EFFECTS OF FOREIGN EXCHANGE RATE CONTROL REGIME ON FOREIGN REMITTANCES: A CASE OF ETHIOPIA

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UNITED STATE INTERNATIONAL UNIVERSITY – AFRICA

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A Project Report Submitted to the Chandaria School of Business in Partial Fulfillment of the Requirement for the Degree of Masters in Business Administration (MBA)

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STUDENT’S DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the United States International University - Africa in Nairobi for academic credit.

Signed: ______________________   Date: ______________________
Mesfin Nega (ID No: 643233)

This research report has been presented for examination with my approval as the appointed supervisor.

Signed: ______________________   Date: ______________________
Dr. George O. Achoki

Signed: ______________________   Date: ______________________
Dean, Chandaria School of Business

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ABSTRACT

The purpose of this study was to investigate the effects of foreign exchange rate control regime on foreign remittances: a case of Ethiopia. The research has given the answers to the following questions: What are factors affecting the state exchange rate control measures? What are the effects of state fixed exchange rate on remittance flow? What is the effect of state fixed exchange rate on acquisition of foreign currencies?

The descriptive research design was applied on this study for the description of the several variables of interest. The target population were Ethiopia’s banks’ employees, business people and government officials. Purposive sampling was used in this study to recruit a total number of forty five respondents. Both qualitative and quantitative techniques were used to carry out this research. The Microsoft Excel was used for figures presentation and tables while SPSS and STATA packages were utilized to analyze quantitative data for the linear regression to determine the effects of state fixed exchange rate on remittance flow.

The study shows that there are policies implemented to control and regulate the quantity of foreign exchange trade in Ethiopia and that the commercial banks in the country were required to maintain their net open position in foreign currency. From the study, it was clear that, the central bank in Ethiopia bought and sold foreign exchange so as to influence the exchange rate in the country and also provided advice and instructions to commercial banks to promote greater discipline in line with policy priorities. The study showed that, the central bank of Ethiopia monitored all inter-bank foreign exchange dealings and that, there was a dynamic relationship between imports, income and exchange rate in the country.

The study shows that Ethiopia like most African countries was not adequately equipped to track and record remittances since it only collected remittance data from banks and overlooked other financial flows. There are a lot of migrants who sent money to their families during hardships in the country and the remittances served as transnational safety net. The study shows that, the difference between domestic and world interest rates had caused capital to flow in the direction of the higher return in the country, but the country had a stable economic status.
obtained from its fixed exchange rate system. Monetary policymakers in the country had the capacity to adjust interest rates and they had placed a system of “risk sharing” to respond to shocks.

The study shows that, accumulation of reserves in the country had occurred at a time of generally stable exchange rates and demand for international reserves had increased due to global trade. The study revealed that, accumulation of reserves in Ethiopia was a form of self-insurance of the global economy as well as a tool for maintaining low exchange rates. Ethiopia had adequate reserves used to boost investors’ confidence and as well as allow policy makers to influence the exchange rate and inflation in the country. From the study, it was revealed that, market forces in the country acted as agents of change of real exchange rate and capital flows in the country were counterbalanced to maintain the country’s peg.

The study recommends for the need to monitor and work on the main factors affecting the exchange rate control measures. In particular, the government needs to take measures in harmonizing economic variables for instance by coming up with appropriate policies to reduce inflation and depreciation that will boost up economic growth. Based on the findings, prediction of a state exchange rate control measures is mainly based on major factors such as economic, black market and institutional among others. Therefore, the government needs to take measures in harmonizing economic variables for instance by coming up with appropriate policies to reduce inflation and boost up economic growth.

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DEDICATION

This project is dedicated to my family for being there as my best cheerleaders throughout my master program. My parents, brothers and sisters have been a strong walking stick and steadfast support in this journey.

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LIST OF ABREVIATIONS

AML  Anti–Money Laundering
ARDL  Autoregressive Distributed Lag
BOP   Balance of payments
CFT   Countering the Financing of Terrorism
FDI   Foreign Direct Investment
FERC  Foreign Exchange Rate Control
GDP   Gross Domestic Product
GLSS  Ghana Living Standard Survey
GoE   Government of Ethiopia
IMF   International Monetary Fund
KIIs  Key Informant Interviews
SPSS  Statistical Package for Social Sciences
CHAPTER ONE 1.0 INTRODUCTION 1.1 Background to the Study

Foreign Exchange Rate Control (FERC) regime is simply defined as the relative price of one currency quoted in relation to another currency (Obstfeld and Rogoff, 1995). According to Husain, Mody and Rogoff (2005), FERC is one of the main economic magnitudes. Indeed the FERC is vitally important to formulate the economic policies for economies, corporations and individual investors (Kaleem, 2013). The type of exchange rate control regime remains one of the most debated and controversial topics in the global economics (Mody and Rogoff, 2005). In a flexible exchange rate control regime, normal exchange rate lead to real appreciation (IMF, 2013). However, in a fixed one, real appreciation is caused by a rise in inflation whenever there is increase in money supply (Husain et al., 2005). Ethiopia uses Duch Auction system with highly controlled bidding committee formed by the government and the National Bank of Ethiopia.

Although the associated costs have not been quantified rigorously, many economists believe that exchange rate uncertainly reduces international trade, discourages investment and compounds the challenges people face in insuring their human capital in incomplete asset markets (Obstfield and Roggof, 1995). It has also been argued that restrictive foreign rate exchange is likely to affect the value of remittance flows during conversion processes (Kaleem, 2013).

The importance of the flow diaspora remittances in the economies of developing countries over the years especially in relation to the current dynamic global order where most of the economies in the world are transforming themselves in the wake of globalization (Ratha, 2007). Diaspora Remittances, defined as the unrequited transfer of funds by the migrants to their families at home (Kapur, 2004), have been considered one of the major sources of foreign exchange to many countries in the world including Ethiopia. Although the shortcomings of state controlled exchange rate regime have not been quantified rigorously, many economists believe that it is likely to affect the value of remittance flows (Kaleem, 2013).
For these developing countries, remittances can be a critical tool, assisting not only with local, grass-roots development but also contributing significantly to a country’s entire economic health (Ratha, 2007). In part, remittances can build foreign currency reserves, address balance of payments (BOPs) deficits, and enable investment in projects involving infrastructure, health, sanitation, and education (Kapur, 2004). Kaleem (2013) observes that, adequate foreign exchange reserves are an important factor of any well-managed economy. These reserves help cushion the effects of economic shocks, domestic or international. According to IMF (2013), the significance of reserves can be demonstrated by the manner in which countries such as Indonesia are currently dealing with the impact of the United States (U.S.) Federal Reserve’s decision to reduce its bond-buying program, used to support the U.S. economy during the recent financial crisis. By building its foreign reserves when it had the opportunity, Indonesia is able to provide vital support to its economy during this current period of stress.

Despite the existence of numerous papers and research on foreign exchange control regimes, the empirical evidence shows the effect of remittance flow is relatively scarce. According to Flood (1995), the empirical results showed the effect of exchange rate control on macroeconomic variables are not obvious. Habib and Stracca (2012) and Galati (2007) summarized that studies on foreign exchange rate control have mainly been concerned with advantages and its implications for currency market stability. Up to date, there are only few empirical studies which have tested how Ethiopia’s exchange rate control regime affects remittance flow.

Ethiopia benefits tremendously from the support of its diaspora, particularly from its rural population who have migrated in search of temporary employment in the Middle East. Often equivalent to at least 50 percent of the recipient’s monthly income, remittances improve quality of life, enhance health and nutrition, and fund investment in local economies (Yamamoto, 2013). Although remittances to Ethiopia bring into question existing foreign exchange controls and create possible challenges to the country’s existing anti-money laundering (AML) and
countering the financing of terrorism (CFT) regime, these funds are undoubtedly positive for the recipients and the Ethiopian economy (GoE, 2012).

Ethiopian economy can significantly been raised from its diaspora remittance if appropriate measures are put in place. Although the country has exhibited notable economic growth over the last ten years, its foreign exchange controls appear restrictive in comparison to peer group countries (GoE, 2004; Keatinge, 2014). It maintains a number of foreign exchange restrictions on payments with transfers that are inconsistent with international standards, as determined by the IMF (GoE, 2014).

The exchange rate policy in Ethiopia has passed different regimes. Prior to 1992, the country was exercising a fixed exchange rate regime, where the rate was solely determined by the government (GoE, 2004). Currently, the country is implementing an exchange rate policy which is more close to managed floating, where there is a government intervention whenever necessary to stabilize the foreign exchange market (Nega, 2015). Following the massive devaluation of 1992 took place, in an attempt to liberalize foreign exchange market; the National Bank has taken a number of initiatives (GoE, 2004).

Accordingly, the fortnightly auction market for foreign exchange was introduced on May 1, 1993 with two rates, namely the Dutch auction system (official rate) and marginal pricing auction system (marginal rate). These two rates were unified in July 1995. In August 1996, the fortnightly auction market was changed to weekly to accommodate the growing demand for foreign exchange and commercial banks were allowed to also established foreign exchange Bureaus (GoE, 2004). In September 1998, the retail auction system was replaced by wholesale system. In the same year, the inter- bank foreign exchange market was introduced and worked alongside the auction system until October 25,2001 when the daily inter-bank has fully replaced wholesale auction system (GoE, 2004).

In the present day, the official exchange rate is determined in the daily inter-bank foreign exchange market as the weighted average exchange rate prevailing on the preceding day.
The country’s foreign exchange controls appear restrictive in comparison to peer group countries. It maintains a number of foreign exchange restrictions on payments and transfers that are not consistent with international standards, as determined by the IMF (GoE, 2004).

The Ethiopian’s currency (birr) is not easily convertible due to the fact that the exchange rates are controlled by the state. Furthermore, the country controls the amount of foreign currency which flows in and out as well as those held by both local and foreign individuals and corporations/organizations (Nega, 2015). This restrictions lead to appreciation of foreign exchange rate, hence expanding the existing deficit. This deficit is further driven upward by the significant imbalance between public capital inflows and moribund export growth, which has been stifled by the strength of the local currency and underdevelopment of private sector banking and manufacturing. Consequently, this leads to a reduction in real income for most employees leading to negative effect on consumer’s spending.

Remittances are a significant contributor to the Ethiopian economy and can help accelerate the country’s development. IMF data suggest that remittances and official transfers represent more than 4 percent of Ethiopian gross domestic product, with estimates of remittance values ranging from $387 million to $3 billion (IMF, 2013). This range partly reflects the difficulty in measuring these flows due to the significant use of informal remittance channels as a result of an underdeveloped banking industry and, likely, the tight foreign exchange control regime that the country imposes. It also highlights the size of the potential AML/CFT risk stemming from the significant use of informal value transfer systems (GoE, 2014). This calls and implies for the need to interrogate how foreign exchange control regimes affect remittances flow of the Ethiopian economic development. Against this background, the current study sought to investigate the effects of foreign exchange rate control regime on foreign remittance flow using a case of Ethiopia.
1.2 Problem Statement
Like most of the developing countries, the exchange rate control policy in Ethiopia has passed through different regimes. Currently, Ethiopia uses Duch Auction system with highly controlled bidding committee formed by government and national bank of Ethiopia, initiated in May, 1993 in order to improve allocation of foreign exchange and to discourage illegal transactions. However, there has been a shortage of foreign reserve and some Ethiopia Diasporas have resorted to illegal channels of foreign exchange. This can be partly attributed to the supply of foreign currency which is pre-determined.

