

**REMITTANCES AS DEVELOPMENT TOOLS  
IN THE ERITREAN ECONOMY**

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**✶**

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## SUPERVISOR'S CONSENT

As the candidate's supervisor, I have approved this dissertation for submission.

Signed: .....  .....

Name: ..... *Thembo B. Temba* .....

Date: ..... *3 May 2006* .....

## **DEDICATION**

This dissertation is dedicated to my parents Ato Abraha Ghebrekidan and Weizero Medhin Araya for their continuous support and encouragement throughout my life and especially in this study.

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## DECLARATION

This dissertation presents the work conducted by Alem Abraha Ghebrekidan in the School of Business, Economics and Finance, University of KwaZulu-Natal, Pietermaritzburg, Republic of South Africa.

I hereby declare that the work contained within this dissertation is original work by the author and has not been submitted in any form for any degree or diploma to any university. Where use has been made of the work of others it is duly acknowledged in the text. The research was carried out between August 2003 and December 2005 under the supervision of Michael Hickson.

Signed .....  .....

Date ..... 03 May 2006 .....

## **ABSTRACT**

Migrant workers in the developed countries remit part of their earnings to their families, relatives, and friends left behind in their old communities in the less developed countries. Remittances, as financial resources whether delivered in cash or in kind, have been playing great roles in the development of the economies of many developing countries. Remittances are now taking the lead after foreign direct investment in most aid recipient countries. Remittances are believed to remain a stable source of foreign exchange (Ratha 2003:163). They have great impact on the society at large and on the living standards of most remittance recipient households. Remittances can be classified as private development assistance because they are sent from individual migrants. At the same time, they are family welfare systems or safety nets that are delivered directly to the beneficiaries.

Why do migrants remit? There are different theories of remittances that attempt to explain the act of remitting. Such theories range from an altruistic behaviour, which according to some studies about 75 percent of remitters claim to be motivated by enlightened-self interest, implicit family loan agreement and implicit co-insurance. The macro-economic determinants and the social networks also play a part in influencing the flow in volumes and frequencies of these moneys.

Eritrea, as a country that has come out of protracted and devastating thirty years of war, started its development from meagre resources. In fact according to Randall (1995), in 1991 - the year Eritrea got its independence - 85 percent of its people were living on foreign aid whether in the form of remittances or food aid. During the armed struggle, the role of the Diaspora Eritreans was significant not only as financial support but also because they acted as spokespersons for the little-known struggle for independence. It was therefore imperative for Eritrea to rely heavily on its Diaspora population for their financial, technical and other material resources to rehabilitate its devastated economy.

To regain sovereignty means a lot to Eritreans as a whole and to the Diaspora Eritreans in particular. After independence, hundreds of thousands of the Eritrean Diaspora flew to their country, met their families and visited different historical places. According to the ministry of Tourism of the State of Eritrea, more than 70,000 Diaspora Eritreans visit the country annually, which means a sustainable level of tourism development can be



achieved. The Diaspora also initiated different projects. The study has come to realise that indeed there are different projects that are sponsored by the Eritrean Diaspora in concern of their immediate families, communities and investments for their potential profits.

Although it is difficult to put it in terms of figures or percentiles, some estimates put the annual remittances received by Eritreans to be between 200 - 300 million US dollars. Remittances, whether consumed or invested, are estimated to contribute enormously to the Eritrean economy, which roughly estimated is 19 – 37 percent of GDP. As in the case of Mexico, remittances' trickling down effect is 3:1 (Adelman and Taylor 1990 as cited in Ratha, 2003). Likewise, the developmental effect of remittances in the Eritrean economy is also estimated no less, if not more.

Furthermore, the Government of the State of Eritrea implemented different policy measures to ease the flow of remittances and to guide the individual remitter in the use of these financial resources in the domestic economy. Different investment opportunities such as housing projects, sale of shares and stocks of government owned enterprises and treasury bonds are to mention but a few. Similarly, the government, to augment the Martyrs' Trust Fund and to increase the tax base of the economy, introduced directives plus nominal tax rates to the Diaspora Eritreans. Institutionalising Diaspora Eritreans and securitization of the future-flow of remittances also helped the government to get access to international markets, to avoid credit rationing in the face of deteriorating sovereign risks.

The dissertation attempts to capture the role of remittances as development tools in the Eritrean economy. After introducing the geopolitical and economic background history of the country in chapter one, in chapter two attempts are made to cover extensively the definitions, uses and drawbacks of remittances. In chapter the different theories or determinants of remittances and the transfer channels and their associated problems are described. In chapter four endeavours are made to assess the different policy measures applied by labour exporting countries to influence the flow of remittances and their uses. For comparison of these policies, three countries experiences are presented. Finally in chapter five the paper tries to draw conclusions and advance some recommendations.

## PREFACE

Migration is a human behaviour, not special to Eritreans. It has long been recorded in the history of mankind. There are different reasons for migration: economic, political, social or the combination of all three. It brings together different ethnic and/or religious groups into one community and equally so, it creates trans-national communities.

Eritrea has never been free of war and its consequences, especially for the last four decades, and the people are frequently observed to be on the move. They have been migrating from their original places. The recurrent drought also aggravated the situation very severely that even those previously self-sufficient farmers left their villages in search of jobs in the urban centres within the country and/or out of the country.

The migrant, though, attempts to blend with her/his new community, as bread winner s/he has also the responsibility to support her/his families back home. Hence, s/he maintains close relationship with families, friends and the old community. The nostalgia towards the old communities, the guilty conscious of survival, and the interest and even more the status the migrant used to have in the old communities makes her/him sacrifice a portion of her/his earnings for these old communities. Remittances, therefore, explain the accumulated effect of these sentiments.

In this paper, attempts are made to capture the flow and impact of remittances to the individual Eritrean households and to the economy at large. The dissertation was first proposed as *Remittances and their economic impact: a case study on the Eritrean economy* with the objective in mind that it would assess the impact of remittances in the lives of remittance-recipient Eritreans and the direct and indirect impact on the Eritrean economy in general.

Two independent survey questionnaires were designed to collect primary data from the perspectives of the remitters as well as their recipient households. For the remitters, an attempt was made to get this first-hand data from three principal destination areas of Eritrean migrants; the United States of America, Germany and Saudi Arabia and a fourth one from the Eritrean capital city, Asmara, during the peak visiting seasons of the Diaspora Eritreans to the country. Not to duplicate things, the collection was designed to be undertaken concurrently in all places within the same season. Similar actions were

taken to collect the recipient households' responses from different localities of the country.

However, the attempt was futile and the results were disappointing. The preliminary survey that was done in collaboration with friends from Seattle and Asmara showed one thing in common: it requires huge budget and ample time to get the needed responses in volumes. From London and Jeddah, they did not even show up. So, it became essential to change strategy and come up with new idea - *remittances as development tools in the Eritrean Economy*. It is similar but with a different tone, which focuses only on the aggregate developmental effects and also based on secondary data.

For this title, therefore, different secondary sources were used to illuminate and enrich the research topic. Furthermore, many similar studies have already been done for various countries and the thesis has used these as a starting point. Various publications and web sites are also accessed to widen the understanding. Practical examples of several third world countries were taken to illustrate the points as well, to help us compare the policy measures that are pursued by the governments of these said countries.

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# CHAPTER 1

## INTRODUCTION to ERITREAN HISTORY

### GEO-POLITICAL AND ECONOMIC BACKGROUND

#### 1.1 ERITREA'S LOCATION

##### 1.1.1 Geographic Location

Eritrea, which is located in the horn of Africa between 12° and 18° latitudes north and 36° and 44° longitudes east, found its name and existing boundaries in 1890 from its former colonizer Italy. The name “Eritrea” is derived from the Greek word for “Red”. It is north of Ethiopia, east of the Sudan, northwest of Djibouti, and stretches about one thousand two hundred kilometres along the Red Sea coast connecting Djibouti in the straits of *Bab-La-Mandeb* at *Cape Dumeira* from the south and the Sudan at *Cape Kasar* from the north. It has got about 350 small and large islands, including the *Dahlak Archipelago*.

##### 1.1.2 Climate

Eritrea is located at the highest landmass of the African continent. As a result, the highlands of Eritrea have ameliorating climatic conditions. Eritrea comprises vegetation cover and fertile soils which are suitable for agricultural purposes. Eritrea has three main geographical and climatic zones: the Eastern Slope and Coastal Plains, the Central Highlands, and the Western Lowlands.

- a) The Eastern Slope and Coastal Plains are desert or semi-desert and have an altitude that ranges from below sea level to 600 m. with less than 200 mm. of rainfall. The hottest months along the coast are June through August, when daily temperatures range from 29° to 41° Celsius (72° to 105° Fahrenheit), with high humidity. During the cool season from December to February, daily temperatures range from 18° to 32° Celsius (65° to 90° Fahrenheit). Along the northern coast, the rainy season lasts from December through February. Rain rarely falls along the southern coast.
- b) The Central Highland covers those areas over 1,500 m. in altitude. It enjoys over 550 mm. of annual rainfall. For the most part, it is a warm to semi-cool climate with the high temperatures of around 29° Celsius (85° Fahrenheit) during the

hottest month of May. The coldest months are December through February with lows around 0° Celsius (32° Fahrenheit). There are two rainy seasons: The short rains in March and April, and the long rains from late June through early September.

- c) The Western Lowlands with an altitude from about 600 m. to 1,500 m. and a warm to hot semi-arid climate begin at 90km. north of the capital and extend westward to the border with Sudan. Rainfall is in excess of 400mm. High temperatures in the Western Lowlands can reach 43° Celsius (110° Fahrenheit) during the hottest months of April through June. December is the coldest month, when temperatures may fall as low as 13° Celsius (55° Fahrenheit). The rainy season comes from late June to early September, similar to the Highlands.

The slogan “*THREE SEASONS IN TWO HOURS*” of the ministry of tourism illuminates the proximity of the cities with different climatic environments. From the port city of *Massawa*, hot lowland area at sea level to the temperate climates of *Ghindaie* and *Nefasit* towns to the cool weather of the capital city - *Asmara*, at an altitude of about 2,300 meters above sea level in the highland, takes only two hours to drive. An expedition along this route is not only remarkable but it offers a quite amazing experience filled with its extraordinary terrain and panoramas along the newly rejuvenated railway facility.

In the good old days, beyond the hospitability of these climatic conditions, the seasonal variation helped the people to enjoy cultivation of crops in both sides of the country, low land and high land. The *Kebessa* highlands enjoys its rainy season with the northern hemisphere from late May up to late September and the *Bahri* lowlands enjoys its rainy season with the southern hemisphere from late October up to late February. Hence, the people managed to alleviate the consequences of drought that have occurred in the region since time immemorial. Furthermore, the majority of the Eritrean urban population had their own land in their native villages and they used to cultivate crops to supplement their living standards until the socialist government in Ethiopia imposed restrictions on the use of agricultural land. Almost all Eritrean families were self-sufficient. However, as Eritrea has never been free of war, especially for the past four decades with the exception of the seven years just after independence, nowadays the people can hardly support their daily food consumption.

### 1.1.3 Population

The population of Eritrea is estimated to be 4,561,500 (2005 estimate). Of these, about 1 million Eritreans live outside the country Tzehaie (2005:1). The population is divided almost equally between the two genders and two major religions with almost equal ratios, while a small percentage observes traditional African religious beliefs. Tzehaie (2005:1), "Age structure of the Eritrean population looks like: **0-14 years** constitutes 44.8 percent of the total population, which is male 1,023,900 and female 1,019,400, **15-64 years** constitutes 51.9 percent of the total population, which is male 1,170,800 and female 1,194,700, **65 years and over** constitutes 3.3 percent of the total population, which is male 74,300 and female 78,400 (2005 estimate)."

The original inhabitants of present day Eritrea were the *Kunama* and the *Nara*. They presently inhabit the area between the *Gash and Setit Rivers* in western Eritrea as a result of pressures first from an invading Hamatic tribe from the northern Nile basin of the Sudan and later from Semitic peoples migrating from southern Arabia around 800-700 B.C. These last two groups intermingled with the original inhabitants to make up most of the population of present day Eritrea. At present nine nationalities or ethnic groups inhabit Eritrea. These are the *Afar*, *Bilen*, *Hidareb*, *Kunama*, *Nara*, *Rashaida*, *Saho*, *Tigre* and *Tigrigna*.

According to CIA (2004:1), "Net migration rate is -13.38 migrant(s)/1,000 populations. However, it should be acknowledged that UNHCR has began repatriating about 150,000 Eritrean refugees from Sudan in 2001 following the restoration of diplomatic relations between the two countries in 2000 (2003 est.)" Besides, there are about 60,000 internally displaced Eritreans who are unable to return to their home towns/villages due to the stalemate created by Ethiopian rejection of the EEBC ruling (Ghebreab, 2003). These people live in makeshift houses and continue to suffer the consequences of war and drought, resulting in inadequate fulfilment of basic needs such as food, water, health care, shelter and education (Nhongo, 2003).



## 1.2 POLITICAL BACKGROUND

### 1.2.1 Eritrea under Italian Rule

The history of Eritrea as a country begins in the late nineteenth and early twentieth century during the scramble for Africa by the European countries. On May 2, 1889 a Treaty was signed between Italy and the then King of Ethiopia, *Menelik II*, and was known as treaty of '*Wichale*'. Thus, the foundation of the present-day Eritrea's boundaries was established under this treaty. Dessalegn (1996:3), "for the first time, an Eritrean boundary line was sanctioned that allowed Italians to colonize Eritrea for 50 years."

What makes Italy unique in the history of Eritrea is that it was the first country to control and administer the entire area whereas the previous colonizers, the Ottoman Turks (1557-1865) and the Anglo-Egyptians (1865-1889) occupied the country partially and left the other regions inaccessible to their respective tribal heads (*Ra`esi*). Hence, before the Italian rule came into being, there was no a unified Eritrean history. Different localities had different experiences with different rulers. *Bahri Negash*, Kings of the Sea was one of the names used to represent the southern highlands of the country.

During those earlier days, it was common to hear about warriors and their deeds and about '*Shiftas*' – armed robbers who used to kidnap or rob in the countryside. Whenever a ruler (*Ra`esi*) felt stronger than those rulers in his surroundings, it was obvious to start a dispute that lead to a war. Italy restored peace to previously dangerous areas. With the coming of the Italians, these previously dangerous places fell under the rule of law and they were cooperative with the occupying power. Dessalegn (1996:3), "Italian colonialism in Eritrea certainly was not designed to bring unity among the religiously and culturally diverse Eritrean population. But some elements of its administrative structure promoted Eritrea's collective identity."

According to Rasmuson (1973:7), "Italian administration won popular acceptance by establishing security and equitable justice, raising the standard of living and developing any number of public services in the cities, particularly in Asmara and Massawa. Eritrea moved gradually toward the 20<sup>th</sup> century with agricultural reform, transportation systems (road, railways, air- and sea-ports), medical services and communication".

However, with the change in government in Italy, the fate of Eritrea also changed. The Fascist administration in Eritrea imposed strict racial segregation and gave urgent priority to military preparations throughout the colony. Eritrea, as staging point to conquer Ethiopia, was transformed into a modern transport network. Rasmuson (1973:7), "The railroad linking *Massawa, Asmara, Keren* and *Agordat* had been completed in 1920, so road construction became the primary focus of the military preparations. *Massawa* blossomed into a modern seaport and the *Gura'e* airport was enlarged and re-equipped." Metras (2000), "The railroad's major function was military transportation and an aerial tramway "*Teleferica*" was constructed to speed up movements of material."

The introduction of fascism made the people reconsider the Italian administration which was not to Eritrean advantage but rather to oppress them. Thus, all the people saw themselves as part and parcel of an oppressed nation and started to fight for the same cause, a free Eritrea. Therefore, Italy not only provided Eritrea with a modern infrastructure at that time but the present day Eritrea's identity, which inculcated a sense of belonging among the nine ethnic groups, was also evolved during those days and further enhanced by the British administration's efforts to upgrade the inadequate educational facilities, freedom of gathering, press and speech.

### **1.2.2 Eritrea under British Rule**

During World War II in 1941, the British defeated Italy in Eritrea and controlled the country for about a decade. General economic upheaval became widespread as local Italian industries ground to a halt. The British military administration, however, embarked on a moderate course of action to win popular support. They provided relief funds and humanitarian activities. Furthermore, they abolished segregation by simply not enforcing the Fascist laws, and at the same time, instituted a variety of programs to strengthen the morale and rejuvenate the economy.

The British gradually integrated Eritreans into the civil service and focused their attention on the inadequate educational facilities. They established the first teacher-training institute (TTI) and converted wartime buildings into schools and hospitals. Dessalegn (1996), the British administration impacted Eritrean Nationalism in two ways

1. *Tigrigna*, an Eritrean language was institutionalised and became a medium of communication and the main language used in schools and other institutions.

2. Although short, this phase signified Eritrean historical continuity.

However, the end of Italian dominance implied the virtual collapse of the Eritrean economy and widespread unemployment. Since all exports used to go to Italy, Eritrea had become wholly dependent on the Italian economy. All Eritrean industries had been managed by Italians and equipped with Italian machinery. Although the British Administration encouraged new Eritrean-owned industries and agricultural developments to absorb the labour force, the ten years of its tenure were trying ones, and the economy was weak.

Boyle (1993:1), "When the age of formal decolonisation began for Africa, Eritrea was the only country in the continent apart from South Africa that was significantly urbanised and had a unionised working class. Eritreans inherited a special heritage - 20% of the population was urban in 1941." However, Eritrea, unlike the former Italian colonies of Libya and Somalia, was not allowed to have its own administration. Rather in 1952, it was forced to accept federation with Ethiopia without the consent of its people. Though Eritreans were disappointed by the UN's action, the federation at least maintained Eritrea's uniqueness and served as a symbol (Dessalegn, 1996).

