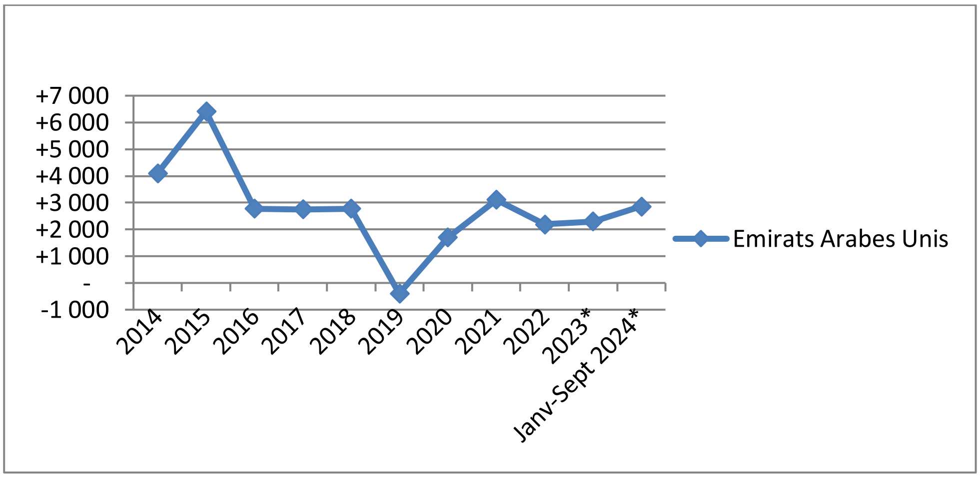
Source: Prepared by us using data from the Moroccan Foreign Exchange Office

Graph 5: The evolution of FDI from France to Morocco



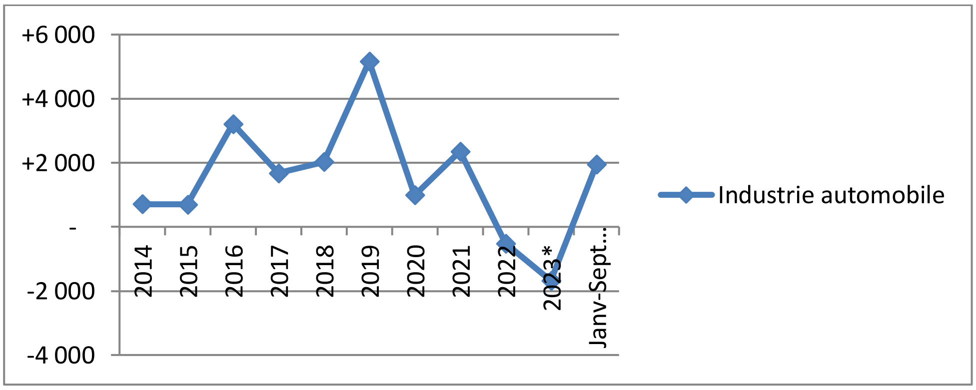
Source: Prepared by us using data from the Moroccan Foreign Exchange Office

Graph 6: The evolution of FDI from United Arab Emirates to Morocco



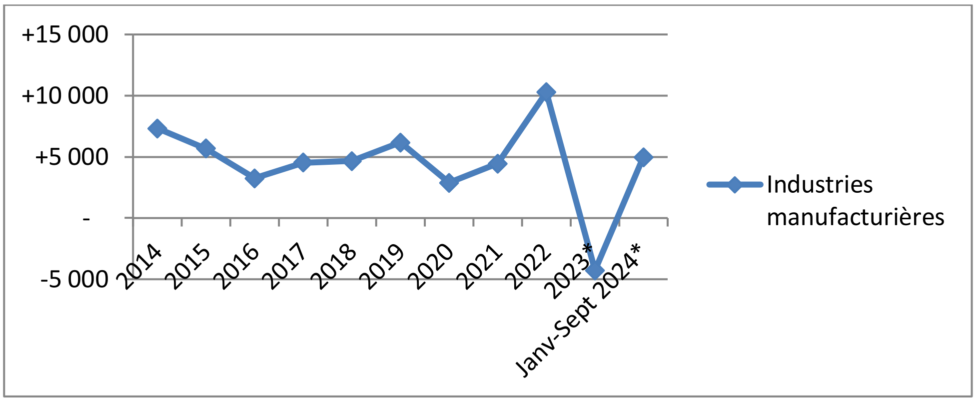
Source: Prepared by us using data from the Moroccan Foreign Exchange Office

