

Available online at <http://www.ijims.com>

ISSN: 2348 – 0343

Workers' remittances, one of the reliable sources of capital inflows to Ethiopia – Its performance analysis towards shaping the economic growth

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Abstract

The internationally migrant workers' income share sent back to home country from the country of employment constitutes a vital portion of capital flows to the home country with multidimensional macroeconomic impacts on the economy. Moreover, Workers' remittances have gained an extraordinary importance in developing countries like Ethiopia. This paper attempts to analyze the role of the workers' remittance as a key component among other capital flows to a country in general and Ethiopia in particular. Further, positive impact of workers' remittances on economic growth in Ethiopia has been examined with the empirical evidences and certain drawbacks in transmission system found which needs rectification by interference of Government's new policy adoption.

Keywords: Capital Flows, Economic Growth, Gross Domestic Product, Migration, Remittances.

1. Introduction

Remittances, the part of international migrant workers' earnings sent back from the country of employment to the home country, play a central role in the economies of many labor-sending countries and have become a focal point in the ongoing debate concerning the costs and benefits of international migration for employment. Immigrants are key protagonists of distant proximities: through their labor, they integrate their home and host countries into the global economy in order to keep their own families together. Nevertheless, their lives are also fragmented by the experience of distance and separation from their families and nations. The end result is a transnational lifestyle, characterized by both opportunities and hardships that feature this paradox of distance and closeness (Orozco 2003f).

This lifestyle has also implications for development. Although development economics has long considered foreign capital and savings as key to increase a country's capital-output ratio (Tarp, 1999), until recently it had neglected one very important source: migration, and worker remittances in particular. There is an inter link between migration and development. Specifically, through remittances, migration has brought new opportunities for social and economic change in many areas.

Migration has diverse socio-economic impact ranging from increasing better opportunities for the migrant to an improved livelihood of sending households and to contributing economic growth. However, in the past three decades, significant changes have influenced economic growth and development through spurring migration flows. The relationship between growth and migration, and the resulting effects of ties between diasporas and home countries' economies are becoming more relevant for development and social change. Consequently, the economic impact of migration and remittances has received an increasing interest from both researchers and policy makers. Remittances are often the most straightforward link between migration and wellbeing of the households in the origin countries.

Ethiopia is experienced with different migration patterns and dynamics of diasporas, which have significant political and socio-economic repercussions for the country. The country has one of the highest African diasporas populations, which undoubtedly affects the government's sustainable development and poverty reduction programs. According to Dejene (2005), international migration is increasing starting from the late 1970's, which is the result of the political instability at that time. Nowadays, many Ethiopians, skilled and unskilled, migrate to different countries legally and illegally looking for better economic opportunities. The main destinations for Ethiopians are North America, Europe, and the Middle East (Dejene, 2005).

It is obvious that foreign exchange shortages and heavy import bill are major problems of developing countries. Certain amount of foreign currencies is necessary to pay the import bills; therefore, workers' remittances provide an opportunity to resolve the problem of foreign exchange reserves shortages. In addition to that, remittances often provide a scope for increasing national income and contributing to the balance of payment crisis. Hence, remittances are found to be main reason for the rapid economic growth in many developing countries (Azam and Khan, 2011). Workers' remittances also provide a substitute for inefficient or non-existent credit markets, thus allowing consumers to reduce credit constraints and find an alternative way to finance investment (Giuliano and Ruiz-Arranz, 2006).

In view of the above, Ethiopia is an interesting country to study in this context since it is one of the top 10 remittance receiving countries in Sub-Saharan Africa, and the inflow of remittances to the country has increased dramatically in the past years, from 46 million USD in 2003 to an estimated number of 389 million USD in 2010 (World Bank 2011a)

According to official World Bank statistics, about 30 million Africans have migrated internationally. Demographic factors are likely to increase the African migration rates substantially over the next decades (World Bank 2011a). Remittance inflows to the continent have seen a fourfold increase in the past 20 years, and were estimated at nearly 40 billion USD, 2.5 % of GDP, in 2010. The inflow of remittances to Africa exceeds the amount of official aid and is the second largest source of net foreign capital inflow after foreign direct investments (FDI) (World Bank, 2011a).