The major research issue in this study tackles on the determination of the effects of foreign exchange rate control regime on foreign remittances in Ethiopia. There is so far no conclusive answer in the literature to the question of foreign exchange rate control and how it affects foreign remittance. Most studies on foreign inflows to Sub-Saharan Africa have more often related to Aid, Foreign Direct Investment (FDI) and to a very limited extent remittance flow (Barajas et al., 2010; Baltagi, 2008).

It is not clear on factors that are influencing state exchange rate control measures and how exchange rate control affects remittance flow. The apparent research gap has partly constrained the depth and insight needed by policy makers to minimize any negative effects of exchange control rate in order to harness remittance inflows as one of the best option or alternative source of external finance for development. So far, only few studies have attempted to assess the effects of foreign exchange rate control regime on foreign remittance in Ethiopia. One of the studies is that of Keatinge (2014). However, the study lacks empirical evidence compromising the accuracy of his interpretations and conclusion. It is against this backdrop that the current study is proposed.

1.3 Purpose of the Study
The purpose of this study was to investigate the effects of foreign exchange rate control regime on foreign remittances with a key focus on Ethiopia.
1.4 Research Questions
This study is guided by the following research questions:
1.4.1 What are factors affecting state of exchange rate control measures?
1.4.2 What are the effects of state fixed exchange rate on remittance flow?
1.4.3 What is the effect of state fixed exchange rate on acquisition of foreign currencies?

1.5 Significance of the Study
1.5.1 Policy Makers
This study contributes to the related literature through fresh empirical evidence on the effect of exchange rate control regime on remittance flow. The study findings could be used by policy makers to make informed choices in formulating appropriate policies on current exchange rate to support improved remittance flow.

1.5.2 Government of Ethiopia
The research findings would be relevant to Ethiopian government and could be used as a framework to establish the exchange rate suitable for Ethiopians’ development. The study findings would also help Ethiopians quenching their information thirst and satisfying their need by understanding the dynamics of remittance flow and exchange rates.

1.5.3 Future Scholars
This study expounds on an area that has not been deeply researched and thus, this study has formed a foundation where other researchers could confirm, expound or enrich the study findings. This research would also supplement studies on other related areas of the subject matter.

1.6 Scope and Limitation of the Study
The topic of remittance flow is quite broad and complex. This study however is directed towards studying only the effects of foreign exchange rate control regime on foreign remittances. It was done within the confines of geographical jurisdiction of Ethiopia. One potential limitation of this study was lack of data due to the fact that only few studies had been
conducted in this area. However, the researcher sought to counter this by using similar studies which have been conducted in other regions.

1.7 Definition of Terms

1.7.1 Exchange Control
This includes various forms of controls imposed by a government on the purchase/sale of foreign currencies by residents or on the purchase/sale of local currency by nonresidents (Wei and Zhang, 2007).

1.7.2 Exchange Rate
This means a country’s currency compared to the currency of another country (Wei and Zhang, 2007).

1.7.3 Foreign Currency
This is a currency other than the reporting currency of the entity (Tamirisa, 1999).

1.7.4 Remittance Flow
This is taken to mean financial flows made up of private and unilateral transfers of money by a migrant worker resident in a foreign country to a person living in the migrant’s country of origin (Okodua, 2010).

1.7.5 State Fixed Exchange Rate
This helps to denote a nominal exchange rate that is set firmly by the monetary authority with respect to a foreign currency or a basket of foreign currencies (Tamirisa, 1999).

1.8 Chapter Summary
This chapter has introduced the background information of the study on the effects of foreign exchange rate control regime on foreign remittances, factors affecting state of exchange rate control measures and the effect of state fixed exchange rate on acquisition of foreign
currencies. This research has identified the knowledge gap in the study of the effects of foreign exchange rate control regime on foreign remittances in Ethiopia.

Chapter two of this research has tackled on the literature review on the effects of foreign exchange rate control regime on foreign remittances in Ethiopia. Chapter three in this study has given a hint on the methodology used in this research including the research design, the population of the study, data collection and data analysis methods. Chapter four highlights the study results and findings using the prescribed measures discussed in the methodology section. Chapter five give the study summary, discussions and conclusions. It further gives recommendations for improvement and further studies.
CHAPTER TWO 2.0 LITERATURE REVIEW 2.1 Introduction

This chapter presents a review of literature from a number of studies that are related to this study and elaborates the theoretical basis for the study. It starts with conceptualization of the key concepts of the factors affecting state exchange rate control measures, the second section focuses on the effects of state fixed exchange rate on foreign remittance flow, and the third section highlights the effect of state fixed exchange rate on acquisition of foreign currencies, and the last bit summarizes the chapter.

2.1 Factors Affecting State Exchange Rate Control Measures

Monetary policy and other tools like fiscal policy are used to keep a check on inflation and its impacts on the other macroeconomic variables like exchange rate especially in economies that are emerging (Ho and McCauley, 2013). Inflation has its effects on all major macroeconomic variables including the exchange rate. There is a significant and long term effect on exchange rate of monetary and inflationary shocks. Monetary policy has its implication on the exchange rate as it controls the inflation (Choudhri and Hakura, 2006).

Inflation in a country that is continuously increasing will affect the growth of the country and thus, the Central Bank governing the country will be required to control the money supply by implementing a monetary policy that can reduce the inflation to the target set for inflation within the particular period as it will affect the whole economy (Khan and Schimmelpfennig, 2006). The countries that control inflation have seen a decline in exchange rates but with such monetary policy the exchange rate variability has increased (Edwards, 2012).

Inflation affects all macroeconomic variables like trade, growth and exchange rate. There should be a tight monetary policy to control the inflation and its impact on the economic variables like growth and exchange rate (Jilani et al., 2010). As the inflation increases the local currency depreciates and exchange rate increases due to which the imports bills increase and economic progress is hampered (Khattak et al., 2012). In African economies the exchange rate is more volatile as compared to those of developed economies. There is no swap between inflation and output in Africa, but in developed countries as inflation increases the output
Monetary policy plays a vital role in controlling the inflation and by which controlling the variations in exchange rate (Baljinnyam and Lu, 2013).

### 2.2.1 Foreign Exchange Control and Regulatory Policies

These are the policies implemented to control or regulate the quantity of foreign exchange traded / available in the market. Such policies are intended to help maintain orderly market transactions and avoid unhealthy market practices and exchange rate volatility (Haider, Ullah and Azim, 2012). The policies include direct controls, interventions and moral suasion. Direct controls are mainly implemented in terms of the Exchange Control Act (Saeed, Awan, Sial and Sher, 2012). At present, foreign exchange transactions reported in the current account of the balance of payments are largely free (current account convertibility). These transactions are exports, imports, services, remittances, and repatriation of investment income (Haider, Ullah and Azim, 2012).

However, capital account transactions, for instance, transactions relating to acquisition or disposal of financial and real assets, have been liberalized only to some extent under certain schemes (Alam and Ahmed, 2011). Such major schemes include inflow of foreign capital to be invested in company shares, non-residents and residents to maintain foreign currency accounts at commercial banks in local banks, foreigners to invest in Treasury bills and bonds up to 10% of the outstanding Treasury bills and bonds and investments of approved projects (Cavallo, 2006). Transactions relating to debt capital inflow and any investments abroad by residents require prior approval of the Central Bank and / or Minister of Finance (Alam and Ahmed, 2011).

Commercial banks are required to maintain their net open position in foreign currency (assets in foreign currency less liabilities in foreign currency) at low levels prescribed by the Central Bank so that the banks do not have highly speculative currency positions (Haider, Ullah and Azim, 2012). The restricted and cautious liberalization of capital account is implemented by most countries in order to forestall currency / financial crises that may occur due to sudden capital outflows as have been seen in many countries including Mexican and Asian financial crises.
The nature of a currency crisis is that the excessive demand for foreign exchange arising from sudden outflow of capital will lead to excessive depreciation of the local currency, dry up foreign exchange reserves and failures of banks and financial institutions due to liquidity problems (Sek et al., 2012). According to the literature on such crises, financial crises are highly detrimental to the countries.

2.2.1 Sterilized Interventions
Interventions mean a central bank’s buying and selling of foreign exchange at times to influence the exchange rate or reduce its excessive volatility by enhancing supply of or demand for foreign exchange (Khan and Schimmelpfennig, 2006). For example, if the Central Bank is of the view that the rate of depreciation of the currency is at unhealthy level, it may sell foreign exchange, that is, US $ at present, in the market so that the increased supply of US $ will reduce the depreciation pressure. Since such interventions affect the market liquidity or money supply and thereby interest rates, a central bank sometimes undertakes “sterilized interventions.” According to Hussain and Malik (2011), intervention is sterilized when a central bank undertakes open market operations in the domestic market in opposite direction to its dealings in the foreign exchange market so that existing level of liquidity in domestic currency or money supply would remain unchanged. For example, when the Central Bank sells foreign exchange to ease the depreciation pressure on the currency, the local currency liquidity in the market will decline immediately by the local currency equivalent of the amount of foreign exchange sold since such money flows to the Central Bank. Therefore, the Central Bank will offset this by buying domestic securities such as Treasury bills and bonds for the same amount of local currency to inject money back to the market.

2.2.1.2 Moral Suasion
Moral suasion which is the process of providing advice and instructions to commercial banks on monetary and financial operations with a view to promote greater discipline in line with policy priorities is immensely helpful for avoiding unhealthy speculation and volatility in the exchange rate (Khan and Schimmelpfennig, 2006). In this regard, the Central Bank monitors all inter-bank foreign exchange dealings on-line basis and examines at times whether such
dealings are supported with underlying customer transactions. Any dealings deviating from normal market conditions will be identified and such banks will be advised appropriately. Such moral suasion has not been captured in the exchange rate models (Hussain and Malik, 2011).

2.2.1.3 Imports
There is a dynamic relationship between imports, income and exchange rate. Autoregressive Distributed Lag (ARDL) approach was used and showed that as real income increases in Pakistan, the demand for imported products from countries like United Kingdom (UK), United States of America (USA), Germany and Japan increases due to which the imports increase because of this the exchange rate is affected as there is a significant relationship between imports and exchange rate (Alam and Ahmed, 2011). The variations in exchange rate have its implications on the whole economy including the financial intermediaries, individual investors and corporate investors. Exchange rate variability affects the profits of companies. The companies that are heavily dependent on imports will suffer from the business and conversion losses because high imports will depreciate the local currency as imports and exchange rate are significantly related and imports is one of the main factors that affects the exchange rate variability (Kisaka and Mwasaru, 2012).

2.2.1.4 Exports
The exports are one of the main sources of correcting the negative balance of payment (BOP). The relationship between exports and exchange rate is there but exchange rate does not affect the exports directly and exchange rate affects the income of the people and which have an effect on the exports (Smith, 2009). It is usually said that exchange rate instability reduces the amount of export but it is evident from that amount of trade may not necessarily be affected by the exchange rate volatility but volatility can change the structure of the trade. Exports and exchange rate have negative relationship so countries trying to keep their exchange rate at a lower level must boost their exports otherwise exchange rate volatility can them dependent on a fewer goods when deciding the systems of exchange rate (Alvarez et al., 2009). The volatility in exchange rate has been taken as a factor that affects the trade.