### **1.2.3 Eritrea under Ethiopian Administration and the Root Cause of Eritrean Migration**

Instead of Ethiopia respecting the federation, in 1962 after just ten years, she dismantled it to annex Eritrea as its fourteenth province. Dessalegn (1996:2), "The forced annexation of Eritrea with Ethiopia marked the beginning of Eritrean exile. After annexation, Ethiopia governed Eritrea by exercising harsh methods in order to replace Eritrean nationalism with an Ethiopian national identity. *Tigrigna*, the Eritrean language, was banned from schools and other institutions and in its place *Amharic*, an Ethiopian language - foreign to Eritreans, was imposed."

Ethiopian governments shut down existing major companies while curbing the establishment of new factories and plants. This forced angry students and workers into exile. The initiation of the Eritrean armed struggle in 1961 also worsened the matter at hand. The government began to exterminate Eritreans, especially in the countryside where Eritrean Moslems reside in large numbers, leading much of the rural population from the lowland Eritrea to take refuge in the neighbouring country, Sudan.

The worst came after the 1974 government change in Ethiopia, when mass killings intensified mass exodus. Dessalegn (1996) by the end of 1976, refugees in the Sudan numbered 150,000. In 1977, 10,000 students, lecturers and workers in Addis Ababa were forced to flee mass murder and assassination. In 1978, thousands more in other cities and towns of Eritrea, also experienced the same treatment and many responded by fleeing to other countries and so many others also joined the liberation struggle.

This continuous threat from Ethiopia and the recent severe but a recurrent drought that appear in the region cyclically compounded the problem and left the country unbearable and many were forced to migrate to avoid the harsh situation.

#### **1.2.4 The Role of the Eritrean Diaspora in the Struggle for Independence**

The history of the struggle for independence of Eritrea is incomplete without mentioning the role played by the Eritrean Diaspora. Eritreans from different parts of the world came in contact with their brothers and sisters from within to express their feelings and by forming an army, fought for their rights and sovereignty. Eritreans in exile, especially those from Cairo, took the initiative for the armed struggle and joined the handful of heroic Eritreans from inside the country.

In addition for those outside the country, the persistence of their cultural identity, their common interests and values, and being the very victims of the oppression, made the potential for active support possible. Hence, Eritreans in the diaspora were active in forming strong associations. The need to form associations along different professions to assist Eritrea in every possible way grew stronger. These associations proved to be crucial means of assistance to the Eritrean People's Liberation Front (hereinafter - EPLF). Without the financial support, policy articulation and "diplomatic" support of the Diaspora, the struggle for independence might have taken another decade (Hiteng, 2000; Negash, 1997).

The EPLF, however, found out that these spontaneously formed associations needed to be reorganised in order for their efforts be fully utilised for the liberation struggle.

- The first step EPLF took was to recruit all Eritreans in the Diaspora (mass mobilisation) and to allow them to obtain full membership in the organisation.
- The second step was to encourage the diaspora to return to the liberated area of the country and join the struggle personally (Dessalegn, 1996; Hiteng, 2000). Most

Eritreans from Diaspora responded positively to the call and their input was so significant in transforming the organisation's approach. Hiteng (2000), this group constituted the bedrock of the movement because they contributed meaningfully inside the various areas of the struggle.

- The third step was to establish symbolic events. By the mid 1980s, after about a decade of socio-political education, these annual conferences evolved into festivals where sports and cultural shows were organized. The establishment of these symbolic festivals was centre of these mass organisations and provided the continuity of the support for the struggle (Dessalegn, 1996).

#### **1.2.5 Post Independence Eritrea - The Government of the State of Eritrea**

After a prolonged and devastating thirty years of war, the struggle came to an end in 1991 with the liberation of Eritrea. The EPLF, by de-facto transforming itself into a provisional government, called for a referendum to be held in April 23-25, 1993. To handle the case, an independent commission was formed. In May 24, 1993 after the UN-sponsored referendum affirmed 99.8% of the vote in favour of independence; Eritrea officially achieved its full independence in world politics. Thus, the provisional government once more transformed into transitional government until a constitutional multi-party government could be formed. However, due to the impasse situation - no war no peace with Ethiopia - the 1997 ratified constitution has not yet translated to meaningful multi-party governance that includes all opposition groups.

### 1.3 ECONOMIC BACKGROUND

As is evident from the above political upheaval, Eritrea's economic history had also to move through crossroads as well as ups and downs. During the Italian rule, Eritrea evolved into a 20<sup>th</sup> century small country, relatively more advanced in manufacturing and infrastructures than the neighbouring countries. At the end of the 1930s, it had about seven hundred and thirty small and medium scale companies exporting commodities and raw materials to many parts of the world. It was the main source of raw materials and labour force for Italian industries. There were many industrial branches, which produced intermediate products and fed Italian mainland industries.

At the time of the Second World War, when imports from Europe to east African markets were disrupted, Eritrean industries were strong enough to supply these markets (World Bank, 1994). According to Rake (1999), a survey conducted revealed that by 1970 Eritrea accounted for thirty five percent of all industrial activities in Ethiopia as a whole. Out of the seventy two companies that were nationalised by the Ethiopian socialist government in 1975, a third was Eritrean-based, including Ethiopia's largest brewery - *Melloti* and its second largest cotton producer – *Baratollo* (Welday, 2003).

However, during the thirty years of devastating and protracted war as well as recurring drought, the whole economy deteriorated. Almost all its infrastructures, economic and social service sectors were completely destroyed. The World Bank report 2005, "Eritrea is now one of the poorest countries in the world, with an average annual per capita income of US \$210 in 2004." Most of the population lives a subsistence lifestyle, supported by remittances and foreign aid. Randall (1995), "At the end of the war in 1991, it was estimated that more than eighty-five percent of the population were surviving on international relief." Fissehatsion (2005), "Over the ten years that Eritrea has been independent, remittances have averaged US \$226 million per year in current prices between 1993 and 2002."

The task of reconstruction is enormous. The need for the government to redevelop the economy is, therefore, the greatest challenge facing the country. In 1993 the ministry of finance estimated that to rejuvenate and redevelop the economy, it would need a budget about US\$3 billion. Eritrea, with its meagre resources has one valuable asset, determination. Eritreans have always had a justified reputation for being industrious and

innovative. The 1994 macro-economic policy has demonstrated their determination to rebuild the country and the vision is so clearly matched by their courage in winning their freedom against massive odds.

Hence, the government is determined to make use of its human and natural resources to their maximum utilization. A fundamental principle of Eritrea's national development program is to progress through self-reliance. To that effect, 'National Service' was proclaimed, commencing on July 14<sup>th</sup> 1994, and requiring every citizen between the ages of 18 - 40 years to participate in the country's development efforts for 18 months, in all fields. Thus, this proclamation provided the government almost 40,000 youngsters annually to build new infrastructure. As a result, the construction of roads, railway lines and residential houses have shown a remarkable progress.

Furthermore, there is an open call to all able Eritreans from within and abroad alike to participate in the country's development programs, such as construction of infra- and super-structures, community service facilities, and to stabilise the economy as a whole. On the superstructure, restructuring of the different government ministries has been the prime task of the Government and human capital formation took the middle ground of the 1994 macro-economic policy discussions. Thus, there are several projects under implementation besides opening of local technical and tertiary institutions. What is more, scholarships to different foreign universities such as South African universities and others have been awarded to students with outstanding performances. In this respect, the population of university students in the domestic university has grown from its all time low of 45 in 1992 to 5000 in 2000 (Kigotho, 2001).

According to the government report significant achievements were made in restructuring and reforming the economies and institutions in the first seven years of independence. The main steps taken during this period are summarized below:

- Demobilizing and reintegration of former combatants into private civilian life;
- Restructuring government ministries to focus their main functions on formulating policies and regulations, research and human resource development activities;
- Reforming the civil service and decentralizing its management structure by reducing the public work force;

- Reforming the tax system and its administration through tax rate reduction and broadening the tax base;
- Motivating private sector development through creating conducive investment and licensing environments;
- Unifying the exchange rate and broadening the foreign exchange market.

Thus, the Government has been engaged in a continuous effort to set up and strengthen appropriate institutions and to implement integrated economic development policies based on principles of market economy. It has adopted a market economy in which the private sector will play a leading role in economic development with a guiding economic principle of efficiency, competitiveness, decentralization and regional balanced growth (Government of the State of Eritrea, 2001).

Although the principle is still in place, the stalemate situation, which Eritrea is currently experiencing, seems to test Eritrea's commitment to lean government structure. The government is seen too involved in all sectors (private as well as public enterprises) to carry on with the heavy duties of rehabilitating the economy. Moreover, the prescribed 18 months national service program has been extended indefinitely. These created some economic, social and political burdens on the society in general and the youth in particular, and on the government budget. As a consequence, the migration fever of the young Eritreans is feared to intensify.

### **1.3.1 Agricultural Sector**

The Eritrean society is predominantly classified as agrarian, with sixty to eighty percent of its population's livelihood based on agriculture. Agriculture being the main source of food and employment, it also generates foreign exchange earnings, which are obtained mostly from livestock and livestock related products like hides and skins. In addition, agriculture provides raw materials to the industrial sector, and is also a source of surplus for other sectors.

Welday (2003), the value added from crop production to total agricultural output was at its highest point in 1998. It contributed about *Nakfa* - the Eritrean currency - five hundred and two million, which covered about fifty eight percent of the country's demand, but dramatically fell down to Nakfa one hundred forty three million, which accounted for about thirty two percent in 2000. The second major contributor to



agriculture, livestock reached its maximum in 1999 with Nakfa two hundred sixty six million and fell to Nakfa one hundred and eighty six million in 2000.

Thus, agriculture as source of food consumption has not been sufficient to provide the required yearly food demand of the country in the last four years. There are different reasons for the low productivity of the sector. Thirlwall (1999) emphasised that the fundamental factors that contribute to low agricultural productivity are topography, organization of agriculture, incentives to produce, the supply of inputs, availability of credit and access to markets. Similarly, agricultural output in Eritrea is very low due to all these combined factors. This low productivity is dictated partly by:

- Geographical factors such as the recurrent climatic conditions and the country's landscape (especially the topography of the highland, eastern and western escarpments of the country is exposed to severe erosions), and
- Land tenure systems, agricultural policies, credit facilities, and lack of extension services that prevail in the country.

For instance, the mountainous and arid regions of the northern, eastern and western escarpments of the country are not only unfavourable for crop production but also densely populated. The highly uncertain and inconsistent rainfall can be so heavy that it washes away the fertile land. This coupled with weak agricultural infrastructure contributed to its low agricultural productivity.

The land tenure system in the country was also not conducive for farmers, partly due to the smallness of the plots allotted to one farmer in a particular area and partly due to quick rotation of land use - every seven years - among members of the same village. Tesfay (1996:3), "The reason was that the increase in rural population coupled with the lack of employment opportunities outside agriculture had caused an intense struggle for more land between related families, in the case of *tsilmi*, and neighbouring villages, in the case of *diesa*. Land fragmentation and its parcellisation into economically unviable tiny plots has, particularly in the highlands, been an impediment to productivity and the introduction of modern techniques of land use. The temporary nature of access to particular plots in the *diesa* system has become the main cause of the disinterest of farmers to properly utilize and improve the productivity of land. Soil erosion and deforestation are serious resultant problems."

In general, land tenure systems in the country as a whole were difficult and discriminatory. (Pool, 2001; Tesfay, 1994; Iyob, 1997) only married males – sons of the village founders – were allotted land, the other fifty percent females along with the unmarried male adults and new comers were not eligible for land allocation. FAO, (1994), with the 1994 land reform, Eritreans qualify automatically for land upon attainment of age 18 regardless of sex, religion or marital status; individual holdings are registered and lifetime usufruct title-deeds issued.

This being so, Eritrea has an arable land area about 1.6 million hectares, which is 13% of the total area. Out of this cultivatable land only 439,000 ha, 26 percent, was cultivated in 1993 (FAO, 1994). The Eastern and Western lowlands of the country are highly fertile and sparsely populated. These places are favourable for high agricultural investment opportunities such as plantations. Indeed there are few examples that developed into modern commercial farms that showed remarkable results. Some visible examples are *Elaber'ed* State Farm and *Aligdir* Agro-Industry.

In general, in order for the agricultural sector to supply enough food for consumption, release labour, provide savings, contribute for the market for the industrial goods and earn foreign exchange, it must generate progressively rising surplus of production in excess of subsistence needs (Thirlwall, 1999). This is only possible if Eritrea fully utilizes its natural resources including its fishing sub-agricultural sector to the maximum. Eritrea has got 52,000 km<sup>2</sup> exclusive fishing rights in probably the richest and for the most part unexploited waters, of the Red Sea. The Fishing industry has been identified as priority sector for ecologically sustainable development and for tourism development. It is also seen as a source of foreign exchange if it develops and equips with modern day technology. Moreover, fish can alleviate the food shortage in the country if only the people changed their consumption habits. However, up to the present its contribution is insignificant in both terms, as source of foreign exchange and food security.

Total agricultural output in Eritrea, throughout the decade, is characterized by fluctuations, depending on the amount of rainfall. According to Welday 2003, agriculture's average percentage contribution to GDP in 1992 was twenty-seven percent, but declined to eighteen in 1993, and deteriorated further to fourteen percent in 1997. It was boosted again to twenty-five in 1998 and falls back to fourteen in 2000.

Eritrea, which has been engaged in rehabilitation and construction of the war-ravaged economy, needs huge capital investment to avoid fluctuation of agricultural output. Despite these agricultural fluctuations the per capita income increased from one hundred U.S. dollars in 1992 to about two hundred U.S dollars in 1999 (World Bank, 2001). (UN Industrial Development Organisation 1995; Government of the State of Eritrea Report 2001) emphasized that based on past experience Eritrea's agricultural sector can produce large amounts of cash crops as well as raw materials for industrial enterprises. The use of modern cultivation methods, fertilization, plant protection, and water conservation techniques coupled with similar attention and protection for Eritrea's livestock population, it is believed that high returns can once again be obtained from that valuable resource.

### **1.3.2 Industrial Sector**

Eritrea's industrial sector is predominantly characterized by small- and medium-scale industries including the versatile informal sectors, with most of their outputs used for domestic consumption. According to Ministry of Trade and Industry 2003, "There were 223 medium-large scale manufacturing establishments, with 10 or more employees, and 1,707 small-scale manufacturing establishments, unevenly distributed throughout the six regions of the country. The small-scale industries include textile factories, leather and shoe factories, plastic and food-processing factories, handicrafts such as welding and carpentry, etc. The structure of the Eritrean industry was 69.3% sole proprietor, 14.7% partnership, 5.6 % government ownership, 5.6% public share holding and 2.5% other types of joint ventures."

In Eritrea, manufacturing capacity expanded from the 1930s - during the Italian rule to mid 1970s - the end of Emperor Haile Silassie's rule. During those periods, the manufacturing sector was used to export goods worth about one hundred million U.S. dollars per year, which is an amount almost four fold of today's export earnings from that sector. The sector's contribution deteriorated rapidly from 1975 when the socialist Ethiopian regime nationalized all the industries under the guise of socialism. After independence, the immediate task of the Government concerning the industrial sector was: -

- To rehabilitate and improve the productivity of this sector, and thereafter
- To privatise the different companies to feasible investors.

The contribution of the manufacturing sector to GDP has grown from Nakfa one hundred and thirty seven million in 1992 to Nakfa two hundred and fifty six million in 2001. Eritrea's manufacturing exports also improved from fifteen million U.S dollars in 1992 to ninety six million U.S. dollars in 1996 at Free on board (FOB) current prices. Thus, the manufacturing sector contributed eleven percent in 1992 and consistently improved up to twenty percent in 1997 but declined by two points to eighteen percent in 2001 (Welday 2003). The decline in manufacturing output from 1998 to 2001 was due to border conflict with the neighbouring country, Ethiopia, which was also one of the major destinations for Eritrea's manufacturing output. It fell again to twenty million U.S. dollars in 1999 and started to revive in 2000 to about thirty-seven million U.S. dollars.

Given the country's pace of economic growth before the 1998 - 2000 war, (EIA, 2003) "GDP yearly growth rate on average it was 7% between 1993 and 1996 and was 8% in 1997." Eritrea would definitely have marched all the way to industrial development. However, for industrial development to take place, a favourable environment that provides the basis for foreign and domestic direct investment is required to release both the needed capital and the technical know-how. As a priority, therefore, the stalemate - no war no peace - situation that has continued to exist between Eritrea and Ethiopia for the last five years, has to come to an end. According to World Bank (2005) "Multilateral Investment Guarantee Agency (MIGA) is waiting for a stable peace that produces conditions that increase FDI flows and create opportunities for MIGA to support foreign investment into Eritrea."

Besides, deliberate policy incentives must be pursued to encourage the growth of indigenous enterprises and to increase national participation in management and financing of new industries. To that end, the different government offices by forging unilateral and/or bilateral agreements are striving to change the fate of the Eritrean economy. For example, the Eritrean electric and power authority, after finalising its feasibility studies for an electric generating project, constructed *Hirghigo* Power Plant with the help of different foreign donor funds (Buskirk, 2001). The completion of this project improved the authority's ability to supply electricity by four fold. Another similar project that focuses on rural electrification was signed with the World Bank

Group with Project budget of 50 million US dollars (The World Bank Group, 2004). This project will benefit 50 villages along the major roads from the capital city to the zone's capitals.

