

CHAPTER 10.

MACROECONOMIC IMPACT OF REMITTANCES¹

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Introduction

Remittances from workers abroad represent a flow of financial resources to a country, and affect economic activity and the macroeconomic environment through various channels. These effects will be particularly significant if remittances are large compared to the size of the economy and other financial flows. Thus, there is much interest on the part of policy makers in the causes, uses, and the economic impact of remittances, as well as how they could contribute to the development of the economy.

This chapter will first summarise briefly what the literature on remittances has to say on these issues. It will then turn to the case of workers remittances to Morocco. More specifically, their relevance in terms of macroeconomic developments and policies will be discussed and the chapter concludes with an assessment of their potential contribution to the development of the Moroccan economy.

Literature on remittances²

There is a vast theoretical and empirical literature on remittances focusing on the causes, uses, and economic effects of remittances. In general, it can be summarised as follows.

- *On the causes of remittances*, most studies observe that family ties and altruism — the concern about the income and consumption levels of the family left behind — are prime motivations for remitting. More recent studies have focused on the idea that there can be self-benefiting reasons as well, such as investments of migrants (in the home country) that need to be tended while they are away. A few studies have also examined the portfolio diversification motives

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1. This paper should not be reported as representing the views of the International Monetary Fund. The views expressed in this paper are those of the author and do not necessarily represent those of the IMF or IMF policy.
 2. For a survey of recent literature on remittances, see Chami *et al.* (2003).

behind remittances, with the flows being a function of the rates of return on various assets or return differentials.

- *On the uses of remittances*, most studies observe that recipients of remittances use the funds to increase family consumption and to invest in real estate. Although there is some evidence that part of remittances goes toward productive investments, the widely held view is that remittances are used to increase family consumption and stock of wealth, but not necessarily the overall economy's capital. Thus, the literature on the causes and uses of remittances tend to reinforce each other.
- *On the impact of remittances on the overall economy*, studies point out that even if remittances are totally spent on consumption, there can be beneficial effects on the economy in the short run, provided that some of these funds are spent on domestically produced goods and services. However the evidence on the positive impact of remittances on longer-term economic growth is not conclusive. This could be related to the idea that remittances affect output mostly through consumption or demand and therefore could only have a short-term Keynesian effect. Some studies associate the lack of a positive impact with moral hazard problems. More specifically, altruistically motivated remittances could be counter-cyclical and create incentive problems, with remittance income reducing the recipient's need to work and adversely affecting economic activity. Large quantities of remittances may also create similar problems at national levels by providing a flow of financial resources and reducing incentives to reform. They may also divert productive resources towards non-tradables sectors through increases in the relative prices of their outputs and the general price level.

Workers' remittances in Morocco

Moroccan workers abroad are relatively large in numbers. According to various estimates, their numbers are in the range of 2.5-3 million. They represent about a quarter of the active labour force in Morocco and have helped alleviate pressures stemming from the rapidly increasing labour force. Close to one-third of Moroccan workers abroad live in France, but recently more workers are going to other countries, in particular Spain and Italy.

Large remittance flows have been a prominent feature of the Moroccan economy. They now amount to about 9% of GDP (up from an average of 5% per year, before 2001) and about 25% of exports of goods and services. Other than exports of goods, remittances, at about USD 4 billion, are the largest source of foreign exchange for Morocco. They almost cover the trade deficit and contribute to the overall balance of payments surplus. They have also tended to act as a relatively stable source of foreign exchange.

Remittances to Morocco are also large relative to remittances in other countries. The average level of remittances for developing and emerging market economies amounted to about 1.3% of GDP and 4.5% of exports of goods and services in 2002. These ratios for Morocco are also large relative to most countries in the Middle East region. For example, in percentage of GDP, they are about 3% in Egypt, 1% in Turkey, 5% in Tunisia and 18% in Jordan.