Real exports demand, export prices and exchange rate volatility are related with each other.
2.2.1.5 Exchange Rate Variability

Fluctuations and variability in exchange rate affect the growth and trade. So to control the exchange rate variability, macroeconomic variables needs to be managed through policies and other economic measures (Ozturk, 2006). The policies should be designed in a way to reduce variability in exchange rate by influencing the macroeconomic factors like inflation and interest rate (Hayakawa and Kimura, 2008).

Policymakers must use the monetary policy as a tool to reduce the changes in macroeconomic variables so that the exchange rate can be controlled as variations in exchange rate have an adverse effect on the economy (Zakeria and Ghauri, 2011). Time varying probabilities approach is used and results show that inflation and exchange rate are significantly related as inflation increases the local currency depreciates and as imports increase the exchange rate also increase while export reduces the uncertainty and with high exports the exchange rate goes down as inflation also reduces (Khemiri and Ali, 2012). The exchange rate importance can never be underestimated as exchange rate has its effect on the economy. Investors need to clearly identify the exchange rate movements before investing in stocks. So the study of those factors that directly affect the exchange rate variability is also of great importance. Policies should be made that reduce the exchange rate variability (Khan et al., 2012). The economic and non-economic elements play a vital role in the determination of exchange rate (Saeed et al., 2012). Frequent and small changes in local and international economic variables cause volatility in exchange rate and variability increases because of these changes. Investor’s decisions, openness of the economy, interest rate, inflation and wealth are such factors that can affect the exchange rate. It is recommended that exchange rate volatility is reduced and exchange rate is kept at a competitive level (Haider et al., 2012).

2.3 Effects of State Fixed Exchange Rate on Foreign Remittance Flow

International financial transfers from migrant workers to family members in their home countries are known as remittances. A typical remittance transaction contains two parts: first, the migrant contracts with an agent - either a money service business such as Western Union,
a bank, or an informal agent - and transmits the money to the agent via cash, check, credit card, or other debit instruction; and second, the agent instructs its own affiliate in the receiving country to deliver the remittance to the beneficiary (Ratha, 2011).

Although the basic remittance transaction sounds straightforward, there are substantial challenges in defining and measuring remittances for financial accounting purposes. The international financial institutions, including the IMF and the World Bank, have adopted a broad definition that includes three components: workers’ remittances, compensation of employees, and migrant transfers (IMF, 2013; World Bank, 2012). Workers’ remittances consist of private transfers from migrants who have lived in the host country for at least one year. Compensation of employees includes all compensation paid to migrants who have lived in the host country for less than one year. And finally, migrant transfers - which are generally the smallest of the three components - are measured as the net worth of migrants at the time of migration who reside in the host country for at least one year. The proper measurement of all three of these components depends on a clear understanding of each migrant’s residency status. According to IMF (2014), countries face considerable difficulties in ascertaining a migrant’s residency status, and are therefore inconsistent in their categorization of remittances.

A more severe problem is that many poor countries are not adequately equipped to track and record remittances. Some countries only collect data from banks and overlook financial flows through money transfer businesses, post offices, and informal channels (de Luna Martinez, 2014). Other countries employ a crude formula of multiplying the number of emigrants by an estimated average remittance amount, rather than attempting to compile the data more accurately (World Bank, 2012). To remedy these problems, the World Bank has adopted a data collection methodology whereby it relies on member countries’ BOP reporting supplemented by surveys of central banks and estimates from its own country desks (World Bank, 2012). Nevertheless, informal remittance flows are virtually impossible to quantify.
2.3.1 Countercyclical Remittance Inflows

Remittances are transfers between families that tend to flow countercyclically relative to the recipient country’s economy (IMF, 2014). Migrants send more money to their families when their home countries experience economic downturns, financial crises, or natural disasters. Moreover, adverse circumstances often trigger more migration, which then results in greater remittance inflows. As Stuart Brown (2012) notes, remittances serve as transnational intrafamily or intra-community safety nets, cushioning societies from the disruption attending more volatile financial flows. Several empirical studies, including Chami et al. (2011), IMF (2013), and Kapur (2013), find a strong relationship between economic contractions and subsequent increases in remittances for developing countries.

Indeed, Kapur (2013) finds that the average share of remittances in private consumption for 14 developing countries more than tripled in the three years after an economic shock. An IMF study (IMF, 2014) reports that countries such as Mexico, Indonesia, and Thailand experienced a significant increase in remittances in the two years immediately after their respective financial crises in the 1990s; similarly, Bangladesh, Dominican Republic, Haiti, and Honduras experienced increases after natural disasters. The same study reports that home-country output has a statistically significant and negative impact on remittances for a panel of 87 countries.

Whereas most capital flows exacerbate the booms and busts of developing economies, remittances are unique in their tendency to mitigate volatility. A large-sample study conducted by the IMF found that remittances substantially reduce the volatility of output, consumption, and investment (IMF, 2014). On the other hand, in periods of stable economic growth, remittances are far less volatile than other capital flows; even foreign aid was more volatile than remittances from 1980 to 2013 (IMF, 2014). It is therefore becoming increasingly common for scholars to tout the “insurance” function of remittances for the developing world (Kapur, 2013; Yang and Choi, 2014).
2.3.2 Relationship between Remittances and Exchange Rates

The analytical heart of the literature on the political economy of exchange rates is the Mundell-Fleming model and its famous implication that countries must choose to forgo one of three policy goals: exchange rate stability, full capital mobility, or domestic monetary policy autonomy (Frieden and Stein, 2011). In today’s world of highly integrated financial markets, a discrepancy between the domestic and world interest rates causes capital to flow in the direction of the higher return. If the exchange rate is allowed to float, it will adjust accordingly - appreciating with capital inflows and depreciating with capital outflows (Bernhard, Broz, and Clark, 2012).

However, if the exchange rate is fixed, then the interest-rate differential is quickly arbitrated away by the capital flows. The result is that the combination of mobile capital and a fixed exchange rate renders monetary policy ineffective as a policy tool. The Mundell-Fleming conditions imply a trade-off between stability and flexibility (Bernhard, Broz, and Clark, 2012; Frieden and Stein, 2011; Bearce, 2007). Stability arises from the fixed exchange rate, which decreases transaction costs for investors, traders, and other groups with ties to the global economy, and also leads to monetary stability by tying the hands of monetary policymakers (Frieden and Stein, 2011). On the other hand, flexibility is associated with floating exchange rates, which provide monetary policymakers with the capacity to adjust interest rates to changing domestic economic circumstances (Bernhard, Broz, and Clark, 2012).

Introducing remittances into the political economy model of exchange rates does not imply an abandonment of the Mundell-Fleming conditions. Indeed, mobile capital will respond to interest-rate differentials even in countries that are heavily dependent on remittances (Frieden and Stein, 2011). They further state that, however, a country that is heavily dependent on remittances will be less concerned about forgoing domestic monetary policy autonomy. In the event of an economic downturn, remittances tend to increase and thereby smooth out the business cycle. Consider the impact of an increase in remittances during a recession. Households use the funds to bolster their consumption of food and basic necessities, and to
maintain existing small businesses and other investments. Such spending and investment has a multiplier effect on the economy, triggering additional investment and consumer spending.

In short, remittances - when sufficiently large in relation to the economy - constitute an automatic stabilizer that performs a similar function to countercyclical monetary policy. As such, remittances stand apart from other capital flows in that they do not exacerbate the trade-off between fixed exchange rates and domestic monetary policy autonomy. In fact, high remittance inflows make it more attractive for countries to adopt fixed rates (Bearce, 2007).

Although the Mundell-Fleming model as applied by political economists comes up short in its simplistic view of capital mobility, Mundell’s Optimum Currency Area (OCA) criteria in fact provide a useful, if inadvertent, perspective on the importance of remittances (Mundell 1961). The OCA framework, elaborated by McKinnon (1963) and others, argues that countries that choose to share a common currency should respond similarly to economic shocks, such as sudden changes in the prices of commodities.

The logic is straightforward: a single currency implies a single monetary policy. If economic conditions vary substantially across different regions of the currency area, a single monetary policy will prove woefully inadequate in stabilizing the economy. However, because asymmetric shocks are always possible even in the most economically homogeneous of currency unions, countries must somehow adjust their own domestic economies to fit the prevailing monetary policy. The OCA literature has focused on two adjustment mechanisms: first, labor mobility within the union should be high enough to allow workers in adversely affected regions to relocate to more favorable employment environments; and second, the currency union itself should have a system of “risk sharing” - usually defined as fiscal transfers - to respond to local shocks, just as the U.S. federal government sends emergency funds to States in times of crisis.

The OCA criteria are rarely realized in practice, especially for developing countries that anchor their currencies to the Euro, the US dollar, or some other developed country currency (Kapur,
2013). Chami et al. (2011) note that, shocks to develop and developing economies are likely to be asymmetric, and labor mobility is rarely high enough to be an effective shortterm stabilizer. On the issue of risk sharing, however, many developing countries depend on remittances to offset economic downturns that are not experienced by the anchor country. Remittances are not “fiscal transfers” per se, as no central government has the power to direct them to countries in need. Yet they do enable countries to cede some of the risks of forgone monetary policy autonomy to migrant workers, who in turn remit funds to their families in countercyclical fashion (Chami et al., 2011).

2.4 The Effect of State Fixed Exchange Rate on Acquisition of Foreign Currencies The buildup of reserves in Africa and emerging economies has accelerated over the last decade with the bulk of the increase occurring in oil-exporting countries. The accumulation of reserves has occurred at a time of generally stable or slightly appreciating exchange rates, particularly against the US dollar. Countries generally maintain reserves in order to effectively manage their exchange rate and to reduce adjustment costs associated with fluctuations in international payments. Accordingly, demand for international reserves increases with global trade. Empirical research shows that both the variance and level of trade (current account and openness to trade or the propensity to import) are important determinants of demand for reserves (Mendoza, 2014). In practice, however, most countries follow the “rules of thumb” in determining the optimal level of reserves, including maintaining reserves equivalent to at least three months of imports (Mendoza, 2014).

The recent accumulation of reserves in developing countries has been largely interpreted as a form of self-insurance precipitated by the high level of global economic and financial instability and the absence of an adequate international system for crisis management. The 1997 East Asian financial crisis is a good example in this regard (Stiglitz, 2006). Moreover, many countries see reserve accumulation not only as a means for effective exchange rate management, but also as a tool for maintaining low exchange rates in order to promote trade and international competitiveness. This motive for holding reserves is referred to as the mercantilist motive (Aizenman and Lee, 2013).
Maintaining adequate reserves can also boost investors’ confidence and enhance investment and growth. This can be seen more clearly in the case of Asian countries that recorded the highest rate of increase in international reserves following the 1997 financial crisis coupled with high growth in external trade and output. A recent study by the IMF (2013) shows that reserve buildup in emerging Asia between 1997 and 2002 was large both in absolute terms and relative to imports and short-term external debt. The study also points out that the reserve buildup in emerging Asia was similar across exchange rate regimes, including countries with limited exchange rate flexibility as well as countries with managed floating exchange rates. More importantly the recent reserve buildup has been in excess of that warranted by the economic fundamentals of the region. Increases in international reserves in Latin America have been largely in line with rising in imports and commercial transactions in general and was only partially driven by demand for insurance against financial shocks (Eichengreen, 2006).

