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Ethiopia, Regional Integration and the COMESA Free Trade Area

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ABSTRACT

Arguments that free trade enhances welfare are persuading more and more countries to liberalise their trade regimes. One way of doing this is to join a free trade area (FTA). The benefits of free trade are not straightforward, and countries considering taking this route should carefully study the potential costs and benefits in the context of their specific political and economic circumstances. This paper examines the potential benefits and costs for Ethiopia of joining the FTA established by the Common Market for Eastern and Southern Africa (COMESA).

Ethiopia is situated at the centre of the Horn of Africa, which is marked by intense and long-standing political conflicts. Despite the complex security situation in the region, Ethiopia has managed to establish and maintain good economic relations with most of its neighbours, including reciprocal trade. However, while it played a significant role in establishing COMESA, it is still not a member of its FTA. Its volume of trade with COMESA member countries is small but is growing rapidly, with petroleum, fertilizers, tobacco, soap and polish being its major imports from the region.

Studies aimed at assessing the costs and benefits of joining the FTA show that the country's manufacturing sector is still in its infancy and cannot yet supply the region with high-quality goods at competitive prices. Moreover, joining the FTA would lead to job losses in some economic sectors that would not be fully offset by employment gains in others. This implies that joining the FTA would result in a net increase in unemployment. However, Ethiopia is increasingly collaborating with its neighbours – notably Kenya, Sudan, Djibouti and South Sudan – in the areas of energy and transport, among others, and the Ethiopian private sector is increasingly investing in those countries. All these countries are thus enhancing their economic co-operation despite the tense and complex security situation in the region, and Ethiopia's still being outside the formal FTA. The benefits for Ethiopia of joining the FTA are therefore unclear, and it may well gain more from continuing to develop its economic relations with its neighbours beyond the formal trade liberalisation within the ambit of the FTA.

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ABBREVIATIONS AND ACRONYMS

AMISOM	African Union Mission in Somalia
ARDUF	Afar Revolutionary Democratic Unity Front
AU	African Union
COMESA	Common Market for Eastern and Southern Africa
CUD	Coalition for Unity and Democracy
EAC	East African Community
EPRDF	Ethiopian People Revolutionary Democratic Front
EU	European Union
FDI	foreign direct investment
FTA	free trade area
GDP	gross domestic product
GoSS	Government of South Sudan
IGAD	Inter-Governmental Authority on Development
LAPSSET	Lamu Port–South Sudan–Ethiopia Transport Corridor
MVA	manufacturing value added
SADC	Southern African Development Community
SPLA	Sudan People’s Liberation Army
TFTA	Tripartite FTA
TPLF	Tigrayan Peoples’ Liberation Front
UNSC	UN Security Council

INTRODUCTION

Given the growing belief that free trade enhances social welfare, developing countries throughout the world have increasingly focused on liberalising their economies. One way of doing this is to form or join regional free trade areas (FTAs), in which member countries abolish or reduce barriers to trade among themselves while maintaining independent external tariffs with non-FTA trade partners. FTAs have been established throughout the world, and some countries belong to more than one. Members may also conclude bilateral trade agreements, or agree to multilateral rules of engagement in trade. The Common Market for Eastern and Southern Africa (COMESA) has established a major African FTA. COMESA has 19 members from across the African continent, 15 of which have joined the FTA (Uganda, Libya, Egypt, Sudan, Kenya, Rwanda, Burundi, Mauritius, Comoros, Zimbabwe, Zambia, Djibouti, Madagascar, Mauritius and Malawi). The other four may also join the FTA (Eritrea, Seychelles, the Democratic Republic of Congo (DRC) and Ethiopia itself), but some are reluctant and others are in the process of assessing the costs and benefits.

Although it played a role in COMESA's formation and is eligible for membership of the FTA, it is clear that Ethiopia still falls among these latter countries. Its economy has, however, changed significantly over the past decade. It has grown rapidly, mainly in the services and agricultural sectors, largely driven by high levels of government expenditure on infrastructure. Trade flows have increased, with imports surpassing exports. Given increased borrowing by public enterprises to finance infrastructure development, the country has also experienced high levels of inflation. The composition of Ethiopia's trading partners is shifting in favour of developing countries. It is now deliberating whether it should join the COMESA FTA.

Against this background, this paper assesses Ethiopia's participation in COMESA, the projected costs and benefits of joining the FTA, and the implications of the country's growing economic engagement with its neighbours. It starts by briefly tracing Ethiopia's political history, outlining the complex peace and security situation on the Horn, and the role played by Ethiopia in maintaining it. Next, it traces Ethiopia's political and diplomatic relations with individual countries on the Horn followed by the development of COMESA, Ethiopia's role in establishing this body, and the potential costs and benefits to Ethiopia of joining its FTA. In the process, it cites the findings of three major studies commissioned by Ethiopia in association with its development partners. Ethiopia's burgeoning economic relations with its neighbours beyond the confines of formal trade liberalisation is also outlined in the analysis. Against this background, the paper ends with some preliminary conclusions about whether or not joining the FTA would be advisable at this stage, and what this means for Ethiopia's and the region's economic development.

ETHIOPIA AND ITS ROLE IN THE HORN OF AFRICA

Ethiopia's route to democracy

Ethiopia is the oldest independent country in Africa. Although its origins as a kingdom date back to the first millennium BC, the history of modern Ethiopia began with the

centralisation of its administration from 1855 onwards.¹ However, it was Emperor Haile Selassie I, who ascended to the throne in 1930, who instituted a modern bureaucracy.² The country has had three different political regimes and has been led by at least the same number of economic ideologies over the past 40 years.

In 1974, after four decades of imperial rule, Haile Selassie was deposed by a military junta known as the Derg, which claimed to embrace a Marxist-Leninist ideology. Led by Major Mengistu Haile Mariam, the Derg declared Ethiopia a communist state and unleashed a reign of terror that lasted for 17 years. No political party or independent press was allowed, and any opposition or dissent was brutally repressed.³

This provoked the formation of various opposition and rebel groups, mostly ethnic based, including the Eritrean People's Liberation Front, Oromo Liberation Front and the Tigrayan People's Liberation Front (TPLF). Almost all the groups fighting the Marxist regime were hosted and supported by neighbouring states, notably Sudan. In 1989, following a dramatic increase in strength, the TPLF formed a coalition known as the Ethiopian People's Revolutionary Democratic Front (EPRDF) and incorporated other ethnic groups, including the Oromo, Amhara and various groups from the southern part of the country. The EPRDF still rules Ethiopia. The coalition, mainly led by the TPLF, overthrew the Derg in 1991. Following a national conference in July 1991, a Transitional Government of Ethiopia was set up and governed the country until the drafting of a democratic constitution and the election of a new House of People's Representatives in 1995. The country was restructured into nine regions mostly along ethnic lines; the city of Harar was given regional status while the capital Addis Ababa and the city of Dire Dawa were made federal cities.

