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ADDIS ABABA UNIVERSITY
SCHOOL OF GRADUATE STUDIES

ETHIOPIAN DIASPORA AND ISSUES OF REMITTANCES
Demand and Supply Factors Determining Remittances

BY
FASIL ASAYE ADAL

Addis Ababa
Ethiopia
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FASIL ASAYE ADAL

A Thesis submitted to the school of graduate Studies in partial fulfillment of the requirement of the degree of Master of Science in Economics (International Economics).

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Supply Factors Determining Remittances.”

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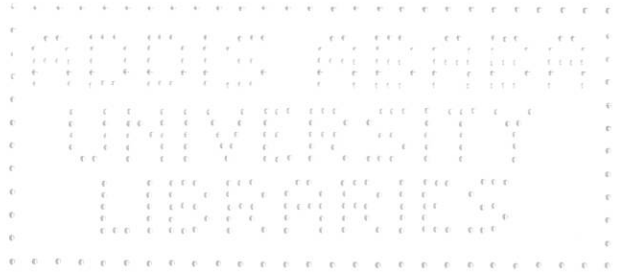
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ii. Abstract

Remittances, an inextricable facet of migration, are the money that the Diaspora sends to family remaining in the country of origin. The very importance of remittances together with the contributions of the Diasporas is grabbing the minds of policy makers in an effort to increase foreign incomes for the enhancement of economic development. However, there are different microeconomic factors influencing the flows of remittances from both the senders' and recipients' side which this thesis has made detail studies using econometric model.

From the sender's side the age, educational level and income of the remitter, the number of years the Diaspora stay abroad, the channel used to send remittances and blood relationship of the sender and recipient are major determinants for the amount and frequency of remittances. On the other hand, the gender and the reason for spending remittances do not have significant influence.

From the recipient's side the country from which the remittances come, the living status of the remitter, the income, the number of years the Diaspora stay abroad and the sending channel are determining factors. The family size and income of the recipient household also influence the inflow of remittances.

These illustrations convey the message that in order to multiply the inflow of remittances, particularly through the formal channel, the factors should be given prior attention and appropriate measures should be taken in connection to the determinants. The secure flow of resources needs to be assured together with carefully increasing the number of migrants.

iii. Abbreviations

BOP	Balance of Payments
DFID	Department for International Development, UK
FDI	Foreign Direct Investment
FIELD	Forum International for Ethiopians Living in Diaspora
GDP	Gross Domestic Product
HTA	Home Town Associations
IMF	International Monetary Fund
IOM	International Organization for Migration
MDG	Millennium Development Goal
MTO	Money Transfer Operator
NBE	National Bank of Ethiopia
NIE	Newly Industrialized Economy
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
OLS	Ordinary Least Square
SPV	Special Purpose Vehicle
USAID	United States Agency for International Development
USD	United States Dollar
WB	World Bank
WEO	World Economic Outlook

1. Introductions and Background

A Diaspora is a community of people living outside the country of origin. The dynamics of rapid globalization and the patterns of labor migration process have considerably increased the Diaspora population and the transnational communities around the world. It is now considered as one of the more benign and virtuous aspects of globalization particularly in the past three decades or so, for people migrate from the poorer labor surplus economies to the better off labor scarce economies. Conservative estimates indicate that around 200 million people migrate annually (Harris 2002) due to the fact that the demand for foreign labor has immensely increased in developed countries and on the other hand the living conditions become difficult in less developed countries for various reasons such as; socio economic conditions, natural and man made calamities and political structures.

Whatever, the motivations or circumstances of their decision to leave the country, people residing over seas often provide invaluable support to home country for the process of development, and wittingly or unwittingly help in meeting the enormous challenges of alleviating poverty and promoting economic and social development their countries are in need of.

Since early 1990's the revolution in transport technology which made long distances travel very cheap and quick; and on the other hand the rapid and massive leaps forwarded in communications techniques such as internet, e-mail, inexpensive phone calls etc, propelled by the impact of the current globalization process have accelerated the dynamics of the transnational networks mediated by the Diaspora.

Currently, the Diaspora people begin to build up intersecting social, economic and political bridges that link their new places of residence with their country of origin.

From the wide-ranging and versatile involvements of the Diaspora in the country of origin, the remittances they sent and their contribution for the growth and development of recipients in particular and the country of origin at large is getting much attention globally.

Besides the growing recognition of the development potential of the Diaspora for both countries of origin and countries of destination the migration and development issues expanded to include the challenges posed by brain drain and the potential of remittances.

When the Diasporas send home part of their earnings in the form of either cash or goods to support their families, these transfers are known as remittances.

Remittances have been growing rapidly in the past few years and now represent the largest source of foreign income in many developing countries (Ratha, 2005). There are individual and collective remittances; which are mainly sent beginning from assistance to meet subsistence needs, such as health care, housings, school fees, etc at a micro or individual level to community welfare activities at macro level.

In the face of inadequate resources to finance long-term development in less developing countries and with poverty reduction and other Millennium Development Goals (MDGs) looking increasingly difficult to achieve, remittances have assumed a prominent place in the strategies of economic renewal being advocated by policy makers at the national, regional and international levels. The experience of a small number of fast-growing East Asian newly industrialized economics (NIEs) and recently China and India, have strengthened the belief that the Diaspora and their remittances are key to bridging the resource gap of low-income countries and avoiding further build-up of debt while directly tackling the immediate causes of poverty.

Family and worker remittances; and to a lesser extent the donations of migrant associations, are making crucial contributions to the subsistence and economic growth in many countries. For instance, Remittances exceed aid flows in Central America and is often larger than import earnings in the Caribbean. In some; European countries, remittances are surpassing the value of government spending on social services.

Worldwide total remittance flows continue to increase overtime, nearly doubling in a period of ten years, with annual average in the previous decade of USA 700 to 1000 per worker (Harris 2002). Estimates of remittances, however, are incomplete and represent only an estimate of the total flow. The actual size of remittance could be much larger than what officially statistics indicate. The possible sources of confusion may be: first; in some cases, International Monetary Fund and World Bank figures differs from official figures offered by Central Banks. Second; in most of the cases remittances are not reported at all or are mixed with other sources; and third; when immigrants make direct deposits in to accounts in their home countries, Central Banks do not register these transfers as remittances, even though immediate relatives are the main beneficiaries of those accounts (IMF Staff Papers: 2005; DAWN- Business January 2004).

As a result of ample benefits, many developing countries are now actively facilitating the inflow of remittances by taking measures that include economic and political reforms designed to improve their saving and investment environment. In 2004 G-8 countries; from which most remittances are transferred, met and decided to take action in lowering the costs of migrant workers who send back money to their friends and families in the country of origin. Various G-8 government developmental organizations such as the United Kingdom government's DFID and the USA government's USAID conducted favorable measures with the ultimate goal of lowering costs to senders of money and thus increasing the amount of monies to the recipient.



In Ethiopia, the gap between Domestic Investment and Savings has been remained wide due to the low levels of Income and Domestic Savings. Relevant financial support as a source of capital together with other business know-how is therefore desperately essential to finance growth and development. Between 1994 and 2005, Gross Capital Formation as a proportion of GDP rose from 16.4% to 21%, while Gross Domestic Saving declined from 11.5% to 5.5% (NBE Annual Report: 2004/05). This saving gap can be filled by private foreign savings and investment of the Diaspora living abroad fostered by favorable domestic policy or by grants/loans and development assistance from multilateral agencies such as the World Bank, WB; International Monetary Fund, IMF; etc or.

Worldwide, annual remittances may amount to more than one hundred billion dollars, primarily sent from the industrial to the developing world. According to a study carried by Manuel Orozco (2003); Latin America and Caribbean is the main remittance recipient area in the world, receiving about 31% of the flows. Following; South Asia, Europe and Central Asia, East Asia and Pacific, and Africa shares with 20, 30, 14 and 5% of the flow, respectively. The interesting feature of the study result is that one or two countries comprise over 50% of the total flow in each region. For example, India, the world's largest recipient country, accounts for 73% of the flow to South Asia. Mexico represents 34% of Latin America and the Philippines 43% of East Asia and the Pacific.

In view of these important roles of remittances, it is essential to understand the input of Diaspora living abroad in general and Ethiopian's in particular. Different factors including individual behaviors, the level of economic development of both the host country and country of origin, the policy regime in place, social and political factor may play a role in determining the inflow of remittances of Diaspora by improving the investment climate and by providing incentive packages.

1.1 Statement of the problem

In the face of international relationships, amongst various contradictory debates on the issues related to the Diaspora residing overseas and their contribution to the host country as well as the country of origin; there is a general presumption in the literature and among policy makers that the Diaspora is a key strategic asset to both countries. The Diaspora role in transferring knowledge, experience and remittances which would enhance human and material capacity building is getting weight and a great deal of concern in the country of origin. It has taken the role of pioneer investors and helps to attract Foreign Direct Investment at a time when major capital markets regarded these economies as too risky.

Remittances of the Diaspora play versatile role in poverty reduction, increasing safety savings and expansion of investment, and in general in economic development as foreign direct investment and other capital flows.

According to the publications of International Organization for Migration (IOM) of the estimated 3.6 million Africans who live in Europe and North America over 100,000 are highly qualified professionals who can shoulder responsibilities in the less growing economies of the country of origin. The World Bank also estimates that Africa loses 50,000 executives and 23,000 university graduates every year looking for greener pastures. However, the increasing brain drain is somehow getting to be compensated by the enormous participation of the Diaspora in the country of origin. One of these contributions is the transfer of monies in the form of remittances. In 2004, remittances to Africa amounted to USD 14 billion, with Egypt, Morocco and Nigeria being the largest recipients.

The number of Ethiopians living in Diaspora is estimated to exceed one million, most living in the Middle East, Europe and North America. However, remittances hover around 1.2% of GDP for the years 1996 to 2000. The most notable justifications given for this smallness of the figure

is associated to the money flows through informal channels to avoid exchange rate restrictions and also the availability of limited branches of the formal money transfer channel in regions and districts which forces the use of informal ways.

On the other hand, Ministry of Foreign Affairs has established a directorate for expatriate affairs to encourage professionals to back home and contribute to development efforts in Ethiopia.

Nevertheless, the inflows of remittances have been lower than anticipated. This raises two important policy questions: 1) Why have remittances transfers remained low in the face of Government improving directives, and 2) What are the major factors determining the Diaspora remittances transfers and what could be done to redirect the Diaspora remittances transfer from informal to formal channels.