For Africa, recent commodity price hikes have allowed reserves accumulation among exporters, while draining reserves among importers. Meanwhile, macroeconomic stabilization remains at the forefront of national economic policymaking and aid conditionality in Africa (Lapavitsas, 2007; Mckinley, 2007; Weeks, 2007). This induces countries to hold reserves to allow monetary authorities to intervene in markets to influence the exchange rate and inflation. Adequate reserves may also allow African countries to borrow abroad, attract foreign capital and promote domestic private investment as a result of strengthened external position and reduced vulnerability to external shocks.

These benefits should be carefully weighed against potentially high economic and social costs. The costs of maintaining reserves comprise the opportunity cost of foregone domestic consumption and investment as well as financial costs and the strain on monetary policy arising from efforts to sterilize the effects of excessive monetary expansion through higher domestic interest rates (Mckinley, 2007). This can increase fiscal pressure (control of government spending and deficits) and make reserve accumulation inconsistent with fiscal policy.
objectives. In addition, reserve buildup can pose challenges to the macroeconomic policy framework.

According to IMF (2013), it is impossible for monetary authorities to reconcile policy objectives vis-à-vis exchange rate stability through a fixed exchange rate, monetary independence, and free capital mobility. While it is possible to combine selective capital controls with occasional interventions in the exchange rate market, still inconsistencies may arise. For example if the economy is overheating, accumulating reserves and keeping domestic currency from appreciating might be inconsistent with a tight monetary policy. Higher domestic interest rates resulting from sterilization may also be inconsistent with a tight fiscal policy (as higher interest payments put pressure on the fiscal balance) (UNDESA, 2007).

2.4.1 Reserve Management in African Countries

More importantly, reserve accumulation in developing countries is akin to buildup of deficits in reserve asset countries, especially the US. Thus adjustments in the US might have important costs for the rest of the world, especially reserve-accumulating countries (Beaufort and Kapteyn, 2011). The question of how to manage large foreign exchange reserves effectively also arises because available reserve assets may not provide an optimal risk-return mix. In the long run there is a need for an alternative reserve system. Furthermore, governments need to stimulate domestic demand along with growth in exports and real GDP, strengthen domestic financial markets and integrate them into the global market in order to reduce precautionary demand for reserves.

To effectively manage foreign exchange reserves, policy makers need to understand the major determinants of reserves in a globalized world. This is essential in determining the optimal reserves level that provides them with necessary security at minimum cost (Mckinley, 2007). In this context, some slowdown in the rate of reserve accumulation is likely to be justifiable for commodity-rich African countries that need to finance high-yield domestic investments instead of locking up the reserves in low-yield foreign assets (Lapavitsas, 2007). Designing a successful reserve management system for African countries requires important institutional
and policy reforms at the national and regional levels. These include policies to enhance domestic demand and intra-African trade, improved exchange rate management and above all a new regional or global reserve system (Weeks, 2007).

2.4.1.1 Exchange Rate as a Determinant of Foreign Reserves

Beaufort and Kapteyn (2011) point out that the type of exchange rate system influences reserve demand. Frenkel (1983) found evidence that after the collapse of the Bretton Woods agreement the move to floating exchange rates decreased the level of reserves. This follows macroeconomic theory. In a fixed exchange rate scenario market forces will still act to change the real exchange rate. Therefore, the government will have to intervene to keep the nominal peg. As established earlier, the use of foreign reserves is one such method. In a floating exchange rate regime, movements in the exchange should not affect reserves as much. This results because the exchange rate is expected to absorb the macroeconomic shocks. Even if a country wished to keep a managed float, the exchange rate under this type of regime is allowed to vary within certain parameters, so adjustment would not occur quite as often and therefore fewer reserves would be necessary.

The exchange rate is said to have devaluated when the exchange rate goes up. Essentially, more of the domestic currency is needed to buy a unit of the foreign currency. In order to counteract this devaluation of the currency, the central currency will have to buy some of its own currency in the open market. Reserves would be used to buy the domestic currency, thus depleting reserves (Beaufort and Kapteyn, 2011).

2.4.1.2 Current Account Balance and Opportunity Cost

The net flow of capital out of a country is equal to domestic saving minus domestic investment; it is also equal to the current account (Higgins and Klitgaard, 2012). A current account surplus then translates into net capital inflows into the country. Net capital inflows would strengthen the domestic currency. Under a fixed exchange rate system such capital flows must be counterbalanced to maintain the peg, under a flexible exchange rate system the currency would appreciate. If a country wishes to maintain its fixed exchange rate or just wishes to maintain a
weaker currency in order to be more competitive, it has to balance the net capital inflows with capital outflows. Purchasing foreign reserves is one way to increase capital outflows since domestic resources are used to purchase foreign currency (Beaufort and Kapteyn, 2011).

Theoretically it is reasonable to assume that there is an opportunity cost related to holding extra reserves. However, it is difficult to predict what this opportunity cost is. First, a benchmark for “necessary” reserves needs to be developed. Again, the literature does not agree as to what the appropriate benchmark is, so they are mostly arbitrary. Second, once a benchmark is set and excess reserves identified a suitable proxy for opportunity cost needs to be found. Several financial variables have been used in the past, such as interest rates and lending rates. However, these variables tend to be correlated to reserves themselves, therefore yielding few satisfactory results (IMF, 2013).

2.5 Chapter Summary
This chapter of literature review discussed on the various studied conducted by other scholars in the line of the effects of foreign exchange rate control regime on foreign remittances in Ethiopia. This chapter has showed the key scenarios used to assess the factors affecting the exchange rate control measures, the effects of state fixed exchange rate on remittance flow and the effect of state fixed exchange rate on acquisition of foreign currencies. The chapter three compromises the research methodology applied in this study includes; research design, population of the study, data collection and data analysis.

CHAPTER THREE 3.0 RESEARCH METHODOLOGY

3.1 Introduction
This section discusses the methodology that was used in carrying out this study. The chapter considers the methods that were used in data collection and identifies the techniques and procedures used in data processing and analysis. The research design, population, data collection instruments, data collection procedures and data analysis are discussed.
3.2 Research Design

Research design is simply defined as the framework and structure of an investigation aimed at finding answers to research questions (Cooper and Schindler, 2006). It gives both the structure of the research problem and the blueprint to be followed in obtaining empirical evidence on existing relationships. This study was descriptive in nature. According to Burns and Grove (2003), descriptive research is designed to paint a picture of a situation the way it is or as it naturally happens. This design may also be used to justify current practice and make judgment as well as developing theories. For the purpose of this study, descriptive research was used to obtain a picture of the respondents’ opinions and their experiences in relation to the effect of exchange rate on remittance flow.

3.3 Population and Sample Design

3.3.1 Population

A population encompasses the entire focus group of a research. It is simply deals with things or events of interest that the researcher seeks to study. Burns and Grove (2003) posit that population entails all elements that meet the criteria for inclusion in a given study. It can also be conceived as the total collection of elements about which the researcher intends to make some inferences (Cooper and Schindler, 2006). This study targeted the employees who worked in the Ethiopian banks as well as government officials.

3.3.2 Sampling Design

3.3.2.1 Sampling Frame

Turner (2003) defined a sampling frame as the entire set of source materials whereby the research sample is selected from. The purpose of this frame is to provide an outline whereby particular members of the target population can be chosen so as to participate in the survey. An ideal sample frame ought to be accurate, complete and most of all up-to-date. The sample frame for the study was obtained from the listing of industries in Ethiopia and the human resource department of the banks that were included in the study.
3.3.2.2 Sampling Techniques
Purposive sampling was employed in this study. According to Parahoo (1997) purposive sampling is a technique in sampling in which the researcher deliberately decides on who to recruit in the study on their ability to provide the needed data. In this study only respondents eligible were purposively selected to take part in the study.

3.3.2.3 Sample Size
According to Bryman and Bell (2007), a sample size of between 30 and 100 ensures that the study findings are sufficiently reliable for the majority of purposes, although there are some occasions when a sample as small as 30 may be sufficient. In total, the study consider 45 respondents.

3.4 Data Collection Methods
This study relied on both secondary and primary sources of data. Secondary data was obtained from previous studies, articles, theses and research papers. On the other hand, primary data was collected using questionnaires and interview schedules. Kothari (2004) defined primary data as that research data that is collected for the first time, thus original in nature. Structured questionnaires were designed and distributed by the researcher to target respondents. The questionnaires comprised of closed ended questions. The researcher distributed the research instruments using the drop and pick method so as to give enough time to the respondents to fill in details accurately and without details without any undue influence.

3.5 Research procedures
Validity is simply defined as the accuracy of inferences based on the research findings. According to Mugenda and Mugenda (2003) validity is the extent or degree at which study findings actually represented the subject under investigation. On the other hand, reliability is the accuracy or consistency of research instruments (Orodho, 2009). In order to control data reliability and validity, measurement and sampling errors; a number of actions will be taken. First, there was pretesting of the questionnaire using a random sample of 15 respondents to ensure that the right questions are posed to the respondents during the study. The outcome of
the pretest was used to adjust or improve in the data collection tools. Enumerators used for administration of questionnaires were under close supervision. Key informant interviews (KIIs) were also be used to get data from those who have relevant information.

Ethical issues relate to moral standards that the researcher should consider in all research approaches in all the research phases and the research (Rubin and Babbie, 2011). The first step of the study process involved was to seek permission from the relevant authorities. All participants were required to give their informed consent prior to their inclusion in the study. A written letter that explains the research idea was provided. Study respondents were informed about the aims and significance of the study, in order to clear any doubt about their involvements in the study.

3.6 Data Analysis Methods

To analyze the data, both qualitative and quantitative techniques were used. The returned data collection instruments were checked and sorted out to ensure they are complete and consistently filled. The response questions were numerically coded, entered and cleaned (to ensure accuracy, consistency, uniformity and completeness) using Statistical Package for Social Sciences (SPSS) version 20, excel computer software for primary data.

A qualitative approach was used to analyze the responses from qualitative data (the interview and open ended questions) in order to obtain an increased understanding of how foreign exchange rate affects remittance flow. In particular, content analysis. This was conducted by first coding the responses from the interviews and open-ended questions. Data was first organized, then the information categorized into themes, sub-themes, concepts and categories (Creswell, 2007). The data were coded manually to enable an in-depth focus on the information itself then entered into SPSS and the results displayed using tables and figures such as graphs and pie charts.
3.7 Chapter Summary

This chapter has introduced and discussed the methodology that was used in carrying out the study. It has elaborated on research techniques, population, data collection including techniques and procedures that were used or adopted in data processing and analysis. Ethical issues to be considered have also been discussed. The following chapter presents and discusses in detail the findings of the study.
CHAPTER FOUR 4.0 STUDY RESULTS AND FINDINGS  4.1 Introduction
This Chapter presents the study findings. The results are presented according to the objectives of the study which reflect the research questions that the researcher set out to answer.

4.2 Demographic Profiles

4.2.1 Gender of Respondents
Participants in the study were asked to indicate their respective genders. Table 4.1 clearly shows that a large proportion of the respondents was composed of males (57.8%) compared to females who were only 42.2%.