The past two decades witnessed relative political stability, and economic development and growth in Ethiopia. The 1995 constitution, a progressive document, declared an ethnic federal state, guaranteed group and individual rights and heralded a new era of democracy. The document, which emphasises respect for pluralism and diversity, introduced the rights of nations, nationalities and peoples to self-determination up to secession.⁴ The move was a clear departure from the centralist one-party military dictatorship towards an experiment with a federalist multiparty democracy and free press. The constitution further rejected censorship and respected freedom of the press. In the years that followed the country saw a mushrooming of political parties and proliferation of the private press, crowding the public and political spheres. In 2007 there were more than 90 registered political parties in Ethiopia. According to figures from the Ministry of Information, 385 publications comprising 265 newspapers and 120 magazines were registered between October 1992 and July 1997.⁵

The role of the private sector and foreign investment in the economy also increased significantly, especially in the post-2000 period. The first private bank was created in 1994 and the country now has more than 15 private banks, all owned and run by Ethiopian citizens. Massive government investment in infrastructure and the focus on education and health supported by international partners have resulted in the expansion and improvement of basic services. The mega and macro infrastructure schemes undertaken, including hydroelectric power, roads, sugar factories and railway projects, have become the defining elements of the current Ethiopian state, which brands itself as a developmental state with a vision to transform the nation. The government states that it is working to make Ethiopia a middle-income country by 2025. The level, sustainability

and distribution of growth and development are, however, constantly contested by the opposition and some experts.

The democratic experiment also faces many challenges. The government is regularly accused of human rights violations, corruption and abusing state institutions to pursue party interests. The 2013 US State Department Human Rights Report accuses the Ethiopian government of restricting freedom of expression and association through arrests, detention, politically motivated trials, harassment and the intimidation of opposition members and journalists.⁶ The opposition claims the legislation that came out in the post-2005 period seriously compromised their freedom and visibly narrowed the public and political spheres.

Arguably the most contested election in Ethiopian history, the 2005 national elections resulted in post-election violence that caused the death of more than 200 civilians and security personnel. The largest two opposition groups, the Coalition for Unity and Democracy (CUD) and the Union for Ethiopian Democratic Forces, challenged the ruling party and won in a landslide in Addis Ababa and other major urban areas. The results increased the number of opposition seats in parliament from 12 to 172. However, key CUD leaders boycotted the parliament citing irregularities and violence.

Though later pardoned, most of the prominent opposition leaders and members of the press were arrested in the post-election crisis. The opposition accused the government of rigging the ballot and using excessive force in dealing with peaceful protests, while the government blamed the opposition for the violence and accused it of conspiring to overthrow the democratically elected government through unconstitutional means. The press law, political parties law, the non-governmental organisation legislation and the anti-terrorism law are considered by the opposition, human rights and democratic activists and international watchdogs as attempts by the government to curb the activities of the opposition and the press and avoid a repeat of the 2005 situation.

In the 2013 Ibrahim Index of African Governance Ethiopia was ranked 33rd out of 52 African countries, scoring lower than the continental average (51.6) and the regional average (47.9) for East Africa. East Africa was ranked 4th out of five regions, a rank that the region has held since 2000. According to the index, the region showed overall improvement in the areas of sustainable economic opportunity and human development, while faring less well with regard to safety and the rule of law.⁷

PEACE AND SECURITY IN THE HORN

The Horn of Africa is one of the most unstable regions in the world, posing a huge challenge to any meaningful attempts at economic co-operation and regional integration. As Sally Healy notes: 'In the Horn, a long history of conflict and poor political relations means that military rather than economic considerations tend to dominate national security debates.' In her view, security interdependence in the region is at least as strong as economic interdependence, and the two frequently pull in opposite directions.⁸

The region has experienced prolonged civil wars and other conflicts over the past three decades, which have severely disrupted its development and integration. As Berouk Mesfin states: 'The collapse of state authority in Somalia, the fragility of the new state of South Sudan and its tensions with Khartoum, the stalemate between Ethiopia and Eritrea, and

a partially developed agenda of political Islam in the region are the major security threats hampering development and regional integration in the area.⁹ In one example, tensions between the leadership of the fragile South Sudanese government reached a new level in December 2013, leading to a violent conflict between groups led by President Salva Kiir and former vice president Riek Machar, with serious security implications for the region.

Experts believe events in the region provide ample grounds for its classification as a security complex. Healy notes that the region is ‘a community of states in which the security of any one country is intimately connected to the security of all the others. This applies as much to states’ internal security as to regional security among them.’¹⁰

Regional security expert Medhane Tadesse says religious, ethnic and cultural differences are major causes of instability. Highlighting the security interdependence of the region, he notes that none of the long-standing conflicts in the Horn is limited to single countries. ‘This security interdependence is at least as strong as the economic interdependence and springs from essentially the same source, namely the connectivity of communities across boundaries, and their struggle to survive and prosper in a harsh environment.’¹¹

Ethiopia is the only country in the Horn that shares a border with all the other countries in the region. Its long and porous borders with countries such as Somalia and South Sudan mean that Ethiopia is more affected by regional issues than any other state in the Horn. It is bordered in the east by Djibouti (349 km), in the south-east by Kenya (861 km), in the north by Eritrea (912 km), in the south-west by Somalia (1 600 km) and in the west by Sudan (769 km) and South Sudan (837 km). African borders can be regarded as the scars of the notorious Berlin Conference of 1884–1885, held to assist European colonial powers in their ‘scramble for Africa’. The conference resulted in the arbitrary creation of colonies with entirely artificial borders, and the forceful amalgamation of native states without their consent. To this day, numerous borders in Africa bisect areas inhabited by the same ethnic and linguistic groups which, as a result, end up living in different countries. The Horn of Africa is no exception. Numerous ethnic groups living in Ethiopia are also found in neighbouring countries. The Somali, the third largest ethnic group in Ethiopia, are also found in Somalia, the autonomous region of Somaliland, Kenya and Djibouti. The Afar people who dominate the north-eastern part of Ethiopia also live in Djibouti and Eritrea; and the Issa are found in Djibouti, Ethiopia and the autonomous region of Somaliland. Most of these people are pastoralists who seldom cross national borders. The border between Ethiopia and Eritrea divides the Tigrinya-speaking people into the Tigray regional state in Ethiopia and neighbouring Eritrea, while the Boran pastoralists share their connections across the Kenya–Ethiopia border. The Anuak and Nuer live in south-western Ethiopia as well as South Sudan, and the Berta and Burun also inhabit both countries.¹²

Healy notes that despite poor infrastructure, political instability, insecure borders and the absence of progressive laws allowing the free movement of people and goods, societies in the region still trade successfully with one another. People in some peripheral areas rely more on provincial centres in neighbouring countries than on distant centres in their own countries. For example, people in the eastern part of the Somali region of Ethiopia still source much of their manufactured goods and processed food from Somalia proper and the autonomous region of Somaliland. These kinds of informal relations could be used to enhance formal relations at the state level. Thus Healy argues that, despite the obvious obstacles to formal economic integration, countries in the region remain bound by history

and geography in relationships of interdependence. As a result, there is ‘great potential to enhance this through the development of transport corridors to sea ports, the management of shared water resources, the common management of pastoral rangelands, and improved energy security’.¹³ However, violent tribal clashes over grazing land and water and the threat of cattle rustling remain serious security threats in the borderlands of the region.