2. Migration, Remittances and Development

Globalization and migration are connected through a political economy of foreign labor demands in services and other divisions of labor (Orozco, 2002a). Mittelman (2000) explains that the current anatomy of the global political economy is composed of a spatial reorganization of production among world regions, large-scale flows of migration among and within them, complex webs of networks that connect production processes and buyers and sellers, and the emergence of transnational cultural structures that mediate among these processes. He stresses that heightened competition among and within regions, mediated by such micro patterns as ethnic and family networks, accelerates cross-flows of migrants. In turn, this cross-flow of migrants produces economic effects in the labor-sending country. These micro patterns have effects on the home country's economic growth and distribution of wealth. Therefore, the movement of people becomes an indicator of economic development. First, the networks resulting from the prevailing ties of labor migration have contributed significantly to the integration of countries into the global economy. This point is important in various sectors, including investment, trade, tourism and unilateral transfers. For example, the mobilization of migrant and their relatives' savings and investments at home, in the acquisition of land, property, or small businesses, are spurring economic growth in areas traditionally neglected by the private and public sectors. Second, unilateral transfers, reflected primarily through family or

worker remittances, and to a lesser extent through donations made by migrant associations, constitute key component of economic growth and subsistence in many countries.

Further, remittances can be analyzed within the context of the relationship between development and migration in a three pronged manner: (a) remittances as another source of foreign savings; (b) remittances as an illustration of a broader process of integration into the global economy through migration, namely, transportation, telecommunication, tourism, transfer of remittances and nostalgic trade (Orozco, 2003d); and (c) remittances as an enabling factor of growth.

3. The Patterns of Migration and Remittance in Ethiopia

Workers' remittances are an important and growing source of foreign funds for several developing countries because of remittance inflows from developed to developing countries. Presently, workers' remittance inflows are more than double the official aid received by developing countries. According to the World Bank and the IMF, if remittances sent through informal channels are included, total remittances would be as much as 50 percent higher than the official record (World Bank 2010). In 2011, officially recorded remittances to developing countries exceed \$334 billion.

Remittances have also become an important source of external finance for the African countries. The data on African migration and remittance flows, however, are likely to be understated because of the scale of undocumented migration within the African continent, the prevalence of informal remittance channels within the region, and the relatively weak official data in many African countries (World Bank 2006). The true size of remittance flows to Africa, including unrecorded flows through formal and informal channels is believed to be significantly larger than the official data. After foreign direct investment (FDI), recorded remittances are the African continent's largest source of foreign inflows. Officially recorded remittance flows to Africa are estimated to have increased from \$9.1 billion in 1990 to nearly \$40 billion in 2010. The true size of remittances including off records flows is believed to be significantly higher. Workers' remittances to African countries reached to 2.6 percent of GDP in 2009, higher than the averaging 1.9 percent of GDP for all developing countries (World Bank, 2010).

The character, direction and volume of international migration flows from Ethiopia have gone through a number of changes in the past decades. Three factors can be identified as the main drivers of the country's migration patterns in the past three decades: political instability, decline or stagnation in the agricultural sector, and the 1980s government resettlement program. Revolution and an unstable political climate in Ethiopia shaped the migration flows during the 70's. In the first phase of migration, most of the diasporas from Ethiopia's urban elite primarily well educated youth who sought to migrate in Western countries for political reasons. In the following decades, it continued, however, migration gradually became an ambition for many Ethiopia's urban people, mainly for economic reasons. Since the mid-1980s, even the rural peasants have started been migrating in large numbers to the Gulf Cooperation Council and other Middle Eastern countries in search of jobs and better *l i v e l i h o o d* . Today, as the Middle East has become an important destination region for Ethiopian migrants, the migrants are to an increasing extent from rural areas migrating to find better (employment) opportunities abroad (Geda and Irving, 2011). According to the World Bank's Migration and Remittances Factbook (2011), the top emigration destination countries for Ethiopians are Sudan, the United States, Israel, Djibouti, Kenya, Saudi Arabia, Canada, Germany, Italy, and Sweden (World Bank, 2011b). More than 1 million Ethiopians are believed to reside abroad (Dejene, 2005) out of a population of 83 million (World Bank 2011). The