1.2 Objectives of the study

Given this recent changes on the essentiality of Remittances and the very important roles and concern of the Diaspora, the objective of this study is to:-

- Review potentials of the Diaspora towards remittances and the respective performances in the case of Ethiopia.
- Empirically investigate the determinants of Diaspora support and inflows in to the country and forward recommendations to enhance the amount and benefit; and
- Highlight some of the policy issues thought to be essential in formally addressing potential remittances in Ethiopia.

1.3 Approached followed

In order to achieve the objectives of the thesis the two main approaches to be involved are:

1. A review of the existing theoretical and empirical literatures and data on the Ethiopian Diaspora living abroad and its financial contribution.
2. Development of pertinent econometric models to empirically investigate the link between the Diaspora remittances and factors influencing them.

1.4 Significance of the Study

The analysis made in this study basis on the existing theories of Remittances and the developmental concerns of the Diaspora for the country of origin. Therefore, it will improve our understanding of the existing potential of the Diaspora as well as its contribution in financing homeland and in enhancing development. It can be a base for further studies in the areas of Diaspora and remittances.

2. Literature Review

2.1 Remittances, an overview

2.1.1 Formal Remittances

According to World Bank official reports (World Bank's annual Global Development Finance; 2003, 2005), migrant remittances are calculated as the sum of workers' remittances, compensation of employees, and migrant transfers. Remittances are one of the developmental effects of migration through which countries are becoming inter connected. Based on this definition, remittances received by developing countries, estimated using officially recorded data, rose to \$167 billion in 2005, which scaled up 73 percent from 2001 (IMF; 2005 World Economic Outlook). More than half of this increase occurred in China, India, and Mexico. Low-income countries, led by India, registered an increase of \$18 billion during this period. This officially recorded data of remittances indicate formal remittances transferred through financial institutions like Commercial Banks and Money Transfer Operators.

Workers' remittances, as defined in the IMF Balance of Payments manual, published in 1993 (fifth edition), are current private transfers from the Diaspora who are considered residents of the host country to recipients in their country of origin. If the migrants live in the host country for a year or longer, they are considered residents, regardless of their immigration status. If the migrants have lived in the host country for less than a year, their entire income in the host country should be classified as compensation of employees. Workers' remittances are transfers, whereas compensation of employees is considered factor income. In the earlier, fourth edition of the BoP manual, compensation of employees was called labor income and was classified as non factor services.

However, many countries compile data based on the citizenship of the migrant worker rather than on their residency status. Further, data are shown entirely as either compensation of employees or as worker remittances, although they should be split between the two categories if the guidelines were correctly followed. The distinction between these two categories appears to be entirely arbitrary, depending on country preference, convenience, and tax laws or data availability. World Bank recognized this fact since the 1980s, and worker remittances have been treated as part of labor income and added to exports of goods and services in calculating debt service ratios.

The growing importance of remittances as a source of foreign exchange is reflected in the fact that remittance growth has outpaced private capital flows and official development assistance (ODA) in developing countries (Table-1).

Table 1 Recorded remittances have grown faster than private capital flows and ODA

\$ Billions		
	1995	2004
Workers' remittances	58	160
Foreign direct investment	107	166
Private debt and portfolio equity	170	136
Official development assistance	59	79

Source: World Bank (2005)

One of the challenges of understanding remittance flows is that their characteristics, costs, and channels can vary widely in different locations. Scholars explain that understanding how remittance differs in the kinds of migrants they serve and their means of transferring money is useful for providers of remittance services as well as policymakers (Hernandez-Coss 2004; Terry 2005).

2.1.2 Informal Remittances

Remittances transferred through informal operators or hand carried by travelers is unlikely to be captured in official statistics, although they may represent a substantial addition to remittances sent through official channels. They are all types of money transfers that do not involve any formal channel and are not recorded in the national accounts of a country. Remittances in-kind, which are mainly consumption goods, sent for family members (such as clothes and shoes) are other types of informal remittances (BME Remittance Survey; 2006).

While it is extremely difficult to estimate the flows through informal channels, they appear to be large. The fact that recorded remittances to several countries through formal channels doubled, tripled, or quadrupled between 2001 and 2003 suggests that a significant part of the increase is likely to reflect a shift from informal to formal channels.

Evidence from household surveys suggests widespread use of informal remittance channels (Table 2). Household surveys also help identify factors affecting the use of remittance channels. In the presence of a well-developed formal sector, regular remitters and large remitters are unlikely to use the informal sector. Trust in the financial system is an important prerequisite for a growing bank presence in the (formal) remittance market.

Table 2 Choice of remittance channel in selected countries

% Remittances

	Formal	Informal
Dominican Republic	96	4
Guatemala	95	5
El Salvador	85	15
Armenia	62	38
Moldova	53	47
Bangladesh	46	54
Uganda	20	80

Source: World Bank staff estimates based on IMF BoP Yearbook 2004 and country sources.

High remittance costs and the presence of dual exchange rates are two key factors affecting the choice of informal remittance channels. If there were no cost advantages to using informal channels, there would be little incentive to use them, and remittances could arguably shift entirely to formal channels. Thus, if the costs of formal transfers were reduced to the range reported in the informal sector (2-5 percent), and if official and parallel exchange rates were unified, the resultant increase in recorded remittance flows could be interpreted as an estimate of the size of informal flows. Cross-country regression analysis shows that reported remittances are lower and informal flows higher, where remittance costs are higher and where there are significant black-market premiums over the official exchange rate.

Furthermore, there are various reasons why Diasporas prefer to use informal means to send money. Among these are:-

- Lack of access of the formal remittance channels in the senders home country;
- The presence of well developed informal system that is very competitive with the formal ones;
- High taxation in home country forces the Diaspora to keep remittances out of government's reach; and
- Illegal migrants prefer to send money informally.

2.2 Compilation of Remittance Records

With regard to the quality and coverage of data on remittances enormous works and elaborated researches should be done to set a common standard for the relevant terminologies applied. First, there is no consensus on the boundaries of the coverage. Should only workers' remittances be counted, or should it include compensation of employees and the Diaspora transfers? Second, in several countries, many types of formal remittances flows go unrecorded, due to weaknesses in data collection, which is related to both definitions and coverage. Reporting of "small" remittance transactions made through formal channels is not mandatory in most countries, and

remittances sent through post offices, exchange bureaus, and other agents of money transfer operators (MTOs) are often not reflected in official statistics (de Luna Martinez 2005). Third, flows through informal channels (such as unregulated money transfer firms or family and friends who carry remittances) are rarely captured. Finally, remittances are often misclassified as export revenue, tourism receipts, nonresident deposits, or even foreign direct investment (FDI). Thus, cooperative international efforts are exerting to improve the quality of remittance statistics.

According to Global Development Finance 2003; even though it is known that emigration from those countries took place, about 87 countries did not report any remittances' data. Furthermore, there was no consistency in reporting the data. For example, only 28 countries report workers' remittances, compensation of employees, and Diasporas' transfers. Forty-five countries report both workers' remittances and compensation of employees. There are 14 countries that report only workers' remittances and 19 countries that report only compensation of employees.

Reported data for developing countries show only \$ 113.4 billion in total remittances for the year 2003 (that is workers' remittances \$97.3 billion, compensation of employees \$14.8 billion, and migrants' transfers \$1.3 billion), and 83.8 billion in 2004 (i.e. workers remittances \$68.7 billion, compensation of employees \$13.5 billion, and migrants' transfers \$ 1.5 billion). By filling in gaps for some developing countries for which remittance data were missing, the remittance transfer is estimated to be \$142 billion in 2003 and \$160 billion in 2004.

There are four main reasons for value gaps in remittance data: vintage, missing data, data recorded under other than the three categories mentioned above, and data collection practices (Global Economic Prospects; 2006).

Vintage

The Balance of Payments Yearbook publishes data with a one-year lag. That is, the yearbook published in December of the current year should have data up to December of the previous year. However, this is not true for a number of developing countries, for which the latest data available are two or even more than three years old.

For example, Algeria and Nigeria, have not reported data to the IMF for a number of years. For Algeria the IMF data stop in 1991, and Nigeria data stop in 1999. However, data for these countries are available from the country and reported in the country databases of the World Bank and IMF.

Missing Data

Several developing countries do not report to IMF. Data from the country desks are used for Gambia, Iran, and Serbia and Montenegro; and data from central banks were used for Lebanon and Vietnam. Some high-income countries (notably Canada, Singapore, and United Arab Emirates) also do not report remittance data.

Classification under other categories

Due to the difficulty in classification, countries have often classified workers' remittances either as other current transfers or as transfers from other sectors. For example, in Kenya and Malaysia data were recorded as workers' remittances at one time and as transfers from other sectors in other times. For these countries, data under "other sectors" from the IMF are treated as worker remittances. In China a large proportion of workers' remittances are classified as other private transfers in the IMF BoP file. Therefore, instead of the IMF's workers' remittances, workers' remittances data are used from the country desk. It is not just the developing countries that reveal this practice; many high-income OECD countries (for example, the United Kingdom) do the same.

There are also other problems in the data, such as the difficulty in separating travel expenditure from remittances. The increased acceptance of credit and debit cards in developing countries further complicates the issue. In some countries remittances may have been misclassified as FDI. The OECD definition of FDI (including the purchase of holiday or second homes by nonresidents) may be counted as FDI. In the case of India and many other countries, remittances may have been classified as nonresident deposits, especially those in local currency terms.

Data collection practices

A survey of central banks, based on responses from 40 central banks, reveals widespread problems with remittance data collection methodology (de Luna Martinez 2005). Most of the central banks use remittance data reported by commercial banks, but leave out flows through money transfer operators and informal personal channels.

Even when data are available and properly classified, in many cases they are not based on actual exchange records. In a number of cases, the preferred methodology of estimating the Diasporas' remittances is based on taking the number of Diasporas, and multiplying by an average amount sent. The sources for these data are migration records, surveys of exchange and financial houses, and household surveys. However, these data are often weak or out of date. Also the methodology for preparing estimates is not the same in all countries, and it is not always described in the country notes in the publicly available balance-of-payments data.

2.3 Factors affecting remittance flows

The surge in remittance flows over the past few years reflects a mix of factors. On the measurement side, the sizable depreciation of the dollar against most other major currencies since 2002 has increased the dollar value of non-dollar remittances over time. Improvements in data recording by central banks-in response to growing recognition of the importance of

remittances by national authorities, and as a result of broader efforts to improve data quality- have generated sharp increase in remittance flows in some cases. In addition, heightened security and scrutiny by immigration and finance authorities in many high income countries may have encouraged outward surges in remittances, as undocumented migrants responded to increased uncertainty and risk of deportation or other legal action by remitting a larger share of their savings or income.