The Intergovernmental Authority on Development (IGAD), which was established in 1986 with the major objective of combating desertification and drought, has transformed itself into a regional body working on conflict prevention and resolution as well as regional integration a decade later. The success of IGAD’s regional peace and security and integration efforts has been mixed. The regional bloc played a leading role in establishing the transitional government in Somalia and also took part in and oversaw the negotiation and implementation of the 2005 Comprehensive Peace Process between Khartoum and Juba. However, it failed to resolve the border conflicts between Ethiopia and Eritrea, and Eritrea and Djibouti, and Somalia still remains a country without an effective central state. Most recently, in March 2014, the IGAD Heads of States decided to deploy ‘a protection and deterrence’ force into South Sudan to help enforce a ceasefire deal between the government and rebel forces.

Ethiopia’s role in regional security

Ethiopia is situated in the centre of the Horn. Despite its war with Eritrea (1998–2000) and its high-profile intervention in Somalia at the end of 2006 to fight Islamic fundamentalists, Ethiopia has enjoyed mostly sound relations with countries in the region. The country hosts the African Union (AU), and plays a central and active role in the seven-member IGAD, which attempts to resolve regional conflicts and promote regional political integration.

Western powers often regard Ethiopia – the second most populous country in Africa – as a strategic ally in the Horn. Both the US and the European Union (EU) view it as a valuable and relatively stable ally, capable of combating extremism and terrorism. The US State Department has identified Ethiopia as one of the four pillars of US foreign policy in Africa, along with South Africa, Nigeria and Egypt. Despite regular criticism on human rights issues, Ethiopia still receives substantial development assistance from foreign governments and multilateral organisations, as there is a belief among diplomats that the government has a pro-poor policy. Addis Ababa also has strong ties with Beijing and other emerging powers. Good diplomatic relations with both hemispheres, a central location, economic and political stability, and the weakening of other regional states such as Sudan, have worked to turn Ethiopia into a key player in the region. Some analysts attribute Ethiopia’s increasing visibility to its military strength, comprising the third largest army in Africa. Beyond its size, the army is experienced in both conventional and anti-guerrilla warfare, and controls an expanding empire of factories and businesses worth billions of birr. It is one of the few armies in the continent with recent conventional, anti-guerrilla and peacekeeping experience. Ethiopia has therefore the most experienced, potent and best-equipped military in the region, ‘with ground and air force personnel numbering 200 000 to 250 000’.¹⁴

Ethiopia, which has been the chair of IGAD from 2008–2014, played a key role in combating the militant Somali group Al-Shabaab, and has participated in the bigger peace

initiatives in the Horn. Addis has played a key role in settling the recent dispute between Sudan and South Sudan and is taking a lead role in resolving the current crisis in South Sudan. Ethiopia also took a leading role in brokering peace between Jubaland and the central government of Somalia.

ETHIOPIA'S POLITICAL RELATIONS WITH ITS NEIGHBOURS

Relations with Sudan

In February 2014 President Omar al-Bashir of Sudan flew to Mekelle, the capital of the Tigray Regional State in northern Ethiopia, to attend the 39th anniversary of the TPLF. The Sudanese President, who has supported the TPLF since its guerrilla days, also has good relations with the EPRDF-led government of which the TPLF is a member. In an event that was televised live by the national Ethiopian broadcaster, al-Bashir presented to the Ethiopian government a jet owned by the Sudanese government in which the late Prime Minister of Ethiopia, Meles Zenawi (then the head of the rebels), had flown to Ethiopia immediately after the fall of the military dictatorship in 1991. The gift was considered yet another gesture between Khartoum and Addis Ababa manifesting cordial relations, especially over the past decade and half.

In the post-2010 period, the issue of the use of the Nile could arguably be the most defining issue shaping regional relations in north-eastern Africa. The Great Ethiopian Renaissance Dam project, which was unveiled in April 2011 by the Ethiopian government, has the potential to produce more than 6 000 MW when completed. The dam will be the biggest in Africa. The project has drawn strong opposition from Egypt, which claims that the dam will reduce its share of the Nile waters. Sudan, which historically allied with Egypt on the matter of the Nile, has publicly and repeatedly supported the project and claimed it will benefit its economy and regional integration. The move is considered a landmark in redefining water politics in the Nile basin.

Ethiopia is the only country in East Africa that borders both Sudans. Throughout the peace process resulting in South Sudan's independence, Addis Ababa tried to project impartiality and maintain good relations with both Khartoum and Juba. In an interview after the 2011 referendum, Zenawi described his country's interest in the referendum as follows: 'Ethiopia can be said to be the only country with balanced relations with both northern and southern Sudan. It has cordial relations with the north and the south. Ethiopia can be said to be a country in which both sides have confidence, and this is so because we have endeavoured to create relations that took into consideration the fact that both sides are our brothers.' In the same interview Zenawi made it clear that developments in Sudan would continue to affect Ethiopia. He said: 'We will burn when Sudan burns, and, since we have strong relations with both sides, we are striving to play a direct and positive role in the matter.'¹⁵

In a rare departure from its principle not to involve neighbouring countries in peacekeeping operations, the UN approved the deployment of Ethiopian forces in the disputed area of Abyei in late June 2011. Similarly Ethiopia has also contributed troops and military equipment to the AU/UN Hybrid Mission in Darfur (UNAMID). In February

2014 Ethiopia and Sudan agreed to form a joint force along the border between the two countries at the conclusion of the military technical committee meetings in the presence of both sides' defence ministers. The Sudanese Defence Minister, Abdul-Rahim Mohammed Hussein, said that regular meetings between the leaders of the two countries had created a great deal of mutual trust and friendship.¹⁶

Ethiopia has played a central mediating role between the governments of Sudan and South Sudan. On 22 April 2012, the chairperson of the AU Commission, Jean Ping, lauded the role played by the late Zenawi in resolving the conflict between Juba and Khartoum. Beyond initiating, hosting and leading the peace talks, Ethiopia also contributed a battalion of 860 troops, a heavy transport company of 125 troops, a reconnaissance company of 160 troops, a multi-role logistics company of 300 troops, 29 staff officers and nine military observers to UNAMID. In 2011, Ethiopia also contributed a 4 200-strong force to the UN Interim Security Force for Abyei.

Sudan tops African foreign direct investment (FDI) flows to Ethiopia and is only second, next to China, in the overall FDI flows to Ethiopia. In September 2010, Sudan became Ethiopia's sole supplier of oil and oil products, including benzene and liquid pressured gas. In turn, Sudan imports cement, sesame, beans and fruit from Ethiopia, making it one of the biggest importers of Ethiopian products. In 2012, Ethiopia started exporting 100 MW of electricity to Sudan.