remittance inflow data for Ethiopia vary by sources. The World Bank (2011) reported workers' remittance flows aggregating 1.3 percent of gross domestic product (GDP) in 2009. However, the National Bank of Ethiopia (NBE) reported that net transfers from private individuals reached \$661 million in the 2009-10 fiscal year (NBE 2010). Informal remittances to Ethiopia also appeared to be significant. The Central Bank of Ethiopia (NBE) reports that out of the above individual transfer of \$661 million, \$428 million was "underground private transfers". The Central Bank (NBE) report (2012) states remittances to Ethiopia was reached to \$ 1.74 billion, which surpassed the export revenue during that period. Again, the remittances inflows recorded \$1.74 billion, exhibited 19.6 percent increase for the same period from the previous year. This was exceeded export earnings by \$140 million which had recorded \$ 1.6 billion. Increasing inflows of remittances to Ethiopia has been attracting our attention to analyze the impact of remittance on economic growth of Ethiopia.

4. Macroeconomic Impacts and Remittances

The migrant's propensity to remit and the effective level of remittances is often influenced by various external factors such as the cost of transfer of fund, regulatory measures, and incentive schemes and over all the political and economic conditions in both the host and home countries, including the changes in exchange and interest rates and investment opportunities. Remittances are higher due to improved economic conditions in the host countries which create employment prospects and better wages and allow the migrants to send more funds to home country. Remittances are also found to be counter cyclical that is higher during the periods of poor outputs, employment and wages and lower during economic booms in the home countries and vice versa. Remittances are apparently responsive to economic policies, institutions and macroeconomic instability in the home country. In situations of exchange rate restrictions, black market premiums, high inflation or overvaluation may discourage remittances from being sent or shift away from formal channels by sending remittances through the informal and unrecorded channels. Countries with well developed financial sector make remittances easier and cheaper either to send or receive, resulting in stimulated remittances (IMF, 2005).

The risk factors in the home country such as political instability, lawlessness and high rate of crime may hinder remittances flows specially those for investment purposes. Improved investment climate and availability of investment opportunities in the home and host countries are likely to influence remittance flows. In case of high potential returns to assets in the host countries (as opposed to the home country), migrants might be encouraged to invest to the host countries exclusively and affect negatively remittances for investment purposes in the home countries (IMF, 2005).

4.1 Remittances and Economic Growth

Remittances have a potential positive impact on growth for the recipient countries. The development effects of remittances can be decomposed into its impact on savings, investments, consumption, poverty alleviation and income distribution. The impact of remittances on growth in the recipient economies is likely to act through savings and investment as well as short-run effects on aggregate demand and output through consumption. Remittances are a component of foreign savings and they complement national savings by increasing the total pool of resources available for investments (Solimano, 2003).

For some recipient countries, remittances are large enough to have broader macroeconomic implications. As Ratha (2003) pointed out that the individuals' incomes increase the recipient country's foreign exchange reserves. If remittances are

invested, it contributes to output growth, and if it is consumed then also generates positive multiplier effects. By generating a steady stream of foreign exchange earnings, it can improve a country's creditworthiness for external borrowing and through innovative financing mechanism (securitization) can expand access to capital and lower the cost of borrowing.

While large and sustained remittance flows can contribute to currency appreciation and so affect the production cost sensitive trade goods (such as labor-intensive manufacturers). Furthermore, the "Dutch-disease" effects of remittances are of relatively minor concern in so far as remittances grow gradually over long periods (World Bank, 2006). Additionally, remittances are more stable in comparison to other sources of external finance such as Official Development Assistance (ODA) and Foreign Direct Investment (FDI) and it may be counter cyclical also.