<table>
<thead>
<tr>
<th>Gender</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Male</td>
<td>26</td>
<td>57.8</td>
</tr>
<tr>
<td>Female</td>
<td>19</td>
<td>42.2</td>
</tr>
<tr>
<td>Total</td>
<td>45</td>
<td>100.0</td>
</tr>
</tbody>
</table>

4.2.2 Levels of Education
Education levels of respondents directly or indirectly influence their responses. In this study, education level of the respondents was sought to establish their distribution. According to the study, most of the respondent had post-secondary education. About 37.8% had first degree/university education. This was followed by respondents with post-graduate education (24.4%). About 22.2% had college education while only 15.6% had secondary education (refer to Table 4.2).

<table>
<thead>
<tr>
<th>Education Levels</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Secondary</td>
<td>7</td>
<td>15.6</td>
</tr>
<tr>
<td>College</td>
<td>10</td>
<td>22.2</td>
</tr>
<tr>
<td>University</td>
<td>17</td>
<td>37.8</td>
</tr>
</tbody>
</table>
4.2.3 Years in Employment

Enquiries were also made on the length of period respondents have been working in their respective fields. The findings are displayed in Table 4.3 reveals that 33.3% of the respondents had worked for less than 5 years. About 26.7% had worked for a period of between 7 to 9 years, 13.3% indicated 10 to 14 years and 20% indicated 15 to 20 years. The table also shows that only 6.7% of the respondents have worked for more than 20 years. In overall, most of the respondents have worked long enough meaning they were well versed with the topic under investigation (Table 4.3).

<table>
<thead>
<tr>
<th>Years</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 5</td>
<td>15</td>
<td>33.3</td>
</tr>
<tr>
<td>5-9</td>
<td>12</td>
<td>26.7</td>
</tr>
<tr>
<td>10-14</td>
<td>6</td>
<td>13.3</td>
</tr>
<tr>
<td>15-20</td>
<td>9</td>
<td>20.0</td>
</tr>
<tr>
<td>More than 20</td>
<td>3</td>
<td>6.7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>45</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

4.3 Factors Influencing State Exchange Rate Control Measures

4.3.1 Factors that Determine Foreign Exchange Rates

When asked, to mention some of the factors which determine the types of foreign exchange rate control, most of the respondents indicated economical. Figure 4.1 displays the various responses.
29

Figure 4.1 Factors that Determine Types of Exchange Rate Control

As can be seen in Figure 4.1 above, economical factor is the most influential of all the factors are revealed by 77.8% of the respondents. Black market is the second most determinant of the type of foreign exchange rate control (51.1%) then followed by political factors (40%). The least important is institutional factor (13.3%).

4.3.2 Extent of State Exchange Rate Measures as Affected by Interest Rate

The researcher enquired about the link between Interest rate and State Exchange rate Control Measures by asking respondent to mention the extent to which state exchange rate measures is affected by interest rate.

Results in Table 4.4 clearly show that 44.4% of the respondents indicated very great extent, while 35.6% indicated great extent. About 15.6% said state exchange rate control is affected by interest rate to a small extent whereas 4.4% argued that the effect was to a very small extent. The findings imply that interest rate has some influence on state exchange rate control.

Table 4.4 Extent to which State Exchange Rate Control is affected by Interest Rate

<table>
<thead>
<tr>
<th>Level of Influence</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Field Data, 2015

Figure 4.1 Factors that Determine Types of Exchange Rate Control

What are some of the factors which determine the type of exchange rate control?
Table 4.5 shows that, there are policies implemented to control and regulate the quantity of foreign exchange trade in Ethiopia and that the commercial banks in the country are required to maintain their net open position in foreign currency. The table shows that, the central bank buys and sells foreign exchange so as to influence the exchange rate and that, it also provides advice and instructions to commercial banks to promote greater discipline in line with policy priorities. The table shows that the central bank of Ethiopia monitors all inter-bank foreign exchange dealings and that, there is a dynamic relationship between imports, income and exchange rate. The table shows that, the country uses exports as a way of correcting its negative balance of payment and increase its exchange rate and that, the exchange rate instability reduces the amount of export in the country. The table indicates that, control of exchange rate variability in the country needs to be managed through policies.

Table 4.5 Rating of State Exchange Rate Control Measures

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>There are policies implemented to control and regulate the quantity of foreign exchange trade in the country</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>23.6</td>
<td>76.4</td>
<td>4.76</td>
<td>0.427</td>
</tr>
</tbody>
</table>

4.3.3 Rating of State Exchange Rate Measures

The researcher enquired about the rating of the State Exchange Rate Control Measures by asking respondent to rate the measures using the key (1=Very Small Extent; 2=Small Extent; 3=No Extent; 4=Great Extent; 5=Very Great Extent).

<table>
<thead>
<tr>
<th></th>
<th>20</th>
<th>44.4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very great extent</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Great extent</td>
<td>16</td>
<td>35.6</td>
</tr>
<tr>
<td>Small extent</td>
<td>7</td>
<td>15.6</td>
</tr>
<tr>
<td>Very small extent</td>
<td>2</td>
<td>4.4</td>
</tr>
<tr>
<td>Total</td>
<td>45</td>
<td>100.0</td>
</tr>
</tbody>
</table>
Commercial banks in the country are required to maintain their net open position in foreign currency

<table>
<thead>
<tr>
<th></th>
<th>0</th>
<th>0</th>
<th>25.8</th>
<th>47.2</th>
<th>27.0</th>
<th>4.01</th>
<th>0.731</th>
</tr>
</thead>
</table>

The central bank buys and sells foreign exchange so as to influence the exchange rate

<table>
<thead>
<tr>
<th></th>
<th>0</th>
<th>0</th>
<th>13.5</th>
<th>34.8</th>
<th>51.7</th>
<th>4.38</th>
<th>0.715</th>
</tr>
</thead>
</table>

The central bank provides advice and instructions to commercial banks to promote greater discipline in line with policy priorities

<table>
<thead>
<tr>
<th></th>
<th>12.4</th>
<th>13.5</th>
<th>24.7</th>
<th>25.8</th>
<th>23.6</th>
<th>3.35</th>
<th>1.315</th>
</tr>
</thead>
</table>

The central bank monitors all inter-bank foreign exchange dealings

<table>
<thead>
<tr>
<th></th>
<th>12.4</th>
<th>13.5</th>
<th>34.8</th>
<th>27.0</th>
<th>12.4</th>
<th>3.13</th>
<th>1.179</th>
</tr>
</thead>
</table>

There is a dynamic relationship between imports, income and exchange rate

<table>
<thead>
<tr>
<th></th>
<th>12.4</th>
<th>13.5</th>
<th>0.0</th>
<th>74.2</th>
<th>0</th>
<th>3.36</th>
<th>1.121</th>
</tr>
</thead>
</table>

The country uses exports as a way of correcting its negative balance of payment and increase its exchange rate

<table>
<thead>
<tr>
<th></th>
<th>12.4</th>
<th>13.5</th>
<th>10.1</th>
<th>51.7</th>
<th>12.4</th>
<th>3.38</th>
<th>1.229</th>
</tr>
</thead>
</table>

The exchange rate instability reduces the amount of export in the country

<table>
<thead>
<tr>
<th></th>
<th>0</th>
<th>25.8</th>
<th>10.1</th>
<th>50.6</th>
<th>13.5</th>
<th>3.52</th>
<th>1.024</th>
</tr>
</thead>
</table>

Control of exchange rate variability need to be managed through policies

<table>
<thead>
<tr>
<th></th>
<th>0</th>
<th>25.8</th>
<th>0</th>
<th>61.8</th>
<th>12.4</th>
<th>3.61</th>
<th>1.007</th>
</tr>
</thead>
</table>

4.3.4 Correlation Test for the Rating of State Exchange Rate Measures

A Pearson Correlation test was carried out to determine the significance of the rating of the State Exchange Rate Measures and the results were as follows:

Table 4.6 Correlations for the Rating of State Exchange Rate Control Measures

<table>
<thead>
<tr>
<th></th>
<th>Correlations</th>
</tr>
</thead>
<tbody>
<tr>
<td>'There are policies implemented to control and regulate the quantity of foreign exchange trade in the country'</td>
<td>.522”</td>
</tr>
<tr>
<td></td>
<td>.000</td>
</tr>
</tbody>
</table>
Table 4.6 shows that there being policies implemented to control and regulate the quantity of foreign exchange trade in the country was significant (P=0.000). Commercial banks in the country being required to maintain their net open position in foreign currency was significant (P=0.000). The central bank buying and selling foreign exchange so as to influence the exchange rate was significant (P=0.000). The central bank providing advice and instructions to commercial banks to promote greater discipline in line with policy priorities was significant (P=0.008). The central bank monitoring all inter-bank foreign exchange dealings was significant (P=0.010). The existence of a dynamic relationship between imports, income and exchange rate was insignificant (P=0.092). The country using exports as a way of correcting its negative balance of payment and increase its exchange rate (P=0.000). The exchange rate

<table>
<thead>
<tr>
<th>Statement</th>
<th>Correlation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial banks in the country are required to maintain their net open</td>
<td>.645”</td>
</tr>
<tr>
<td>position in foreign currency</td>
<td>.000</td>
</tr>
<tr>
<td>The central bank buys and sells foreign exchange so as to influence the</td>
<td>-.380”</td>
</tr>
<tr>
<td>exchange rate</td>
<td>.000</td>
</tr>
<tr>
<td>The central bank provides advice and instructions to commercial banks to</td>
<td>.282”</td>
</tr>
<tr>
<td>promote greater discipline in line with policy priorities</td>
<td>.008</td>
</tr>
<tr>
<td>The central bank monitors all inter-bank foreign exchange dealings</td>
<td>.273”</td>
</tr>
<tr>
<td>There is a dynamic relationship between imports, income and exchange rate</td>
<td>.180</td>
</tr>
<tr>
<td>The country uses exports as a way of correcting its negative balance of</td>
<td>-.372”</td>
</tr>
<tr>
<td>payment and increase its exchange rate</td>
<td>.000</td>
</tr>
<tr>
<td>The exchange rate instability reduces the amount of export in the country</td>
<td>.710”</td>
</tr>
<tr>
<td>Control of exchange rate variability need to be managed through policies</td>
<td>.269’</td>
</tr>
<tr>
<td></td>
<td>.011</td>
</tr>
</tbody>
</table>

** Correlation is significant at the 0.01 level (2-tailed)
* Correlation is significant at the 0.05 level (2-tailed)
instability reducing the amount of export in the country was significant (P=0.000). Control of exchange rate variability needing to be managed through policies was significant (P=0.011).

4.4 Effects of State Fixed Exchange Rate on Remittance Flow

4.4.1 Effect of State Fixed Exchange Rate on Remittance Flow

The study sought to find out the effect of state fixed exchange Rate on remittance flow. The findings are summarized in Table 4.7.

Table 4.7 Perceived Effects of State Fixed Exchange Rate on Remittance Flow

<table>
<thead>
<tr>
<th>Effects</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>It causes an increase in the flow</td>
<td>22</td>
<td>40</td>
</tr>
<tr>
<td>It causes a decrease</td>
<td>18</td>
<td>48.9</td>
</tr>
<tr>
<td>Remittance flow stays the same</td>
<td>5</td>
<td>11.1</td>
</tr>
<tr>
<td>Total</td>
<td>45</td>
<td>100</td>
</tr>
</tbody>
</table>

From Table 4.7 above, it is clear that most of the respondents (48.8%) believe that State Fixed Exchange Rate causes a decrease in the remittance flow. However, 40% of the respondents argue that it causes an increase in the flow. The least number of respondents, 11.1% were of the opinion that remittance flow stay the same, meaning there is no change.