Relations with South Sudan

South Sudan, which became an independent state in January 2011, has good relations with most IGAD member states. Most of the countries in the region, including Ethiopia, Uganda, Kenya and Eritrea, have supported the decades-long liberation struggle by the Sudan People's Liberation Army (SPLA). The creation of the new state has made Sudan less important and more isolated, both geographically and politically. This could create diplomatic competition among other countries in the region for leverage over the oil-rich South Sudan, which will also have a say on other regional issues such as the Nile, Somalia, and the Ethiopia–Eritrea conflict. Security tops the Juba–Addis agenda. According to Berouk, the Ethiopian government knows that any conflict in South Sudan will spill over into Ethiopia. Among other things, Addis Ababa fears that any security vacuum or ungoverned spaces in South Sudan could create a safe haven for rebel groups such as Ginbot 7, the Oromo Liberation Front and the Ogaden National Liberation Front, which enjoy ongoing support from Eritrea.¹⁷

The political crisis and tension in the leadership of the SPLA evolved into a violent conflict in mid-December 2013. The war between the factions led by Kiir and Machar respectively has created the biggest security crisis in South Sudan to date and a humanitarian catastrophe with visible implications for the economy and stability of the region. The crisis in South Sudan, which started as a political crisis, is becoming extremely complicated. The violence and the fast ethnicisation of the conflict are spiralling out of control. Kiir is from the Dinka ethnic group while Machar comes from the Nuer community, the second largest ethnic group in South Sudan. There are unconfirmed reports that some members of the Nuer in Ethiopia may have taken part in the conflict.

IGAD, chaired by Prime Minister Hailemariam Desalegn of Ethiopia, has created a mediation team led by the former Foreign Minister of Ethiopia, Seyoum Mesfin. A series

of talks held in Addis Ababa resulted in the signing of agreements on the cessation of hostilities and the status of detainees between the Government of the Republic of South Sudan (GoSS) and the Sudan People's Liberation Movement/Army (in opposition) in January 2014. Ethiopia is once again playing a major role in hosting and initiating the talks and tried to project an impartial image in light of the controversial military intervention by Uganda favouring the Juba administration.¹⁸

Ethiopia shares a border of more than 800 km with South Sudan, which is straddled by the Anuak and Nuer peoples. The Gambella region of Ethiopia, which borders South Sudan, has a history of conflict between communities, mainly over natural resources. In 2012 armed groups in the South Sudanese state of Jonglei crossed the border into Ethiopia to escape a government disarmament campaign following tribal clashes. In January 2013 the two countries signed an agreement to co-operate in combating regional security threats and securing their shared border.¹⁹

The Ethiopian government has created numerous forums and partnership mechanisms for building the security capacity of the newly formed state, and discussing and resolving shared security threats. Senior representatives of the SPLA – South Sudan's army – and the Ethiopian army meet every month. Ethiopia has also trained SPLA officers, pilots, technical experts and engineers in Addis, and has sent officers and non-government security experts to Juba to support the transformation of the South Sudanese army. In turn, South Sudan buys small arms and ammunition as well as refurbished tanks and other military equipment from Ethiopia. Relations between Juba and Addis Ababa have broadened to include new agreements on trade and economic development, telecommunications, housing, electricity, transport and security. Ethiopian Airlines, one of the top carriers on the continent, had regular flights to Juba and Malakal before the conflict erupted, and the state-owned Commercial Bank of Ethiopia has begun to operate in South Sudan. Thousands of Ethiopian business people, professionals and labourers are also helping to build the new state. In May 2012, Ethiopia, South Sudan and Djibouti agreed to construct border roads, oil pipelines and fibre-optic infrastructure connecting the three countries.²⁰

Kiir has repeatedly offered to mediate between Addis and Asmara in the Ethiopia–Eritrea conflict. Juba declared three days of mourning after Zenawi's death in 2012, and contributed \$1 million to his memorial library. In February 2013, South Sudan also announced that it would not accept the 1929 and 1959 Nile Waters Agreement between Cairo and Khartoum, and would join the camp of Uganda, Tanzania, Rwanda, Ethiopia and Kenya to create a new framework on the utilisation of the Nile.

Relations with Eritrea

Following Italy's defeat in the Second World War, Eritrea became a protectorate of the United Kingdom. In 1952 a UN resolution turned Eritrea into an autonomous region within the Ethiopian federation. Ethiopia's full annexation of Eritrea as a province 10 years later sparked a violent 30-year struggle for independence that ended in 1991. Following a referendum, Eritrea finally became an independent state in 1993.

Ethiopia and Eritrea had enjoyed good relations, with the Eritrean port of Assab handling about 90% of Ethiopia's exports, until the Ethiopian-Eritrean border war of 1998–2000, which severed economic ties between the two countries. Tensions between

them remain high. Avoiding direct confrontation, Eritrea backs anti-Ethiopian armed groups as proxies in its long-standing conflict with Ethiopia. Ethiopia also officially supports the Eritrean opposition and rebel groups.

In 2009 Ethiopia supported and sponsored sanctions against Eritrea for backing the Islamist rebels attempting to overthrow Somalia's internationally backed Transitional Federal Government and battling the AU Mission in Somalia (AMISOM). The UN Security Council (UNSC) imposed sanctions on Eritrea in 2009 and expanded them in December 2011.²¹ The Ethiopian government blames Asmara for destabilising the region, and arming and hosting rebel groups that seek to overthrow it. In 2011 Addis Ababa announced that it would start taking more active steps against Eritrea, using all the means at its disposal to force the Eritrean government to change its ways or, failing this, remove it from power.

In January 2012 the abduction and killing of tourists in the north-eastern region of Ethiopia bordering Eritrea by the Afar Revolutionary Democratic Unity Front (ARDUF) escalated tensions. Ethiopia accused Eritrea of supporting the ARDUF. In March 2012, Ethiopia announced that it had attacked three military bases inside Eritrea used by rebels. In April 2012 Zenawi accused Eritrea of abducting more than 100 youths mining for gold in a border area. The Ethiopian government accuses Asmara of arming and training Ethiopian rebel groups, including the Ogaden National Liberation Front, the Oromo Liberation Front and the ARDUF. In March 2014 the Ethiopian government accused Eritrea of involvement in the South Sudanese crisis.²²

Relations with Kenya

Ethiopia has warm relations with Kenya. During the 1950s' Mau Mau rebellion against British colonial rule, Kenyan freedom fighters were able to operate from Ethiopian territory across the shared border. Ethiopia appointed its first ambassador to Kenya in 1961, and Kenya opened an embassy in Addis Ababa six years later. Desalegn was the first head of state to visit Kenya after the new administration of President Uhuru Kenyatta took office in April 2013. Kenyatta described relations between the two countries as 'warm and cordial', and added that he would work to enhance Kenya's long-standing friendship with Ethiopia. Kenya and Ethiopia have a defence pact and work together on revising border controls to encourage trade, ease inter-ethnic tensions, and disrupt illicit small arms trade.

In March 2014 Kenyatta made a high-profile four-day official visit to Ethiopia. The visit included a delegation of several ministers and a group of top Kenyan business people. The two governments signed numerous economic and strategic agreements and pledged to fully implement the Special Status Agreement – the highest level of relations the countries can have with another, signed in 2012. Other agreements include partnership in key sectors of the economy, namely trade, investment, and infrastructure and food security. Kenyatta said that Kenya was looking forward to benefiting from the hydroelectric power that will become available from Gilgel Gibe III while Ethiopia's Desalegn announced his country was ready to 'work together to integrate the two nations in telecommunications, power, roads and railways infrastructures'.²³ An agreement has been reached to export 400 MW of hydroelectric power from Gilgel Gibe III.