4.1.2 Remittance – Growth Nexus Analysis



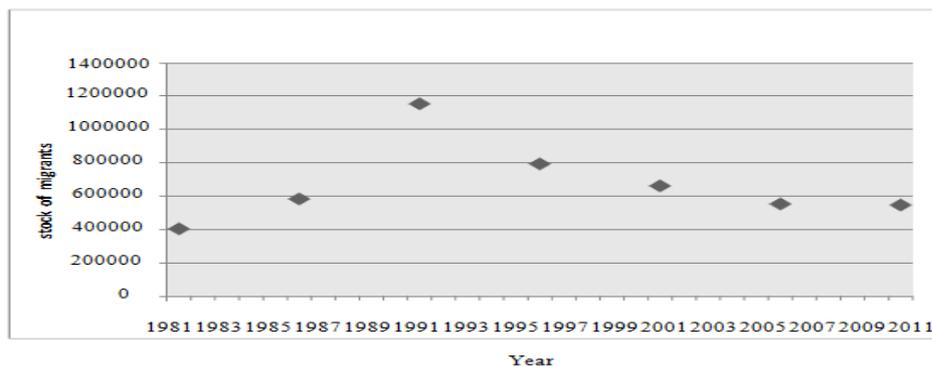
The working of this nexus depends on how remittance receipts are used and the motives driving the remittance flows. Remittances motivated primarily by altruistic (for self consumption as well as caring for relatives in the home country) considerations tend to be countercyclical in its effects on the receiving economy. In the periods of economic boom, less remittances is likely to be received and in periods of economic downturn more remittances would be received to compensate loss of income and general wellbeing of loved ones. Within this context, remittances flow is likely to instigate more consumption expenditure of recipient households at all times, increase per capita income and boost aggregate output in the receiving economy. Overall, the phenomenon of remittance receipts motivated by altruism will positively impact on output growth of the receiving economy.

Secondly, remittances motivated essentially by migrant's self-interest will tend to flow as disguised capital flows into the receiving economy. The overall assumption here is that remittances flow responds to real investment opportunities in migrants' country of origin. Thus, it represents direct investments by migrants in the receiving economy. The consequence here is that remittances as disguised capital flow would enhance domestic investment and help to reduce the investment-saving gap in recipient economy. Finally, increased output growth and domestic investment have direct impact to raise the economic growth of the home country.

5. Changing Trends of Ethiopian Migrants

Ethiopia is one of the largest and the poorest country in general and in particular in Sub Saharan Africa. Ethiopia has low migration rate compared to the rest of Sub-Saharan countries, the total stock of emigrants in 2001 was estimated 0.6 million which was 0.7 percent of the total population. But the total population of Ethiopia is reaching approximately 82 million in absolute numbers. In view of this, it can be stated that the country has large emigrants worldwide.

Graph 1: Stock of Ethiopian Migrants Year Wise (1981-2011)



Source: World Bank (2011), World Development Indicators.

Because of political instability since 1970's a large number refugee flows in the 1980s leading to a strong migration stream from Ethiopia. From the above graph we can understand that the stock of emigrants from Ethiopia is steadily increases until the 1990's. But since the Ethiopian People Revolutionary Democratic Front (EPRDF) came in to power, comparatively the country becomes stable and the stock of emigrants is declining. During the 1970's, the migration is purely political instability and unrest under the Derg regime, but recently peoples migrate mainly because of economic reasons, though there are cases that individuals migrate due to the distrust on the current ruling party. Here, the shocking news is that Ethiopia is one of the worst cases of brain drains comparing to any other country in the world, especially in the medical field. Attracted by the better overseas prospects in other nations, Ethiopia's best and brightest youth haven't been sticking even after the completion of graduation. This huge flight of qualified professionals have had a strong impact on the country, leaving it with too few physicians, engineers and scientists to fill the positions of the country that needs badly to prosper economically.