Increases in the number of Diasporas will have the greatest and most direct impact, of course, along with compositional features, such as the mix between temporary and permanent workers (temporary workers are believed to remit a larger share of their income and the skill mix (low-skilled workers tend to send a higher proportion of their lower incomes). Employment opportunities in the host country affect income, and therefore remittances, while changes in the cost of living may affect the size of the surplus that remitters are able to send.

The complex interplay of these factors makes assessing the future growth potential of remittance flows quite difficult. In addition to this, there are many powerful economic factors influencing the growth of remittances. Some of the most plausible influential factors are illustrated here under.

Government policies

Many sending and receiving governments are now beginning to think about policies to increase remittance flows and promote transfers through formal channels. In the remittance-receiving countries, these policies include tax exemptions for remittance income; improved access to banking services by recipients; incentives to attract investments by the Diaspora; access to foreign exchange or lower duties on imports; support for the project or migrant associations; and help for migrants in accessing financial system. In the remittance-source countries, they include policies affecting access to

banks, access to foreign exchange, support to migrant groups, types of immigration regimes, and cooperation with receiving countries.

Policies in remittance-receiving countries

Taxes on incoming remittances Most remittance-receiving countries today do not impose taxes on incoming remittances, however, in the form of a general financial services tax or on remittances in kind (for example, food, clothing, electronic items, or vehicles). When Vietnam removed its 5 percent tax on remittances in 1997, it found that the flow of remittances through formal channels increased. Such tax exemptions may well increase remittance inflows, but they also raise the possibility of misuse for tax evasion.

Travel and customs privileges for returns and imported goods Many remittance-receiving countries give preferential treatment to migrants sending home or bringing with them goods and equipment. For example, once a year Tunisians are entitled to import goods and/or services up to some fixed customs value without paying tax, and a private vehicle, home equipment, and furniture are tax-free when they return.

Relaxation of exchange and capital controls Unification of exchange rates and allowing more banks and financial institutions to undertake foreign exchange transactions have been among the most successful ways of attracting remittances to formal channels and expanding remittance services in many countries. Also, allowing residents to hold foreign currency deposits using remittances from abroad is believed to have resulted in a large increase in formal remittances in many countries in South Asia and Africa (Siddiquie 2004). India's liberalization of the exchange rate in 1991 has been linked to a decrease in the use of illegal transfer channels. Philippines found that by abolishing exchange controls it quadrupled its formal inward remittances in the same year (Buencamino and Gorbunov 2002). In 2004,

an increase in foreign currency reserves in Zimbabwe was ascribed, in part; to the introduction of new money transfer system (Home link) set up by the government to facilitate formal transfers.

Allowing domestic banks to operate overseas Governments have allowed more of their domestic financial institutions (including micro finance institutions in some countries) to open branches and provide services to their Diasporas working in other countries. These domestic banks bring trust and offer remittance services at competitive prices. For example, the Grope Banques Polpulaire of Morocco has picked up 66 percent to total remittances by offering low fees, simple procedures, and other non financial services to Moroccans abroad (Amin and Freund 2005). Two small Armenian banks specializing in remittance transfers have come to dominate the formal transfer system for Armenians in parts of Europe.

Identity cards for Migrants providing identification cards to Diasporas regardless of their legal migration status) to access banking facilities has also opened up more opportunists for formal remittance transfer. This card is widely accepted by commercial banks to open bank accounts (and in many countries, for issuing driving licenses and shopping in super markets). Most sending countries require legal documentation for any bank transactions, and some receiving countries issue identification cards to expedite domestic services for their emigrants, for example, the Tunisian carte consular for special customs clearance, reduced airfares, and foreign currency bank accounts in Tunisia.

Support to hometown associations (HTAs) and matching grants providing funds to supplement or match collective remittances made by the Diaspora groups is another means to engage Diasporas in the development of home communities. With enhanced institutional capacities, HTAs could be valuable development partners for governments, the private sector, and communities, but importantly as a complement, not a substitute for,

strengthened financial and investment systems on the ground (Gubert 2002).

Loans/pension schemes and bonds targeted at the Diasporas These measures can expand opportunities for investment and provide incentives for the formal transfer of money from abroad. While investments in the form of nonresident deposits or Diaspora bonds are not, strictly speaking, remittances (because they involve the purchase of assets, rather than transfers to households), they may indirectly encourage remittances. Many countries have successfully issued premium bonds to their Diaspora (for instance; Bangladesh, china, Eritrea, India, Israel, Lebanon, Pakistan and the Philippines are noted in this regard, Carling 2005). Even when investments in these bonds are in foreign currency terms, after maturity some portion is likely to remain in the country. Such schemes were a major factor behind the doubling of remittance flows to India between 2002 and 2003.

Active policies and institutional arrangements to support the Diaspora. Countries with more successful remittance programs tend to have well-established institutional frameworks to train, support and ensure the welfare of their expatriates abroad. There is also a broad range of outreach activities to assist Diaspora welfare and promote remittances and investment in the home country, from pre-migration information and orientation, identification cards for customs and other purposes, finance for study support in legal and administrative disputes, fairs and re-orientation visits for émigrés and their families and a Diaspora trust fund.

Policies in remittance source countries

Only a handful of remittance-sending countries have proactive remittance-supporting policies. Most are noninterventionist or have had little engagement to date, but this is changing with the growing appreciation of the significance of remittances for development. (Ellerman 2003, Carling

2005). The objective is to forward for more proactive policies by sending countries-for example, to support migrant associations, facilitate low cost, reduce bureaucratic remittance transfer, greater competition in the remittance market, and inform decision making by migrants and affected communities.

Immigration Policies. Policies that affect the size, type, and tenure of migration flows also affect remittance patterns. A larger migration stock would in general imply larger remittance flows to the country of origin. Given the migration stock, a larger share of temporary migrants is likely to lead to larger remittances. It is usually agreed that the ties of migrants to their home country weaken with the passage of time, causing remittances to decline.

There are in fact some “forced” remittance transfer programs between sending and receiving countries, although these raise vexing legal issues and do not appear to be effective either in encouraging Diaspora return or mobilizing resources.

Banking and Financial Markets. Greater relaxation and competition in money transfer markets leads to reduced prices and more money reaching the beneficiaries. Improving access of remittance service providers to national payment and settlement systems facilitates this process further. Spain has initiated agreements between Spanish and Latin American financial institutions to reduce transfer fees and foster the entry of new agents into the financial market, particularly in rural areas. Germany also worked closely with Turkey to encourage remittances into formal channels (UN 2005).

Support to Home Town Associations (HTAs) or migrant associations. HTAs and similar entities receive some support from host governments in the United States, France, and parts of Africa in recognition of their development assistance potential. While HTAs could potentially play a

useful role in community infrastructure and other collectively funded projects, their ability to effectively channel large amounts of aid remains untested (Nneoma Nwogu: Michigan Journal of Public Affairs; 2005).

2.3.1 Macroeconomic effects of remittances

Until recently, most of the discussions and researches on remittances focused on the (microeconomic) end use by the recipient households, including the effects on poverty. But, large size of remittances relative to other external flows and to the GDP in many countries suggests that the macroeconomic effects of remittances may be of critical importance in many countries. High levels (or large increase) in remittance flows can be expected to have direct repercussions on foreign exchange rates, domestic interest rates, and the balance of payments, and indirect repercussions on macro variables.

However, as the experience with and analysis of natural resource booms have shown, large inflows can also have some undesirable side effects. And to the extent that remittance flows may naturally just go to countries that are doing poorly or respond anti-cyclically (increase during downturns, due to a drought, for example), it may be hard to disentangle how remittances affect macro-performance. Some of the macroeconomic channels through which remittances affect recipient countries are briefly discussed as follows.

Stability and counter cyclical movements of Remittances

Remittances may move counter cyclically relative to the economic cycle of the recipient country. Remittances may rise when the recipient economy suffers a downturn in activity or macroeconomic shocks due to financial crisis, natural disaster, or political conflict, because migrants may send more funds during hard times to help their families and friends. Remittances may thus smooth consumption and contribute to the stability of recipient



economies by compensating for foreign exchange losses due to macroeconomic shocks.

Many authors have observed an increase in remittance inflows following a natural disaster (Clarke and Wallsten 2004, Kapur 2003 as stated by Mishra). To the extent that remittances are used for investment purposes, however, they may behave pro-cyclically just as other investment flows do. In Turkey and the Philippines, remittances were more volatile and pro-cyclical in the 1990s than in the 1980s; Mishra (2005).

Improvement in country creditworthiness

Remittances can improve a country's credit worthiness and thereby enhance its access to international capital markets. The ratio of debt to exports of goods and services, a key indebtedness indicator, would increase significantly if remittances were excluded from the denominator. Country credit ratings by major international rating agencies often fail to account for remittances (Journal of Asian Studies; 2005).

Remittance Securitization and external financing

Remittance securitization involves the borrowing entity (such as a bank) pledging its future remittance receivables to an offshore special purpose vehicle (SPV). The SPV issues the debt (Journal of Asian Studies; 2005). Designated correspondent banks are directed to channel remittance flows of the borrowing bank through an offshore collection account managed by a trustee. The collection agent makes principal and interest payments to the investors and sends excess collections to the borrowing bank. Since remittances do not enter the issuer's home country, the rating agencies believe that the structure mitigates the usual sovereign transfer and convertibility risks. Such transactions also often resort to excess coverage to mitigate the risk of volatility and seasonality in remittances.

By mitigating currency convertibility risk, a key component of sovereign risk, the future flow securitization structure allows securities to be rated better than the sovereign credit rating. These securities are typically structured to obtain an investment grade rating. Investment-grade rating makes these transactions attractive to a wider range of “buy-and-hold” investors (for example, insurance companies) that face limitations on buying sub-investment grade. As a result, the issuer can access international capital markets at a lower interest rate spread and longer maturity. Moreover, by establishing a credit history for the borrower, these deals enhance the ability and reduce the costs of accessing capital markets in the future.

As experience with this instrument broadens, and investors become more comfortable with its characteristics, it is possible that it could be used by a wider range of countries (including poor countries) and for a broader range of external flows (remittances, tourism receipts, and commodity earnings). It is not easy to estimate the potential size of such future flow securitization. But preliminary calculations, assuming an over-collateralization ration of 5:1 and using migrant remittance figures for 2003, show that developing countries could potentially issue nearly \$9 billion and low income countries could raise up to \$ 3 billion annually from international capital markets.

Several policy hurdles need to be crossed before securitization deals can proceed. High fixed costs of legal, investment banking, and credit-rating services and long lead times can pose difficulties for developing countries with few large entities and high borrowing needs. A master trust arrangement can permit issuers to structure a large deal but to tap the market in several trenches.