Remittances to Morocco are mainly driven by altruism. In a very recent empirical analysis, Bouhga-Hagbe (2004) finds that the elasticity of remittances with respect to real

GDP in Morocco is negative, suggesting that altruistic and solidarity motives are behind workers' remittances. This is in line with findings in other studies. Also in line with the findings in the literature related to their causes, remittances are mainly used for consumption and invested in housing. Investment in real estate by Moroccans living abroad is evidenced by the positive correlation between remittances and construction GDP.

Impact of workers' remittances on the economic development of Morocco

Despite the importance of their magnitude in the balance of payments, remittances do not seem to pose a significant risk in terms of stability. The large size of the financial flows through remittances raises questions about the vulnerability of the balance of payments. The empirical analysis by Bouhga-Hagbe (2004) also suggests that portfolio diversification motives (sensitivity to rate of return) are not significant among the long-run explanatory factors of workers remittances. This would suggest that risks for a sharp slowdown or reversal of workers remittances are not large.

Remittances pose a challenge for liquidity management and the conduct of monetary policy. In the context of the current fixed exchange rate regime, large inflows of remittances have contributed to balance of payments surpluses, the accumulation of foreign exchange reserves and excess liquidity in the banking system. Thus, the potential impact of remittances could come from credit growth through the availability of dirham liquidity and from inflation. Inflation is currently not a problem, with banks increasing their excess reserves. Flushed with liquidity however commercial banks invest in the money market and government securities, contributing to a decline in interest rates. To limit the downward pressure on interest rates, the central bank has been mopping up excess liquidity using deposit auctions and reserve requirements. This reflects the concern to maintain interest rates positive in real terms since, at their current level, they do not seem to be a binding constraint to credit expansion. Monetary policy will need to remain vigilant to prevent demand pressures that would tend to increase the price level of non-tradables and therefore inflation.

If the monetary policy framework were different, remittances could contribute as much to determining the level of the exchange rate as any other source of foreign exchange. The stability of these flows suggests that they would not be a source of exchange rate volatility. They could, however, lead to an appreciation of the dirham as could be the case in the current context of a balance of payments surplus. In the second round, the appreciation of the dirham could increase domestic demand which could in turn dampen the pressures for appreciation. An appreciation of the exchange rate would also dampen potential inflationary pressures from remittances if balance of payments surpluses persisted.

Remittances facilitate the financing of the government budget deficit. As noted earlier, remittances contribute to excess liquidity in the banking system. This excess liquidity helps finance the government budget deficit without crowding out the private sector. This could potentially reduce the government's incentive to lower its deficit. In the future, there could be interest rate hikes and crowding out if the liquidity in the banking system became insufficient to meet the economy's financing needs as a result of larger private investment or higher budget deficits.

Remittances in the banking sector could be channeled to productive investments by the private sector. The empirical analysis suggests that remittances to Morocco are not

driven by return arbitrages that could make them volatile. Thus they could be used to finance investments by others through the banking system. The increased allocation of remittances for private investment could then contribute to sustained and higher economic growth rates. In this regard, measures to enhance the investment climate and render the financial system more efficient and diversified should help. If reforms aimed at increasing private investment were to succeed, however, the government deficits should be reduced so as to prevent upward pressures on interest rates and crowding out. It is encouraging that the measures being taken by the government to reform the public sector and reduce the deficit go in the direction of helping increase investment from remittances.

In sum, remittances are likely to continue to be an important source of foreign exchange inflows to Morocco for the foreseeable future. With continued macroeconomic stability, ongoing financial sector reforms, an improved investment climate through structural reforms, and the envisaged reforms of the public sector, remittances could increase further and be channelled to productive investments. They could thus become an important source of capital for development.

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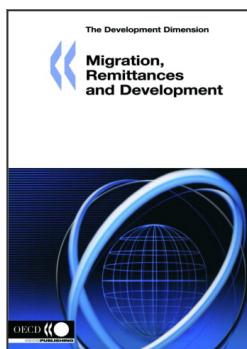
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