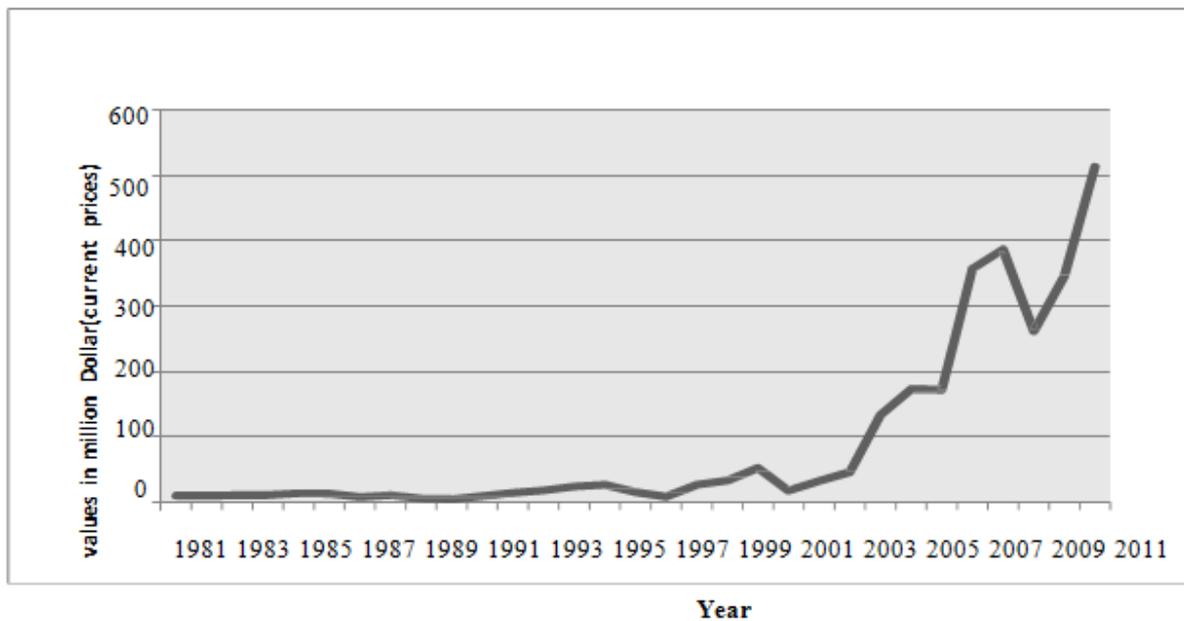
The top destinations countries of Ethiopian migrants are Sudan, United States, Israel and Djibouti, Kenya and Saudi Arabia. The total number of emigrants in the first four countries covers more than 65 percent of Ethiopian emigrants worldwide.

Table 1: Ethiopian Migrants in the Countries Worldwide

Receiving Country	Number of Migrants	Percentage
Sudan	152,094	24.5
United States	139,693	22.5
Israel	87,556	14.1
Djibouti	34,697	5.6
Kenya	30,763	5.0
Saudi Arabia	28,618	4.6
Canada	22,951	3.7
Germany	21,085	3.4
Italy	17,226	2.8
Sweden	12,534	2.0
Others	73,189	11.8
Total	620,405	100

6. Magnitude of Remittance Flows to Ethiopia

One of the positive effects of emigration flows from Ethiopia is the inflow of remittances from the Ethiopian citizens who migrated abroad. Like many other migrants from developing countries, Ethiopian migrants also sent money back to their home country. Remittance flows are the important and stable sources of external finance for many developing countries and constitute a substantial part of financial inflows for the countries with the large migrant labor force. Similarly, remittances inflows to Ethiopia from migrants provide an important source of income for the families to meet their basic needs. Though Ethiopia is not among the highest remittance receivers even in the Sub Saharan countries, the volume of remittance inflow to Ethiopia remarkably increased in the past decades. As Ethiopia is one of the poorest countries in the world, remittances are important for economic growth as they constitute a large share of foreign capital flows (NBE, 2010). Even though the flow of international remittances is increasing from time to time, the amount is less than two percent of Ethiopian gross domestic product.

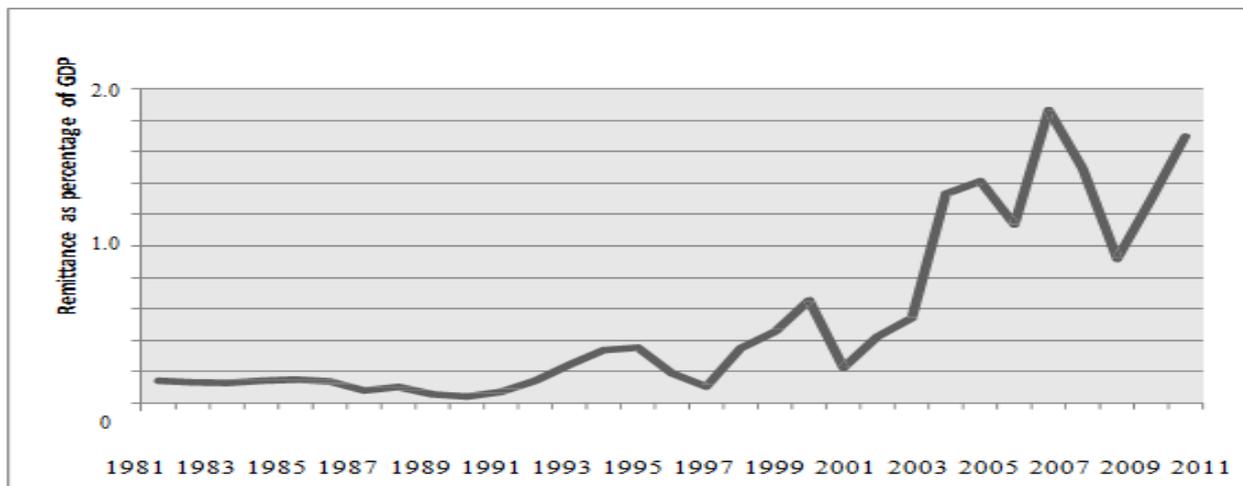
Graph 2: Remittance Flows to Ethiopia (1981-2011)