On 4 March 2012, the construction of Lamu Port in Kenya was officially launched by the then Kenyan President Mwai Kibaki, Kiir and Zenawi. The Lamu Port–South Sudan–Ethiopia Transport (LAPSSET) Corridor is one of the fruits of this relationship.

The two countries often collaborate on major issues under IGAD's framework, such as on the Somali conflict and peace and security issues in the Horn. During the March 2014 visit the two countries further agreed to inaugurate a Co-operative Framework Agreement that would establish a Joint Lake Turkana, Omo and Dawa Rivers Basins Commission to manage their resources to international standards.

Relations with Djibouti

Djibouti formed part of the territory ruled by the Ethiopian monarchy until 1887. An agreement between the Ethiopian Emperor Menelik II and France recognised Djibouti as part of the French administration. Diplomatic relations between Ethiopia and Djibouti were established in 1984, and in 1991 the Ethiopian and Djiboutian governments signed a Treaty of Friendship and Co-operation. Since then, the two countries have signed more than 30 agreements. About 70% of traffic through the Port of Djibouti comprises imports to and exports from Ethiopia. Ethiopia and Djibouti have a free trade zone on their border for goods worth up to \$285 (ETB²⁴ 2,000).

Ethiopia enjoys good relations with Djibouti. Djibouti had a brief border conflict with Eritrea in 2008, which is still unresolved. In 2011, Ethiopia and Djibouti lobbied the UNSC to step up sanctions against Eritrea. In February 2012, Ethiopia, Djibouti and South Sudan signed a memorandum of understanding for the construction of an oil pipeline via Djibouti. In May 2012, a joint co-ordination commission for Ethiopia, Djibouti and South Sudan held its first technical meeting to discuss the development of cross-border roads, the oil pipeline and fibre-optic infrastructure.

The 12th annual Ethiopian-Djibouti Joint Commission Ministerial Meeting held in July 2013 reached agreements on trade, investment, infrastructure, security and other issues. In the words of Ethiopian Foreign Minister Dr Tedros Adhanom, Ethiopia and Djibouti have had and continue to have 'excellent and exemplary ties in all spheres'. The two countries are executing joint mega projects, including railway and road infrastructural development, the construction of new ports, power and water services.²⁵ Ethiopia already exports 65 MW of electricity and clean water to Djibouti. A multimillion-dollar new railway between Addis Ababa and Djibouti was more than 30% complete as of April 2014.²⁶

Relations with Somalia

Relations between Ethiopia and Somalia have been marred by a series of border wars and conflicts. The first war took place from 1960–1964, followed by the 1977–1978 Ogaden War. In 1982 there was also a border clash between the two states. Recent relations between the two countries have been security oriented.

The Somali ethnic group is the third largest group in Ethiopia and Ethiopia shares its longest borderline with Somalia. The Ethiopian Somali regional state has been characterised by instability and rebellion and was also affected by the spillover of Somalia's long-running state of lawlessness. In 2006, following the fast rise and expansion of Islamist groups in Somalia, Ethiopia sent a military force into Somalia to assist the Transitional Federal Government against the insurgent Islamic Court Union and other Islamist militias. The Ethiopian forces officially remained in Somalia until 2009. Despite endorsement from IGAD and the AU, the intervention remains controversial in light of international law and

efforts to resolve the crisis in Somalia. In February 2012, Ethiopia sent a force back into Somalia that helped Somali troops to recapture Baidoa, the third biggest Somali city, from al-Shabaab insurgents. The Somalia government, which hopes to create a federal structure in 2014, also works with Addis Ababa to learn from the Ethiopian experience.

In January 2014 Ethiopia officially joined AMISOM after UNSC Resolution 2124 authorised an additional force of over 4 000 troops. In mid-February 2014 ministers from Ethiopia and Somalia signed an agreement to enhance their partnership on security, business and information in the presence of Somali President Hassan Sheikh Mohamud and Ethiopia's Desalegn in Addis Ababa.

Relations with Somaliland

Ethiopia has also developed strong ties with the autonomous administration of Somaliland. Somaliland is an autonomous region in Somalia, based on the history and territory occupied by the colonial British Somaliland protectorate. Somaliland relies on Ethiopia for about 60% of its trade, and the relationship shows the peace and prosperity dividends to be gained from integrated economic linkages. Ethiopia plans to increase its use of the port of Berbera and to improve the road corridor to the Gulf, in order to address informal cross-border livestock trade. In recent years, scores of Somali cadets have been trained in Ethiopian military and police colleges. Ethiopia and Somaliland are also negotiating an agreement over the supply of electricity to Somaliland's capital of Hargessa.

Somaliland's President Ahmed Mohamud Ahmud and Foreign Minister Dr Abdullahi Omar visited Addis Ababa in 2012 to strengthen ties with Ethiopia on economic, diplomatic and security issues and seek the Ethiopian government's support for international recognition of Somaliland as a sovereign country.

ETHIOPIA, THE COMESA FTA AND REGIONAL ECONOMIC RELATIONS

The Ethiopian economy has changed significantly over the past eight years. The traditionally dominant agricultural sector is increasingly losing ground to a rapidly growing services sector. According to official statistics, real GDP growth averaged 11% over the past eight years, making Ethiopia the fastest growing non-oil-producing country in Africa. The government plays an active role in economic development by channelling foreign investment and other financial resources to the sectors it believes can contribute most to economic growth. It has invested heavily in infrastructure, education and health, which has created an environment conducive to economic growth. However, this has also fuelled rampant inflation, which peaked at 60% in 2008.

The productive sectors (agriculture and industry) have grown significantly, although their share of GDP growth has not increased as expected. In 2012, out of the 8.5% annual GDP growth, the agricultural sector contributed 1.9% while the industrial sector contributed only 1.3%. Instead, growth was largely driven by the services sector, which contributed 4.7% out of the 8.5%. The growth of the agricultural sector has been attributed to cereal crop production, and the growth of the industrial sector to construction. The growth of the services sector has been driven by wholesale and retail trade, along with

real estate and rental services. As noted earlier, the construction boom has largely resulted from massive government investment in infrastructure. The growth in the services sector, in turn, has been attributed to growth in both external and internal trade.

External trade and economic growth have mutually reinforced each other. Increasing government investment stimulated the demand for imported capital goods, and increased agricultural production boosted exports. The total value of imports is almost four times higher than that of exports, however, due to the difference between high value capital imports and relatively lower value agricultural exports. Except for the past two years, the value of imports grew by 20% a year on average; and the value of exports by 24% a year on average. The trade deficit has grown, leading to foreign exchange constraints. This has been financed from surpluses in private transfers (remittances) and the capital account (external loans and grants).