Graph 7: The evolution of FDI in Automotive Industry in Morocco



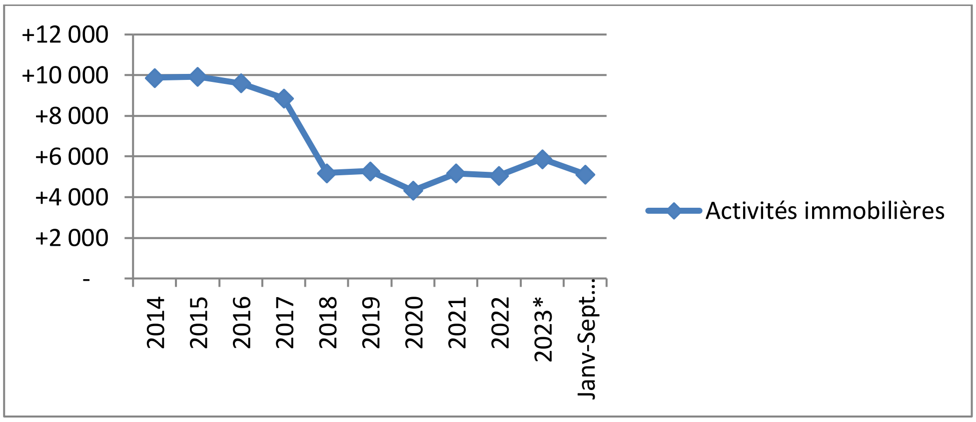
Source: Prepared by us using data from the Moroccan Foreign Exchange Office

Graph 8: The evolution of FDI in Manufacturing Industry in Morocco



Source: Prepared by us using data from the Moroccan Foreign Exchange Office

Graph 9: The evolution of FDI in Real Estate Activities in Morocco



Source: Prepared by us using data from the Moroccan Foreign Exchange Office

We are witnessing a sharp rise in USA's FDI before it crashes; however, Chinese FDI continues to rise, and FDI from France and the UAE continues to fluctuate.

Concerning the economic sector, the automobile industry has been marked by a sharp decline since 2021, before it started to recover in 2024, but without reaching a high level, such as the level of 2018. This performance of the automobile industry is reflected in the manufacturing industry, which recorded an annual average of 4536 million dirhams between 2014 and 2024. This period has recognized a high fluctuation, reaching a decline in 2023 because of the decline in FDI in the automobile industry.

The other sector that still leads FDI in Morocco is the Real Estate with steady flow, which has also declined to stabilize around an annual average of 5140 million dirhams between 2018 and 2024; before, it had been around an annual average of 9551 million dirhams between 2014 and 2017.

5. Discussion

FDI contributes to the modernization of the economy by integrating new technologies and a new modality of production that does not exist in the country; it also contributes to the elevation of private investment and helps finance some branches of activities. This constitutes a way to lighten the burden on state public investment financed by debt and taxes.

However, the realization in terms of attraction of FDI constitutes different difficulties that could limit its aspired impact, especially its fluctuation, productivity, concentration in a few sectors, and dependence on public incentives in terms of aid, guarantees, legal frameworks, and infrastructure.

Therefore, FDI depends on what the state offers. In this context, adjustment of the actual policy is necessary to meet FDI requirements. Nevertheless, this adjustment may present some constraints in terms of the regulatory state and its impact on public finance.

Therefore, Morocco must adjust its current investment and other policies in a coherent manner to guarantee the mitigation of the risk of the rise of geopolitical tensions and to ameliorate the aspects that will constitute a buffer to the rise of GPR and to attract more investment.

However, vulnerability and lack of resilience might be affected by the rise in geopolitical tension, especially with the existence of economic vulnerability. These risks are summarized in the following table:

Table 2: the economic aspects affected by geopolitical tensions risks in Morocco

Structural Vulnerabilities	Manifestation of vulnerability	geopolitical tension risks
Economic vulnerability	Dependence on agriculture	the interruption of supply chain
	Reliance on imports (especially energy)	the rise of the cost of energy

	the part of tourism on export	the reduction of tourism due to conflicts
	MRE remittance	risk of restriction from origin countries
	FDI inflows	slowdown in FDI

Source: Prepared by us

The impact of geopolitical tension and technological change manifests in FDI fragmentation. The evidence of FDI fragmentation is clear based on an analysis of the change in FDI flow after the 2008 financial crisis. This means that FDI seems to invest in aligned countries that represent advantages in new technologies.