So far, only the top-rated (in local currency terms) financial institutions have issued future remittance-backed bonds in an effort to pierce the sovereign foreign currency rating ceiling (that is, to obtain a higher rating for these bonds than the sovereign foreign currency rating). The securitization

transactions typically do not affect financial institutions' ability to deliver remittances to the ultimate beneficiaries. Loosely speaking, the financial institutions' that undertake a securitization transaction are pledging their rights to foreign currency, but not their obligations to deliver remittances (typically in local currency terms). Potential issuers should be reminded, however, of significant risks – currency devaluation and, in the case of flexible rate debt, unexpected increases in interest rates- that are associated with market-based foreign currency debt. Moreover, securitized debt is inflexible debt. Securitization of remittances (and other future flows) by public sector entities reduces the government's flexibility in managing its external payments and can conflict with the negative pledge provision included in multilateral agencies' loan and guarantee agreements, which prohibit the establishment of a priority for other debts over the multilateral debts (Journal of Asian Studies; 2005).

Exchange rate appreciation and lower export competitiveness

Large and sustained remittance inflows can cause an appreciation of the real exchange rate and make the production of cost-sensitive tradable, including cash crops and manufacturing less profitable. Although empirical evidence on the adverse effect of large inflows of foreign exchange in terms of trade and growth is limited, it is plausible that this effect exists and is significant for some small economies where remittances are very high. Amuedo Dorantes and Pozo (2004) found that a doubling of workers' remittances resulted in real exchange rate appreciation of about 22 percent in a panel of 13 Latin America and the Caribbean countries. Rajan and Subramanian (2005), however, did not find any evidence that remittance flows slow down growth by affecting competitiveness. Moreover, as remittances tend to be relatively stable and persistent over long periods, the "Dutch disease" effects of remittances are less of a concern than similar effects of natural resource windfalls and other cyclical flows, and the real exchange rate level achieved through sensible policies may be sustainable (IMF 2005). Governments in countries receiving large remittances can

mitigate the effects of real exchange rate appreciation by allocating a larger portion of government expenditures on infrastructure and also practicing more liberal trade policies; both these measures would tend to increase exports and also contribute to improved labor productivity and competitiveness.

A related concern is whether reliance on unearned income in the form of remittances has adverse effects on the incentives to work, as well as on the quality of economic policies and governance, similar to the well-documented effects of windfall gains from natural resources such as oil. While oil exports are almost always found to have a strong negative impact on various governance indicators, such as control of corruption and rule of law, preliminary cross-country analysis suggests that remittance flows may not have such negative effects.

2.4 Development Impacts of Remittances

Surveys are available for many countries and periods, and many of these have common or comparable structures, but substantial differences in coverage and circumstances complicate their interpretation.

Such caveats suggest that remittances can:

- Reduce poverty, even where they appear to have little impact on measured inequality;
- Help smooth household consumption by responding positively to adverse shocks (for example, crop failure, job loss, or a health crisis);
- Ease working capital constraints on farms and small-scale entrepreneurs;
- Lead to increase household expenditures in areas considered to be important for development, particularly education, entrepreneurship, and health.

Brief explanations are prevailed as follows.

2.4.1 Remittances, Poverty and Inequality

Most scholars argue that remittances directly affect poverty by increasing the income of the recipient. They also indirectly affect poverty in the recipient country through their effects on growth, inflation, exchange rates, and access to capital. Measuring the impact of remittances is complex (in part because of the difficulties of accounting for the loss of income from migration). But different model assisted evidences (such as; poverty simulation models, cross-country regressions, and analysis of household survey data) show that remittances, in fact, do reduce poverty –although the evidence of their effect on in-equality is mixed.

Remittance and Poverty

In what follows, evidence on the effects of remittances on poverty is presented, based on three sources: (i.e. a poverty simulation model, a cross-country regression analysis, and household survey data from selected countries). The illustrative poverty simulation model asks a straightforward question: how would poverty rates change in the samples of developing countries if remittances were to disappear completely? Since the model is easy to implement, it can provide some sense of the effect of remittances across countries. However, it is relatively crude and cannot account for the fact that while remittances affect poverty, the level of poverty also affects the volume of remittances. In comparison, cross-country regression analysis requires more data and is harder to implement, but it is better able to control for reverse causality between remittances and poverty. Household surveys are most likely to provide the data required for a rigorous analysis of the relationship between remittances and poverty. The surveys also allow one to analyze the counterfactual loss of income due to migration. It is difficult, however, to generalize across countries on the basis of household data, particularly because most available household surveys do not have usable data on remittances, especially international remittances.

While remittances had only a limited role, they did significantly reduce the depth and severity of poverty (Adams 2004a). International remittances accounted for 60 percent of income decile, but were not very large for households located near the poverty line. As a result, international remittances had more impact on reducing the depth of poverty than on the poverty headcount: in other words, they were really helpful for the poorest of the poor.

Wodon and others (2002) conclude that in two southern Mexican states with significant international emigration and remittance inflows, the share of the population living in poverty is lower by 2 percentage points due to remittance income. They argue that this poverty effect is similar in magnitude to that of many government programs in poverty reduction, education, health, and nutrition. (Taylor, Mora, and Adams; 2005), using data from a 2003 survey, find that international remittances account for 15 percent of per capital household income in some developing countries. They conclude that an increase in international remittances would reduce both the poverty headcount and poverty gap.

Remittances and Inequality

In contrast to the link between remittances and poverty, no strong conclusion is found in household studies of the relationship between remittances and inequality: remittances sometimes go disproportionately to better-off households and so widen disparities, but in other cases they appear to target the less well off, causing disparities to shrink. Some studies suggest that the remittances from new migration may raise inequality in the short term, but the effect on inequality is small over the long term. Calculations that impute incomes for the migrant had he/she stayed and worked at home generally show an increase in inequality from the combined effect of migration and remittances (Barham and Boucher 1998).

Two recent studies, however, did not find an increase in inequality even after controlling for the counterfactual income loss from migration: Adams (2005a) found that in Ghana, the inclusion of international remittances in household expenditures led to only a slight increase in income inequality, but that the Gini coefficient remained relatively stable, between 0.38 and 0.40. De and Ratha (2005) found that in Sri Lanka, the Gini coefficient drops from 0.46 to 0.40 as result of remittance receipt.

Differences in findings on the impact of remittances on inequality also stem from varying geographic and historic circumstances, such as the distance from high-income destination countries and the prevalence of networks of earlier Diasporas. Both proximity to high-income countries and established networks will tend to reduce the cost of migration, making migration an option for poorer (and often credit-constrained) households. One reason for the inconclusive empirical evidence on inequality effects is that the Gini coefficient does not adequately capture income mobility; it remains unchanged, for example, if one person moves up and another moves down the income ladder.

Beyond the contradictory or inconclusive results, some scholars question whether the link between remittances and inequality is all that important. They present it as inequality matters when it interferes with the functioning of the economy (for example, when credit constraints bind more households) or the political system (for example, when growing inequality increases support for governments that pursue damaging populist policies). Greater inequality may also be considered bad because of its impact on social welfare. But it should be kept in mind that in the context of remittances, inequality relates to income differences among groups that would all be viewed as relatively poor in an industrial-country context. The rich in developing countries probably receive little in the way of remittances; the rich who migrate tend to take their families with them.

2.4.2 Remittances and Household Consumption Smoothing

Remittances may play a significant role in smoothing consumption. Poor households that lack access to insurance and credit markets are vulnerable to severe declines in income from adverse shocks, and they may be forced to forgo income generating –but risky– strategies (Morduch 1994). Informal community institutions generally play a limited role in mitigating risk, especially in the face of adverse events such as a community-wide crop failure. One strategy to reduce risk is for households to send family members to other regions or countries, where they are not likely to face the same income shocks as those found in the domestic market. Migration patterns and policies that encourage migrants to travel unaccompanied by family members encourage this form of risk sharing.

There is some evidence that remittances from internal migration provide insurance. Remittances increased with the extent of drought in the migrant's home region, and the responsiveness of remittance levels to drought was greater for households with more drought-sensitive assets such as cattle (Lucas and Stark 1985). The anticipation of insurance may allow the household to pursue a more risky asset accumulation strategy- although it is also possible that households with more to lose from drought (whatever the reason) are simply more likely to receive remittances. (Paulson2000). The effect is particularly strong for remittances to rural households, which are likely to be poorer and have less access to formal insurance products to mitigate weather related risks.

Studies of how remittances respond to adverse household shocks generally support the view that remittances provide some insurance. However, interpreting these correlations is complicated by the likelihood of reverse causality (remittances can influence household outcomes as well as be influenced by them) and omitted variable bias (certain hard-to-measure household characteristics may affect a household's susceptibility to risks as well as the likelihood of receiving remittances.)

2.4.3 Remittances and Indirect Effects on Household Income

Remittances may indirectly affect household income through changes to the labor supply of those remaining behind, relaxation of working capital constraints that expand income from entrepreneurial or farming activities; and multiplier effects on household income. Although the evidence on these channels is quite limited, the following relevant illustrations are presented.

Remittances on labor supply

Remittances may tend to reduce the supply of labor provided by remaining household members, who may take a portion of the remittances gain as leisure. The income effect is generally not a concern, because it represents part of welfare gain from remittances. By contrast, remittances may change the return to supply of labor, for example, if the migrant conditions the remittance on low household income. Such a substitution effect will reduce the welfare gain from remittances by distorting household labor decisions.

However, it is difficult to separate income and substitution effects of remittances on the labor supply of those remaining behind. When looking at the overall effects, a rise in remittances may reduce labor force participation but increased self-employment (Funkhouser 1992). Remittances were estimated to reduce the participation rates of remaining household heads in a number of Caribbean countries, although the direction of causality was hard to establish (Itzigsohn 1995). Yang (2004) points to more encouraging labor-supply effects than the standard model when he determined that remittances reduce the supply of child labor but increase that of adult labor.

Remittances on provision of working capital

There is some evidence that remittances provide working capital to households that lack access to credit markets. For example, migration to South Africa's mines initially reduced agricultural production in countries of

origin, because labor was removed from the farm (Lucas 1985). However, over time production rose with migration, perhaps due to remittance-funded capital investment and a greater willingness to take risks with agricultural production, owing to the more diversified sources of family income. Remittances had a small negative effect on household income for Mexico in 1982, but a large positive effect for 1988 (Taylor 1992). One possible explanation is that over time the development of migrant networks allowed migration from poorer households that are more likely to be credit constrained. The effect of remittances on household income depends on both the liquidity of household assets (which determines their value as collateral) and on the availability of inputs that complement entrepreneurial activity (Taylor and Wyatt 1996). Mishra (2005) found that a 1 percentage point increase in remittance inflows in 13 Caribbean countries increased private investment by 0.6 percentage point (all measured relative to GDP).