Source: World Bank world development indicators (various years)

Over the past twenty years international remittances inflow to Ethiopia has grown over fifty fold. In 1991 the total flow of remittance was US\$ 10 million, but in 2000 the inflow of remittance reaches to US\$ 53 million. In the year 2011, the figure increased to an alarming rate and reaches to US\$ 513 million. The significant increase in remittances inflows means that it is becoming an increasingly important component of private capital flow (PCF). As it is shown on the graph the inflow of international remittances sharply increases beginning from 2001 to 2007. Between the years 2007 and 2009, the inflow of remittances decreases mainly because of the worldwide financial as well economic crisis. This worldwide crisis made all the migrants of different countries mainly to puts its steps in the United States and the Western countries which were also the top destinations of the Ethiopian migrants. Therefore, remittance inflow decreases because of the degree of bounciness to the crises is dependent on the source countries from that migrants are sending money. According to World Bank report the global economic crisis leads to 5.5 percent decline in remittance flow to developing countries between 2008 and 2009. During this time the fall in the inflow remittances is more severe for Ethiopia which registers 33 percent decline. Starting from 2009 onwards the inflow of remittances to the country started booming with the largest inflow registered in 2011 which is US\$ 513.

7. Remittance as Percentage of GDP (1981-2011)

The reason for dramatic increase in remittance flows was that remittances through the informal channels were being subjected to greater verification specially, since the events of September 11, 2001. The detection of large size of remittance flows in recent years stimulated the governments worldwide to improve the recording channels. Secondly, the reduction in remittances costs and expansion of remittances networks have increased migrants disposable income and their incentives to remit. Thirdly, the appreciation of Euro relative to US dollar has raised the value of remittances from Europe. The last but not the least reason is that increase in the stock of migrants (because of a decline in travel costs and increased globalization) and the increase in migrants' income have also contributed for the larger flow of remittances.

Graph 3: Remittances as Percentage of GDP (1981-2011)

Source: World Bank World Development Indicators (various years)

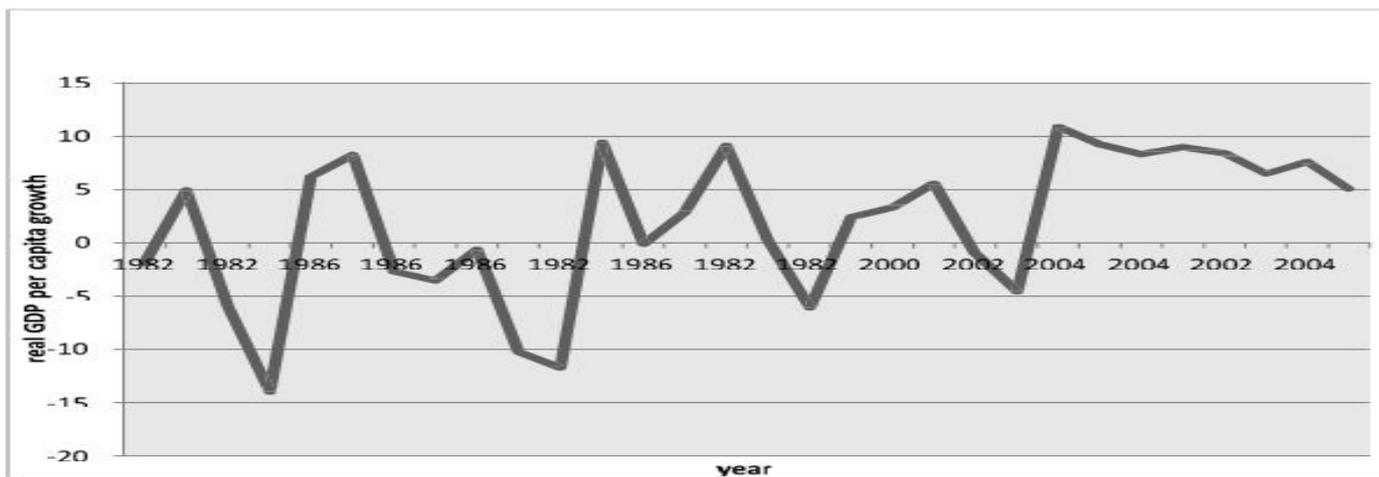
According to UN Report (2009), North America is the most important source of remittance to Ethiopia with 41 percent of total inflow followed by Europe and Asia with 29 and 24 percent of t inflows respectively. The reason behind the large inflows from North America and Europe is mainly due to higher stock of migrants receive higher remuneration in these continents.