In parallel development, many similar endeavours have been taking place with different government bodies. Policies pursued to construct new roads and widening existing ones, modernising and enlarging sea- and air-ports and construction new ones and introducing railway networks into the Eritrean economy are some good examples of the government's devotion to improve the devastated infra-structure.

On the super-structure, the choices of appropriate industrial policies have been followed. The government privatised publicly-owned industries, which is the first promising step expected to result in efficiency and higher productivity. However, private sector productivity is still at its low level due to the above-mentioned constraints. Thus, more skilled human resources, technological transfer, entrepreneurial ability, and capital investment on manufacturing industry are required to make the sector competitive in the international markets. Given the country's meagre and insufficient domestic market, export promotion is recommended as the best policy. Therefore, industrialization based on export promotion is seen as the way out from the morass situation created by four decades of neglect and deliberate destruction of the country's economy.

### **1.3.3 Service Sector**

The service sector includes mainly the financial, tourism, and transportation and communication services. These sub-sectors are prerequisite economic activities to agricultural and industrial development. Investing in these sub-sectors would increase the economic growth of the country at large. Agricultural and industrial sectors could be dependent on the service sector. However, the over all linkage, coordination and complementarities among these sectors would determine the rate of output growth in the economy.

**Tourism** is one of the important service sectors commonly practised in many African countries. It is believed to be an industry with a tremendous potential for foreign exchange earnings. The tourism industry is increasingly providing opportunities to the

wider service sector and for the construction and development of infrastructure in particular.

Eritrea has both benefits of tourism and offshore investments. It has many historic sites that go back to the 4<sup>th</sup> century A.D and beyond. Furthermore, its terrains with their varying climatic conditions are viable for different sport-related entertainment businesses. The convenience and proximity of each site with one another as well as the hospitality of the people all makes it feasible for tourism. In addition, the different festivals, besides being cohesive for the diverse Eritrean culture, give colour to the country's tourist attractions. Since independence hundreds of thousands of Eritreans from the Diaspora are estimated to visit the country annually. See the table below, as reproduced from the report of the ministry of tourism.

**Table 1.1** International Tourist Arrivals to Eritrea 1994-2000

Year	1994	1995	1996	1997	1998	1999	2000
No. of Arrivals(000)	222	421	525	521	303	120	80
Amount in Mil. US \$.	28	58	69	90	60	45	35

Source: Tourism Statistics, Min. of Tourism, 2000.

**Transport and Communication** facilities as part of service sector are also not fully developed. Road construction in different parts of the country is underway. The railway has started to revive after 30 years of non-existence. As already mentioned, enlarging and renovating of sea and airports is in progress. In 2004, mobile phone networks started to expand throughout the country and a satellite radio and TV programs were launched to Eritreans residing in the USA.

**The Financial** sector is another service sector, which could contribute a higher share to GDP if fully developed. In small economies like Eritrea, domestic financial markets are also frequently non-existent, and international movements of capital are usually controlled. The fragmented market structures and high transaction cost of financial institutions of these countries constrain the process of financial intermediation. It is believed that there is a positive correlation between the levels of economic development and financial developments. Financial development plays a great role in augmenting the quantities of real savings and capital formation from given national income. It also ensures and facilitates capital movements and increases productivity of investment by improving its reallocation.

The financial sector of Eritrea has limited financial services relative to other countries' financial institutions. The government-owned Commercial Bank of Eritrea with more than eighty percent of deposits and domestic lending, dominates the sector. There is only one housing and commerce bank (hereinafter- HCB) and another development and investment bank in the country. A private bank pledged to open in 2003 with an initial capital of US \$5 million. However, it has not yet become operational. The banking system of the country has limited competition under the narrow or non-existence capital market. Thus, it has got abundant liquidity reflecting high level of transfers from the Eritrean Diaspora into the domestic banks but at less rate of alternating between saving and investment.

Furthermore, there are also small- and micro-financial institutions (hereinafter - SMFIs) operating in the economy. The SMCP (small and micro credit program) was established as a component of the ECDF in 1996 to support pilot savings and micro-credit programs. It was launched primarily to help the investment activities of enterprises at the village level, to create new income and employment opportunities in poor communities and contribute to the improvement of their living standards. After 7 years of experience under the ECDF, SMCP has evolved as an independent entity; and to date 162 village banks with 13,891 clients are operating and a total of ERN 136 million have been disbursed to these clients (Lensink, R. and Mehrteab, H.T., 2003).

The National Insurance Corporation of Eritrea (hereinafter - NICE) is another non-bank financial institution, which plays a big role in the financial transactions of the country. Other than the banking system, there are a few small formal and informal (black market) moneychangers that exchange foreign currencies into the local currency. In addition, there are traditional and informal micro-financial institutions known as *Ukub* - Rotating saving and credit associations. Under the ministry of defence, quite different version of money transfer channels *Tequoratsi Nsdra-Biet* – remittances to families are operating.

The financial sector in Eritrea has very limited contribution to GDP. Financial sector improvement is measured by the percentage contribution of the financial asset to the total wealth. If the percentage of financial asset contribution for Eritrea is compared from 1992 to 2001, we see it fluctuates with the growth of the whole economy. In 1992 its contribution was 0.1 percent and even after a decade in 2001, it was only 0.4 percent.

Thus, Eritrea needs to develop modern and competitive financial institutions that are easily accessible to savers and investors to mobilize sufficient public and private savings and provide investment capital.

**Table 1.2** Gross Domestic Product of Eritrea by Industrial Origin (1992-2002) at 1992 constant factor cost in millions of Nakfa (ERN)

Item	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
GDP	1957	2150	2702	2777	3032	3267	3395	3404	2997	3257	3574
Agric	598	482	659	582	548	551	867	800	452	584	739
Industrial	235	337	385	466	638	765	715	736	688	732	793
Service	1124	1331	1659	1730	1846	1951	1813	1868	1857	1942	2042

Source: Ministry of Finance and IMF estimates

However, the percentage share of the service sector in general to GDP is relatively higher than the other sectors. When the distribution service is combined with other services, it accounts for more than fifty percent of the share of GDP. The table below shows the percentage contributions of the different sectors and is derived from the above table.

**Table 1.3** Percentages Sectoral Contributions to the Eritrean Economy

Sectoral Contribution	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Agriculture	30.57	22.42	24.39	20.96	18.07	25.24	25.54	23.50	15.08	17.94	20.68
Industrial	12.00	15.67	14.25	16.78	21.04	20.92	21.06	21.62	22.97	22.49	22.19
Service	57.53	61.91	61.36	62.26	60.89	53.74	53.40	54.88	61.96	59.72	57.13
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Derivative of Table 1.2.

This has been the geo-political and economic background history of Eritrea. In the following chapters due attention is given to the discussions of remittances and their uses.



## CHAPTER 2

### REMITTANCES: DEFINITION, IMPORTANCE, DRAWBACKS

#### 2.1 DEFINITION of REMITTANCES

Before discussing remittances and their impact on the Eritrean economy, it is important to know what they are and what significance they have in the world economy in general, and their contributions to a specific country's economic growth in particular. Based on the different studies done so far, the contributions of remittances to a country's economy are tremendous. As it can be explained using different economic measurements and comparing to other financial flows, their contribution to GDP is significant. The paper will try to present the recent definitions of remittances, as some major world players in the field theorise them; thereafter it will proceed to their importance as expressed in relation to these economic indicators and their uses in the different economies.

##### 2.1.1 International Labour Organisation (ILO's) Definition of Remittances

**Remittances** are defined as migrant workers' earnings sent back home from the country of employment to the country of origin. They are monies transmitted from one place to another. Although remittances can also be sent in kind, the term "remittances" usually refers to cash transfers. Migrant worker remittances are the part of total remittance flow that is transmitted by migrant workers, usually to their families or friends back home. Remittances can be sent between or within countries. Money that is sent from international migration is international remittances, whereas money that is earned from persons who migrated within their country of origin is intra-national remittances.

##### 2.1.2. Migration Policy Institute (MPI's) Definition of Remittances

In migration literature, the term "migrant remittances" has generally come to refer to the transfers in cash or in kind from a migrant to household residents in the country of origin. However, the *International Monetary Fund (IMF)* data are based on a much broader definition and include three categories of data:

- **Workers' remittances** refer to transfers in cash or in kind from migrants to resident households in the countries of origin. Usually these are ongoing transfers between members of the same family, with persons abroad being absent for a year or longer.

- **Compensation to employees** refers to the wages, salaries, and other remuneration, in cash or in kind, paid to individuals who work in a country other than where they legally reside. For example, the wages earned by seasonal or other short-term migrant workers (i.e., abroad for less than a year) would be included in this category, as well as border workers who work, but do not reside, in a neighbouring country. It also includes wages and salaries earned by the local staff of foreign institutions, such as embassies and international organizations, and companies based abroad but operating locally.
- **Migrants' transfers** refer to capital transfers of financial assets made by migrants as they move from one country to another and stay for more than one year.

### **2.1.3 Multilateral Investment Fund's (MIF) Definition of Remittances**

**Remittances**, the portion of international migrant workers' earnings sent back to countries of origin, have been a traditional means of financial support to family members remaining in less-developed countries for several generations. Remittances are the expression of profound emotional bonds between relatives separated by geography and borders, and they are the manifestations of the constant interactions of these relatives regardless of the distances between them.

### **2.1.4. Bannock Consulting Firm's Definition of Remittances**

**Remittances** are monies sent from one individual or household to another. International remittances are those sent by migrant workers who left their home country. Domestic remittances are those sent by migrant workers who left their home village or town to work elsewhere in their home country (example rural-urban migration, which sometimes is called national remittances). According to this definition, remittances are cash transfers rather than goods but it acknowledges the imports or purchased goods on location are as common practice.

**Communal or collective remittances:** - Monies sent by migrant workers' associations or church groups to their home communities. By being communal or collective, however, these remittances are very different from household or individual remittances both in intended use and that the volume is very low on a global scale.

In general, remittances are the money that foreign-born workers send to their relatives and/or communities abroad. They are not tax exempted and are only sent after all payroll taxes have been collected. All types of migrant workers - legal, illegal, permanent, temporary, skilled, unskilled, male, and female - send remittances. In short, remittances are the human face of globalisation.

## **2.2 WHY DO MIGRANTS SEND REMITTANCES?**

The paper will discuss this question in depth in chapter three under the theories of remittances or determinants that influence the flow of remittances. But to give a brief introduction, migrants send remittances for several reasons. Some of them can be presented in brief as follows: -

- (1) People who work abroad often cannot afford to bring their families with them. Therefore, as breadwinners they are obligated to send a portion of their earnings back home.
- (2) In other cases, they maintain strong ties to relatives outside their immediate families or to the communities that they left behind and want to preserve the status they had already acquired.
- (3) As guilt of survival always haunts people who are better off than their relatives or friends, migrant workers may feel responsible to support development projects in their home countries.
- (4) As the other theory of remittances suggested, it could be as in accordance with the already agreed arrangements of repayment of the loan the migrants took while they were at home and for the trip to the promised land of their migration.

## **2.3 REMITTANCES: their importance and share of a country's GDP**

### **2.3.1 International Remittances and their Comparisons to Other Financial Flows**

International migration and remittances have come to play increasingly important role in international economic relations between the poor less developed - labour exporting countries and labour - scarce more advanced rich countries (Russell, 1986). As globalisation increased its presence and persisted to engulf more countries of the third world into its inner circles, many families of the less developed countries found

themselves continuously pulled into it forming trans-national communities. As a result, a parallel development of migration of people, equally skilled and unskilled, started to leave these countries in the hope of better-paid jobs in the developed countries. Today there are many families that have one or more of their family members residing across borders, forming trans-national communities. However, although migration leads to general remittances, which are bound to remain substantial and important flows to these less developed countries, it is always associated with mixed feelings. Especially because the migration of their more skilled manpower, the distortion of the domestic labour market and the change in the work habit of the remaining labour force puts increased pressure on their economies. The trade-off between migration and remittances being hard to calculate, the paper attempted to assess the contributions of remittances.

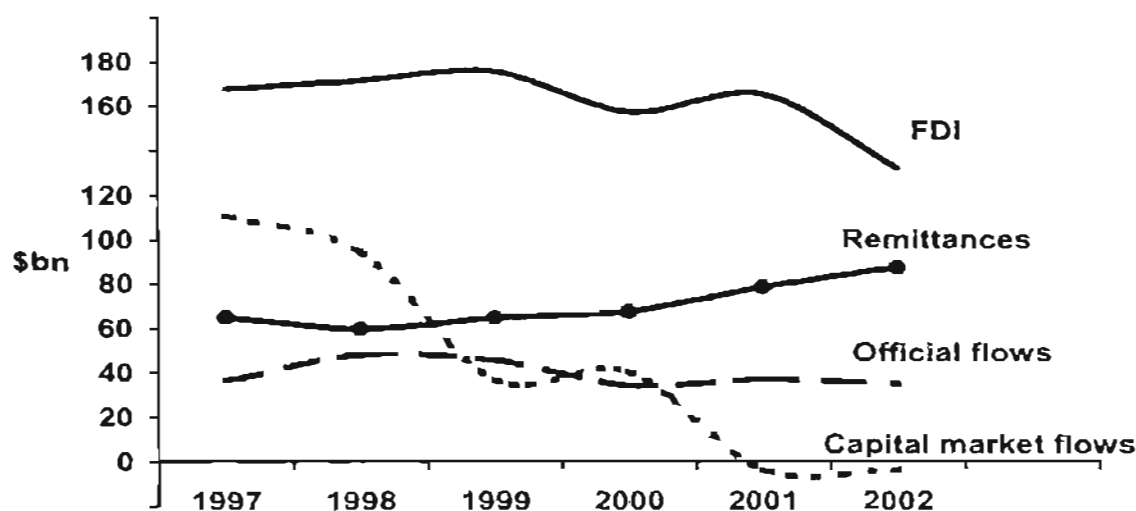
According to Castles and Miller (1998:5), some 30 million recent immigrants are foreign workers and they are believed to remit over US \$67 billion annually to their home countries. In fact, one would expect remittances to have grown with migration, although such growth has not been observed in official remittance data. According to Lowell and Garza (2000), since the 1980s remittances have averaged 26 percent annual growth to the Latino countries of Mexico, the Dominican Republic, El Salvador, Guatemala, and Colombia. Naturally, migration patterns and remittances do not readily mirror each other, nor do their respective flows correlate statistically. The reason is justified as there are a number of informal or unrecorded remittances that suggest documented remittances are only small percentage of a larger group. Taking into account the informal and domestic flows of remittances, which are not recorded in statistics, the volume is estimated to be as high as US \$200 billion yearly (Sander and Miambo, 2003).

According to Ratha (2003:160), although recorded remittances are small relative to their total flow, they have been documented as a stable source of foreign income for the immigrant home economy over a period of fifteen years. Remittances to developing countries are, therefore, the most reliable and broadly-based source of finance. Scott and Joseph (2004) also named remittances as “effectively a new form of foreign aid” that goes straight to the people on the ground, rather than being mediated by governments, non-governmental organizations (hereinafter - NGOs) or foreign businesses.

Remittances indeed, dwarf the amount of official development assistance (hereinafter - ODA) poor countries receive. Looking at the official figures for the years 1988-2002, Ratha (2001) once said that remittances have become the second largest capital inflow to developing countries behind foreign direct investment (hereinafter - FDI), which account for US \$180 billion and ahead of ODA, which accounts for US \$53 billion. The following figure is reproduced from the work of Wimaladharna, Pearce and Stanton (2004). It depicts the flows of these financial resources to the developing countries for the years indicated.

Figure 1: Financial flows to developing countries for the years 1997-2002.

***When the going gets tough, remittances keep flowing....***



Source: Ratha 2003

As a disadvantage of FDI and ODA, they tend to fluctuate with global economic swings. Moreover, FDI involve short time speculations on financial transactions for merely capital gains that hinder the genuine flow of FDI. In the worst case, all ODA try to tie their donations either to procurement or projects, where the aid receiving countries would end up being importers of goods and technical staff of the donor countries. Thus, they attach strings of simple and complex clauses to tie the receiver/borrower in. Whereas, remittances revenues as Foreign Exchange earnings, according to Scott and Joseph (2004) sometimes described as “globalisation bottom up”, are inflows without a liability as they are the sale of an invisible commodity - migrants’ labour or service. Remittances can also be treated as an invisible export earnings.

Though there are some discrepancies in the figures that were presented on the different studies (Ratha, 2003; Orozco, 2002), what these figures suggested is that surprisingly significant flows of remittances do persist in their volumes, frequencies and their importance to developing countries. For instance, Ratha (2003) calculated that the value of remittances that were transferred through the formal channels in 2001 was US \$73.2 billion, for which Ballard (2003) remarked “a sum very substantially greater than that delivered through economic and development aid.”

In another similar study (Orozco, 2002), global estimates for 1998 shows that official remittance flows amounted to US \$90 billion. In that year, total official remittances accounted for 84% of total ODA from the Organisation of Economic Co-operation and Development (hereinafter - OECD) countries. However, these represent only the tip of the iceberg as only a fraction of the total remittances flow uses the official channels. Remittances sent through informal channels - like self-carry, hand-carry by individuals (friends and family members) who travel to home country and traders who serve as intermediaries, as well as remittances in kind of durable consumer goods such as electronics, washing machines and the like make up a considerable amount but undetected in many of the records of recipient countries.

In general, remittances help to alleviate poverty, spur investment and cushion the impact of worldwide recession when private capital (FDI) dries up. They make substantial developmental contributions to recipient households and to their national economies. The following section will try to see the different contributions of these remittance flows from the perspectives of individual country's economic indicators and recipient household's total income.