Capital goods – especially machinery and motor vehicles – have dominated imports over the past two decades (32%), followed by consumer goods (29%), fuel (16%), and raw materials and semi-finished goods. This pattern is likely to continue for the next decade. Agricultural products will continue to dominate exports for the foreseeable future. This is because of growing export-oriented foreign investment in the agricultural sector, while it will take time for the industrial sector to start exporting high-quality manufactured goods. Capital goods will probably continue to dominate imports, as the government wants to continue investing in infrastructure and manufacturing capacity.

Regional economic co-operation in the Horn extends beyond trade liberalisation and could also involve investment in infrastructure and aid. Much of the current literature on trade and its contribution to development deals with the implications of trade liberalisation. Trade liberalisation is meant to link national economies with the rest of the world, either bilaterally or multilaterally. Although trade is a major aspect of economic co-operation, it isn't the only one. In recent years the Ethiopian government has taken steps to enhance non-trade aspects of economic co-operation, which could strengthen economic ties among the countries in the region. As in the case of trade, this is aimed at utilising available resources in a mutually beneficial way.

The COMESA FTA presents the most immediate challenge and opportunity for Ethiopia in its economic relations with the region. The UN Development Programme, in collaboration with the Ministry of Trade and Industry, has commissioned two studies aimed at establishing the potential impact of FTA membership. These are by no means exhaustive accounts of all the possible impacts of joining the FTA and more studies are needed. The findings presented here also have to be treated with caution as the studies have not yet been officially released and minor changes could still be made. However, they do identify the major issues.

The first study deals with the implications of joining the tripartite FTA, which is open to members of COMESA, the East African Community (EAC) and the Southern African Development Community (SADC). The second deals with the competitiveness of Ethiopian manufacturing firms in the context of the COMESA FTA. The findings are discussed further below.

COMESA and its members

COMESA was established in Kampala, Uganda in November 1993, and the treaty was ratified on 8 December 1994, replacing a Preferential Trade Area created in 1981. Its main objectives are to:²⁷

- achieve the sustainable growth and development of member states by promoting a more balanced and harmonious development of production and marketing structures; and
- promote the joint development of all fields of economic activity and the joint adoption of macro-economic policies and programmes in order to raise the standard of living of its peoples, and foster closer relations among member states.

Besides these major objectives, COMESA encourages investment in and the sharing of science and technology suitable for development; promotes peace and security; promotes common positions in international forums; and works towards realising an African Economic Community. COMESA thus plays a wider role than just promoting free trade among its members, and the treaty also focuses on specific sectors such as trade, agriculture, energy and industry, transport and communications.

More specifically, COMESA membership commits countries to a wide spectrum of economic engagements with other member states. These include removing both tariff and non-tariff barriers to trade goods produced by member states. It also harmonises the tariff charges to non-COMESA members through the formation of a customs union, and entails the removal of barriers to free movement of capital and investment within the FTA. These objectives are achieved by harmonising transit costs and licences, along with instituting trade insurance and bond guarantee schemes. In general, reducing the cost of trade and investment is at the heart of these agreements.

To complement these cost reductions in trade and investment, reforms in other supporting sectors is expected to further reduce the cost of doing business among members. Some of the multi-sectoral programmes aimed at reducing the cost of doing business are liberalising air transport and telecommunication sectors to reduce transport and communication costs; developing a regional competition policy; and establishing a regional payment and settlement system. In addition, the African Trade Insurance Agency to cover political risks and the Comtel project to reduce the cost of telecommunications have also been established.

When assessing membership countries need to take into consideration these multifaceted requirements and trade-offs.

COMESA has 19 members, namely Burundi, Comoros, Djibouti, the DRC, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe. Six other countries – Angola, Lesotho, Mozambique, Namibia, Tanzania and Botswana – are eligible for membership.

Not all COMESA members are members of its FTA. The countries that have not yet joined the FTA are the DRC, Eritrea, Ethiopia and the Seychelles. They cite a range of reasons for their reluctance to join, including the FTA's actual potential for boosting trade; possible revenue losses as a result of the FTA; sensitive products; and the protection of key industries. Ethiopia is working towards joining the FTA, and has conducted studies

into the implications of doing so. The major findings of these studies are presented in the section below.

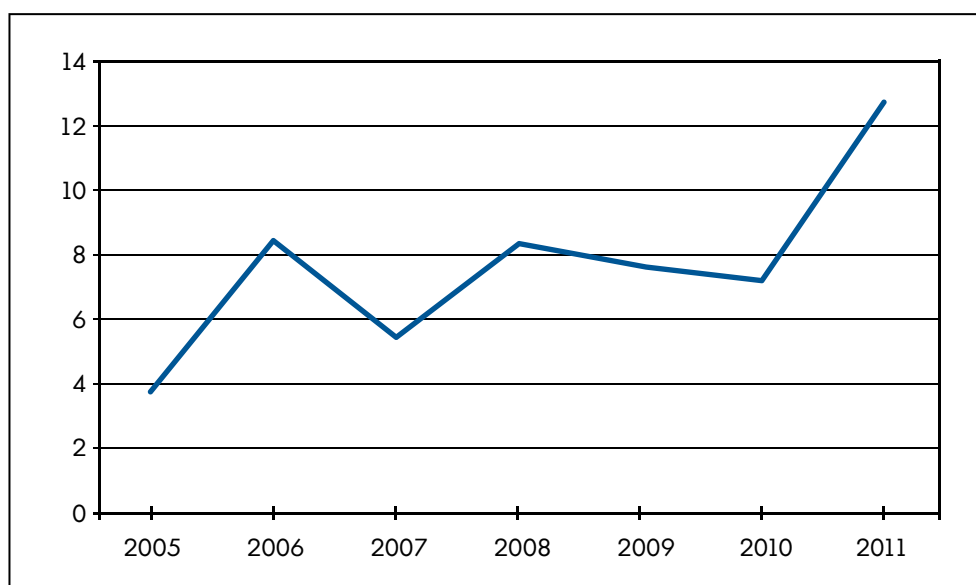
Although Ethiopia has not yet joined the COMESA FTA, it has played an active role in COMESA's formation and leadership. In 2002, Zenawi was elected to chair COMESA for a one-year period. Ethiopia also introduced a 10% tariff reduction on goods imported from COMESA member states. Ethiopia is one of six countries chosen for an oil seed development project in the region. It has also been chosen as COMESA's centre for producing livestock medicine, the site of the COMESA leather institute, and a regional site for manufacturing hand tools and spare parts.

All this confirms Ethiopia's active participation in COMESA. However, membership of the FTA is obviously a key issue.

Official trade data, Ethiopia and COMESA

The volume of trade between Ethiopia and other COMESA member states is small. In 2005–2011, the Ethiopian Revenue and Customs Authority estimated that revenue from exports to COMESA members amounted to 4.2% of total export revenue, and the cost of imports from COMESA members amounted to 3.7% of total import costs. Significant imports from COMESA member states included tobacco (15% of total imports), soap and polish (12%), petroleum (8.2%), and fertiliser (7%). While these volumes are small, some of these imports – notably petroleum and fertiliser – are essential. Moreover, the COMESA share of total imports has been increasing. For example, the share of petroleum products imported from COMESA countries increased from less than 4% in 2005 to 12% in 2011. This is due to the increasing role of Sudan in supplying petroleum products to Ethiopia.