The increase in remittance inflows has gained importance relative to the size of the economy. As a share of Ethiopian GDP, remittances increase from 0.07 percent in 1991 to 1.69 percent in 2011, with much of the increase recorded between 2003 and 2011. Though the volume of remittance inflow increased sharply in the last decade, the value of remittances as a percentage of GDP is low in general and did not grow much because, the GDP growth in those years was also very high. From the graph shown above, it obvious that remittance as percentage of GDP has got an overall rising trend since 1991 irrespective of upswing and downswing intermittently.

8. The Trend of Economic Growth

The recent trend of the growth rate of per capita GDP of Ethiopia suggests that the country is experiencing significant improvements in its overall performance since 1993. During the Derg regime (before 1992) the growth rate of per capita GDP was not that much significant and even falls to negative for most of the sampling period. But after the current government (EPRDF) took power (after 1992), the growth rate of per capita GDP moderately progressed except some years. Ethiopian economy was experienced an incredible per capita growth performance in the sampling years 2004 and 2007 registering eleven and nine percent annual growth respectively. During this year Ethiopia even was taking the leading position in the sub-Saharan Africa. Looking at the graph below, the Ethiopian economy suffered a major decline in real GDP growth in 1998 and 2003 mainly because at the time of regime change and severe drought respectively. Generally the quick remark is to observe that on average the growth performance of per capita GDP remained robust in the study period.

Graph 4: Real GDP Per Capita Growth

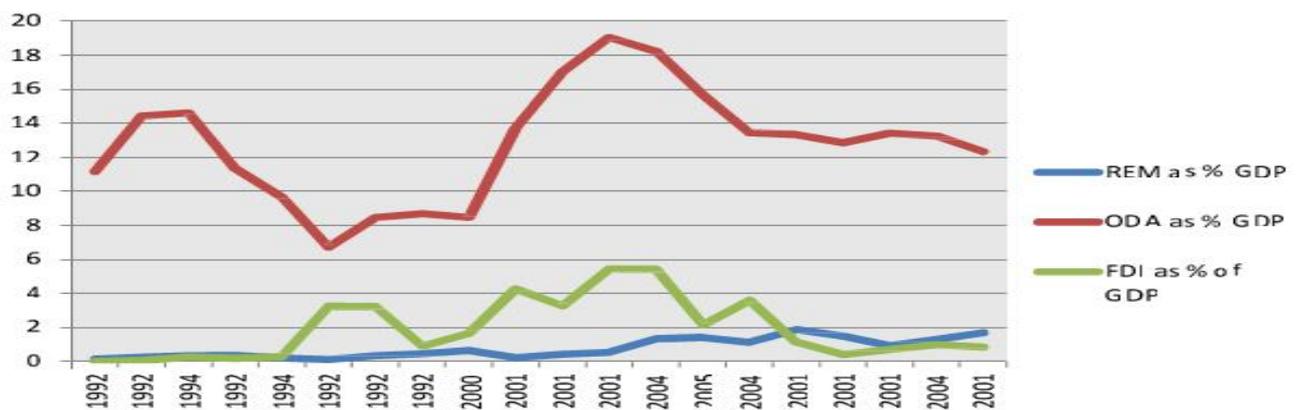


Source: National Bank of Ethiopia.