### **2.3.2 Remittances from the Perspective of Individual Countries' Economic Indicators**

Remittance flows to the specific countries as expressed in their national accounts are very substantial. These flows, if measured based on the different economic indicators, such as their percentage contribution to gross domestic product (hereinafter – GDP, the market value of the final goods and services produced by labour and property located in a country) and their relative significance to the economy as compared to the different sectors – such as, merchandise exports, ODA, and FDI are indeed very pronounced.

According to Orozco (2002), total remittances to Jamaica in 2001 for example, were estimated at US \$967 million (representing 15 percent of GDP) as compared to US \$136 million in 1990. In Haiti, flows of remittances increased from US \$152 million in 1996 to US \$810 million in 2001 (24.5 percent of GDP). For individual country, these contributions can be much more evident. Examples are summarised below as they are reproduced in Table 2 from (Orozco, 2002).

Table 2.1: Relevance of Remittances to Each Country in 2000

Country	Remittances, (Millions US\$)	Remittances as percentage of			
		Merchandise Exports	ODA	FDI (Net inflows)	GDP
<i>Egypt</i>	3,747	80%	282%	303%	4%
Greece	1,613	16%	-	149%	1%
India	11,586	27%	779%	500%	3%
Pakistan	1,086	12%	155%	353%	2%
Portugal	3,131	13%	-	50%	3%
Philippines	6,050	15%	1047%	298%	8%
Turkey	4,560	17%	1403%	464%	2%

Source: World Bank "World Development Indicators in 2002" CD-ROM. Remittances to Philippines are from Central Bank of the Philippines.

Remittances to some African countries, as for other regions, constitute a major source of foreign exchange and influence, often quite significantly, the national balance of payments. They also make up a fair share of GDP in many countries and may outstrip other financial inflows. In some low-income countries, remittances can account for up to 15 percent of GDP and even higher in others. **Remittances to Eritrea were 194 percent of merchandise exports, a staggering 85.8 percent of the ODA and 19.68 percent of GDP in 1999**; for Cape Verde remittances were 51 percent merchandise exports and 12 percent of GDP; for Comoros the same values were 24 percent and 6 percent; *for Egypt, 26 percent (there is some discrepancy here from the above table)* and 4 percent; and for Morocco, 18 percent and 5 percent respectively (Rapoport and others 2001, as cited in Sander and Maimbo 2003).

In other similar studies done by International Organisation for Migration (hereinafter - IOM), Nigerians in the Diaspora remitted US \$1.3 billion in 1999, equivalent to 3.71%

of the country's GDP and 55% of ODA. The same study reported that *remittances to Eritrea from its Diaspora population accounted for 19.68% of the country's GDP and a staggering 85.8% of the ODA* (Wasow, Jan.07, 2004). But these figures for Eritrea as it is always the case with remittances elsewhere have some discrepancies. Looking at the report from the IMF, it puts it at *about 37% of GDP for the last 10 years* (Yamauchi, 2004).

**Table 2.2** Grants to Eritrea for the years 1993 - 2002

Eritrea: Key Fiscal Indicators, 1993-2002 (In percent of GDP, unless otherwise indicated)

Fiscal Year	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Grants	20.6	19.0	12.3	10.8	5.8	9.4	8.2	19.4	17.7	12.4
Contribution from Diaspora	0.0	0.0	0.0	0.0	0.0	1.1	2.2	3.2	0.5	0.2
Grants in kind/earmarked	20.6	19.0	12.3	10.8	5.8	8.3	6.0	16.3	17.2	12.2

Sources: Ministry of Finance, Bank of Eritrea and IMF staff estimates. (IMF WP/04/7)

From the above table and the previous few paragraphs, *it is obvious to observe that remittances to Eritrea have indeed discrepancies*. There was no written explanation why this happened but it is understandable as remittances are not easily quantifiable. The fact that remittances use different formal and informal transfer channels and at the same time they have various interpretations with their definitions that include or exclude some items, the reported data are likely to show such discrepancies.

In general, remittances increase the home economy's foreign exchange reserves. Since flows of remittances are less volatile than foreign investment, future flows of remittances can also be used as collateral agreement by the Government of the State of Eritrea to access international capital markets.

### **2.3.3 The Role of Remittances on Individual Recipient Households Income**

Apart from their contributions to fiscal spending that are measured by the different national economic indicators, these funds are often a vital source of income for remittance recipient households and have an important income-smoothing effect. Remittances have all the subsidiary effects of a private flow of funds intended primarily as family support directed at individuals and households. However, they are not only limited to that end, but also to community projects as well. Although remittances are generally spent for consumption and other individual or household needs, a small portion is invested, usually in property or a business.



Remittances, as expected, constitute a net positive transfer from relatively richer to relatively poorer individuals or households. They form a family welfare system 'safety net' that smoothes consumption, alleviates liquidity constraints, and provides a form of mutual insurance. The vast majority of remittances go to family members who are either spouses or parents. Many of the households receiving remittances are headed by females. In El Salvador, 47.5 percent of families receiving remittances are female headed compared to 32.2 percent for non-recipients. In Guatemala, 38.2 percent of receiving families are female-headed compared to 24.8 percent of non-recipients (The ECLAC 1991 study, cited in Meyers 1997).

The bulk of these funds are used for consumption or investment in human capital such as education, health, and better nutrition. Meyers (1997:9), "for the most part, remittances are used for daily expenses such as food, clothing, and health care—basic subsistence needs—and they make up a significant portion of the income of those households." El-Sakka (1997), investment in land, livestock, and in building or improving a home is also relatively common but secondary to daily needs and human capital expenses. Less is used in business, or to repay debt used for the expenses of going abroad.

According to (Ratha, 2003), insecurity tends to be the main motivator for investment and the type of insecurity affects the type of investment. That is, Land is more attractive than a financial investment if the currency is volatile or if there is high inflation. Furthermore, the marginal propensity to save from remittances was 7 times higher than the propensity to save from rental income (Adams, 2002). Uncertainty being the reason for variation, Adams concluded that those incomes, which are more variable, tend to be saved at a higher marginal rate. Here, remittance income is more variable than rental income.

High proportion of remittances devoted to consumption reflects that migration and remittances are part of the strategies of individual migrants and their families to escape poverty and raise their standard of living. For instance, Remittances helped to improve the standards of living of a significant segment of the Jamaican population, providing money for basic needs and providing hard currency for consumer goods. Davies (2002) reported that while there was a high level of support from migrants abroad for poor

households, 34 percent currently receive remittances; the funds also went to a significant portion of households above the poverty line, 35 percent.

Many studies therefore put the contributions of remittances in their micro level as devoted to:

- Daily needs and expenses (70–90 percent of remittances), typically labelled as consumption or as improving the recipients' standard of living
- Health-related expenses and education, often grouped with consumption when seen as improving the standard of living
- Consumer durables (stereos, televisions, washing machines)
- Improvement or acquisition of housing, purchases of land or livestock
- Socio-cultural investment (birth, marriage, pilgrimage, death) such socio-cultural events always influence the flow of remittances.
- Loan repayments (often loans to pay for cost of migration)
- Savings and
- Income- or employment-generating activities.

Remittances to Eritrea constitute a significant part of recipient households' total income. Although no data are readily available to show how many households receive remittances and what percentage remittances constitute in the households income, Randall (1995) puts a figure that in 1991 nearly 85 percent of the Eritrean population survived either from foreign aid or from international remittances.

The response to my survey questionnaire (although the response rate was too low to draw any concrete conclusions) showed that Eritreans who reside in Seattle area of WA suggested that they send home approximately 10 percent (about US \$1,000) of their annual income. The respondents further said the length of time in the host country does not really affect their decision to remit. What affects their decision to remit or not is how much they have saved and the reliability of the person that takes the money to relatives in the home country. If they save enough they claim to send 10 percent of their salary. Furthermore, the answer suggests that they use informal transfer channels as the formal channels charge US \$40, which is expensive relative to the small amounts sent. However, the earlier GDP indicators suggest that officially recorded international remittances alone provide unquestionably significant financial resources. When

recorded remittances are combined with informal and other unrecorded domestic remittances, their contributions to recipient households and their trickle-down effect to the country's economy in general are clearly substantial even if not readily quantifiable. The unofficial names of some foreign countries given to certain localities and venues in the capital city, Asmara, names such as Via Jeddah, Via Germany, are some concrete examples of the contributions of international remittances in the lives of many households. These venues alone demonstrate that, if examined from an economic point view – the value of the buildings, the wages of the daily labourers who were employed in the construction of these buildings and other related activities that had directly or indirectly association with the construction of these buildings – indeed the trickle down effect of remittances is tremendous.

Other examples are the relocation of the people or the unparalleled growth of the population of the capital city and other towns with respect to their natural population growth signifying that international remittances not only reinforce rural urban migration but also favour some localities more than others. While many remittance recipients often use the money for basic needs, such as buying food and consumer goods, still more people use them to relocate themselves in the urban centres in order to get better services from city life. Experts say whatever remittances are used for, even if the money is spent in conspicuous consumption, it can have trickle-down benefits in the economy. As Scott and Joseph (2004:31) quantified the multiplier effect, for every dollar that is sent back to Mexico, they estimated a trickling down effect of US \$3 more is generated in the form of construction material, food or contract work.

Despite the above contributions to the living standards of many recipient households, many non-recipient household families, who do not have relatives in a foreign country nor receive remittances from friends, might feel envious of remittances. Thus, they create some stress in the lives of these latter people. The fever of migration that seems to engulf the Eritrean youth post independence has partly emanated from this envy. The stalemate situation that forced the government to extend the national service beyond its prescribed 18 months period not only aggravated the country's budget deficits but it could also be the prime reason for the individual national service participant's sufferings and migration to foreign lands.

In many parts of Africa, unrecorded remittances include domestic urban-to-rural payments that are not captured in official statistics either. (de Haan 2000, as cited in Sander and Maimbo 2003), "Estimates suggest that these domestic remittances could contribute as much as three-quarters of non-farm earnings in areas close to major cities and one fifth of non-farm earnings in more remote areas." In the Eritrean economy, domestic remittances are also far from being quantifiable. As discussed briefly in the above paragraph, this study attempted to obtain data concerning remittances to Eritrea. Using a survey it tried to get what percentage remittances constitute, what their uses are, what factors affect their flow, etc. but due to time and costs constraints this proved to be impossible. Consequently, secondary data are relied upon to see remittances and their impact on the Eritrea economy. Data from IMF and some other studies are traced to assess these above said contributions of remittances.

#### **2.3.4 Communal Remittances**

Besides the individual and family supports, almost all migrants participate in community or church groups that make collective remittances to their home communities. Communal or collective remittances, while making up a tiny fraction of total remittances, are typically invested in community improvements. They are often collected through fundraisers and are applied to a range of investments, including building or renovating schools, churches, and public utilities. Therefore, communal or collective remittances require a separate discussion because they differ from household or individual remittances, both in their intended use and in their low volume.

Sander and Maimbo (2003:18), "Although no comprehensive survey of communal or collective remittances to Africa has been done, there are references in the literature to communal or collective mobilisation and use of remittances, such as by Malians and Senegalese in France. The Kayes region of Mali, which is home to the great majority of migrants to France, has benefited from support by some 40-immigrant associations in France. Most of these associations have counterparts in Kayes and in the span of a decade they supported 146 projects with a total budget of about three million euros. Some 94 percent of this budget came from immigrant savings and the rest from donor-funded NGOs. AFFORD (2001) quoting Libercier and Schneider (1996), estimated that over 60 percent of the infrastructure in the villages of Kayes can be attributed to the Diaspora in France." Similarly, building the University of Hargeisa by the Somali

Diaspora further illuminates the role of collective or communal remittances. (IOM 2000, as cited in Sander and Maimbo 2003), “Nigerian migrants also make individual or pooled remittances through “home improvement unions.”

In Eritrea this is another success story, which extends back to the years of liberation struggle where such community-based associations made headlines in the different renowned world papers. One such association of that time was the Eritrean Relief Association (ERA), which played an important role in alleviating the different natural and man-made hazards in the then liberated part of Eritrea. Today as their legacy, there are many Eritrean Diaspora associations that follow up and participate in the country’s reconstruction and development projects.

African migrants’ groupings take the form of associations based on cultural or church groups, refugee groups, ethnic professional groups and/or virtual organizations that use the Internet such as Somali Forum (AFFORD 2001 as cited in Sander and Maimbo 2003). With the exception of very minor groupings, the majority of the Eritrean Diaspora associations took the form of an imagined community. The Government of the State of Eritrea mobilises the people to form ‘national’ associations that constitute people with different religious, linguistic, ethnic, or regional backgrounds.

As Adamson (2002:165) points out, members of trans-national communities if left alone, breed polarised politics and provide material and financial support for armed conflicts within the so-called homeland. As associations based on regional, ethnic, or church groups are deemed to form a polarized minority-thinking that breeds all types of evil spirit and confusion. Furthermore, these latter groups, if allowed to flourish, are the prime cause of widening of the inequalities in a nation. The region of Kayes in Mali is one concrete example of these inequalities.

Thus, the Diaspora Eritrean associations as discussed are broadly defined to include every ethnic, linguistic, religious, as well as regional background within the same group. The National Union of Eritrean Workers, Women and Students were and are the forerunners of these imagined communities. Besides, there are other associations that include non-Eritreans from the host countries. Eritrea Development Foundation (hereinafter - EDF) is one whose members are from all races and nationalities from continental America who are volunteers and interested in helping.

For instance, the contributions of these associations for the first quarter of 2004 were remarkable and substantial. Eritrean associations in Britain and Canada donated US \$98,000 and 2,600,000 Nakfa in support of drought victims and to augment the Martyrs' Families Trust Fund (Shaebia, 2004). According to the commissioner for Eritreans Residing Abroad – Mr. Tekeste, the above was only a fraction of what the Eritrean Diaspora contributed. Similar contributions exist everywhere Eritreans reside. Many projects that are co-sponsored by the Eritrean Diaspora and their counterpart stakeholders in the home country (such as government bodies, NGOs, and churches) are flourishing. The successes of these individual projects signify a sense of commitment that Diaspora Eritreans show towards their country.

As it is a common experience in many instances, the sustainability of projects has been exposed whenever returning migrants start projects that do not meet and reflect the needs of villagers. Therefore, to prevent such disasters, the Government of the State of Eritrea provides adequate support and guidelines on how, where, and in what forms they should participate. The people, mobilized under the above associations, were made to contribute to projects that are formulated by the different ministries, which in turn are consulted by concerned villagers. These projects were designed and governed in such a way as to give a sense of ownership to both sides – local villagers and Diaspora Eritreans by participating equally in their implementations. Local villagers confirm their participation by contributing 10 percent of the total cost of a particular project in addition to their personal involvement in its designing and implementation whereas the Diaspora Eritreans cover the larger portion of the total cost.

In short, the potential benefits of remittances whether it is in their macro or micro levels, or whether they are used for the individual household or community uses, can best be summarised as follows:

1. They ease foreign exchange constraints and improve balance of payment and are net addition of resources.
2. They permit imports of capital goods and raw materials for industrial development.
3. They are potential sources of savings and investment of capital formation for development.

4. They cushion effects of international price shocks.
5. They raise the immediate living standards of the recipient households.
6. They have potential to improve income distribution (if poorer and less skilled are migrated).

#### **2.4. REMITTANCES and THEIR ASSOCIATED NEGATIVE DRAWBACKS**

The potential benefits of remittances are not without some drawbacks. Remittances equally motivate both skilled and semi-skilled personnel to migrate and look for better-paid jobs elsewhere in the rich and industrialized countries. These countries recruit and advertise for skilled workers in different ways to spur their own industrial development as well as to fill the gap in their labour force for lower level jobs. Though they have very strict criteria that need to be followed, both skilled and unskilled people migrate in the hope that they might be counted as one of the lucky ones. However, most of them end up being cleaners, waiters, farm labourers and construction workers. These jobs are by their own right, better-paid jobs when the monies are converted to the local currency and compared to the wages in the home country. After all migrants are not usually concerned about the type of job, but rather how much money one earns out of these jobs.

In addition, the industrialised countries need young talented individuals who are a potential to replace the aging population of their own societies and to carry the burden this aging population will have on their budget. Therefore, in many regions of the world such as Europe and the United States, high influxes of migrants, legal and illegal, were exacerbated through programs that give incentives for skilled workers of underdeveloped regions to come to the developed regions. DV – programs of the United States is one of the concrete examples that can be mentioned in this regard.

The outflow of these migrants, many of whom could be skilled workers back home, destabilises the home country's labour market - a sign, not of development but of desperation that agitates many more to migrate (Scott and Joseph 2004). Thus, remittances, instead of alleviating the foreign exchange earning of these countries, seem to aggravate their economies by taking their capable (skilled and young) labourers and

as a result, creating dependency. This happens in the following way: firstly, by luring their more skilled labour force (brain drain), which were never enough to spur the domestic economy; secondly, by influencing a change in the habit of the consumers, they initiate a shift in demand from domestically produced goods to imported goods thus increasing demand for foreign exchange; thirdly, remittances seem to further extend the gap of inequality between regions as well as among individual families. Those who receive remittances buy larger areas for the construction of homes and thereby increase the land value of the regions. By contrast, those who do not send a family member abroad can no longer afford the overvalued properties of all type – imported consumer durables as well as land and the cost of living.