4.4.2 Rating of the Effect of State Fixed Exchange Rate on Remittance Flow

The researcher enquired about the rating of the State Fixed Exchange Rate on the Remittance Flow by asking respondent to rate the measures using the key (1=Very Small Extent; 2=Small Extent; 3=No Extent; 4=Great Extent; 5=Very Great Extent).

Table 4.8 Rating of the Effect of State Fixed Exchange Rate on Remittance Flow

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>The country is not adequately equipped to track and record remittances</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>51.7</td>
<td>48.3</td>
<td>4.48</td>
<td>0.503</td>
</tr>
<tr>
<td></td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>40.4</td>
<td>59.6</td>
<td>4.60</td>
<td>0.494</td>
</tr>
<tr>
<td>------------------------------------------------------------------</td>
<td>-----</td>
<td>-----</td>
<td>-----</td>
<td>------</td>
<td>------</td>
<td>------</td>
<td>-------</td>
</tr>
<tr>
<td>The country only collects remittance data from banks and overlooks other financial flows</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>There are a lot of migrants who send money to their families during hardships</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Remittances serve as transnational safety nets for the country</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The difference between domestic and world interest rates has caused capital to flow in the direction of the higher return within the country</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The country has a stable economic status from its fixed exchange rate system</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Monetary policymakers in the country have the capacity to adjust interest rates in the country</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Remittances stand apart from other capital flows in the country</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The country has a system of “risk sharing” to respond to local shocks</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 4.8 shows that, the country is not adequately equipped to track and record remittances and that, it only collects remittance data from banks and overlooks other financial flows. The table indicates that there are a lot of migrants who send money to their families during hardships and that the, remittances serve as transnational safety nets for the country. The table shows that the difference between domestic and world interest rates has caused capital to flow in the direction of the higher return within the country and that, the country has a stable economic status from its fixed exchange rate system. From the table, it can be seen that, monetary policymakers in the country have the capacity to adjust interest rates in the country, remittances stand apart from other capital flows in the country and that, the country has a system of “risk sharing” to respond to local shocks.
4.4.3 Correlation Test for the Effect of State Fixed Exchange Rate on Remittance Flow

A Pearson Correlation test was carried out to determine the significance of the rating of the Effect of State Fixed Exchange Rate on Remittance and the results were as follows: Table 4.9 shows that the country not being adequately equipped to track and record remittances was significant (P=0.000). The country only collecting remittance data from banks and overlooking other financial flows was insignificant (P=.069). There being a lot of migrants who send money to their families during hardships was significant (P=0.000). Remittances serving as transnational safety nets for the country was significant (P=0.000). The difference between domestic and world interest rates having caused capital to flow in the direction of the higher return within the country was insignificant (P=0.689). The country having a stable economic status from its fixed exchange rate system was significant (P=0.003). Monetary policymakers in the country having the capacity to adjust interest rates in the country was significant (P=0.000). Remittances standing apart from other capital flows in the country was significant (P=0.005). The country having a system of “risk sharing” to respond to local shocks was significant (P=0.000).

Table 4.9 Correlations for the Effect of State Fixed Exchange Rate on Remittance Flow

<table>
<thead>
<tr>
<th></th>
<th>Correlations</th>
</tr>
</thead>
<tbody>
<tr>
<td>The country is not adequately equipped to track and record remittances</td>
<td>.777”</td>
</tr>
<tr>
<td></td>
<td>.000</td>
</tr>
<tr>
<td>The country only collects remittance data from banks and overlooks other financial flows</td>
<td>.194</td>
</tr>
<tr>
<td></td>
<td>.069</td>
</tr>
<tr>
<td>There are a lot of migrants who send money to their families during hardships</td>
<td>.438”</td>
</tr>
<tr>
<td></td>
<td>.000</td>
</tr>
<tr>
<td>Remittances serve as transnational safety nets for the country</td>
<td>.562”</td>
</tr>
<tr>
<td></td>
<td>.000</td>
</tr>
<tr>
<td>The difference between domestic and world interest rates has caused capital to flow in the direction of the higher return within the country</td>
<td>-.043</td>
</tr>
<tr>
<td></td>
<td>.689</td>
</tr>
</tbody>
</table>
The country has a stable economic status from its fixed exchange rate system

Monetary policymakers in the country have the capacity to adjust interest rates in the country

Remittances stand apart from other capital flows in the country

The country has a system of “risk sharing” to respond to local shocks

<table>
<thead>
<tr>
<th>Description</th>
<th>Correlation</th>
<th>P-Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>The country has a stable economic status from its fixed exchange rate system</td>
<td>.311</td>
<td>.003</td>
</tr>
<tr>
<td>Monetary policymakers in the country have the capacity to adjust interest rates in the country</td>
<td>.618</td>
<td>.000</td>
</tr>
<tr>
<td>Remittances stand apart from other capital flows in the country</td>
<td>.293</td>
<td>.005</td>
</tr>
<tr>
<td>The country has a system of “risk sharing” to respond to local shocks</td>
<td>.775</td>
<td>.000</td>
</tr>
</tbody>
</table>

** Correlation is significant at the 0.01 level (2-tailed)
* Correlation is significant at the 0.05 level (2-tailed)

4.5 Effects of State Fixed Exchange Rate on Acquisition of Foreign Currencies

4.5.1 Effect of State Fixed Exchange Rate on Acquisition of Foreign Currencies

Enquiries were also made to establish the extent to which State Fixed Exchange Rate affect Acquisition of Foreign Currencies. According to the findings, most of the respondents (40%) indicated that the effect was to a very great extent. About a third (28.9%) of the respondents were of the opinion that the influence was to great extent. On the contrary, only small proportion of respondents felt that the effect was minimal. In particular, 24.4% of the respondents felt the effect was to a very small extent while 6.7% small extent.
4.5.2 Extent to which Foreign Exchange Rate affects Acquisition of Foreign Currency

When asked to explain, one of the respondents said the following: If there is a rate fluctuation the individual financial institution are interested to hold the foreign currency to set a better income from the exchange (Male Respondent, 2015). Other respondents said the following: Of course we have a difficult transaction (ways) of FCY acquisition. For example remittance is one major way of our mobilization of FCY in this case because of the rate fluctuation; customers changes that FCY into birr though illegal bodies especially black market (Male Respondent, 2015). If the exchange rate is high there will be more currency because the customers wants today’s money value rather than future so they will exchange their currency (Female Respondent, 2015). The exchange rate has a great effect. For example we see in our organization sometimes if exchange rate is low number of currency also decreases. If the rate is high out currency also increases (Male Respondent, 2015).

4.5.3 Effects of State Fixed Exchange Rate on Acquisition of Foreign Currencies

The researcher enquired about the rating of the State Fixed Exchange Rate on acquisition of foreign currencies by asking respondent to rate the measures using the key (1=Very Small Extent; 2=Small Extent; 3=No Extent; 4=Great Extent; 5=Very Great Extent).
Table 4.10 Effects of State Fixed Exchange Rate on Acquisition of Foreign Currencies

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulation of reserves in the country has occurred at a time</td>
<td>0</td>
<td>0</td>
<td>14.6</td>
<td>38.2</td>
<td>47.2</td>
<td>4.33</td>
<td>0.719</td>
</tr>
<tr>
<td>of generally stable exchange rates</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Demand for international reserves has increased due to global</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>66.3</td>
<td>33.7</td>
<td>4.34</td>
<td>0.0475</td>
</tr>
<tr>
<td>trade</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accumulation of reserves in the country is a form of self-</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>13.5</td>
<td>86.5</td>
<td>4.87</td>
<td>0.343</td>
</tr>
<tr>
<td>insurance of the global economy</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The country uses accumulation of reserves as a tool for</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>13.5</td>
<td>86.5</td>
<td>4.87</td>
<td>0.343</td>
</tr>
<tr>
<td>maintaining low exchange rates</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The country has adequate reserves used to boost investors’</td>
<td>0</td>
<td>12.4</td>
<td>14.6</td>
<td>39.3</td>
<td>33.7</td>
<td>3.94</td>
<td>0.993</td>
</tr>
<tr>
<td>confidence</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The country uses reserves to allow policy makers to influence</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>25.8</td>
<td>74.2</td>
<td>4.74</td>
<td>0.440</td>
</tr>
<tr>
<td>the exchange rate and inflation in the country</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Market forces in the country act as agents of change of real</td>
<td>0</td>
<td>0</td>
<td>12.3</td>
<td>51.7</td>
<td>36.0</td>
<td>4.24</td>
<td>0.432</td>
</tr>
<tr>
<td>exchange rate</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital flows in the country are counterbalanced to maintain the</td>
<td>0</td>
<td>0</td>
<td>14.6</td>
<td>23.6</td>
<td>61.8</td>
<td>4.33</td>
<td>1.109</td>
</tr>
<tr>
<td>country’s peg</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The country incurs opportunity costs for holding on to extra</td>
<td>0</td>
<td>0</td>
<td>14.6</td>
<td>62.9</td>
<td>22.5</td>
<td>4.08</td>
<td>0.369</td>
</tr>
<tr>
<td>reserves</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 4.10 shows that, accumulation of reserves in the country has occurred at a time of generally stable exchange rates and that, demand for international reserves has increased due to global trade. The table also shows that, accumulation of reserves in the country is a form of
self-insurance of the global economy and that, the country uses accumulation of reserves as a tool for maintaining low exchange rates. The table also shows that, the country has adequate reserves used to boost investors’ confidence and that, the country uses reserves to allow policy makers to influence the exchange rate and inflation in the country. The table indicates that, market forces in the country act as agents of change of real exchange rate and that, capital flows in the country are counterbalanced to maintain the country’s peg. The table shows that, the country incurs opportunity costs for holding on to extra reserves.

4.5.2 Correlations for Effect of State Fixed Exchange Rate on Acquisition of Foreign Currencies

A Pearson Correlation test was carried out to determine the significance of the rating of the Effect of State Fixed Exchange Rate on Acquisition of Foreign Currencies and the results were as follows: Table 4.11 shows that, accumulation of reserves in the country having occurred at a time of generally stable exchange rates was significant (P=0.000). Demand for international reserves having increased due to global trade was significant (P=0.000). Accumulation of reserves in the country being a form of self-insurance of the global economy was significant (P=0.011). The country using accumulation of reserves as a tool for maintaining low exchange rates was significant (P=0.000). The country having adequate reserves used to boost investors’ confidence was significant (P=0.001). The country using reserves to allow policy makers to influence the exchange rate and inflation in the country was significant (P=0.000). Market forces in the country acting as agents of change of real exchange rate was significant (P=0.005). Capital flows in the country being counterbalanced to maintain the country’s peg was significant (P=0.000). The country incurring opportunity costs for holding on to extra reserves was insignificant (P=0.473).