Figure 1: The share of Sudan in supplying petroleum products to Ethiopia (%), 2005–2011



Source: Ethiopian Revenue and Customs Authority, Import Export Info 2011, Addis Ababa, http://www.erca.gov.et/index.jsp?id=import_export_info, accessed January 2012

There is therefore significant potential for growth in trade among COMESA member countries. Besides this, as COMESA member states are developing countries they have the potential to develop new sectors in which they have comparative advantages, thus creating new trading opportunities among themselves. As such, while trade volumes are likely to remain modest in the short term, there is scope for expansion.

In line with trade volumes, tax revenues from imports from COMESA countries comprise a relatively small portion of total tax revenue from imports (thereby lessening the potential revenue loss from joining the COMESA FTA), but a slightly higher one than COMESA's share of the value of total imports. This is because taxes collected from the import of petroleum products from Sudan accounted for 62% of total petroleum import taxes. Ethiopia imported close to 64% of petroleum products from Saudi Arabia, but the import taxes from these imports only accounted for 17% of tax revenues on petroleum imports tax. Ethiopia's second biggest source of petroleum is the United Arab Emirates, with a 22% share. In this case, taxes only account for 10% of total tax revenue from petroleum imports. Otherwise, taxes collected from COMESA imports roughly match the percentage value of the imports themselves.

Ethiopia's manufacturing sector and the FTA

One of the two studies on the potential impacts of joining the COMESA FTA looks at the Ethiopian manufacturing sector.²⁸ According to this study, Ethiopia's industrial sector remains weak despite the country's rapid economic growth, only accounting for about 11% of GDP. Manufacturing, as a component of the industrial sector, contributes only 5% to GDP and less than 10% to total export earnings. Moreover, industrial and allied activities account for less than 5% of total employment. According to the manufacturing value added (MVA) compounded rate of growth calculated by the UN Industrial Development Organization and the UN Conference on Trade and Development, Ethiopia's manufacturing sector falls in the infant stage, the lowest of five categories. Six other COMESA member states – Eritrea, Ethiopia, Djibouti, Malawi, Rwanda and Burundi – also fall in this category, but the others fall in higher categories. This shows that Ethiopia's manufacturing sector is relatively weak, even within COMESA.²⁹

The largest subsector in the large and medium manufacturing sector is food and beverages (adding 32% to total value). This is followed by non-metallic mineral products (10%). The other major subsectors are chemicals, rubber and plastic, metal products, textiles, leather and furniture. Most of these are agro-processing sub-sectors that source their inputs from the agricultural sector. This focus on the agro-processing sector is intentional and spelled out in most development strategies. Agro-processing industries create more sectoral linkages, but the actual value of production is less than those of other large-scale manufacturing sectors. This has implications for the competitiveness of the sector.

This study uses three measures to assess the competitiveness of Ethiopian manufacturing firms, namely total factor productivity, technical efficiency, and unit cost and performance indicators. As regards total factor productivity, tobacco, clothing apparel, basic chemicals, furniture and other industries achieve higher scores. In general, it was found that output responds more to raw material inputs than other factors of production. The productivity of most manufacturing firms is poor. Most operate far below optimal

levels, and there is a lot of room for improvement without further investments being needed. The footwear industry contains both the most efficient and inefficient firms. In the food industry, edible oil, macaroni and pasta manufacturing are inefficient. Similarly, unit cost-based indicators show that 50% of manufacturing firms are not competitive, even in a protected environment.

Performance indicators also show that the manufacturing sector is relatively uncompetitive. This has been attributed to various external factors, including certain trade practices, tariff reductions as a result of trade liberalisation, and product dumping, especially in edible oil, clothing apparel, footwear, and electronics. Under-invoicing and contraband are other factors considered to have affected the manufacturing sector. Internal factors include a shortage of human capital and low levels of technology, resulting in poor-quality products. Other challenges include poor entrepreneurial and business development skills, limited financial services, and a weak contract enforcement and legal framework.

The manufacturing sector has, however, improved over the past few years, and most of the challenges cited above will probably be progressively addressed in the future. However, at present, the manufacturing sector is not internationally competitive and only competitive regionally with regard to just under half of the FTA signatories.

The implications of joining the FTA

The second study assesses the implications of Ethiopia joining the Tripartite FTA (TFTA). The TFTA is open to members of COMESA, the EAC and SADC. These regional communities were formed at different times to facilitate co-operation in respect of trade as well as other areas of regional activity. The study uses a general equilibrium framework to follow the transmission mechanism of trade liberalisation within the tripartite FTA. The memberships of the three bodies overlap significantly – in fact, most countries belong to more than one regional economic community. More importantly, all but five countries are members of COMESA.³⁰

According to the study, if TFTA member countries reduce their import tariffs by 60%, 70%, 80% and 90% respectively, Ethiopia's economy would grow by 1.5%, 1.87%, 2.26% and 3.15% respectively. This would be due to increased investment and consumption resulting from increased trade. However, this positive impact would not occur across all countries, since some have different types of economies and would therefore be losers.

The study finds that the sectoral impact on the Ethiopian economy would be uneven. Given that its manufacturing sector lacks competitive advantages, it would probably contract if tariffs were reciprocally reduced by member countries. This contradicts the industrial focus of the current Growth and Transformation Plan. If the manufacturing sector contracts some workers will lose their jobs, and this loss of employment would not be totally offset by the gains in employment in expanding sectors. In contrast, household welfare improves in all the scenarios, mainly due to reductions in the prices of imported goods. Another positive finding is that trade would be diverted from non-member countries to member countries.

Countries may also negotiate terms aimed at warding off the negative outcomes of joining an FTA. This could include identifying sensitive products that should be protected on the grounds that they are either vital for growth or provide the state with vital tariff revenue. According to the study, sensitive products in the case of Ethiopia include edible

oils, apparel, rubber products, and soap. It also emphasises the importance of rules of origin, although capacity constraints may hinder their implementation.

The study concludes that although trade liberalisation would result in welfare gains, it would also result in job losses, revenue reduction and de-industrialisation. However, the results need to be regarded with caution, as they rely on a neo-classical market-clearing model that assumes that all markets are in equilibrium. In order to ensure that markets clear, closures are included in the model that may not occur in reality. Therefore, the results need to be triangulated with a descriptive analysis. It is also important not to rely on the actual magnitude of the results. However, it should be assumed that its broad findings are accurate and valid. Therefore, potential gains from trade liberalisation should be carefully considered.

As noted above, while these studies are by no means exhaustive, they are among the very few empirical studies that highlight the more pressing issues. The impact of the multisectoral programmes such as liberalisation of the financial, transport and communications sectors are by themselves major study areas. They entail reforms whose impact goes beyond trade and investment.

In the case of Ethiopia, the protection of some sectors is deeply entrenched in the development ideology of the government. The developmental state principles that advocate a very active governmental role in allocating resources are made possible through controlling financial and foreign exchange flows. This implies that the liberalisation of the financial sector is not just a trade and investment issue. In addition, the highly profitable government-owned telecommunications and air transport sectors are considered by the government to be cash cows that generate the development resources it needs.