These drawbacks of remittances can be summarised as follows:

1. *Remittances are unpredictable:* As recession and business cycles become common and strikes frequently affect the economies of the developed world, unemployment is likely to hit these migrants. Besides, there is a continuous fight in the legislatures of the developed world to protect their labour markets from influxes of undocumented migrants. However, many studies suggest differently: that remittances are the only reliable source of finance developing countries obtain because migrants do not wait for the economy to recover, but rather go in search of jobs. Therefore, except for the transitional unemployment between jobs, they are employed for almost the whole year. Therefore, remittances are stable and can be used for predictions. The only concern is how to design mechanisms that influence the flow of remittances through formal channels and maximise their use in following the countries' development strategies.
2. *Remittances are spent on consumer goods:* which increase the demand especially for imported goods and thereby *increase inflation*, which in turn pushes up wage levels that do not reflect an increase in the production levels but are rather due to the impact of remittances in the domestic economy. (Ratha 2004), the side effect may be diversion of scarce budgetary resources to projects that non-resident nationals favour.
3. *They result in little or no investment in income- generating activities.* In Ghana, 70 percent of remittances are used for recurrent expenditure - school fees, health care, and so on. Less than 30 percent are invested in assets - land, cattle, construction (Schoorl et al., 2000 as cited in Sander and Maimbo 2003). In Mali, 80–90 percent



of remittances go toward consumption; little is invested in local business (Martin et al., 2002 as cited in Sander and Maimbo 2003). Just like the "Dutch disease", remittances increase the national income without an equal increase in the country's production abilities. Thus, the high import content of consumption demand increases dependency on imports and exacerbates the balance of payment.

4. *Replace other sources of income and thereby increase dependency.* It was not uncommon to have single women heads-of-household refuse minimum wage employment because of the regular higher income received from their children's fathers living abroad. While remittances had a positive impact on a country's foreign exchange reserves, increased dependence on these flows could also limit long-term development, eroding good work habits and not only heightening potential negative of returnee migrants, but also create envy and resentment and induce conspicuous consumption spending among non-migrants.
5. *Domestic currency appreciation:* A sudden high inflow of foreign currency – international remittances, can create a condition where the domestic currency is appreciated, which in turn hurts the domestic economy by hindering the trade of exports, resources and jobs in general. Thus, this results in negative balance of payments.

The balance between costs due to migration and benefits due to remittances to the labour-exporting countries is controversial. The argument usually comes down to one of remittances versus "brain drain," and the evidence on both sides is weak. Furthermore, different studies have different conclusions. Developing tools to identify with greater precision the effects of both factors on development, growth, and poverty reduction is necessary in order to come up with any valid conclusions about the impact of migration policy on development.

On the contrary, however, there is a counter hypothesis that suggests that remittances decline after some time. (Stark 1978 as cited in Grieco 2004), "The remittance - decay hypothesis suggests that individual remittances will peak soon after arrival and then decline, increasing occasionally in response to specific events or needs by relatives in the home country." (Brown, 1997) suggests that current remittances are declining due to lower migration rates, economic recession in the host countries and a decrease of migrants' willingness to remit. This hypothesis may have some truth if we see it from

one country's perspective or from an internationally tradable occupation. But taking it at its face value may be misleading.

- Firstly, from one perspective, where a country comes out of severe drought or prolonged civil or cross-border wars, there might be a decline in the flow of remittances. Since most of the remittances that are sent are primarily meant to alleviate the sufferings of family members who experienced such problems, migrant workers feel relieved when these conditions normalized. Thus, they decrease the amount and frequency of remittances that they send.
- Secondly, migration and remittances are not always the same among different occupational categories. Internationally tradable occupations such as nursing are likely to attract individuals with particular attributes and a strong propensity to migrate and thereby increase remittances or continue to preserve the flow without a decline.

However, migration of individuals and their subsequent flow of remittances differ from country to country and even within one country and between families. Furthermore, remittance behaviour could also be affected by occupation. Therefore, it needs to be discussed from both individual countries' perspective and from occupational differences. That is, why there are differences in the flow of remittances from one country to another. In some instances, it actually doubles while in other times declines.

In addition to other reasons, people migrate in search of better-paid jobs. This is more pronounced now than any previous time due to globalisation and free trade agreements. (Massey 2004, cited in Scott and Joseph 2004) when every market is debated and finally agreed to integrate worldwide, the only market that was left unspoken was the labour market and it is still protected by different laws and regulations. However, this did not help to deter the flow of people beyond their borders. Hence, overall flows of migration and remittances worldwide are not declining but rather increasing, although not comparable. Remittance flows are in hundreds of billions of dollars.

The ideas behind the theory of migration and remittances vary from one researcher to the other. However, the main focus of this paper is on remittances. Correspondingly, we have different theories concerning determinants of remittances. The next chapter will try to assess the most popular theories of determinants.

## CHAPTER 3

### THEORIES of DETERMINANTS of REMITTANCES

#### 3.1 MICRO-ECONOMIC DETERMINANTS

Under this heading we have four theories that try to explain why remittances occur between migrant family members and their non-migrant households. These are: - An Implicit Family Loan Arrangement; the Altruistic Behaviour Theory; The Implicit Co-insurance Arrangement and Enlightened Self-Interest Theory of Remittances.

##### 3.1.1 An Implicit Family Loan Arrangement

A theory of remittances as an implicit family loan arrangement discussed by Poirine (1997), compares the family unit to a corporation, with the main body of the company (the family members remaining in the home country) investing in its subsidiaries, the younger members of the family. When these subsidiaries have established themselves in a host country, the loans are repaid as remittances. According to Poirine, this works in the same way with urban and rural situations within the home country. Both arrangements are informal within the family group. The theory can also be applied to internal migration, simply by replacing home country and host country with rural and urban sectors.

Poirine (1997, 590) explains his argument by placing three stages to the implicit family loan arrangement. “The first stage, remittances mainly consist of the *repayment* of an informal and implicit loan taken out by emigrants during their youth, in order to secure a better education that later makes them more productive in the “modern” sector. The second stage, remittances are *implicit loans* made by emigrants to children or family members, to finance their education back home, until they are ready to emigrate. The third stage, the next generation emigrants repay the loan to the former emigrant-lenders who may have retired in the home village sector. As they near retirement age, older emigrants may also send remittances to relatives to build a house or set up a small business. Thus, three waves of loans, loan repayments, and savings to prepare retirement, sent by emigrants to family relatives back home, make up the remittance flow over time.”

### **3.1.2 The Altruistic Behaviour Theory**

According to Germenji, et al., (2000:3), “the altruistic behaviour was first modelled by Becker in 1974 in the context of household. The model explains that the utility of the migrant is affected by the well being of his/her family members who are left behind back home.” The assertion of the model is, Germenji (2000:3) “A rise in the income gap between the (sender) migrant and (recipient) household will increase the probability and the size of transferred income whereas a reduction in the income gap reduces both of them.”

This theory stresses the very fact that sending remittances, more than any thing else, is a gesture that brings satisfaction to the remitter out of concern for the well-being of his/her family members who are left behind. It explains that the emigrant worker has a strong bond with his/her non-migrant family members especially when the time of migration is short. S/he feels an inner push to change the well-being of these people by remitting either money or in-kind from what he earns as income in the host country.

Furthermore, the model suggests that the frequency and amount of remittances, however, decreases over time. Thus, by reducing remittances s/he starts to save enough money that could provide support for the years of his/her retirement either in the host or home country.

### **3.1.3 The Implicit Co-insurance Arrangement**

This theory explains remittances as an implicit family contract. Tina (2003:1) “The household as the primary decision-making unit in the context of imperfect credit and risk markets endeavours to diversify risk between the migrant and non-migrant family members. The New Economics of Labour Migration (NELM), unlike neo-classical theories, which focus only on distinct labour market phenomena such as wage differentials, NELM examines constraints in capital and insurance markets and links these to the migration mechanism.”

To reach this agreement, they assess every possible risk associated with migration and with being unemployed for so long in one’s own country. Solimano (2003:8), “Assuming that economic risks between home country and the host country are not positively correlated then it becomes a convenient strategy for the family as a whole to send some of its members to the host country as an emigrant in order to diversify

economic risks.” Then the non-migrant family members support the emigrant for his/her time of migration until he gets a job and settles down in the host country. Consequently, when the emigrant is settled and starts to earn his own income, he does his share by remitting money and non-monetary goods (in-kind) to his family members back home. Hence, migration diversifies risk and reduces dependency solely on the home country’s ability to generate income, and remittances in turn play a role as insurance.

### **3.1.4 Enlightened Self-Interest Theory of Remittances**

Citing the works of Lucas and Stark (1991), Germenji (2000:4) discussed remittances as Tempered Altruism or Enlightened Self-Interest. “Remittances, as part of an inter-temporal, mutually beneficial contractual arrangement between the migrant and the household in the country of origin, are based on investment and risk and they are also voluntary and self-enforcing.” Initially, the rural household insures the migrant against the early uncertainties associated with migration but subsequently the migrant adopts the role of insurer to allow the rural household to undertake riskier, higher yield ventures. The mechanism for self-enforcement can be mutual altruism that explains why such arrangements are usually struck between members of a household. The aspiration to inherit, the desire to return home and the need to have reliable agents to assist in the accumulation and maintenance of assets are additional considerations for self-enforcement.”

In general, these are the four theories of remittances and at some point they seem to overlap. Poirine (1997:590) “for instance the theory of an implicit family loan arrangement is neither exclusive of the “co-insurance” hypothesis nor of the “altruistic” hypothesis.” Thus, remittances comprise the four elements at the same time, each one explaining one part of the remittance element. Similarly, Lucas and Stark (1991) also acknowledged the overlap of these theories and provided three explanations. Firstly, migrants may remit for purely altruistic reasons in order to increase the well-being of family members at home by providing additional income and thus, higher consumption levels. Secondly, migrants may remit part of their savings for motives of self-interest to be used to finance the purchase of durable goods, real and financial assets and/or investment at home. Finally, remittances can be seen as part of a mutually beneficial arrangement between the migrant and his or her family at home.”

Despite this fact, all the above-mentioned theories explain something about the relationships between remittances and the behaviour of the remitter. Hence, this paper considers all of them as theories of remittances which can help us explain the cause and effect of remittances in the Eritrean economy. However, these are not the only theories that attempt to explain the determinants of remittances; we have additional theories that associate the act with the general situation that prevails in an economy, the macro-economic determinants.

### **3.2 MACRO-ECONOMIC DETERMINANTS**

At the macro-economic level, factors operating in both the host country and country of origin will affect the flow of remittances.

#### **3.2.1 Factors in the Host Country**

Developmental effects of remittances depend on various factors. One of which is their continued flow, which in turn depends on the ease remitters have with transfer channels and related costs (Sander, 2003). As discussed in chapter two, most remittances are made in the form of money. To a much lesser extent, remittances take the form of consumer goods such as staple foods, household appliances or services like life-cycle and religious ceremonies, school fees, airline tickets, etc. However to give full account of remittance flows, it is not only difficult but also necessitates a prior knowledge of these flows and to know how they reach their destinations. As remittances are diverse in their nature and use, they pass through formal and informal transfer channels.

##### **3.2.1.1 Direct Factors Related to Transfer Channels**

Generally, formal and informal transfer channels include money transfer services such as financial and non-financial institutions. Commercial Banks, foreign exchange bureaus that are dedicated to money transfer operations and post offices are being part of the formal transfer channels, small and medium traders, transport companies and social networks also constitute the informal transfer channels. Activities of the vast majority of Money Transfer Operators' (hereinafter - MTOs) to developing countries are recipients of funds and lack other services.

- **Transfer Costs:** - Remittance channels to and within Africa are similar to those in other parts of the developing world. The industry continues to be dominated by a small number of money transmitters that generally tend to charge higher fees than banks or credit unions. These money transmitters are not fully developed and have little competition among them and thus they are expensive. Bair (2002:2) found that “although charges have declined significantly over the past two years, transfer costs for remittances are still high. The average transfer fee and exchange rate commission to send \$200 varies from approximately \$15 to \$26. The cost varies as a result of the type of institution used and which country the money is being sent. When transmission fees and losses on the exchange rate are both factored in, the cost can often reach up to 20 percent of the amount being sent.” Ratha (2003: 158) estimated that “if transaction costs were lowered by 5 percent, overall remittances to developing countries would have increased by US \$3.5 billion.” Hence, high transfer costs either reduced the flow of remittances or diverted them into informal channels that obscure their correct figures.

- **Inflexibility of service:** - Besides the costs of transfer, each of these transfer channels has its own advantages and disadvantages with regard to its service that makes it different from others. Lack of flexibility in their service is one factor that limits the usage of the official transfer channels. For example, migrants have few opportunities to manage their finances, including remittances, in their home countries. They want to support their families in different forms. Services such as air tickets, vouchers for goods reflect the desire of migrants to support recipients in a particular way, rather than to send cash. Currently it is not possible to send money home with instructions that some of the money be credited to a savings account and the rest paid out to a specific individual Sander and Maimbo (2003: 19). Thus, inflexibility of service has reduced the flow of remittances.

- **Accessibility or Legal documentation:** - Formal transfer channels demand a legal document to process a transfer. Legal documentation, though necessary to prevent money laundering, however denies access to many of the illegal immigrants, who want to support their relatives back at home. These illegal migrants could constitute a large percentage of the total migrants. As a consequence, large portions of remittances find their way through other alternatives, the informal transfer channels. Bair (2002:3), “The Patriot Act, which was declared after September 11, 2001 requires financial institutions,

including money transfer businesses such as the above-mentioned to establish anti-money laundering programs and verify the identification of their clients. These requirements are in addition to the suspicious activity reporting requirements of Financial Action Task Force on money laundering (hereinafter - FATF) of 1989 that already apply to money services businesses.”

Though no one has to take the risk of terrorist act, preventing access to large numbers of undocumented immigrant workers diverts the flow of remittances to informal channels that charge large money and/or other means of transfer channels - like hand carry with people who travel back home. However, a study from Pakistan reveals quite a different result. Despite strict control of these transfer channels, the flow of remittances to Pakistan has indeed increased after September 11, 2001. But the study did not explain the cause of the increase nor did it depict which formal or informal channels they used. Therefore, one could not argue in favour or against the Act.

- **Other factors:** - (i) Lack of awareness. Many remitters are first time users of banks if they use the formal financial channels. (ii) Inconvenience. Most of them work long hours or in remote areas so time and location are factors that create some inconvenience. Thus, due to the above-mentioned reasons the flow of remittances to the developing world could be underestimated.

### **3.2.1.2 Indirect Factors**

There are a number of indirect factors in the host country that could influence the flow of remittances.

- **Economic activities:** - First the level of economic activity has a direct impact on the demand for migrant labour. Labour-importing countries often set quotas, which limit the number of immigrants who can enter these countries and how long they should stay within their borders. These quotas fluctuate over time, usually according to what is happening to the state of the economy. However, the figures do not usually reflect the true numbers of emigrants as large numbers of illegal (undocumented) migrants do operate in their economies. Although the level of economic activities varies with business cycles and seasonality, emigrants usually do not remain unemployed for long except for an initial period spent job hunting. Besides, they have strong social networks that deliver timely information.



- **Levels of wages:** - Second, the levels of wages migrants face have an impact on the amount of remittance that migrant workers can send home. The level of migrants' earnings will determine their own consumption and saving behaviour and thus the potential amount that can be remitted. The partially answered questionnaire from Eritreans living in Seattle, Washington, DC - USA, confirmed this notion. The amount remitted depends solely on the level saved and the wages earned.

- **Differential interest rates:** - Thirdly, the differential interest rates between the host and home countries and comparison of other opportunity costs among several potential portfolio investments have some impact on the flow of remittances. If this difference favours either country, then the flow of remittances fluctuates depending on which one dominates over other. If the difference is higher in the host country, people tend to delay remittances or decrease the amount and frequency they send. For example, in the host countries, many migrants have established small and medium enterprises as well as having house mortgages that extend for twenty years. This act is definitely going to reduce the flow of remittances in volume as well as in frequency.

- **Ratio of females to population:** - Finally, the ratio of females to population in the host country will also have an impact on the number of female migrants. Females not only dominate in domestic work but many of the outdoor service jobs also demand female migrants over males and this has an impact on the flow of remittances.

### **3.2.2 Factors in the country of Origin**

The prime reason for migrant workers to remit, is family responsibility. As breadwinners, they bear the burden to support their families especially when the level of income of those family members who are left behind, is below the minimum wage or due to bad weather if crops fail. It is expected that migrants will transfer a large portion of their earnings home, the lower the average level of income in the country of origin.

#### **3.2.2.1 Other factors**

Other factors, including those that involve transfer channels and associated charges that are discussed in the above section, also influence the flow of remittances. In addition, since financial institutions in most developing economies are backward and located mostly in the city centres, they provide inadequate service to both domestic and

international remittances. As a result, there are informal (black market) channels. Exchange rate differentials between commercial banks and the black market also influence the flow of remittances. As indicated in the above paragraphs, the problem with transfer channels in the developed world being documentation, costs and inflexibility, in the developing economies the problems are related to the inefficiency and limited distribution capacity of these institutions.

Another equally important factor in the flow of remittances is the rate of inflation in domestic market. High rates of inflation in the home markets may mean reduced living standards, which force migrants to send more remittances in order to maintain family consumption levels constant. However, this is a controversial issue that needs further research. High domestic rates of inflation reduce the pressure on migrants because their remitted foreign exchange would double or triple its value relative to the domestic currency. Thus, it might enable the recipient households to afford to buy durable consumer goods and hence it would even upgrade their living standards as a result of higher rates of domestic inflation.