The emerging market and developing countries are facing restrictions from advanced economies that affect FDI; however, the latter are becoming concentrated in geopolitically aligned countries, which can be beneficial for Morocco as it has good relationships with European countries, the USA, and China. In this context, Morocco has the opportunity to reduce the risks of its vulnerability by engaging in multilateral consultation, especially as the different agreements are constantly violated in what qualifies as a commercial war.

From this perspective, Morocco presents opportunities for many countries, which have recently been observed. The effect of fragmentation was positive in Morocco. However, the advantages of Morocco should align with this fragmentation; otherwise, the country could miss the opportunity to take advantage of the situation despite its investment in good diplomatic relationships and infrastructure.

If the decline in FDI in its globalization has been witnessed since the 2008 crisis, it is marked by an increase in other sectors, especially in strategic sectors such as semiconductors, which are concentrated in geopolitically aligned countries. However, participating in a race in which others have an advantage could be risky. In that perspective tries to invest to cover its vulnerability, especially its dependence on energy, therefore he is investing in Green Hydrogen in addition to GVC. However, the important part of the automotive industry in the manufacturing sector constitutes another aspect of vulnerability for this sector and for the entire Moroccan economy.

The correction of the vulnerability aspect in Morocco are dependent to the nature of those vulnerability, the latest are divided in two types the structural one and the cyclical one, the first are the result of the past policies that are hard to change in the short term, it concerns the structure of the economy and its dependence on agriculture, for the second one it is related to the dependence on the flow of the FDI and to the remittance of Moroccans residing abroad to equilibrate the payment balance.

However, the correction of the first vulnerability might help adjust the second one related to the dependence of the Moroccan economy on agriculture, which requires the reinforcement of the actual policy to be more resilient to external shocks. In other words, Morocco has not to make a radical change to correct the actual situation, but to adjust the current situation to meet new challenges, especially those related to geopolitical tensions.

Moreover, despite the rise of geopolitical tension risks, Morocco can benefit from its geographic proximity and its commercial and economic partnership to attract more investment from UE, especially as the latest is shifting its economy toward a new industry that will guarantee its dependence from its ally USA, especially the uprising of the European defense industry due to the instability and fragility of geopolitical alliances.

GPR is becoming an exogenous factor affecting the economy worldwide, and it is affected by conflicts In Ukraine because of its dependence on certain commodities and the significant supply chain issue that affects consumers and investors. However, policymakers in Morocco face challenges in adjusting their policies to exogenous factors that are difficult to predict via economic models.

In this context, the investment policy in Morocco helps mitigate risks and vulnerabilities. Moreover, the country started to benefit from global geo-economic fragmentation; the global framework of investment in Morocco is more than ever favorable from more FDI, especially the greenfield one.

From this perspective, the geographic location, diversity of trade agreements, scaling up of public investment in infrastructure, switching toward renewable clean energy, emergence of new Moroccan industries integrated in the GVC, and political stability are factors that help attract new investors in new sectors and attenuate the effects of geopolitical tensions.

This explains the rise in Greenfield FDI in 2021, which is the result of China's entry as an investor. This contrasted with the decline of FDI from the USA States, the fluctuation of traditional investors such as France, and the relative stability of FDI from the UAE.

The recovery of FDI after the Ukraine War concerns the manufacturing industry, especially the automobile industry, which reflects the dynamism and resilience of these sectors. However, Real Estate investments constitute a large part of FDI despite its decline in volume; these latest investments are susceptible to investing in speculation and non-exportable products with low remuneration of workers and lack of technology transfer.

6 Conclusion

Morocco is not immune from the impact of geopolitical tension on FDI; moreover, the actual level of those fluxes is still under the aspiration of the Moroccan authority, which means that it is still a work to be done from the perspective of attracting more FDI.

In this context, policymakers and firms are looking for new partnerships with less risk of supply chain disruption and greater resilience to geopolitical tension. This is manifested in the relocation of firms to countries that are qualified as trusted. From this perspective, Morocco has emerged in the region, especially to attract firms from its traditional partners, especially France and more from the USA. However, this task is becoming more complex, particularly after the call of those countries to invest more in their territory, which could hinder the efforts to attract FDI from those countries. However, the opportunity exists to overcome the risk if the actual policy conducted by Morocco is not adjusted, especially as the FDI attracted by Morocco is vulnerable to geopolitical tension, and a large part of their origins are from those countries.

Morocco benefited from a geographic position close to Europe to increase FDI originating from this country. However, there is still an effort to reinforce the affair law, governance of investment, market openness, and the introduction of new technologies.

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