Remittances may ease credit constraints because a stable stream of remittance income may make households credit worthier in the eyes of formal sector financial institutions. Remittance receipts that increase when the household receives an adverse shock may be even more important in relaxing credit constraints, since they increase the lender's confidence that they will be repaid even if things turn out badly for the household.

Remittances and multiplier effects

Remittances have a multiplier effect, whereby the increase in domestic income is some multiple of the remittances income. Multipliers will occur if output is constrained by insufficient demand. However, in many developing countries sustained underemployment is likely to have supply-side causes, for example, government policies that increase the cost of hiring and firing workers, so that increased demand will ultimately result in higher inflation rather than increased output (Manuel Orozco (2003); Access Finance, 2005).

Nevertheless, there may be greater scope for sustained multiplier effects at the regional level. The local spending of remittance income will generate further income for other local households, which in turn is likely to cause local inflation for non-traded goods and possibly a small increase in national inflation. A national government with a formal or informal inflation target is likely to respond to any increase in the national inflation rate by tightening monetary policy, thereby leading to an offsetting effect on national aggregate demand. The net effect would be multiplier effects at the local level but not at the national level. Indeed, the local gains come partly at the expense of the regions that do not receive the remittances but are forced to suffer the tighter monetary policy.

Remittances also may have multiplier effects in the context of increasing returns, typically as the expansion of one-sector increases the optimal size of other sectors. Although such income-expanding feedback loops could be present at the national level, they are again more likely to be relevant at the regional level, because expanding regions attract labor and capital from elsewhere in the economy. The bottom line is that remittance-induced multiplier effects cannot be ruled out—especially at the regional level.

2.4.4 Remittances, Savings and Investment

From a welfare perspective, an extra dollar of investment is only better than an extra dollar of present consumption if the marginal social value of investment is greater than its marginal private value. Although a number of factors can drive a wedge between social and private values (such as capital income taxes, monopoly powers, and credit constraints), one prominent reason raised in the development context is the possible existence of positive externalities from investment expenditure. Thus the way that remittances are allocated by households may affect the social value given remittances flow.

The rate of investment of remittances income will be high when:

- Remittances flows are viewed by the household as transitory rather than permanent and thus should be saved (and invested) rather than spent.
- The sender conditions the remittance on it being spent for particular purposes, which are more likely to involve investment than current consumption. Examples include education or the purchase of new farm machinery.
- The remittance is targeted (or “tagged”) to household members more likely to use the funds for investment purposes (women rather than men).
- Households practice a form of mental accounting with their overall budget, with remittances being disproportionately put in accounts set aside for investment purposes.

On the other hand, some of the literature suggests reasons to expect that the marginal propensity to invest remittance income will be low, when (a) remittances are targeted to poor households that are struggling to meet subsistence needs and (b) They are targeted to credit-constrained households that are experiencing adverse consumption shocks.

Measuring the impact of remittances on investment -either in physical or in human capital-is not as such easy. Household budget surveys are best suited for this purpose, but most of the existing surveys either do not record data on international remittances or are poorly designed.

Remittances to investments in education and health

Some of the clearest evidence for remittance-induced investments comes from work on human capital. According to Yang 2004; the dramatic depreciation of the Philippine exchange rate during the Asian financial crisis increased remittances from Filipino Diasporas (because from the Diasporas' perspective, exchange-rate depreciation raised the relative price of their own consumption in the host country compared with consumption by

household members back home), leading to greater child schooling, reduced child labor, and increased educational expenditure in origin households. Remittances are estimated to reduce the probability of children leaving school by 10 times the effect of other sources of income in urban areas and by 2.6 times in rural areas (Cox Edwards and Ureta 2003). The writers speculate that remittances have a disproportionate influence on schooling expenditures because the Diaspora has made it a condition for the financial support.

Health status is both an important component of human capital and a central element of well being in its own right. Unfortunately, the effect of remittances on the health of family members remaining behind –notably children –is poorly understood. The positive health effects come through increased access to health related knowledge as well as through increased household wealth. Notwithstanding these encouraging outcomes, the impact of migration on child health is quite nuanced, with migration associated with lower measures of preventive health care such as breast-feeding and vaccinations.

Remittances and entrepreneurship

There has been a marked shift from the belief that Diasporas are unlikely to establish new business enterprises in their countries of origin (either upon return or through remittances financing) to the view that migration encourages entrepreneurship. Remittances also appear to ease credit constraints on new business formation in the Philippines (Yang 2004). The effect of exogenous increases in remittances income on the probability of entering into entrepreneurship is larger for low-to middle-income households, which are the ones most likely to face credit constraints. Policies that facilitate easy exit and reentry for migrants may encourage increased involvement in remittances-funded investments or enterprises.

Remittances and Investment by recipient households

Contrary to the conventional wisdom those remittances tend to be “frittered away” by recipient households; recent works has estimated that a large proportion of remittance income is saved. Only 12 percent of net increments to expenditure by rural Egyptian households were allocated to consumption, with large propensities to invest in the construction and repair of houses, and in agricultural or building land (Adams 1991). This relatively high propensity to invest is assumed to result from households treating remittance receipts as temporary income flows, which forward looking households are save (and invest) rather than consume. These findings are largely confirmed in a later study of Pakistani households (Adams 1991).

It is noted in some surveys that result for a number of Latin American countries point too much higher propensities to consume remittance income. The percentage of remittances spent on household expenditures is quite high; while spending on real estate and education is low (Adams 2005c). However, surveys of how income from a particular source is spent tend to be unreliable, because the household considers monies from different sources perfect substitutes.

The role of remittances in funding investment has recently been questioned in a macroeconomic paper with the finding that remittances tend to be negatively associated with economic growth (Chami, Fullenkamp, and Jahjah; 2005). This countercyclical behavior of remittances is consistent with the evidence discussed above that remittances respond to adverse household shocks. But the observation that remittances tend to move counter-cyclically does not necessarily obviate their role in funding investment. The micro studies reviewed point to remittances as both smoothing consumption and providing funds for investment. Moreover, the increased flow of remittances in the face of adverse shocks may allow

households to sustain funding for key investments in areas such as business working capital, education, and health care.

2.5 Remittances in Ethiopia

In the case of Ethiopia, formal remittances are taking place through Governmental as well as Private owned Commercial Banks and Money Transfer Operators such as; Western Union and Money Gram. It is possible to know the amount transferred through these formal means as it is recorded officially.

Data from National Bank of Ethiopia shows the increasing flow of remittances from 1997/98 to 2004/05. The following table (Table-3) shows the amount of individual transfers and its percentage share in GDP and private transfers.

Table 3 Amount Remitted (in Million Birr)

Year	Amount of Individual transfer	% Share in GDP	% Share in private transfer
1997/1998	920	N.A	42.81
1998/1999	658.2	1.23	31.65
1999/2000	958.5	1.61	30.91
2000/2001	928.5	1.53	29.40
2001/2002	875.1	1.52	29.39
2002/2003	1,411.5	2.25	33.24
2003/2004	2,012.3	2.65	34.78
2004/2005	3,207.4	3.65	45.72

Source: National Bank of Ethiopia

In 1998/99 the share in GDP was 1.23 % and in 2004/05 it increased to 3.65 %. The share of individual transfers in all private transfers has grown from 31.65% to 45% in 1998/99 and 2004/2005 respectively. Therefore, it will be easier to remark that the amount of flow of officially recorded remittances have increased over a period of time.

With regard to informal remittances, similar to other countries; the amount of remittances transferred informally is estimated in Ethiopia. Observers suspect that informal flows may range from 50% to 250% of the formal remittances (Celent and AITE, 2005). If the average of the above estimation is considered (i.e. 175%) to estimate Ethiopia's informal remittance by using the data of National Bank of Ethiopia for the year 2004/05 then, it would make about Birr 5,612.95 millions.

A mission commissioned by IOM Ethiopia estimated the amount of informal remittances flow to the country could be around Birr 3,326.8 millions. The same study estimated the potential remittances, which could flow to be Birr 18 billion per annum. The figures are used as a pointer towards the potential remittance the country may have.

2.5.1 Measures taken by the government

In order to encourage the formal flow of remittances, the Government of Ethiopia has made different policy directives through National Bank of Ethiopia and other pertinent government offices. Some of the incentives are presented here under;

Tax incentive: The government of Ethiopia has introduced tax incentive entitlement that is given to Ethiopians returning home after living abroad for reasons such as diplomatic assignment, migration etc. to bring personal effects free of tax and tariff. These personal effects include a range of household items and car for private use. Those who stayed abroad for longer period have more entitlement than those who stayed for short period.

Provision of Identity Cards: It is issuing of an identity card for Ethiopians living abroad, if they want to construct residential houses, open bank accounts, etc in Ethiopia.

Opening Bank account in Foreign Currency: The other measure taken by the government of Ethiopia is to allow Ethiopians living abroad and Ethiopian born foreigners to open a fixed and current account in Ethiopian commercial banks in selected foreign currency that is US Dollars, Pound Sterling, Japanese Yen and Euro.

3. Methodology and Data Source

3.1. Methodology

In comparison to the ever-increasing worldwide remittances flow from one continent to other continent and from country to country, the amount transferred to Africa is very minimal. Ethiopian's remittances share in turn is insignificant and most of the records do not recognize the data. On the other hand, the country has very large number of Diaspora people residing in different parts of the world who are well quoted by the immense contribution they made for the host countries. There are also so many people migrating, working and learning. Nevertheless, the financial transfers and contributions are not observable.

One of the reasons is that the recorded data about remittances, which is of course relatively smaller, only represent the funds remitted through formal channels. But, there are large scales of illegally moving funds, uncontrollable, and inaccessible to the financial authorities, and thus, are not included in the official figures of recorded remittances.

Recorded remittances in most cases underestimate the real flows of money remitted by the Diaspora. The greatest source of bias of the data about remittances arises from remittances transferred through unofficial channels, remittances transferred by emigrants themselves, and remittances in kind. These items constitute in certain cases a substantial proportion of remittance inflows.

This study mainly concentrates in the analysis of remittances and, therefore, will try to examine and pin point major factors such as emigration

patterns, wages, and other variables among the determinants and proposed an econometric model concentrating in these inputs.

In identifying factors that are responsible for the inflow of remittances the microeconomic model is estimated based on the cross-sectional data set collected from the primary source.

3.2. Data Source

In order to carry the analysis a primary data is collected from Ethiopian Diaspora residing in USA, Europe and the Middle East Countries who transfer remittances and similarly to most urban dwellers in Addis Ababa and other five major towns of the country who are recipients of remittances up on the replies from the questionnaire distributed. Around 400 people are contacted through the questionnaire but from these 327 have replied (i.e. 208 from the senders and 119 from the recipients).