#### **3.2.2.2 The Eritrean experience of Transfer Channels**

In Eritrea, both Western Union and Moneygram operate in transferring international remittances in collaboration with Commercial Bank of Eritrea. Besides, Housing and Commercial Bank, *Himbol Exchange Bureau*, Post Office and other small private moneychangers also operate in the international market. In the early years of independence, there were exchange rate differentials between Commercial Banks and Himbol. People favoured the latter as its rate was a bit higher than the commercial banks. Then Eritrea was using Ethiopian *Birr* and the exchange rates in these channels were: - US \$1 = 5Eth. Birr in the banks while it was equal to 6.20Eth. Birr in Himbol. Furthermore, Himbol before its recent restructuring, it was the extension of the banking system - *Bank Hafash* (people's bank) - of the liberation struggle years that used to operate within the liberated areas. Thus, the Eritrean Diaspora was fully familiar with its services and they continued to operate for a while even after liberation.

Other MTOs tend to have much smaller networks serving geographic niches or specific population groups. These latter MTOs are the ones that were recently established by the returnee Eritreans and their connections or contacts from overseas. These handful of privately owned transfer channels use somewhat flexible exchange rates usually a bit

higher than that of the government-owned national bank or Commercial banks. There are some informal transfer channels as well. Some are Internet-based and quite a few include in their service the option to have goods delivered or to purchase vouchers to be redeemed in shops in the home country. Most of the latter MTOs are family run small businesses or social networks that connect the Diaspora with their relatives in the home country. The other factor for proliferation of these channels is that commercial banks' operations always require a high degree of bureaucratic work, checking and re-checking for the accuracy of the names of recipients and remitters alike. As a result, many migrants do not always favour the banks in fear of the delay they create. In addition, another reason for the bank's inefficiency is their location. Since their services are mostly confined to the main towns or the capital city of the country, they have few clients.

**- Internal Remittances:** - Under the Ministry of Defence, quite different versions of money transfer channels "*Tequoratsi Nsdra-Biet*" operate. These channels transfer money exclusively from the military personnel to their families back home. The ongoing war of the 1998 - 2000 created a situation that necessitated the formation of money transfer channels within the ministry. Thus, *Tequoratsi Nsdra-Biet* (hereinafter – TNB) were opened in every division under the division's finance department and extended their operations both directions, down to the Battalions and up to the head quarters of the fronts. *Nequtas*, the counterpart offices of TNBs that pay the money to individual recipient family member, also opened in the sub-zones of the local governments. Between these two offices millions of Nakfa transfer monthly to families of the military personnel all over the country. Furthermore, they have the advantage of smoothing the flow of remittances between the remitters and their households. They reduced greatly the transport costs the recipient families used to pay to travel to banks, which are located in the city centre or at the big towns. The transfer costs also reduced. A more visible advantage, however, is once a family reaches the particular *Nequta*, processing time takes only a very few minutes and the frustration of not getting the funds is greatly reduced.

### 3.3 SOCIAL NETWORKS AS DETERMINANTS

Networks are defined as a web of relationships through which goods, services, money and information are traded and through which mutual obligation and gift-giving activities directly enhance social status (Kuehnast and Dudwick, 2002). Furthermore, the role of social networks in a society and to an economy in transition has important implications for institutional reform at every level.

In traditional societies like Eritrea, social networks have a role to play in determining the size (amount) and frequency of the flow of remittances. The socio-cultural integrity among the different Eritrean associations in the Diaspora and their attachment with relatives back home reinforces the flow of remittances especially during the different social and cultural ceremonial events. The Diaspora Eritreans, as a continuity of their inherited cultural values, have different networks. One vivid example of these associations is “*U’kub*” - rotating savings associations.

**U’kub** clubs are traditional and informal associations consisting of people who make regular cash contributions to a fund. This fund is given in whole or in part to each contributor in turn. Most of the communal remittances are facilitated by these associations. These informal institutions can also respond to members’ problems. They quickly raise large sums of money and also compensate for ineffective or non-existent banking systems. Furthermore, during crisis and economic depression, these networks still provide social support, personal financing, and mutual assistance. There is a remarkably low rate of default on what are in effect loans, because participants are intensely concerned to avoid both social disgrace and exclusion from this useful exchange network.

Other advantages of these social networks are those related with religious events. *Tsebel* is an occasion when a particular household celebrates an event in memory of the family’s archangel or its dead family member’s - commemoration. In a similar fashion, there is an occasion where a particular village holds a religious festive. This is a common feature that has been followed for centuries in almost all of the villages in the highlands. Besides, people who emigrated from the particular village still maintained their extended family value systems and show their appreciation by reimbursing some money to the village church and pledging to construct or give something of value to the

community at large. In light of which, remittances and visits to the home country to participate in such occasions is a common practice experienced by both domestic and international migrants. Furthermore, the honour or status given to the family in the communities of both the host and home countries depends on the role, participation, and contribution of the family in the communities' projects and in the said occasions.

Hometown associations, in their different forms, are not only essential but also strengthen the ties between individual migrants. Those associations in the Diaspora helped each individual migrant to strengthen its commitment towards the home communities and thereby the flow of remittances to the country of origin. The Diaspora Eritreans participate in every development project from the village level to the big projects like construction of roads and dams. Perhaps the most spectacular example is Koser (2002 :) "An Eritrean woman who lives in Jeddah, Saudi Arabia, paid 1,000,000 Nakfa (about 70,000 GBP – 1999 ex rates) for the construction of a new mosque in *Mai Edaga*." He writes, "When I interviewed her in 1999 in the same village, her status was apparent and she told me, she earned respect from both Eritreans and Arabs - especially men - in Jeddah." This kind of dedication among Eritrean Diaspora communities is common.

However, informal networks are not only "safety nets", they could equally be institutions that can undermine or sabotage apparently well-designed programs intended to target the poor or marginalized part of the society. The word of mouth disseminated through these networks could also result in potentially strong ties that facilitate the destruction of a nation. These associations can sometimes become the sources of all sorts of confusion. Most of the time, illegal migration to neighbouring countries is the result of unclear information propagated through these networks. The illegal migrants found themselves stranded for months sometimes for years in harsh environments worse than their place of origin. Many end up frustrated and psychologically devastated. Similarly, human traffickers also use these networks for their own purposes and inflict havoc upon the individuals and their families and the countries that become victims of their plot. In such situations, remittances are sent to these unfortunate immigrants to alleviate their problems and to help them to get out of that situation. If remittances are injections of financial capital into the economy, these can be seen as leakages or outflows.

Even worse events than that could happen. It is simply logical for the enemies of a country to infiltrate such social networks and manipulate their agendas or programmes. In this respect, the so-called virtual communities are far the worst victims of this confusion. According to Adamson (2002:165) "Members of trans-national communities provide material and financial support for armed conflicts within the so-called homeland. Adamson quoting a World Bank report wrote that countries which had recently experienced internal conflict and which had an unusually large American Diaspora had a 36 percent chance of conflict recurring, whereas countries with an unusually small Diaspora had only a 6 percent chance of conflict recurring."

However, concerning this issue the author would like to express its doubt, and to give such an assertion based merely on the number of immigrants to the United State of America is equally mistaken. Rather the qualities of social networks as described by their composition in ethnicities, religious, regional, professional backgrounds is much more important in bridging or disbanding a country's identity. Those groupings of the same ethnicity, religion, or region could create much trouble by polarising the political situation of the home country than could those groupings composed of diversity. Firstly, they could be sources of tribal and minority thinking that polarise a country's politics and leads to fierce competition among regional, religious, ethnic or class actors, which in turn could lead to conflicts among these groups. Secondly, they tend to "keep up with the Joneses" in spending more money on conspicuous consumption rather than putting it into long-term investments. Thirdly, money laundering is another problem associated with such kinds of social networks. Since people tend to use these networks as a means of transfer channels, both genuine and misappropriated money equally use these channels. As a result, it is hard to differentiate one from the other.

The next chapter will focus on the policy measures that the Government of the State of Eritrea has taken to attract these remittance monies and to influence their usage in the domestic economy. Some countries' experiences are also traced to help the reader to understand the different policy measures that were pursued by these countries' governments.

## **CHAPTER 4**

### **REMITTANCES AS DEVELOPMENT TOOL**

#### **IN THE CONTEXT OF THE ERITREAN ECONOMY**

#### **4.1 GOVERNMENT POLICIES to INFLUENCE the FLOW of REMITTANCES**

Remittances, as financial resources injected into an economy, deserve careful attention if they are to produce the desired results. As liquid assets that are more diffused in the public domains, they could end up inflating domestic prices and devastating the economy by creating dependency on imported goods.

Different governments acknowledge the potential flow of remittances and their use in the domestic economy. Hence, they apply different policy measures to influence the future-flows of remittances in their frequencies and volumes. They implemented different mechanisms to direct their use in the domestic economy according to the particular country's development plans. Some governments even went a step further by preparing feasibility studies for some projects with collaboration of host countries for returnees as in the case of Eritrea-Germany. Furthermore, some governments open Commissions for their citizens residing abroad that facilitate and follow up the interests of these groups – examples are Eritrea, India, etc.

It is generally accepted that financial regulations and policies can encourage remittances both recorded and unrecorded. These policies when they are designed to smooth the flows of remittances can yield longer-term growth and income security in labour-exporting economies in three ways:

- By encouraging migrants to hold savings in financial assets in their home countries or spending their savings on consumer goods
- By redirecting remittances through official channels and
- By facilitating the investment by migrants in self-employment and enterprise creation in their home countries.

In this section, this paper is going to discuss issues related to policy measures that are directed to attract remittances and to influence their use in the domestic economy. First,

it is appropriate to look at some countries' experiences concerning these issues before committing to the Eritrean case. Policies related to the Cuban, Indian and Egyptian governments are taken as examples in this pursuit.

#### **4.1.1 Cuban experience**

Cuba, as a socialist country, experienced different problems related to migration and remittances. First, the government, due to its own internal policy, was not only against remittances but it went further to prohibit its entrance to the country. Second, the different USA governments also imposed equally parallel measures to prevent the flow of remittances to the country. After the collapse of the Soviet Bloc economies, however, Cuba experienced a shrinking economy. Thus, it faced difficulties in maintaining its economy, which forced the government to consider remittances as a viable option for development. Hence, it started to implement policy measures in order to influence and thereby to increase the flow of remittances to the country. Some of these policies were: -

- Legalizing the use of the US dollar in the Cuban domestic market,
- Opening of dollar exchange bureaus, *Casas de Cambio S.A.* (CADECA) where US dollars could be exchanged for convertible pesos at a one to one exchange rate and Cuban pesos at a fluctuating exchange rate (Barberia, 2002).

The first step was important because it sanctioned significant flows that had spontaneously begun to increase in response to the crisis in the domestic market due to the failure of trade with former allies - the Soviet Bloc. However, the legalization of dollar holding and circulation in the domestic economy was not without impediments. It soon began to undermine the government's ability to effectively manage its monetary policy and its distribution of resources. Dual '*official and black market*' exchange rates operated concurrently in the domestic market. Yet, the government had little, if any, control over the unofficial - black market exchange rate.

Therefore, it had to reconcile domestic needs with its ability to finance the trade deficit and foreign borrowing. Hence, the second step was meant to solve these difficulties. Thus by 1995, the Cuban government created domestic convertibility through the introduction of an extra-official exchange rate between Cuban pesos and US dollars and a domestically "convertible peso" that would replace the need for the US dollar in commercial transactions. According to Barberia (2002), the Central Bank of Cuba



issued “convertible pesos”, which were promissory notes equivalent to legal tender for domestic transactions in US dollars and backed 100% by dollar reserves. An extra-official exchange rate was introduced by CADECA to allow dollars to be sold for Cuban pesos.

The government took both these measures concurrently to augment its ability to catch the scarce foreign exchange in circulation by exchanging them for legal notes and Cuban pesos and indeed it benefited greatly. However, Cuba’s efforts to augment the flow and use of these remittances were not always smooth. The host country, the source of these remittance funds, United States of America, explicitly or implicitly tried to impose sanctions that undermine the flow of remittances. In the more recent years, official remittance flows were reduced from a limit of US \$500 per quarter to \$300 per quarter. Three years later however, President Clinton went one step further, banning family remittances altogether - except under extreme humanitarian emergencies - from August 1994 until 1998 (Barberia, 2002).

However, whatever measures a host country takes to curb the flow of remittances, it is futile and uncivilised. In this regard, it is enough to look into the experience of the USA attempting to curb remittances to Cuba. The host country’s policies created undeniably discomforts and delays to Cuban population. However, the policies were futile to curb remittances altogether as the majority represent altruistic behaviour. They only diverted the flow to informal transfer channels.

#### **4.1.2 The Indian Experience**

Unlike Cuba’s experience, India’s past experience is characterized by indecisiveness of the different Indian governments over their Diaspora communities. Bhat (2002:5), “After the 1970s liberalisation and new industrial policy, however, the Indian governments sought involvement of overseas Indians in investing both in terms of capital and technology.” This paper will only focus on the recent policies that were taken to influence the flow of remittances to the country.

The first step the Indian government took was to recognise and legitimatise these immigrant Indians, the Non-Resident Indians (hereinafter - NRIs) and their spouses. Bhat (2002:6), “‘The People of Indian Origin Card’ (hereinafter - PIO) was launched by the Ministry of Home Affairs in March 1999 to reinforce the emotional bonds of Indians

who have made other countries their homes, but who now have a yearning to renew their ties with the land of their origin. This scheme provides a host of facilities to PIOs, which were generally open to NRIs. NRIs were encouraged to invest in India through certain attractive schemes *such as Resurgent India Bond (RIB)* and they were welcomed to launch industrial enterprises along with transfer of technology. The PIO Card holders would get facilities for acquisition, holding, transfer and disposal of immovable properties in India, except agricultural/plantation properties, admission of children in educational institutions India under the general category quota for NRIs, various housing schemes of Life Insurance Corporation of India, state governments and other government agencies.”

In general, they are allowed to acquire property, encouraged to invest in industries and have access to the educational facilities. Bhat (2002:6), “Under the PIO Card scheme, there is no need for getting a visa to visit India and for registering with the Foreigner's Registration Officer if continuous stay does not exceed 180 days. The Card would also enable the journey of PIOs back to their roots much simpler, easier and flexible.” According to estimates, the NRI population is about 6.7 million and that of PIOs is around 15 million. By investing an amount of US \$1000, PIO's could now secure visa permit for the next 20 years with multiple entries.”

India has benefited greatly from this scheme. The flow of remittances reached an all time high. Moreover, the leading NRIs are demanding the government involve them in improving India's global ranking in literacy rate, life expectancy, infant mortality and poverty while attaining higher economic growth.

#### **4.1.3 The Egyptian Experience**

Egypt has a moderate number of migrant populations. What it gets as remittances from its Diaspora has undeniable impact. El-Sakka (1997:17), “Before 1967, Egyptian emigrants were obliged to transfer 10 percent of their income in foreign exchange.” Since then, the Egyptian government has attempted new and more motivating measures to attract emigrant remittances through official channels. Among those measures are, El-Sakka (1997:19), “Progressive devaluation of the Egyptian pound, tax free interest on special deposits of foreign exchange earnings, invitations to Egyptians living abroad to purchase foreign-currency denominated development bonds on advantageous terms, and

instant delivery of locally produced durable goods to emigrants who paid in foreign exchange.”

The government of Egypt introduced a special import system known as the Own Exchange Import System (hereinafter - OEIS). Similar to “*Franco –Valute*” as in the case of Eritrea and Somali, OEIS offers import permits to individuals who, from their own sources, could provide the necessary foreign exchange for imported goods. The system encouraged emigrants to use their savings to finance the imports Egypt needed from abroad. El-Sakka (1997:20), “The main sources of foreign exchange to these importers were the savings of emigrants and on average, more than two-thirds of total recorded savings finance these imported goods.”

The liberal policy the Egyptian government adopted helps the economy to augment foreign exchange reserves. El-Sakka (1997), “After liberalization, the bank had access to 18 months’ worth of foreign exchange to buy imports, before liberalization however, the average reserves were less than 3 months.”

## **4.2 THE ERITREAN EXPERIENCE**

The following are some of the policies that were implemented by the Government of the State of Eritrea to influence remittances in their flows in volumes, frequencies and their use in the domestic market.

### **4.2.1 Nominal Income Tax**

The Government of the State of Eritrea imposed a nominal income tax upon the Diaspora Eritreans in order to play their part in the heavy responsibilities of national reconstruction and development programs. The fact that the country has to start from scratch due to the thirty years of devastating war and destruction that left the people as well as the country almost empty-handed, neither the government nor the public can sustain these projects without the support of the Diaspora. That is, according to Randall (1995), “At the end of the war in 1991, it was estimated that more than eighty - five percent of the population were surviving on international relief or remittances sent from their relatives in the diasporas.”

According to Koser (2002), “Eritrea after its independence imposed a flat 2 percent nominal income tax to its Diaspora communities.” This, being similar to that of Egypt’s 1967 tax on its Diaspora citizens, however when compared, Eritrea’s tax is a bit mild. Under this proclamation, every adult Eritrean in the Diaspora is liable to pay 2 percent of his/her annual income to the country. This rate applies across the entire Diaspora, and includes the unemployed (seasonal unemployment) and all social categories.

Until December 1994 rehabilitation tax (a similar - 2 percent) was also levied upon Eritreans who reside inside the country, from their monthly income. Both these taxes were similar in concept except that they were levied on different currencies. They were meant to expand the country’s tax base and the government source of revenue. During awkward economic situations such as the country is currently experiencing, due to the impasse situation created as a consequence of Ethiopia’s failure to abide by the Eritrean-Ethiopian Border Commission (EEBC) ruling, the Government calls on its citizens to contribute to the national treasury. Other short-lived rehabilitation taxes are also used in order to augment its sources of income.