9. Remittances amongst Other Capital Flows

Ethiopia has experienced a continuing surge in remittance flows both in terms of volume as well as the share of the GDP over the past two decades. One of the remarkable features of remittances in the empirical evidences is its resilience compared to other capital flows; in turn remittances are resilient stable in Ethiopia. From the graph given in the next page, it is observed that remittances inflows to Ethiopia is stable, less volatile and continuously rising as a share of the GDP compared to other external capital flows such as Official development Assistance (ODA) and Foreign Direct Investment (FDI).

Graph 5: Remittances and Other Capital Flows to Ethiopia



Source: Data from World Bank.

On the other hand, ODA and FDI are experiencing a number of sharp drops where as remittance has counter cyclical characteristics. Resilience of remittances shows that it is the source of incomes which can be relied on.

Ethiopia is a country which is highly dependent on ODA which represents an average of 12 percent of GDP and FDI also has an average share of 18 percent of GDP. While remittances inflows to Ethiopia shows overall upward trend and almost more than tripled between 2006 and 2011. On an average it accounted 14 percent of GDP share between these two years.

10. Conclusion

In general, it is anticipated that workers' remittances are spent basically on enhanced consumption rather than on investment in productive assets that can improve future output and welfare for the developing countries. From the empirical analysis it is obvious that being a reliable source of capital remittances have positive impact over GDP growth and development of financial market in developing countries. According to Giuliano and Ruiz-Arranz, the lack of financial development in recipient countries makes the investment and insurance roles of remittances more prominent. The relationship between remittances, financial development and economic growth could in principle go in either direction. On the one hand it is possible that highly developed, efficient financial markets may stimulate the effect of remittances as capital inflows by channeling them into their most productive use. Hence, in this situation remittances are more effective with financially developed countries. Similarly, the association between economic growth and remittances is stronger with financially developed countries. On the contrary, remittances may compensate for an inefficient financial system especially for the developing countries. Here, the remittances might assist the investors to overcome the constraints of the financial market to take advantage of high economic returns that are inaccessible to them because of less developed credit and financial systems. In this case, remittances are more strongly associated with investment and economic growth when financial development is poor.

On the other hand, enhanced economic growth led by the remittances is also likely to be achieved as it facilitates to overcome inadequacies in the financial infrastructure in rural areas and unorganized financial markets in urban areas. In general, workers' remittances could promote the development of financial infrastructure as commercial banks and other financial institutions are attracted to the countryside by the remitted inflows. Although, the varying cost of remittances to the developing countries reacts to fluctuate the amount of inflows that actually makes it to the receivers. The high cost of remittances decreases the amount of fund inflows and vice versa. There is a role for international cooperation with the host governments in developing banking and credit systems, along with prompting and increasing trust and usage of such systems, in areas which are not presently banked for lowering the cost of remittances. Further, the benefits of "banking the unbanked" areas may also translate into more regularized usage of savings caused by the remittances.

The impact of remittances on economic development is clear. Remittances spent for consumption motive on goods or services domestically generate positive multiplier effects on an economy. Further, the value added for improved nutrition, education and health care is a long term investment which will increase social and economic benefits to a country. Finally, it should be noted that remittances are acting, not only to change the consumption patterns of receivers in the home countries, but the internal government policies of receiving countries. With a view to increase and encourage the flow of remittances, governments must reach out to their nationals abroad by policies, such as dual citizenship, which cater to their Diasporas. Internationally, this also prompts a more activist role for governments in the human rights of their migrants abroad.

It is another aspect of recognizing the reality of unrecorded remittances in Ethiopia. The Government of Ethiopia has to take various policy initiatives to channelize remittances towards the formal commercial banking sector, as well as to motivate migrant household decisions regarding the use of remittances in line with national development issues. This analysis offers a number of scopes for further policy formulation. In addition, the effectiveness of channelizing the remittances depends crucially on the ability of the existing formal banking networks to compete with the informal networks.

Finally, migrant workers' remittances are fundamentally private fund transfers across the nations; they are used rationally by the migrants and their relatives. Even under the unfavorable macroeconomic conditions of the country, remittances can

be enhanced by a reduction in transmission costs, making information available on profitable investment opportunities, offering attractive exchange rates and making partnership between fund remitting banks and the fund remitting institutions. In this connection, It is now or never for the Government of Ethiopia to formulate remedial policies like entrepreneurship development program so as to obtain the effects of remittances inflows towards development of the country curbing all the leakages in remittance flows and creating competitiveness in the formal channels of transmission of funds.

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