Sampling of dwellers in urban areas is done owing to the fact that history of noticeable Ethiopian out migration began in late 1970's following the then political upheavals and it is associated with the dwellers in the urban areas (i.e. urban elites, young and the educated who sought refuge in the west because of political reasons) and on the other hand urban dwellers have relative advantages in getting access to remittances due to availability of financial infrastructure and relatively developed information and communication technology (Dejene; 2005). Name of the selected five towns moreover to Addis Ababa are Mekelle, Gondar, Awassa, Dire Dawa and Dessie. In comparison to other towns of the country, these towns have large number of Diaspora relatives over seas. Moreover, although data of National Bank of Ethiopia does not have split flows of remittances to regions and towns of Ethiopia, financial transaction documents of money transfer operators reveal frequent transfers to these towns.

The questionnaire covered the following categories of information: 1) From the senders side; the existing ground situation of the remitter like age, sex, duration of stay, the reason for living in the host country, average monthly income, educational level, amount and frequency of sending remittances and the most probable reason for sending, the relationship with the recipients, channel of transferring remittances and why they select the channel, what prevents them from sending more support frequently and finally their expectation on the changes the remittances may bring on the recipients lively hood. 2) From the recipients' side: the raised issues are from which country/countries do they receive remittance, the living status of the remittance sender in the host country and how long she/he stays abroad, the gender of the remitter, the frequency of getting the support and its average amount in Ethiopian Birr, which transferring channel does the remitter used (i.e. formal or informal with the detail options of sending mechanisms), which channel is in fact easy, reliable and convenient for the recipient, what is the primary use of the remittance they get, the family size of the recipient, availability of additional or alternative income to the recipients and the extent of improvement in the lively hood of the recipient as the result of the support.

Secondary data and other pertinent information used in this study are collected from National Bank of Ethiopia statistics. For Purposes of the study all foreign currency types will be converted into Ethiopian National Currency (Birr) using official exchange rates.

The study could also include descriptive explanations based on the nature of the dependent variables and the type of issues raised on the questionnaire.

3.3. Model specification and Estimation

Literatures on the determinants of remittances bases on:

- **The Supply side conditions:** This comprises micro-factors in individual characteristics of the remitter Diaspora such as education, age, sex, marital status and the length of their stay in the host country. Moreover, the level of their earnings in host countries influence the motives individual emigrants have for remitting part of their incomes for family support. This in turn determines their consumption behavior and thus, the potential amount of earnings that can be remitted to the country of origin.

On the macro level, factors affecting remittances can be attributed to both the rate of growth of the host country and the cycles in economic activity, which affects demand for immigrant labor. In most of the cases the labor demand in the host countries is constrained by immigration quotas. Limited numbers of foreign workers are permitted to enter or remain in the host country. However, the supply of immigrant labor to the host countries is infinitely elastic, then the growth of/and fluctuations in economic activity determine the total number of immigrant workers in the host economy. People may leave their country of origin for a short period of time for study, visit, getting a job or even for permanent residence in the host country. Such cases create an opportunity for the Diaspora people to send remittances to those remaining at home.

The rate of inflation in the host country is also a major determinate of the Diaspora savings. Inflation in the host country usually decreases remittances because changes in nominal wages do not correspond to price changes. Besides, the rate of return on various

assets affects the attitudes of the Diaspora to remit their savings outside the host country.

Concerning the countries of origin, potential remitters have different decisions to make towards their savings or investment. First, they have to decide whether to retain their funds abroad or to send them home. If they decided to remit, another decision must then be made in the use of either official or unofficial channels. Provided that individuals have the right to hold foreign exchange accounts, or other assets denominated in foreign exchange in their countries of origin, a supplementary decision is likely to be taken. This is whether to remit in domestic or foreign currencies. These decisions depend on a variety of factors that are important for the inflow of remittances to the countries of origin.

- **The Demand Side Conditions:** Characteristics of the remittance-receiving households such as their number, socio-economic conditions, availability of additional income, etc are the basic determinants in such approach.

In this study it is proposed that emigrants transfer their earnings for two reasons: family support purposes and saving or investment purposes. Remittances for family support are a very essential element in the process of the Diaspora decision. This amount is not necessarily responsive to incentives. Concerning remittances for family support, the level of incomes available in the country of origin will be negatively related to the inflow of remittances. Since remittances for family support will be used to support family consumption in countries of origin, lower income levels in the country of origin will thus raise the need for more transfers of remittances to maintain living standards of the Diasporas' families. At the macro level, domestic rate of inflation is also a major determinant of

fluctuations in real income levels. Higher domestic inflation rates will require larger remittances to maintain family consumption levels at home.

Hence the remittance inflow can be represented as the following; from the senders' perspective:

$$R_{\text{senders}} = F(\text{Age}_i, \text{Sex}_i, \text{Stay}_i, \text{Cond}_i, Y_i, \text{Edu}_i, \text{Purp}_i, \text{Type}_i, \text{Ch}_i)$$

Where;

Age_i = Age of the Diaspora i who send remittances

Sex_i = Gender (Male or Female) of the Diaspora i who send remittances

Stay_i = the number of years the Diaspora i stay in the host country

Cond_i = the living condition of the Diaspora i in the host country

Y_i = Average income of the Diaspora i who send remittances

Edu_i = Educational level of the Diaspora i who send remittances

Purp_i = The main reason for an individual Diaspora i to send remittances

Type_i = The type (relationship) of the recipient i with the Diaspora in the country of origin

Ch_i = The channel i through which the Diaspora send remittances

From the senders perspective; **R_{senders}** is the amount of remittances send in Ethiopian Birr. The amount represents the total inflow through both formal and informal channels. **Age_i** represents Age of the Diaspora i who send remittances, although it is difficult to predict the effects of age on remittance transfers. **Stay_i** represents the number of years the Diaspora stay in the host country. Of course, the longer the emigrants stay or expect to stay in the host country, the more integrated they may be assumed to become in

the host country, the less likely they may be to sending remittances to the country of origin regularly. In the extreme case of permanent Diasporas, remittances may cease altogether. **Cond_i** reveals the living condition or the main reason for the Diaspora to live in the host country. Job transfer or joining new job, searching for job, moving together with parents or family, schooling, refugee and marriage are the major patterns people often move from their country of origin. **Y_i** stands for the average income of the Diaspora *i* who send remittances. It is expected that the Diasporas will be encouraged to send more, when they get better income. **Edu_i** shows educational level of the Diaspora *i* who send remittances. It ranges from the elementary level and goes to secondary/ high school, college or university or even possession of other professional or academic qualifications. In this category it is also expected that those with better academic performance shall have the chance to win more competition and get better income. **Purp_i** shows the reason why the Diaspora transfers remittances. There are in fact diversified reasons the Diaspora may be encouraged to send remittances and the major once are; for the recovery of income shocks; for savings or investment; for political reasons; for covering expenses such as school/ college fees, accommodation (rent or buy) of freehold properties, clothing and the like; for medical expenses; for purchases of durable properties such as household, car, etc; for special events like wedding, funeral, illness. **Type_i** represents the relationship of the Diaspora with the recipients of the remittance. The recipients may be the wife/husband, father/mother, son/daughter, sister/brother, other relatives, friends, Governmental/Non-Governmental institutions, religious institutions, etc. **Ch_i** shows the channel through which the remittances are transferred. Obviously, there are two channels (i.e. the formal channel comprising Government Official Banks, Private Official Banks, Western Union, Money Gram and Post Offices and the informal channel consisting of sending through people going home and Money Mediators such as Hawala). **Ch_i** is a

dichotomous variable, which takes the value 1, if remittances are transferred through one of the formal channels. Otherwise it has a 0 value.

Amount of Remittances thus can be represented as;

$$R_{\text{senders}} = \beta_0 + \beta_1 \text{Age}_i + \beta_2 \text{Sex}_i + \beta_3 \text{Stay}_i + \beta_4 \text{Cond}_i + \beta_5 Y_i + \beta_6 \text{Edu}_i + \beta_7 \text{Purp}_i + \beta_8 \text{Type}_i + \beta_9 \text{Ch}_i + \theta_i \dots \dots \dots (1)$$

Conversely, remittances on the recipients' side are solely affected and determined by the following factors:

$$R_{\text{recipients}} = F(\text{Ctry}_i, \text{Status}_i, \text{Stay}_i, \text{Sex}_i, \text{Ch}_i, \text{Purp}_i, \text{Size}_i, M_i)$$

Where;

Ctry_i = the type of country i from which remittances are send

Status_i = the living condition of the Diaspora i in the host country
(as low skilled, High Skilled, Refugee or Permanent Residence)

Stay_i = the number of years the Diaspora i stay in the host country

Sex_i = Gender (Male or Female) of the Diaspora i who send remittances

Ch_i = The channel i through which the Diaspora send remittances

Purp_i = The main reason for an individual Diaspora i to send remittances

Size_i = the number of members of the recipient's family in the country of origin

M_i = Average income of the Diaspora i who send remittances

R_{recipients} represents the total amount of remittances received by households in Ethiopian Birr. **Ctry_i** stands for the country from which

remittances are received. In the case of Ethiopia, the principal sources of remittances where most Ethiopian Diaspora is residing are the United States of America, Europe and Middle East. **Status_i** represents the living condition of the Diaspora in the host country like educational level (low-skilled or high-skilled), Asylum seeker/ Refugee, Employment with legal and fixed contract or Migrant with permanent residential status/ Citizenship. **Stay_i** shows the number of years the Diaspora stays in the host country. The longer the emigrants stay or expect to stay in the host country, the more integrated they may be assumed to become in the host country and the less likely they may be to sending remittances to the country of origin regularly. **Sex_i** shows the Gender (Male or Female) of the Diaspora *i* who send remittances. It is a binary variable and takes the value 1, if the sender is male and 0, if female. **Ch_i**, **Purp_i**, and **Size_i** have similar nature and justifications with that of factors affecting remittance senders. **M_i** represents the availability of an additional income for the recipients of remittances. Different sources of income can be mentioned here such as; Income from employment in government or private institutions, income from private/ own business, income from pension, etc. It is a mere fact that when the recipient gets more income its tendency to be dependent on remittances for routine expenses and day-to-day life declines.

Amount of Remittances thus can be represented as;

$$R_{\text{recipients}} = \alpha_0 + \alpha_1 Ctry_i + \alpha_2 Status_i + \alpha_3 Stay_i + \alpha_4 Sex_i + \alpha_5 Ch_i + \alpha_6 Purp_i + \alpha_7 Size_i + \alpha_8 M_i + \gamma_i \dots \dots \dots (2)$$

θ_i and γ_i represent an error term which is assumed an independent and normally distributed random variable with zero mean.