When the issue of taxes is raised, the burden of collecting them also becomes an issue of concern. But collecting these taxes from the Diaspora Eritreans is easy for two reasons. Firstly, except for a very small minority, every Eritrean, whether s/he is in the country or outside, always volunteers to fulfil his/her national duties. Most Eritreans view this tax not as a burden, but rather as a duty towards their homeland. The people always consider its contribution as minor compared to the sacrifices paid by the fighters and their immediate families. Koser (2002,), “As taxes are national duties, everyone from Diaspora pays this contribution, and none seemed to resent paying – not even those in open opposition to the Eritrean government.” Secondly, since everyone wants to preserve the social status one acquires and the respect it brings about in his/her community, paying these taxes works implicitly as a means of control and preservation of one’s status among the Eritrean society in the Diaspora. Nobody wishes to lose this.

In addition, to obtain any right in the country, everyone is required to do his/her part. However, due to the fact that neither the number of Eritreans who reside overseas nor their contributions in terms of remittances or direct tax to the country’s economy are

found in any data, it is hard to associate figures to how much actually is collected through these taxes.

#### **4.2.2 Franco- Valuta and Savings Account in Foreign Currency**

Glossary Somalia describes “*Franco-Valuta* as a system that permits the private repatriation of hard currency by traders and overseas workers.” Franco-Valuta was legalised in the Eritrean economy from the start of independence. It was meant to motivate traders who can get Dollars and Euro through their own means and import commodities without requiring them to open a letter of credit (LC accounts) in the national bank of the country.

In fact, some critics attach the cause of the war between Eritrea and Ethiopia to the countries’ different monetary policies, where the Ethiopian government condemns such acts. However, as the Eritrean government policy of free trade allows traders to move freely, this policy of *Franco – Valuta* encouraged them to use migrants’ remittances, if they can get them through their own means, for import transactions that demand hard currencies. Thus, using migrants’ remittances and *Franco – Valuta*, the government tried to give leeway for traders to alleviate the shortage of the foreign exchange earnings. Otherwise it would be required of the national bank to provide traders as well as investors who equally demand these hard currencies. Hence, competition to obtain them would impose pressure on the national bank in importing consumer goods and other necessary capital goods for the huge burden of reconstruction needs of the country.

Prioritising the demand for these currencies would definitely put traders last in the line. They would be crowded out in the competition. Which means imported consumer goods would become rare and costly. *Franco-Valuta*, therefore, has played a great role in reducing the shortage of these commodities and in stabilising their prices. This policy partly explains the semi-floating exchange rates in the country for foreign exchange and the monetary stabilisation policy.

In addition, the government encouraged any Eritrean who wants to open a savings’ account in hard currencies in the local banking system. For instance in 2001, HCB advertised that savings account could be opened in foreign currency (US\$) or (Euro) on personal application with an initial deposit of USD or Euro 100.00. Subsequent deposits

can be made in cash, by cheque and/or transfer payments. Furthermore, HCB offers dollar denominated certificates of deposit (hereinafter - CD) in the amount US \$1000.00 or over. The purchase of these CD's strengthens the foreign currency holding of Eritrea while offering the holder adequate interest income and guaranteed repayment at maturity. Purchase can take place to that effect if individuals initiated the transaction either by applying in person to the bank or by instructing their banks in the host countries, to make transfer or by contacting those exchange agents in their locality if available.

In order to facilitate the transfer of these above mentioned and other similar transactions including remittances, Commercial Bank of Eritrea (hereinafter – CBE) and HCB have agreed to form alliances with different banks in the host countries. Accordingly the most visible examples of such agreements are those made between CBE and Western Union and CBE and MoneyGram. These two money transfer corporations are among the official channels that transfer money including remittances to Eritrea.

Furthermore, HCB facilitates financing for those who can afford to pay 25 percent deposit for the construction of a house in the country. This scheme allows individuals who fulfil the above requirements to mortgage a house from the bank for 10, 15, and 20 years. The bank is also willing to go further if there are other preferable options for both the parties. On behalf of the bank, office of the commissioner informed interested citizens from the Diaspora to use this opportunity and to keep in touch with their respective Eritrean Embassies or Consulates to see what opportunities are available.

#### **4.2.3 Free of Import Duty**

Although some countries may not impose import duty on minor or less valuable commodities, it is well documented for any government to impose import duties on any goods that crosses its borders. These duties may include the goods and services tax (GST) or harmonized sales tax (HST), and provincial sales tax (PST).

In Eritrea for those returnee Eritreans and liberation fighters, there was a one-time-free-of-import duties opportunity to bring whatever commodities they chose into the country. The reason is that the fighters spent their time and efforts in the armed struggle thus, sacrificed their youth for the country's independence. Similarly, returnees Eritreans have suffered as they were forced exiles. Therefore, these latter groups are granted duty

free import to motivate them to bring their entire household utensils and one private car when they decided to return to their home country permanently. Those Eritreans who prefer to stay behind in the host countries, were also encouraged to send commodities of any kind like washing machine and other household utensils and/or private cars, to their relatives back home, duty-free. A similar proposal was given to both sides to motivate the inflow of remittances in kind. This was thought to compensate partly for what these parties had lost during the length of the struggle. This policy is similar to that of *Franco - Valuta* except that it did not impose taxes on the commodities.

#### **4.2.4 Institutionalising the Eritrean Diaspora**

Since the outbreak of the war with Ethiopia in 1998, the Government took the initiative for the second time to institutionalise and mobilise Eritreans in the Diaspora. A commission was formed that looked after the interests of the Diaspora and their contributions to the country. Besides, many government officials and party members held seminars to update the Diaspora Eritreans about the situation in Eritrea. As a result (Biddiho, 2003), "The 1999 Washington DC's festival revived and saw an attendance like it had never seen before, which was a minimum of 8,000 people."

In this second mobilisation, Commissioner Tesfamariam Tekeste praised the crucial role the Diaspora Eritreans have been playing in the country's development efforts; buying bonds, purchasing stocks, showing generosity towards Eritrea's needy and much more. He specially commended the contributions geared towards Martyrs' Families Trust Fund, which can be seen as communal remittances. The commission is given a mandate to:

- To strengthen ties between Eritreans inside the country and those abroad,
- To encourage Eritreans to contribute their expertise in nation-building process,
- To open opportunities for Eritreans and their partners to invest in Eritrea,
- To encourage the establishment of Eritrean community and organization in line with the laws and principles of the country where they live and work, and finally
- To ensure the rendering of fast and efficient services to Eritreans visiting the homeland.

The role of this office is evident when one sees it from the study done by Scott (2001). In the study on the settlement experience of Eritrean Canadians in Toronto, Scott found

out that Eritrean parents focused on maintaining their culture and heritage while they experienced difficulties in understanding the Canadian school system. In such a situation, the office of the commissioner participates in narrowing the gap the Eritrean Diaspora experienced due to language and cultural barriers. By coordinating the skills of the Eritrean communities in the host countries the office further provides translated materials and holds tutoring classes that help them to upgrade their knowledge in all spheres possible.

Besides integrating the Diaspora Eritreans into the main stream of their home country's political life, six seats were reserved for them in the Transitional National Assembly. Among the Transitional National Assembly members 10 percent are representatives of Eritreans residing abroad. These parliamentarians along with their counterparts from inside the country act as the country's legislative body.

In other developments, it is well remembered that during the early days of independence, there was an open call to Eritreans who reside in the Diaspora to come and participate in the country's reconstruction programmes. The initiative was part of the government's capacity-building strategy, which sought to contribute to socio-economic development through the mobilisation of skills, financial and other resources of the Eritrean Diaspora to reduce poverty and strengthen the technical and institutional capacities of the public and private sectors. It was a demand-driven capacity-building program, targeting the skills, which were lacking or in high demand in the various sectors of the Eritrean economy and in the different ministries of the government.

Besides, there was a motivational house/rent allowance, especially to those skilled and professional Eritreans who were scarce. To augment the Eritrean Government's capacity, the German government also participated in this aspect by providing returnee Eritreans their monthly salaries for the first two years consecutively after their repatriation.

Even those Eritreans, who prefer to stay behind in the host countries, were motivated to come in person for one or two years. Many came and served for one or two years in the country under the different ministries including the University of Asmara before they returned to their new countries, the host countries. They participated in drafting and ratification of the different laws of the country starting from constitution to the various



land, commercial and financial policies. Dr. Haile M. Mezghebe is the most prominent figure in this respect. Being a co-founder of the Eritrean Development Foundation (hereinafter – EDF), he travelled to the country almost annually for one or two weeks with his colleagues from the United States of America to do surgical operations.

Others, who could not come, took the initiative by increasing their monthly contributions towards the different projects or to the country's treasury in general. They also formed or revived old organisations. Some visible examples that took place immediately after these seminars were: -

1. In the UK the Diaspora started to pay one-Pound Sterling a day plus a one-off annual payment of 500-GB Pound Sterling for 1999 (Koser, 2002; Tekeste, 2000).
2. Similarly, in Germany for the month of December 1998 the rate of 2 percent was raised to 10 percent and a one-time payment of DM 1,000 and an additional DM 30 per month was immediately started (Koser, 2002).

Elsewhere, Eritreans worldwide responded with similar elation and a slogan to defend their country of origin's sovereignty. "A dollar a day, keeps *Weyane* away" was the slogan used at that time of the war (Negash, 2000). *Weyane* – is the ruling party of Prime Minister Meles of Ethiopia. According to Koser 2002 many Eritreans on voluntary bases pledged to sponsor individually US \$30 monthly contribution to Martyrs' Families Trust Fund.

Some returned permanently, bringing with them their household utensils and started life afresh in their home country. Those returnees from Germany were given the above-mentioned motivational salaries for two years. Moreover if they came up with a feasible business plan, they would be given fund from a bank that is exclusively established to serve them by the German-government. Many of these returnees become beneficiaries of this bank and started up different small and medium companies. According to Abraha (2004:1), Tesinma is one of these companies that are partly funded from this bank. Tesinma is a Share Company that assembles a wide range of commercial vehicles such as buses, cargo trucks, and tippers, skip loaders, hook loaders garbage compactors, and incinerators and weigh bridges using imported chassises and motors. The Company has the capacity to build from 50 to 70 buses annually.

### **4.3 The INVESTMENT CLIMATE and DIASPORA FINANCING in the ERITREAN ECONOMY**

The above being government directives to influence the future-flows of remittances, especially as contributions towards government cash vault and to augment investment in the country in general, the actual figures were above and beyond these contributions.

#### **4.3.1 Treasury Bonds**

In the past, Eritrea substantially benefited from Diaspora financing, which brought the country much-needed foreign exchange earnings. This support is mainly guided by family relationships and patriotism, but it has also increasingly been viewed as an investment in the country.

The importance of the Diaspora for public finance and foreign exchange earnings is demonstrated by the fact that the level of bonds issued to the Diaspora reached 3.1 percent of GDP in 1999 (Yamauchi, 2004). The treasury of the State of Eritrea issued bonds for the first time in its history at the beginning of 1999 (Koser, 2002). According to Koser, there were seven types of bonds, which range in duration from three to ten years, and in cost from US \$300 to US \$1,000. These bonds had different interest rates varying from 3.5 percent to 3.69 percent depending upon the termination dates. The response was quite remarkable. The Eritrean Diaspora purchased millions of US dollars worth of bonds. In July 1999, only six months after their issuance, US \$20 million worth of bonds had been purchased in the North America, US \$20 million in Europe and US \$15 million in the Middle East (Koser, 2002).

Likewise, the voluntarily granted transfers to the department of treasury reached to 3.2 percent of GDP in 2000 (IMF, 2004). According to the IMF report, recorded private transfers from the Diaspora are the largest single source of foreign currency inflows into the country, with the ratio of these transfers to GDP averaging 37 percent over the last ten years.

In the face of credit rationing and national risks, many developing countries resort to securitization of workers' remittances as collateral for credit purpose. Since these countries lack good deposit, Ratha (2003:161) "In recent years, many emerging markets issuers have resorted to securitization of the future-flow of any stable source of foreign

exchange to access international markets, to avoid credit rationing in the face of deteriorating sovereign risks.” Workers’ remittances have been used quite frequently along with other future-flow receivables such as oil exports and credit cards receivables (Ketkar and Ratha (2001), as cited in Ratha 2003). Hence, in light of the above arguments, Eritrea has sufficient opportunity to use these flows of remittances to access international markets but unfortunately there is no written evidence that supports such action in the Eritrean economy except for the recent issuance of the treasury bonds.

#### **4.3.2 Stock and Shares**

Other similar opportunities for investors were the sale of the different government owned industries. Those industries that remained in the hands of the government also went public according to the privatisation policy of the Government of the State of Eritrea. According to Shaebia web site (2004) starting this year the two biggest companies (*Asmara Brewery* and *National Insurance Corporation of Eritrea (NICE)*) are selling their shares on the open market to Eritreans in the country and outside. For these companies, this paved a cheaper way of injecting fresh capital into their system. Similarly for the country, it strengthens the foreign currency holdings. As these companies are among the well-performing companies in the Eritrean economy, the individual investor also benefits from these stocks either from capital gains or dividends. These companies are known for:-

- *Asmara Brewery* – being the only Brewery in the country with high demand for its products both from the local and international markets, it provides a good opportunity for a first time investor. This company offers one-third of its assets for sale in the open market to the public.
- *National Insurance Corporation of Eritrea (NICE)*, which offers up to 1,348,549 shares with a cost of US \$15 per share or Euro 12.50 per share, is also the only insurance company in the country with high profits and has great prospects for growth. Investors may also buy shares in any other convertible currencies.

These policies resemble FDI though they are procured by citizens who reside abroad. Attracting sufficient volumes of FDI is difficult because they require concessions of small and big regulations besides exemption of taxes. Thus, for countries that do not want to make sacrifices or compromise their environs and labour regulations, they are unable to have access to international financial markets to obtain external funds for

private and public investment. Diaspora-based financial instruments hence play a crucial role in financing these countries' development programmes and can compensate the lost opportunities. The Diaspora members, due to their connections and affinities to their homeland, may accept a lower rate of return and assume greater levels of risk in exchange for a 'special rate of return' - resulting in lower cost financing.

According to Johnson and Sedaca (2004), investment vehicles targeting the Diaspora can also add to the depth and diversity of a financial system, as well as help create a positive track record that will help attract conventional FDI. There are various forms through which these private investment vehicles can take shape. For instance, *certificate of deposits (CD)* as in the case of Eritrea and Cuba and *Sovereign Diaspora bonds*, such as those raised in *Israel* and *India* have all proven effective in raising funds for public investment. That is, banks in numerous countries have issued remittance-backed bonds to leverage Diaspora funds for development.

However, the creation of financial instruments targeting the Diaspora may not guarantee the provision of adequate funds for a country's development. Even with affinities and connections with their homeland, Diaspora investors are still wary of the risk and losing their investment. Countries with poor investment climates, weak fiscal discipline and government mismanagement will attract limited Diaspora investment. Furthermore, some instruments require a level of institutional sophistication and state of the art technology, which most third world countries including Eritrea could not yet achieve.

#### **4.3.3 Eritrean Diaspora and the Development Program**

A brief and practical definition of community economic development may be stated as the long-term process of change with the goal of stimulating local economic activity. A fundamental principle of Eritrea's national development program is, therefore, an evolutionary development through self-reliance, which long term progress would be achieved on one's own resources. The motto, self-reliance, confirms continuity and sustainability that comprises the entire society rather than to focus on a very few fortunate wealth individuals or foreign capital.

In this regard, there was and still there is an open call to all able Eritreans from within and from the Diaspora to participate in the country's development programs, such as construction of infrastructures, community facility services, and to invest in the

economy at large. Eritreans embraced the call in an unprecedented manner and continued to sacrifice their time and energy, skills and financial resources towards the country's reconstruction and development efforts. *Warsay YkaAlo* development projects that are flourishing in every corner of the country justify this continuity.

In other development, the tourism industry started to revive. As mentioned briefly in chapter one, during the length of the struggle years, Bologna and Washington DC festivals evolved as the symbol of unity among Eritreans from all over the world. In those days, these festivals were seen as a meeting ground and served to communicate their feelings for each other. As a legacy of those days, therefore the national festival started to be held in Asmara, the capital city of Eritrea, in the months of July or August. Tens of thousands of Eritreans who live overseas come to Eritrea to partake in the festival and visit their parents, relatives, friends, and their hometown. Many come to participate in this big occasion, like pilgrimages that visit annual festival of honourable religion place.

These Diaspora Eritreans visit their home country once every two or three years. According to Teele (2004:106), the number of Eritreans who visited the country for the past thirteen years on average was between 60,000 to 80,000 annually .They come for a whole month or two though the festival is only for a week or ten days at maximum starting late July to early August. Besides the money (remittances) they carried with them for friends and relatives who were not able to make the trip themselves, what they spent in the local economy is just like a hard currency earned from a foreign visitor or tourist. During these periods the recreation facilities in the big cities of the country are crowded with people and are fully engaged with these tourists.

As briefly mentioned in chapter two, these Diaspora Eritreans also continued their concern for their country and founded associations that look after the reconstruction of the country. As a rational human being, one might expect to see a dwindling number of Eritrean business communities due to the stalemate situation created first by the Ethiopian aggression and now by their rejection of the EEBC's ruling. However, many of the Eritrean Diaspora still continue to travel to Eritrea in large numbers to explore business opportunities, to find ways of acquiring a piece of land and look into the

country's development as a whole. They seek for a niche, negotiate and pick the opportunity to do business.