Table 4.11 Correlations for Effect of State Fixed Exchange Rate on Acquisition of Foreign Currencies

<table>
<thead>
<tr>
<th>Correlations</th>
<th>Values</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulation of reserves in the country has occurred at a time of generally stable exchange rates</td>
<td>-.372” .000</td>
</tr>
</tbody>
</table>
Demand for international reserves has increased due to global trade
Accumulation of reserves in the country is a form of self-insurance of the global economy
The country uses accumulation of reserves as a tool for maintaining low exchange rates
The country has adequate reserves used to boost investors’ confidence
The country uses reserves to allow policy makers to influence the exchange rate and inflation in the country
Market forces in the country act as agents of change of real exchange rate
Capital flows in the country are counterbalanced to maintain the country’s peg
The country incurs opportunity costs for holding on to extra reserves

** Correlation is significant at the 0.01 level (2-tailed)
* Correlation is significant at the 0.05 level (2-tailed)

4.6 Regression Data of Remittance Flow against the Ethiopian Birr

4.6.1 Effect of US Dollar on Remittance Flow
The effect of the effect of the US dollar exchange rate on remittance flow, there is an overall strong statistical significant relationship between the US dollar exchange rate on remittance flow because Prob > F = 0.0009, where it is less than the level of significance (P-value).

. regress remittanceflow usdbid usdask
4.6.2 Effect of the Euro on Remittance Flow

The effect of the effect of Euro exchange rate on remittance flow, there is an overall strong statistical significant relationship between the Euro exchange rate and remittance flow because \( \text{Prob} > F = 0.0004 \) where, it is less than the level of significance (P-value). There is a statistical significant relationship between the Eurobid exchange rate and remittance flow because the p-value of Eurobid is less than the level of significance (P-value = 5%).

\`
. regress remittanceflow eurobid euroask
\`
<table>
<thead>
<tr>
<th>Source</th>
<th>df</th>
<th>SS</th>
<th>MS</th>
<th>Number of obs = 11</th>
</tr>
</thead>
<tbody>
<tr>
<td>Model</td>
<td>2</td>
<td>4.0711e+17</td>
<td>2.0356e+17</td>
<td>F(2,8) = 24.26</td>
</tr>
<tr>
<td>Residual</td>
<td>8</td>
<td>6.7113e+16</td>
<td>8.3892e+15</td>
<td>Prob &gt; F = 0.0004</td>
</tr>
<tr>
<td>Total</td>
<td>10</td>
<td>4.7423e+17</td>
<td>4.7423e+16</td>
<td>R-squared = 0.8585</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Adj R-squared = 0.8231</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Root MSE = 9.2e+07</td>
</tr>
</tbody>
</table>

| remittancef~w | Coef. | Std. Err. | t | P>|t| | [95% Conf. Interval] |
|----------------|-------|-----------|---|------|----------------------|
| eurobid        | 2.18e+08 | 8.45e+07  | 2.58 | 0.032 | 2.34e+07 | 4.13e+08 |
| euroask        | -1.94e+08 | 8.78e+07  | -2.21 | 0.058 | -3.96e+08 | 8424113 |
| _cons          | -1.78e+07 | 1.15e+08  | -0.15 | 0.881 | -2.83e+08 | 2.48e+08 |

Figure 4.4 Effect of the EURO BID and EURO ASK on Remittance Flow

4.6.3 Effect of the Great Britain Pound on Remittance Flow

The effect of the Great Britain Pound (GBP) exchange rate on remittance flow, there is an overall statistical significant between the Great Britain Pound (GBP) exchange rate and
remittance flow because Prob > F = 0.0010, where it is less than the level of significance (P-value).

\[ \text{regress remittanceflow gbpbid gbpask} \]

<table>
<thead>
<tr>
<th>Source</th>
<th>SS</th>
<th>df</th>
<th>Number of obs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Model</td>
<td>3.8996e+17</td>
<td>2</td>
<td>18.51</td>
</tr>
<tr>
<td>Residual</td>
<td>1.0533e+16</td>
<td>8</td>
<td>0.0010</td>
</tr>
<tr>
<td>Total</td>
<td>4.7423e+17</td>
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Root MSE = 1.0e+08

| remittanceflow | Coef.  | Std. Err. | t     | P>|t| |
|----------------|--------|-----------|-------|-----|
|                | [95% Conf. Interval] |       |       |     |
| gbpbid         | 1.66e+08 | 8.58e+07  | 1.94  | 0.089|
|                | -3.18e+07 | 3.64e+08  |       |     |
| gbpask         | -1.44e+08 | 9.02e+07  | -1.60 | 0.149|
|                | -3.52e+08 | 6.39e+07  |       |     |
| _cons          | -7.10e+07 | 1.62e+08  | -0.44 | 0.672|
|                | -4.44e+08 | 3.02e+08  |       |     |

Figure 4.5 Effect of the GBP BID and GBP ASK on Remittance Flow

The State Fixed Exchange Rate in US Dollar, in EURO, and GBP are most popular foreign currencies affect the remittance flow as all above regressions are demonstrating in this findings.
4.7 Chapter Summary
In this chapter, data analysis methods, study results and a discussion of the findings have been presented. Findings from this study have been found to be consistent with the findings of several related studies on effects of foreign exchange rate control regime on foreign remittances. In addition the impact of various economic data like interest rate, inflation, political and market, has been explored. Data findings were described as correlations to the study variables and presented as tabulations. In the next chapter, concludes the study.

CHAPTER FIVE 5.0 DISCUSSIONS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction
The broad aim of this study was to investigate the effects of foreign exchange rate control regime on foreign remittances: a case of Ethiopia. This chapter finalizes the study by discussing the findings and providing conclusions as well as recommendations. All these are aligned to the specific objectives of the study.

5.2 Summary
The purpose of this study was to investigate the effects of foreign exchange rate control regime on foreign remittances: a case of Ethiopia. The research has given the answers to the following questions: What are factors affecting the state exchange rate control measures? What are the effects of state fixed exchange rate on remittance flow? What is the effect of state fixed exchange rate on acquisition of foreign currencies?

The descriptive research design was applied on this study for the description of the several variables of interest. The target population were Ethiopia’s banks’ employees, business people and government officials. Purposive sampling was used in this study to recruit a total number of forty five respondents. Both qualitative and quantitative techniques were used to carry out this research. The Microsoft Excel was used for figures presentation and tables while SPSS and STATA packages were utilized to analyze quantitative data for the linear regression to determine the effects of state fixed exchange rate on remittance flow.
The study shows that there are policies implemented to control and regulate the quantity of foreign exchange trade in Ethiopia and that the commercial banks in the country were required to maintain their net open position in foreign currency. From the study, it was clear that, the central bank in Ethiopia bought and sold foreign exchange so as to influence the exchange rate in the country and also provided advice and instructions to commercial banks to promote greater discipline in line with policy priorities. The study showed that, the central bank of Ethiopia monitored all inter-bank foreign exchange dealings and that, there was a dynamic relationship between imports, income and exchange rate in the country.

The study shows that Ethiopia like most African countries was not adequately equipped to track and record remittances since it only collected remittance data from banks and overlooked other financial flows. There are a lot of migrants who sent money to their families during hardships in the country and the remittances served as transnational safety net. The study shows that, the difference between domestic and world interest rates had caused capital to flow in the direction of the higher return in the country, but the country had a stable economic status obtained from its fixed exchange rate system. Monetary policymakers in the country had the capacity to adjust interest rates and they had placed a system of “risk sharing” to respond to shocks.

The study shows that, accumulation of reserves in the country had occurred at a time of generally stable exchange rates and demand for international reserves had increased due to global trade. The study revealed that, accumulation of reserves in Ethiopia was a form of self-insurance of the global economy as well as a tool for maintaining low exchange rates. Ethiopia had adequate reserves used to boost investors’ confidence and as well as allow policymakers to influence the exchange rate and inflation in the country. From the study, it was revealed that, market forces in the country acted as agents of change of real exchange rate and capital flows in the country were counterbalanced to maintain the country’s peg.
5.3 Discussions

5.3.1 Factors Influencing State Exchange Rate Control Measures

The study showed that, there were policies implemented to control and regulate the quantity of foreign exchange trade in Ethiopia. Haider, Ullah and Azim (2012) states that foreign exchange control and regulatory policies are policies implemented to control or regulate the quantity of foreign exchange traded / available in the market and that they are intended to help maintain orderly market transactions and avoid unhealthy market practices and exchange rate volatility.

The study revealed that commercial banks in the country were required to maintain their net open position in foreign currency. Haider, Ullah and Azim (2012) state that, commercial banks are required to maintain their net open position in foreign currency (assets in foreign currency less liabilities in foreign currency) at low levels prescribed by the Central Bank so that the banks do not have highly speculative currency positions.

The study showed that, the central bank bought and sold foreign exchange so as to influence the exchange rate in the country. According to Khan and Schimmelpfennig (2006), interventions mean a central bank’s buying and selling of foreign exchange at times to influence the exchange rate or reduce its excessive volatility by enhancing supply of or demand for foreign exchange.

The study showed that the central bank provided advice and instructions to other commercial banks to promote greater discipline in line with policy priorities. According to Khan and Schimmelpfennig (2006), moral suasion which is the process of providing advice and instructions to commercial banks on monetary and financial operations with a view to promote greater discipline in line with policy priorities is immensely helpful for avoiding unhealthy speculation and volatility in the exchange rate.

The study revealed that the central bank of Ethiopia monitored all inter-bank foreign exchange dealings. Hussain and Malik (2011) state that, in moral suasion, the Central Bank monitors all inter-bank foreign exchange dealings on-line basis and examines at times whether such
dealings are supported with underlying customer transactions. Any dealings deviating from normal market conditions will be identified and such banks will be advised appropriately. Such moral suasion has not been captured in the exchange rate models.

The study showed that, there was a dynamic relationship between imports, income and exchange rate. Alam and Ahmed (2011) note that, there is a dynamic relationship between imports, income and exchange rate. Autoregressive Distributed Lag (ARDL) approach is used to show that as real income increases in a country, the demand for imported products increases due to which the imports increase because of this the exchange rate is affected as there is a significant relationship between imports and exchange rate.

The study showed that, the country used exports as a way of correcting its negative balance of payment and increase its exchange rate. According to Smith (2009), exports are one of the main sources of correcting the negative balance of payment (BOP). He further states that, the relationship between exports and exchange rate is there but exchange rate does not affect the exports directly and exchange rate affects the income of the people and which have an effect on the exports.

The study showed that, the exchange rate instability reduced the amount of export in the country. Alvarez et al. (2009) states that, it is usually said that exchange rate instability reduces the amount of export but it is evident from that amount of trade may not necessarily be affected by the exchange rate volatility but volatility can change the structure of the trade. The study showed, control of exchange rate variability in the country needed to be managed through policies. Khan et al. (2012) states that, policies should be made that reduce the exchange rate variability.

5.3.2 Effects of State Fixed Exchange Rate on Remittance Flow
The study showed that, the country was not adequately equipped to track and record remittances. The study also revealed that, the country only collects remittance data from banks and overlooks other financial flows. According to de Luna (2014), a more severe problem is
that many poor countries are not adequately equipped to track and record remittances. She further states that, some countries only collect data from banks and overlook financial flows through money transfer businesses, post offices, and informal channels.

The study showed that, there were a lot of migrants who sent money to their families during hardships. Stuart (2012) states that, migrants send more money to their families when their home countries experience economic downturns, financial crises, or natural disasters. Moreover, adverse circumstances often trigger more migration, which then results in greater remittance inflows.