Obviously the above two equations, (1) and (2) concentrate on the major variables that are determining the total inflow of remittances. Accordingly, the regression coefficients will be determined using economic software such as STATA, SPSS or a combination of them.

4. Results and Discussions

4.1 Descriptive Analysis and Discussions

4.1.1 Descriptive Analysis: Senders Perspective

The age distribution of respondents cover a minimum of 18 years of age to a maximum of 56 years of age with the stay in the host countries ranging from one year to twenty two years. Working full time is not a pre-requisite for sending money; where the greater the income gained through work the highest will be the level of remittance. Regarding the reasons for stay in the host country the most dominant reason is schooling (particularly in the tertiary educational level and less than 40 years of age). This is an alarming case while examining the brain drain, which the country would face versus the inflow of remittances together with knowledge and experience sharing.

Next to schooling is the search for work, refuge (i.e. requesting asylum) and marriage. The official job transfers to foreign countries are relatively small, 5%. On the other hand, the minimum monthly income observed is about USD 100 ranging to a maximum of USD 9,000. The majority of the people obtain between USD 1,600.00 and USD 2,000.00 per month. With regard to educational level 58% of respondents are colleges or university graduates, 25% are secondary (high school) completed and 8% are at elementary school level. Some respondents about 9% are known with other qualifications such as sports, music and different artistic activities.

Almost 50% of respondents have opened saving accounts in Ethiopia either in foreign currency or the Ethiopian Birr. Regarding frequency of sending remittances, 60% send with a maximum interval of three months time and widens to random transfers, which is associated with some known holidays and festivities.

The reason for sending remittances varies from daily consumption expenses to savings, investment and purchase of durable properties.

Remittances for schooling expenses takes the highest motive 27.2%, followed by supports for food purchases 23.2% and special and occasional events such as wedding, funeral, holidays, illness and etc, 21.8%. Recovery of income shocks; clothing and medical expenses are also the major reasons for transfers of remittances with 20%, 19.3% and 17.3% share respectively.

The purchase of durable assets (like households and car) and buying free hold properties take a relatively lower share of remittance transfers, 10%. This observation reveals the idea that remittances are not profit driven. Rather they are compensatory transfers, implying that remittances may not be intended to serve as a source of capital for development (Ralph Chami and et al, 2005). Accordingly, remittances for savings and capital development/ investment take relatively lower share 5.8% and 2.4% respectively.

Principal recipients of remittances are mothers and/or fathers 37%, followed by sisters' and/ or brothers 34.5%. Intimate friends also have a good share of remittances 26.4% relative to others. Wife or Husband recipients' rate 13% share succeeded by daughters and sons 9%. Father in law/ mother in law and niece/ nephew recipients have shared 9% and 7% respectively. The patterns of recipients show that the closer the family blood relationship, the better would be the response to remittances.

With regard to the sending channel most respondents who live longer in the host countries use both formal and informal channels with slightly repeated usage of informal channels. Those who live for short periods and those who are not legally registered predominantly use the informal channel. With in the formal channel Western Union takes the lead with 28.5% users followed by government commercial banks 19.2%, Money Gram 16.1%, Private Commercial Banks 10.9% and Post Offices 5.3%.

Money Mediators (eg. Hawala) are the widely used informal channel often preferred by remittances senders with 49% share followed by remittances send through people coming to Ethiopia 29%. The main reason cited by respondents to use the informal channel is its low charges 29.5% and some times no charges when it is send through people; 15.5%. Other reasons are convenience 27.5% followed by its easiness to use and understand by senders and recipients 22.8%, good customer service 15.5%, and secure way of sending money 10.9%.

Conversely, the complaints on formal sector concentrate mainly on the fact that the banking system has got lengthy processes 29.5% and poor services that is inflexibility of the formal systems in handling the desires of senders and recipients 21.8%. The limitedness of accesses of the formal channel to reach provinces is also another problem mentioned by the users together with its delays to reach at destination 18.7%. About 17.1% of senders also acclaimed that currency exchange rates differential between the formal banking system and the black market forces them to incline to the informal channel.

On the side of the remitters, the main barrier stated for not sending additional remittances is lack of financial ability, which inhibits them from affording more remittances 38%, and high transaction costs and charges of sending remittances, especially in the formal channel 20.7%. Some people 8.8% also replied that recipients do not need the money. Others 11.9% have their own reasons for not sending more remittances, but they do not explicitly mentioned them.

Regarding the plausible effect of their remittances on the livelihood of the recipient; 33.2% respondents declared that the remittances do not have very much effect. 20.7% replied remittances do not at all change the welfare, except simple minimization of the wider income gap. 19.2% responded the support has brought a fair change on the recipients. Those

who declared that remittances have brought a great deal of changes and those saying they do not actually know the changes rate similar level: 12%.

4.1.2 Descriptive Analysis: Recipient's perspective

Recipients residing in different cities of the country have been communicated through a questionnaire. Based on the information gathered from the respondents 35.3% of the repliers obtain the support from USA, 52% from European countries and 25.2% form the Middle East countries.

The migration status of the senders is revealed as follows: 39.9% are highly skilled professionals with legal and fixed term contracts, whereas asylum seekers/ refugees and migrants with permanent residential status cover 42% of the observation. The remaining 18.1% comprise different reasons such as college level studies, temporary job opportunity; short term contract works after completing higher studies. Similarly, the duration of the Diaspora senders stay in the host country ranges from a minimum of One year to a maximum of 15 years, averaging 4 to 6 years in most observations.

The gender compositions of remittance sender's as replied by recipients' averages to 54% male and 46% female.

Frequency duration of getting the support varies from a minimum of one month to the extent of random support in connection to different occasions and holidays.

Regarding the amount of remittances supports received at a time, the minimum value is 57USD to a maximum of 750USD averaging between 200 to 330USD in most of the cases. In fact the pattern of the receipt varies from person to person. For some households the sender remits a huge amount of money at once when they get people coming to Ethiopia; whereas, others send equivalent amount periodically.

In connection to remittances channel there is no clear departure between the users of the formal and informal channel. Most senders often use both channels arbitrarily. In any case, 24% usually receive through the formal channel, 25% through the informal channel and 33% through either of the two. From the recipients interest 48.2% of the repliers prefer the informal channel for its easiness, reliability and convenience due to the fact that the recipients have the access to receive foreign currency as well as local currency with a better exchange rate in the black market. Moreover, the documents and registers used in the informal channel are simple and understandable by the recipient. Those recipients who prefer the formal channel rated 45.3%.

Depending on the household member's size and the socioeconomic condition of recipient household, the use of remittances varies. In the eyes of the respondents, the receipts are used for mixed purposes and 46.3% of the household spends for food purchases, 41.4% for educational expenses, 40.5% for clothing and 35.3% for health care/ medicines. 34.1% for housing rents and purchase of durable assets, and 9.7% for utility costs such as water, electricity, fuel, etc and transportation and communication activities. The mixed use of remittances is often observed in relatively large family sized households.

The family size of the recipient respondents comprises from a minimum of 2 persons to a maximum of 16 family members and an average of 6 to 7 individuals per household. From the group of the recipients observed 46.3% have additional income from employment from either governmental or private institutions. 28% have income from personal /privately owned/ business. For the others 19.5% respondents, the family entirely depends on social security funds and pensions.

With regard to the effects of remittances 36.6% have replied that the remittances completely changed their lively hood, and the remaining



recipients evaluate it as fair, not very much and not at all with 29.4%, 26.8%, and 6.2% respectively. Simple relationship observed from the data is that as the family size gets larger, the life improvement effects of the remittance declined. In other words, remittance will be utilized for short-term consumption alone rather than savings and investment.

4.2 Econometric Analysis and Discussions

The above descriptive analysis concludes the significance of different socioeconomic factors, the individual behaviors and the prevailing situations as determinants of remittances from both the senders' and the recipients' side. Nevertheless, the univariate analysis may not reveal some of the underlying relationships, which need to be seen in isolation. This section presents multivariate analysis of the relationships by controlling some underlying observed and unobserved characteristics. The econometric model to be employed was developed in the previous chapter.

In the analysis of remittance senders' data, the Probit model was used and the results are presented on (Table 4) below.

Table 4: Probit Regression results for Remittance Senders Model

Variable	Coefficient and Standard Deviations
Age2	4.7735595** (0.6142468)
Age3	-2.1750928* (0.4427535)
Sex	1.461919 (0.369901)
Stay	2.4582783** (0.4716614)
Reason for sending	1.6798063 (0.4519273)
Income 2	3.5451339** (0.5841654)
Income 3	5.2859204** (0.513437)
Education 2	3.924627**

	(1.121301)
Education 3	4.9951397** (1.098078)
Major Recipient	10.490912* (0.426301)
Channel	-5.4941406* (0.3573807)

**** 5% Significance; * 10% Significance**

Note: Number of Observations: 208

As indicated in the table, in order to reveal the pure effects; the age of the remitters are divided into three sections (less than 25, between 35 and 45 years and greater 45 years of age). The first section was dropped to avoid the possible influences of the dummy variable trap. The age variable is significant. According to the result obtained when the Diaspora migrates in the earlier ages there is a possibility of getting better chance while striving for survival (i.e. through working for longer hours and at different places), which would result in success by being a better competent in the host country.

The third age group has a negative sign and it indicates that as the age of the remitter increased, two plausible outcomes may result. One if the Diaspora migrates in the earlier age, then there is a probability that he/she may get accustomed with the situations of the host country and loses the link with relatives in the country of origin. This is manifested by the declining of the rates and amounts of remittances. Parallel to this if the Diaspora migrates in his/her later age; it would take ample time to be mixed with the social and cultural structures of the society in the host country and thus, will be hindered to acquire different trainings, formal classes and the like, which make the life difficult and the earnings would also decline. This in turn reduces the amount of remittances transfers from overseas.

Gender of the remitter does not seem to be significant (at 10% level of confidence) to influence the amount of remittance. The duration of the stay

of the remitter in the host country is estimated by a dummy variable. (That is, if the remitters stay in the host country for a maximum of five years, it would be 1 and otherwise 0). Accordingly, the stay in the host country is significantly positively associated with the likelihood of sending remittances; implying that more remittances are sent in the earlier years of migration which is consistent with most previous theories.