Besides remittances and other community development contributions, there are many Eritrean returnees' initiated businesses: *Mereb garment factory, Kokob Company, East Africa Construction Company, Tesinma* are to mention but a few. Kokob Company, after only few years of existence, has currently evolved into a big mother company with four subsidiary companies. These returnees' initiated small and medium companies that all together have invested capital of hundreds of millions of *Nakfa*. They are engaged in all kinds of activities from farming - labour intensive - to the sophisticated banking business.

Furthermore, the office of the commissioner to help Eritreans who reside abroad disseminates timely notices that are concerned with investment opportunities in the different sectors of the economy.

## **CHAPTER 5**

### **CONCLUSION and RECOMMENDATIONS**

#### **5.1 CONCLUSION**

Remittances, the portion of migrant workers' earnings sent back home from the place of employment, play a central role in the economies of many less developed countries in general and to their recipient households and communities in particular. Remittances are the by-product of invisible exports, skilled and unskilled workers' service, which are always associated with brain drain that obscures the contributions of remittances to the domestic economy.

Remittances, although they are primarily concerned with extended family relationships, make substantial contributions to gross national product and to a country's overall economic performance. Their effects on foreign exchange reserves, balance of payments, improved livelihoods, and investments in human capital are enormous. Their relative percentage contributions as compared to different economic indicators such as merchandise exports, foreign direct investment, or official development assistance are staggeringly large. In addition, remittances have proved to be more reliable than foreign direct investment or official development assistance and are also stable for a period of 15 years.

However, remittances encompass so many small transactions that could easily be affected by the cost, service and accessibility of transfer channels. There are formal and informal transfer channels. Furthermore, the flow of remittances through the informal transfer channels on a large scale obscures not only the correct figure from the national income accounts, but also it could undermine the country's monetary policy.

The ability of a government to divert these flows into the main stream - the banking system - has double advantages. Firstly, as the majority of both remitters and their recipient households are first time bank users, the act will not only create awareness on the part of the public but also broadens the savings base of the country. Secondly, the

business community - merchants and industrialists could obtain hard currencies at cheaper rates from the formal institutions rather than be forced into the black markets.

Apart from the use of informal channels, the other reason for the variability in the figures of the flow of remittances from one study to another is that there is no convention definition. The inclusive and exclusive nature of these definitions of remittances creates some problems in analysing the collected data. As it could be evident from the few tables that were presented in the text, different studies show different results for the same period of a particular country. The Eritrean case is a good example. Therefore, it is difficult to know exactly what percentage remittances really contribute to a country's gross national product.

A large amount of the remittances sent by family members, is spent directly on consumption or related expenditures that supplement the living expenses of the recipient households. Hence, remittances as family welfare systems primarily create safety nets among family members. Small amounts are also spent on revitalizing community facilities and augment the government budget of the recipient country.

Although the majority of the theories attribute remittances to altruism - extended family concerns - there are micro- and macro-economic theories that explain the determinants of remittances to factors other than social networks. In addition, remitters, as they are primarily concerned by the well-being of their families, are likely to take considerable risk to support families and old communities during harsh economic situations. They are less risk averse and are likely to continue to invest even at lower interest rates or low rates of return plus under unfavourable investment climates. In addition, the existence of trans-national communities creates the opportunities to develop feasible business enterprises that could exploit the five Ts. Hence, there are a number of projects related to the development of Tourism, Transportation, Transfer channels, Trade and Telecommunication in the country of origin and as well as in the host country.

It is a common practice to find traditional organisations - social and financial - among migrant workers. Many countries, therefore, have attempted to institutionalise the mobilization of the financial, technical and professional resources that the Diasporas have acquired from their newly adopted countries. In the history of Eritrea,



institutionalising the Diaspora is not a new phenomenon. During the struggle for independence, the people were made to organise in mass organisations and their efforts were directed to finance the cause. They were also encouraged to form associations to look after the conditions of the war-affected communities. Moreover, they were also motivated to come in person to partake in the armed struggle. The 1970s and 1980s mass organisations not only played an important role in this aspect, but they also went a bit further to form symbolic events that combine the diverse Eritrean public into a unified national identity.

The Government of the State of Eritrea recently established a commission – Eritreans residing abroad, which focuses on revitalizing these mass organisations (second time institutionalising) and to give them a boost in order to cope with the new developmental challenges the country is currently facing. The commission coordinates the Diasporas' efforts and works along with various organisations to enhance awareness about priorities and challenges facing the country and what measures should be taken. Furthermore, the office of the commissioner attempts to maintain and enhance Eritreans' cultural heritage in the face of big melting pot of migrants host countries' cultures.

As a result, the Diasporas are in turn engaged in lobbying different projects of the government to the international bodies and NGO groups. Equally they are lobbying for the genuine cause of Eritrea on the border dispute with Ethiopia. They are also engaged in organising concerts and festivals to raise funds in order to give the country's development efforts an advance. Eritrea has benefited from its Diaspora population throughout the armed struggle for independence and still the majority continue to sponsor the reconstruction and development efforts of the Government. Hence, the Eritrean Diasporas participate in every way possible to primarily support their families and communities and then their country in general. They continue to send remittances in cash or in kind and invest in projects that are deemed to benefit Eritreans as a whole.

Whether the money is spent directly on investment, consumption of durable consumer goods or conspicuous ones, its impact on the economy is visible. *The IMF report for the last ten years suggests remittance's contribution to Eritrea's GDP was averaged at 37 percent. This seems a little bit exaggerated when it is compared with table 2.2 and other*

reports that put the figure around 19.68 percent. Although knowing the correct figure is necessary, it is often difficult for many reasons. Nevertheless the effect of remittance as a whole to the economy remains enormous. Besides, remittances' trickling down effect on the economy as whole is undeniable. If it is not more, it equals that of Mexico, 3:1.

Remittances, as they are believed to remain stable over a period of fifteen years, many of the developing countries started to incorporate them in their development plans (Ratha, 2003). Securitization of future flow of remittances using different financial instruments enables countries to void partially the implicit and explicit burdens of external financiers. Hence, in recent times many of the less developed countries including Eritrea have resorted to securitization of the future-flows of workers' remittances than to go after "risk" money from foreign banks.

Eritrea, in its first attempt to secure the future flows of remittances, used different financial instruments and was able to mortgage considerable amounts. Treasury bonds, certificate of deposits, and sale of government owned companies and shares to private investors especially to the Diaspora Eritreans all aimed at primarily boosting the cash reserves of the country. Similarly, permitting merchants to use *Franco-Valuta*, levying nominal income tax to the Diaspora and allowing one-time-free-of-import duties to returnee Eritreans are also other methods that are implemented to augment the country's hard currencies reserves.

Furthermore, by securing these future flows of remittances, the monetary authorities are not only indirectly curbing the use of informal transfer channels but may actually enable them to incorporate remittance flows timeously into the broader definition of money supply of the country. However, as still many remittances find their way to the country through the informal transfer channels; it is beyond the authorities' capacities to correct the inflationary impact of remittances. Especially the prices of land, other consumer durables and properties such as residential houses, have shot up beyond the means of the majority.

Remittances, as the human face of globalisation, are not totally free of risk. If proper measures are not in place, remittances could not only distort the domestic labour markets but they could also widen the income gap between the rich and the poor. Remittances cause continuous influx of unskilled labour into the modern sector creating

social and economic burdens of unemployment in the urban areas while abandoning the rural agricultural sector productive resources. Likewise, remittances are also blamed for brain drain from the less developed to the more developed countries and for changing the consumption habit of the local people.

## **5.2 RECOMMENDATIONS**

Before suggesting anything, the study indeed acknowledges the government's efforts to smooth the future-flows of remittances and all the processes that have been taken to encourage the Eritrean Diaspora and their recipient families in raising their awareness on how to send remittances. The various opportunities that are presented to the Diaspora through the different seminars and guidance issued, were meant primarily to benefit both the remitters and their recipient families. In this regard it is important to quote Fessehazion's historic note, "Now wouldn't it be nice to present your nephew with three shares of Coca Cola (say at US \$100 each) than a pair of Nike Air Jordan!"

Remittances as financial flows are liquid assets that demand great attention. It is difficult to manipulate them in accordance with the country's development priorities because of their scattered nature. Thus, a thorough knowledge of their flows is required in order to incorporate them with the monetary and fiscal policies of the country. However, remittance is not easy to handle because the majority of remitters and recipients are not familiar with the banking system. If well-designed procedures are followed, it might be possible to estimate nearly-correct figures and would be possible to use them vigorously in securitization of loans. So, the main question is what should be done to avoid these critical implications and complexity of unorganised future-flows of remittances?

Furthermore, as investment increases in importance, people's behaviour also changes from a bold 'altruistic' patriotism to a sceptical investor. The soundness of government policies and the performance of the economy will increasingly condition the preparedness of the Diaspora to make savings available to the country and influence the sustainability of the public finances. All factors that minimise risk, and thereby build investors confidence that motivate investment, should carefully analysed. Investors,

whether they are remitters or financial capitalists, both need to keep track of the individual firm's records before they undergo any investment decisions. Therefore, the execution process should be transparent. In addition, they need a little push in terms of motivational interest rates that encourage them to save their money in the country's banks and make it available for investors and merchants. Likewise, the exchange rate must match at least the black market exchange rate.

The government should also support transfer channels to introduce technologies that smooths the flow of remittances. Introduction of new communication technologies not only help transfer channels to work in more transparent and efficient way but the cheap and flexible facilities will also benefit both remitters and their recipient households. Moreover, ways and means have to be devised for the small micro financial institutions and *Tequoratsi Nsdra-Biet* offices to have wider-coverage in order to partake in the operations of international remittances. Using the recent advanced wireless Internet facilities - Wi-Fi (Wireless Fidelity) - these channels could not only reap the potential of these flows but they could also integrate the rural sector into the modern economy. Besides, these might help the monetary authorities to obtain timely and accurate data both from domestic and international flows of remittances. Hence, it might help the monetary authorities to direct and influence these flows into the desired economic plan.

Besides, if ways are devised to coordinate migration under the minister of labour and human welfare, the licensed recruiting agencies can provide reliable information about the types of labour that are highly demanded in the labour-receiving countries. Thus, it would be easier to control migration and avoid the unnecessary troubles migrants face to reach their destination. Beyond the explicit flows of both labour and their remittances, more vigorous pension schemes could also be designed. The scheme, while providing the Diaspora Eritreans the benefit at retirement age, in the meantime however, might help the country to save enough foreign exchange reserves.

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## Appendices:

### Survey Questionnaire

#### Dear respondent:

I am a student at the University of Kwazulu - Natal, South Africa. I would be very grateful if you would provide me with the following data (information) to help me complete my research thesis entitled: *Remittances and their economic impact: a case study on the Eritrea economy*. By taking your response as a sample, my aim is to assess the extent to which remittances as a development tool play in the Eritrean economy.

#### General Instructions

You may respond through the e-mail using any sign (X, a dot, tick mark, etc...); you may also use a pen or a pencil. Where written responses are required space is provided, however you may write in additional comments and elaborate on your answers whenever you wish to do so. In such cases, feel free to use the back of each page or the last page.

Please complete this survey questionnaire as openly and honestly as you can. I strongly believe that your feedback is very valuable and can be used as a reference for future improvement. Note that this questionnaire is solely for student research purposes.

**Thank you for your co-operation!**

### Appendix A: Survey Questionnaire to be answered by the recipient households

1. How many of your family members emigrated to a foreign country or countries?  
A. One      B. Two      C. More than two, \_\_\_\_\_
2. How many of your family members work in other parts of Eritrea?  
A. One      B. Two      C. More than two, \_\_\_\_\_
3. Do they send remittances (money and in-kind) back home?  
A. Yes      B. No
4. Why do emigrants remit part of their income to their family members back home?

- A. Because they care about the well being of their families?  
 B. Because they have personal interest such as to purchase property, land, etc.?  
 C. Because they have a responsibility to pay back the family loan arrangement that helped them to migrate?  
 D. Because we had an agreement to co-insure among ourselves?  
 E. Because they care about the development process in our country?  
 F. \_\_\_\_\_?

The answer to the above question can be one or more of the choices given, choose those answer(s) that seem(s) to satisfy your behaviour and indicate what percentage of your behaviour they represent.

A.	B.	C.	D.	E.	F.	Total
____%	____%	____%	____%	____%	____%	100%

5. How much is the amount remitted to you per year?

Total	100%	\$_____(US)
Cash	_____ %	\$_____(US)
Kind	_____ %	\$_____(US)

6. How much is this amount compared to your yearly income or salary?

_____ %
---------

7. Who send most?

- A. Male   B. Female   C. Educated   D. Less educated  
 E. Bachelor   F. Married   G. Professional   H. semi skilled

A.	B.	C.	D.	E.	F.	G.	H.
____%	____%	____%	____%	____%	____%	____%	____%

8. What do you do with the remittances?

- A. Consumption   B. Building a house   C. Modernize agricultural activities  
 D. If different please specify \_\_\_\_\_

A.	B.	C.	D.
____%	____%	____%	____%

9. How is your behaviour affected by remittances?

- A. Feel secured    B. Motivated towards my job and more investment  
 C. Want to migrate    D. Other please specify \_\_\_\_\_
10. Where do you collect the remittances sent to you?  
 A. Banks    B. Individuals (cash in-hand)    C. Postal money order  
 D. Agents    E. \_\_\_\_\_
11. Which one of these transfer-methods is convenient for you? \_\_\_\_\_
12. Why? \_\_\_\_\_
13. How much do the banks charge per one time remittance?  
 \_\_\_\_\_ %
14. Is there a difference between the banks' rate of exchange and the black market?  
 A. Yes, \_\_\_\_\_  
 B. No, \_\_\_\_\_
15. Is there any motivation on the part of the banks to make you save part or all of your received remittances with them?  
 A. Yes, \_\_\_\_\_  
 B. No, \_\_\_\_\_
16. Is there any motivation on the part of the government that help your remitter to send you more?  
 A. Yes, \_\_\_\_\_ B. No, \_\_\_\_\_

## Appendix B: Survey Questionnaire to be answered by the remitters

Country (The host/foreign) \_\_\_\_\_

Gender: F ☐ M ☐

Education: \_\_\_\_\_

Occupation (Or yearly Salary) \_\_\_\_\_

Age

Duration (length of stay in foreign country): years  months

1. Do you send remittances back home to your country Eritrea?  
 A. Yes    B. No
2. Why do you send remittances back home to Eritrea?  
 A. Because I care about the well being of my families?



- B. Because I have personal interest such as to purchase property, land, etc.?
- C. Because I have a responsibility to pay back the family loan arrangement that helped me to migrate?
- D. Because we had an agreement to co-insure between our families?
- E. Because I care about the development process in my country?
- E. \_\_\_\_\_?

The answer of the above question can be one or more of the choices given, choose those answer(s) that seem(s) to satisfy your behavior and indicate what percentage of your behavior they represent.

A.	B.	C.	D.	E.	F.	Total
_____%	_____%	_____%	_____%	_____%	_____%	100%

3. To whom and on average how much is the amount you remit per year?

- A. Parents      B. Brothers/Sisters      C. Close relatives
- D. Government Development programmes
- E. Non-governmental Organizations such as churches, mosques, community help facilities, schools, etc)      F. \_\_\_\_\_

The answer of the above question can be one or more of the choices given, choose those answer(s) that seem(s) to satisfy your behaviour and indicate what percentage of your behaviour they represent.

A.	B.	C.	D.	E.	F.	Total
_____%	_____%	_____%	_____%	_____%	_____%	100%
\$ _____(US)	\$ _____(US)	\$ _____(US)	\$ _____(US)	\$ _____(US)	\$ _____(US)	\$ _____(US)

4. How much is this amount compared to your yearly salary in percentage terms?

_____%
--------

5. How do you see your behaviour of remitting (what affects your decision to remit)?

- A. With the length of time of your stay in the host country?
- B. With the economic situation (boom/recession) in the host country?
- C. With interest rate differential between the host and home country?
- D. Service charges for one time remittance?
- E. With economic situation (boom/recession) in your home country?
- F. Any other different reason, \_\_\_\_\_?

Choose either of the following (I, II, or III) and put your choice in the table below.

- I. Increasing      II. Decreasing      III. The same amount yearly

A.	B.	C.	D.	E.	F.

6. How do you explain the role of remittances on the behaviour of your recipients?

A. Positive, \_\_\_\_\_

B. Negative, \_\_\_\_\_

7. Do you care about where your remitted money spent by the recipient(s)?

A. Yes, \_\_\_\_\_

B. No, \_\_\_\_\_

8. What uses do you see that are done by the help of your remitted money?

\_\_\_\_\_

9. Do you agree remittances encourage dependency and discourage self-support programs as well as enrolment in lower grade jobs?

A. Yes, \_\_\_\_\_

B. No, \_\_\_\_\_

10. What should be done to influence the flow of remittances and their uses by the recipient(s)?

\_\_\_\_\_

11. What methods do you use to remit money back home?

A. Banks B. Agents C. Cash-in-hand (with returnees/visitors)

D. In kind (goods)

12. Is there a difference you like one from the other of these methods?

a. Yes, \_\_\_\_\_

b. No, \_\_\_\_\_

13. How much is the charge per one time remittance?

A. Flat \_\_\_\_% per hundred

B. B. (\_\_\_\_% for the 1<sup>st</sup> \_\_\_\_ hundred/s then reduces with more amounts remitted)

14. Is the interest rates in the host country or back in your home country Eritrea affects your decision to how much to remit?

A. Yes, \_\_\_\_\_

B. No

15. Is the exchange rates in the host country or back in your home country Eritrea affects your decision to how much to remit?

A. Yes, \_\_\_\_\_

B. No