The study showed that remittances served as transnational safety nets for the country. According to Stuart (2012), remittances serve as transnational intra-family or intracommunity safety nets, cushioning societies from the disruption attending more volatile financial flows. Several empirical studies, including Chami et al. (2011), IMF (2013), and Kapur (2013), find a strong relationship between economic contractions and subsequent increases in remittances for developing countries.

The study showed that the difference between domestic and world interest rates had caused capital to flow in the direction of the higher return within the country. Bernhard, Broz, and Clark (2012) states that, in today’s world of highly integrated financial markets, a discrepancy between the domestic and world interest rates causes capital to flow in the direction of the higher return. If the exchange rate is allowed to float, it will adjust accordingly - appreciating with capital inflows and depreciating with capital outflows.

The study showed that, the country had a stable economic status from its fixed exchange rate system; and it also showed that, monetary policymakers in the country have the capacity to adjust interest rates in the country. Frieden and Stein (2011) states that, stability arises from the fixed exchange rate, which decreases transaction costs for investors, traders, and other groups with ties to the global economy, and also leads to monetary stability by tying the hands of monetary policymakers. Bernhard, Broz, and Clark (2012) notes that, flexibility is
associated with floating exchange rates, which provide monetary policymakers with the capacity to adjust interest rates to changing domestic economic circumstances.

The study showed that, remittances stand apart from other capital flows in the country. Bearce (2007) states that, remittances - when sufficiently large in relation to the economy - constitute an automatic stabilizer that performs a similar function to countercyclical monetary policy. As such, remittances stand apart from other capital flows in that they do not exacerbate the trade-off between fixed exchange rates and domestic monetary policy autonomy.

The study showed that, the country had a system of “risk sharing” to respond to local shocks. Chami et al. (2011) states that, the currency union itself should have a system of “risk sharing” - usually defined as fiscal transfers - to respond to local shocks, just as the US federal government sends emergency funds to States in times of crisis.

5.3.3 Effect of State Fixed Exchange Rate on Acquisition of Foreign Currencies The study showed that, accumulation of reserves in the country had occurred at a time of generally stable exchange rates. According to Mendoza (2014), the accumulation of reserves has occurred at a time of generally stable or slightly appreciating exchange rates, particularly against the US dollar.

The study showed that, demand for international reserves had increased due to global trade. According to Mendoza (2014), demand for international reserves increases with global trade. Empirical research shows that both the variance and level of trade (current account and openness to trade or the propensity to import) are important determinants of demand for reserves.

The study showed that, accumulation of reserves in the country was a form of self-insurance of the global economy. According to Stiglitz (2006), the recent accumulation of reserves in developing countries has been largely interpreted as a form of self-insurance precipitated by
the high level of global economic and financial instability and the absence of an adequate international system for crisis management.

The study revealed that, the country used accumulation of reserves as a tool for maintaining low exchange rates. According to Aizenman and Lee (2013), many countries see reserve accumulation not only as a means for effective exchange rate management, but also as a tool for maintaining low exchange rates in order to promote trade and international competitiveness. This motive for holding reserves is referred to as the mercantilist motive.

The study also showed that, the country had adequate reserves used to boost investors’ confidence. Eichengreen (2006) states that, maintaining adequate reserves can also boost investors’ confidence and enhance investment and growth. This can be seen more clearly in the case of Asian countries that recorded the highest rate of increase in international reserves following the 1997 financial crisis coupled with high growth in external trade and output.

The study showed that, the country used reserves to allow policy makers to influence the exchange rate and inflation in the country. According to Lapavitsas (2007), macroeconomic stabilization induces countries to hold reserves to allow monetary authorities to intervene in markets to influence the exchange rate and inflation.

The study indicated that, market forces in the country acted as agents of change of real exchange rate, Beaufort and Kapteyn (2011) states that, in a fixed exchange rate scenario market forces will still act to change the real exchange rate. Therefore, the government will have to intervene to keep the nominal peg.

The study showed that, capital flows in the country were counterbalanced to maintain the country’s peg. Higgins and Klitgaard (2012) state that, under a fixed exchange rate system such capital flows must be counterbalanced to maintain the peg, under a flexible exchange rate system the currency would appreciate. If a country wishes to maintain its fixed exchange rate
or just wishes to maintain a weaker currency in order to be more competitive, it has to balance the net capital inflows with capital outflows.

The study showed that, the country incurred opportunity costs for holding on to extra reserves. Mckinley (2007) states that, the costs of maintaining reserves comprise the opportunity cost of foregone domestic consumption and investment as well as financial costs and the strain on monetary policy arising from efforts to sterilize the effects of excessive monetary expansion through higher domestic interest rates.

5.4 Conclusion

5.4.1 Factors Influencing State Exchange Rate Control Measures

From the study, it can be concluded that there are policies implemented to control and regulate the quantity of foreign exchange trade in Ethiopia and that the commercial banks in the country are required to maintain their net open position in foreign currency. From the study, it is clear that, the central bank in Ethiopia buys and sells foreign exchange so as to influence the exchange rate in the country and also provides advice and instructions to commercial banks to promote greater discipline in line with policy priorities. The study concludes that, the central bank of Ethiopia monitors all inter-bank foreign exchange dealings and that, there was a dynamic relationship between imports, income and exchange rate in the country. It can be concluded that, the country used exports as a way of correcting negative balance of payment and increase its exchange rate.

5.4.2 Effects of State Fixed Exchange Rate on Remittance Flow

The study concludes that Ethiopia like most African countries is not adequately equipped to track and record remittances since it only collects remittance data from banks and overlooks other financial flows. There are a lot of migrants who sent money to their families during hardships in the country and the remittances served as transnational safety nets for the country. The study concludes that, the difference between domestic and world interest rates had caused capital to flow in the direction of the higher return in the country, but the country had a stable economic status obtained from its fixed exchange rate system. Monetary policymakers in the
country had the capacity to adjust interest rates and they had placed a system of “risk sharing” to respond to shocks.

5.4.3 Effect of State Fixed Exchange Rate on Acquisition of Foreign Currencies  The study concludes that, accumulation of reserves in the country had occurred at a time of generally stable exchange rates and demand for international reserves had increased due to global trade. It can be concluded that, accumulation of reserves in Ethiopia was a form of self-insurance of the global economy as well as a tool for maintaining low exchange rates. Ethiopia had adequate reserves used to boost investors’ confidence and as well as allow policy makers to influence the exchange rate and inflation in the country. From the study, it can be concluded that, market forces in the country acted as agents of change of real exchange rate and capital flows in the country were counterbalanced to maintain the country’s peg.

5.5 Recommendations
5.5.1 Recommendations for Improvement
5.5.1.1 Factors Influencing State Exchange Rate Control Measures
Based on the findings, prediction of a state exchange Rate Control Measures is mainly based on major factors such as economic, black market and institutional among others. Therefore, in order to have healthy economic status of the country, the government need to closely a country monitor and work on the main factors affecting the exchange rate control measures.

5.5.1.2 Effects of State Fixed Exchange Rate on Remittance Flow
Based on this study, State Fixed Exchange Rate tends to reduce the amount of remittance sent home. Therefore, the government needs to have a more competitive exchange rate to encourage the rate of remittance flow. Perhaps, there is need to have incentives which encourage the flow.

5.5.1.3 Effect of State Fixed Exchange Rate on Acquisition of Foreign Currencies  The government needs to take measures in harmonizing economic variables for instance by coming up with appropriate policies to reduce inflation and boost up economic growth. The gap
between policy formation and its implementation both in fiscal and in monetary policy required.

5.5.2 Suggestions for Further Research

The current study sought to investigate the effects of foreign exchange rate control regime on foreign remittances with special references to Ethiopia, though the variables used may not be exhaustive. Therefore, it would be more interesting if future studies could improve on variables such as exchange control rate and remittance flow.

REFERENCES


APPENDICES APPENDIX I: INTRODUCTION TO RESPONDENTS

Dear Sir/Madam,

I am currently carrying out a study of MBA Finance in United State International- University Africa in Nairobi, Kenya. As part of this, am seeking your views or contribution. The questionnaire is divided into a number of sections. Each section contains a number of tables which we would like you complete. Also, in some cases, you will be required to put in some brief written comments. Therefore, you are hereby asked to complete the questionnaire as conscientiously as possible. Note that there is no right or wrong answers: in all cases, we are asking you to indicate how you think or feel.

Your responses to various questions in the questionnaire are crucial for us to be able to process your answers to the questionnaire. However, all information will be treated with utmost confidentiality, and will not be disclosed to any other persons.

Thank your in Advance for taking part in this study.

APPENDIX II: QUESTIONNAIRE FOR RESPONDENTS

Please indicate, by placing a tick (√) where appropriate

<table>
<thead>
<tr>
<th>Section A: Respondent’s Profiles</th>
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58
Section B: Factors Influencing State Exchange Rate Control Measures

Q5. What are some of the factors which determines the types of foreign Exchange rate control?

(i) Political     [ ]
(ii) Economical  [ ]
(iii) Institutional[ ]
(iv) Historical  [ ]
(v) Black Market[ ]

Q6. To what extent is state exchange rate measures affected by interest rate?

i. Very great extent [ ]  ii. Great extent  [ ]  iii. Small extent  [ ]

To what extent is state exchange rate affected by the following control measures.

Use the following key: 1=Very Small Extent; 2=Small Extent;
3=No Extent; 4=Great Extent; 5=Very Great Extent.
Commercial banks in the country are required to maintain their net open position in foreign currency

The central bank buys and sells foreign exchange so as to influence the exchange rate

The central bank provides advice and instructions to commercial banks to promote greater discipline in line with policy priorities

The central bank monitors all inter-bank foreign exchange dealings

There is a dynamic relationship between imports, income and exchange rate

The country uses exports as a way of correcting its negative balance of payment and increase its exchange rate

The exchange rate instability reduces the amount of export in the country

Control of exchange rate variability need to be managed through policies

**Section C: Effects of State Fixed Exchange Rate on Remittance Flow**

Q8. In your opinion, to what extent do you think foreign exchange rate affects remittance flow?

   i. Very great extent [    ]  ii.
   Great extent [    ] iii.
   Small extent [    ] iv.
   Very small extent [    ]

Q9. What is the effect of State Fixed exchange on Remittance Flow?

   i. It causes an increase in the flow [    ]  ii.
   It causes a decrease [    ] iii.
   Remittance flow stays the same [    ]

Q10. To what extent has state fixed exchange rate affected the flow of foreign remittance? Use the following key: 1=Very Small Extent; 2=Small Extent; 3=No Extent; 4=Great Extent; 5=Very Great Extent.
### Section D: Effects of State Fixed Exchange Rate on Acquisition of Foreign Currencies

Q11. Foreign exchange rate has some effect of acquisition of foreign currency. To what extent do you agree with this statement?

1. Very great extent [ ]
2. Great extent [ ]
3. Small extent [ ]
4. Very small extent [ ]

Q12. In your opinion, what is the actual effect of fixed exchange rate on Acquisition of foreign currencies?
i. It encourages acquisition of foreign exchange ii. It discourages acquisition of foreign exchange iii. Others (specify) …………………………………………………………………………………

Q13. To what extent has state fixed exchange rate affected the acquisition of foreign currencies? Use the following key: 1=Very Small Extent; 2=Small Extent; 3=No Extent; 4=Great Extent; 5=Very Great Extent.

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Thank You for Your Participation