The various reasons for sending remittances are categorized into two groupings evaluated as dummy. The first represents remittances spent to cover the routine and daily expenses (like food purchase, recovery of income shocks, schooling expenses, rents, buying household items, medical expenses, clothing and ceremonial events). The second group is associated with capital development, savings purchase of durable property (house, car, etc) and investments. Thus, the first group is assigned 1 and otherwise it is 0.

The reason for sending remittances is insignificant. This implies that remitters do not that much worry about where the fund would be spent. The result obtained fosters the idea that remitters often send funds because of altruistic motive just to take care of the recipients' wellbeing that are left behind. The recipient has the right to allocate the fund prioritizing its desires.

Income of the sender is also evaluated by classifying it into three major groups. The first class comprises those who earn less than or equal to the equivalent of Birr4, 000 per month. The second group contains earning between the equivalent of Birr4, 000 and Birr10, 000 per month and the third class represents those who earn more than Birr10, 000 per month. The analysis results show that the income of the sender is found to be significant at 5% implying that remittances rise steadily with the Diasporas earnings, which is consistent with a variety of motives.

On the other hand, to explain the impact of the level of educational attainment; Remitters schooling stage is categorized into three classes, i.e. the elementary level, secondary school completed and tertiary level (college/ university graduates) and those with other professional qualifications. Keeping the primary level as reference the other two levels were regressed.

The level of schooling of the remitter is found to be significant at 5% level and positive. This implies that completion of secondary and tertiary educations have strong association with the probability of sending remittances. This seems consistent with human capital theory where education is assumed to increase productivity and hence earnings. However, the coefficients of different classes of schooling dummies are not the same, suggesting that different levels of education affect remittances differently.

In connection to the relationship of the remitter with recipients, two groups are formulated from the observations of data collected. Very near family of the remitter such as father/mother, wife/husband, son/daughter, sister/brother, etc comprise one category and friends, other relatives', religious and non-governmental institutions comprise the other category. By dummifying the variables very near family members takes the value 1 and otherwise 0. The analysis result reveals that the likelihood and level of remittances is significantly positively affected by proximity through blood or marriage relations, i.e. remittances increase with the degree of proximity between the migrant and the remaining household members.

The sending channel is found to be significant (at 10% level of confidence). However the sign of the coefficient is negative implying that the remitters tend to use the informal channel due to the fact that formal channel is not inviting. The very convincing reasons in association to this factor are the paramount transaction costs of using official channels, the inconvenience of

the formal channel to the living circumstances of the remitter; for instance, non-registered (or illegal) dwellers in the overseas do not use the formal channel. Others do not use the formal channel either, due to the exchange rate disparities between the formal and informal channels, which in turn affects the local currency equivalent of the amount remitted.

The econometric analysis results of factors affecting remittances from the side of recipients are presented and discussed as follows.

Table 5: OLS Regression results for Remittance Recipients model

Remittance	Coefficient
Country 2	6.0370996* (0.1519722)
Country 3	-3.1911696* (0.1794419)
Migration Status	2.0578446** (0.1202271)
Stay 1	4.0578446 (0.1188191)
Stay 3	-2.1073937 (0.1881741)
Sex	1.0449806 (0.1143708)
Sending Channel	-2.0642529 (0.1112008)
Use of Fund	7.2340341* (0.1353928)
Additional Income of the Recipient	-3.1269725* (0.1121801)
Family Size	4.010586* (0.0170448)

**** 5% Significance; * 10% Significance**
Note: Number of Observations: 119

The country from which the remittances are transferred is a crucial leading factor for analysis. The three known sources are considered. Accordingly, the remittances source countries are positively significant at 10% level of confidence with different coefficient signs. The higher exchange rate of

Dollar, Pound Sterling and Euro for remittances transferred from USA and European Countries would benefit the recipient by increasing the amount at hand, despite the higher transaction costs of the banking system.

The living status of the remitter is also another important factor considered. To make the necessary analysis in connection to the living status of the senders; dummy variable is used. High skilled professionals working with legal and fixed terms of contracts and migrants with permanent residence/ citizenship are assigned 1, whereas those asylum seekers who are not legally registered and temporary workers assume 0 values. Thus, living status is statistically significant at 5% level of confidence and has a positive sign. This is an indication that remittances are subject to the citizenship security of the sender. Legal residences that transfer remittances have the confidence to send more without having any contingency in their hand thinking of better future at their part. On the other hand, short-term contract workers may incline to save more for future investment when they get back home. Similarly, illegal migrants tend to save more whatever they have until they confirm reliable acceptance in the host country.

The duration of the stay of the Diaspora in the host country has been analyzed by three categories. Diasporas residing in the host country (for less than or equal to 2 years, between 2 and 5 years and greater than 5 years). Accordingly, stay in the host country for less than two years is significant, while stay for longer years (greater than five years) is insignificant.

Similar to the observations from the sender's side, sex variable does not have significant influence from the recipient's side. Sending channel as well as use of funds (reason for sending) as observed from the recipient's perspective has similar pattern and back ground explanation with the remitters' analysis.

Availability of additional income to the recipient household has a significant influence on the amount of remittances and the coefficient has negative sign, with a possible explanation that the higher the income of the household from different sources, the less it would be dependent on remittances. Therefore, Periodical support is not required. The remitters will send randomly for some peculiar programs and occasions, and also for the purchase of durable properties.

A family size influence is significant at 10% confidence interval. This indicates that household with large member of individuals are more likely to be highly dependent on supports beginning from daily expenses to acquiring savings and durable assets.

5. Conclusions and Policy Implications

5.1 Conclusions

The importance of remittances has been a debating point of discussion among the scholars with pessimistic and optimistic views regarding its impact on the recipient household as well as the country. The pessimistic view was that remittances do not promote growth but exacerbate the dependency of sending communities by raising financial and material expectations without providing a means of satisfying them, other than more migration and displacement. Individual families may attain higher standard of living, but communities and in effect the country achieve little autonomous growth.

Conversely, the proponents of optimistic idea present the importance of remittances by elaborating its advantage as a stable source of foreign exchange that ease foreign exchange constraints and help finance external deficits, its use as a potential sources of savings and investment for capital formation and development, its use to facilitate investment in children's education and human capital formation, its use to raise the standard of living of recipients through increasing consumption and eventually its contribution to reduce poverty and enhance growth and development.

There has been a sea change in advocacy towards the importance of remittances and currently there is a great deal of consensus and excitement about its potential inflows to support the economy and development.

Powerful political decision makers all over the world started to take time to facilitate the smooth flow of remittances. Countries are taking diversified policy measures and directives to encourage the respective inflows. Policies and measures taken in different countries tried the facilitation of both voluntary based as well as commitment-based transfers.

The very ground and crucial efforts of all governments; however, are to redirect the flows of remittances through the formal channel, although the transaction costs seem expensive.

The Ethiopian government has taken different step-by-step directives, so far but the responses observed are not satisfactory.

The prevailing condition as from the respective analysis of the data collection, under this study implies the need for seeing the determinants of remittances so as to take the appropriate measure.

The study has attempted to identify and investigate major determinants of remittances from both the senders and the recipients' perspective. Simple OLS (Ordinary Least Square) and Probit econometric models are used to analyze the cross-sectional data obtained from the questionnaire.

Initially, the very reason for creating a link between host country and the country of origin is the presence of Diaspora in the overseas. The Diaspora, besides remittances can have an immense contribution to strengthen the growing activities of the country. It can help in institution building, program development, and promotion of dialogue, public enlightenment and cultural renaissance. Therefore protecting and favoring the Diaspora could create an enabling situation for sustainable mobilization of physical recourses as well as virtual participation.

The regression analysis has demonstrated that from the senders' side the age of the remitter, the number of years the Diaspora stay in the host country, the educational level and the channel of sending remittances are crucial factors to determine the amount of remittances.

On the recipients side the country from which the remittance is coming, the number of years spend in the host country and living status of the Diaspora

and the family size of the recipient household are found to be strong determinants of the amount of remittances.

As observed from the descriptive analysis, most parts of remittances sent are used for consumption purposes. This result emanated likely, because the amount of remittances received is not sufficient enough to cover the daily expenses of the household member or conversely, the share of fund going to each individual member of the household will be reduced in poor and large sized households.

5.2 Policy Implications

In this study the determinants of remittances are explored and the following major points are stated as policy implications of the study.

Diaspora is in the best position to enhance remittance supports, develop investment, and transfer technical know-how together with technological advancements. It is the most important factor in determining the existence and transfer of remittances. In connection to the Diaspora, explicitly determined factors are the educational level and legal citizenship of the Diaspora.

Delivering quality education with intensive practical and theoretical grounds would help the success and competitiveness of people in international market. Diversifying educational streams together with quality services is a future potential investment in human capital. However, there should be broad research in evaluating the effects of brain drain the country is facing due to out migration of the scholars against the potential merits that would be obtained from the Diaspora. Besides, there should be a platform to strengthen relationships between the Diaspora residing in different parts of the world and government representative offices both in Ethiopia and Embassies or consular offices in the host country. The Government is required to establish favorable environment to protect and safeguard the Diasporas' right, so as to harness the respective unearned potentials.

There should also be continuous and reliable information exchanges, which notify the on-going social, economical and political events in the country. Such dialogues and forums will certainly reduce the information gap experienced when people stay longer in the host countries. Different policy measures should be taken to anchor the belongingness of the Diaspora to Ethiopia. Effective channel of communication with government officials, highly qualified scholars who are capable of understanding problems and the media is essential to have a well-tailored think-tank meeting with the Diaspora.

The other very important issue is redirecting the informal flows of remittances to the formal channels. As, the findings of this study-identified funds transferred through the informal channels surpasses the formal ones. Narrowing the gap between the official and parallel market exchange rates, improving efficiency of service delivery by the banking system are to be looked with in the policy realm of the government to direct remittances into the formal sector. The identification, evaluation and capacity building of some of potential informal channels into formal system are also another option, which needs meticulous attention.

Policies addressing the improvement of well beings of poor also have direct contributions in shifting remittances used for consumption into savings and investment. The problem of large family size also can be relived through this measure.

Last but not least, taking measures to facilitate, monitor and regulate temporary and long term migration and increase access of population to international labor markets, establishing remittance-baked bonds through securitization and future remittance flows and extending the availability of financial services to poor people and rural areas are vital macro level policy issues that should be properly examined in connection to remittances.

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Declaration

I, the undersigned, declare that this thesis is my own work and has not been presented in any other University.

All sources of material used for this thesis have been duly acknowledged.

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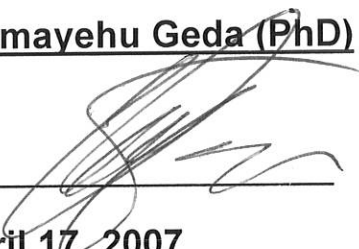


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