Therefore, apart from the direct implications presented above, these considerations also affect the country's decision to join the FTA. This, however, does not mean that there is no regional economic engagement. On the contrary, the government is taking an active role (as it does in the whole economy) to bilaterally design projects with neighbouring countries to build infrastructure.

ECONOMIC COLLABORATION BETWEEN ETHIOPIA AND ITS NEIGHBOURS

Over the past few years, the Ethiopian government has been planning projects involving its neighbours, either in respect of investment or consumption. They range from small infrastructure projects to large highway projects.

Ethiopia and South Sudan

As noted earlier, Ethiopia has established strong diplomatic ties with the newly formed nation of South Sudan. This started even before South Sudan became an independent state. These relations have been formalised, and the two countries have agreed to collaborate in various areas. In late February and early March 2012, a joint ministerial committee signed a series of agreements. Among others, the two countries agreed to co-operate in the areas of transit, transport, export, communication, education and capacity-building. They are also actively promoting increased trade.

Ethiopian businesses are increasingly investing in South Sudan. As the two governments start to pave the way towards further co-operation, Ethiopian businesses have already begun to invest in South Sudan in anticipation of increased oil revenues, which would spill over into the private sector. Current investors include construction companies and service providers. Although the extent of these investments is not known, the trend is clearly observable. Among others, the National Oil Company, the largest fuel retailer in Ethiopia, has announced plans to invest in South Sudan. The Commercial Bank of Ethiopia opened a branch in South Sudan even before independence, and an Ethiopian private bank, United Bank, also plans to open a branch in South Sudan.

Regional energy projects

Ethiopia is also planning the collaborative exploitation of regional energy resources. Among others, it wanted to source all its petroleum products from Sudan by 2010. Although this did not happen, its oil imports from Sudan have increased significantly, from 4% in 2005 to more than 12% in 2011. This growth in Sudan's share of Ethiopia's petroleum imports is likely to continue once political stability is achieved. Among others, this will give Sudan an increased interest in maintaining regional peace.

Ethiopia is also planning to supply neighbouring countries, including South Sudan, with electric power. Given the current borders between South Sudan and Sudan, 75% of oil reserves are located in South Sudan, while most of the transport and supply infrastructure is located in Sudan. The government of South Sudan has expressed its intentions to build the necessary infrastructure, and electricity from Ethiopia would help it to do so. Ethiopia has a hydropower generation capacity of 45 000 MW. It is currently generating about 2 000 MW, and intends to generate 10 000 MW by 2015. Some of this power is earmarked for neighbouring countries (Sudan, Djibouti and Kenya) at relatively low prices. Ethiopia has already started exporting hydropower to Sudan and Djibouti. It has also started negotiations with Kenya and South Sudan over the supply of hydropower.

When Ethiopia and South Sudan develop their respective energy sectors, there could be some substitutability that could threaten bilateral trade (as Ethiopia increases its reliance on hydropower, and South Sudan increases its reliance on fuel). However, this will not be complete, as these two forms of energy are not substitutable in all sectors (such as transport, lighting, etc.). The development of the two countries would increase demand for both forms of energy, which would in turn create more room for co-operation.

Regional transport corridors

Ethiopia, Kenya and South Sudan have also embarked on joint transport projects that will enhance economic co-operation. In November 2011, Ethiopia and Kenya signed a memorandum of understanding to construct the Addis Ababa–Mombasa highway. The African Development Bank approved a loan of \$743 million for the project, which has been divided between the two countries. The highway will enhance regional integration, and will also be linked to the trans-Africa highway. It will allow Ethiopia to use the port of Mombasa, and increase trade ties with southern African countries.

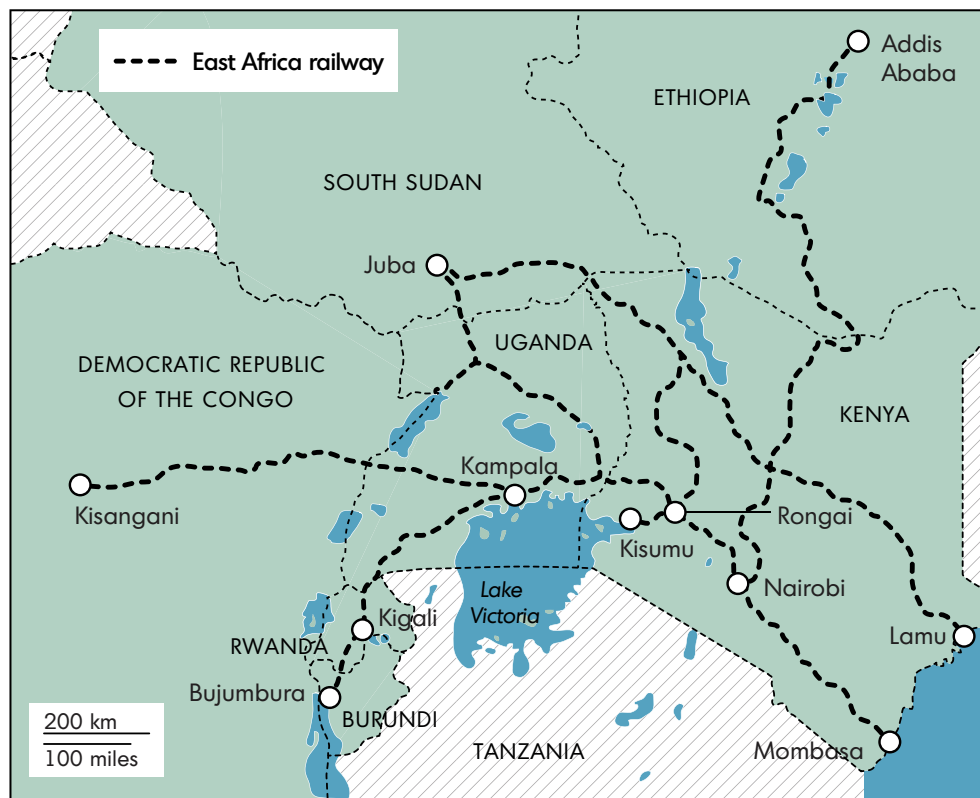
Another notable project is the LAPSET Corridor, which will stretch from the port of Lamu in Kenya to South Sudan and Ethiopia. It will comprise a 100 m-wide highway, a

high-speed railway, and oil pipelines (to South Sudan). The route starts at Lamu Port and splits into two to reach Moyale on the border between Kenya and Ethiopia, and Nakodok on the border between Kenya and South Sudan. To connect to the West African coast, the highway will link up with the Central African Republic–Cameroon highway. The Moyale highway will continue through Addis Ababa to Djibouti, and the South Sudan highway through Sudan to Port Sudan. Kenya, Ethiopia and South Sudan launched the project on 2 March 2012. Upon completion, this corridor is expected to enhance the economic growth of all three countries by facilitating trade, investment and tourism.

If successfully completed, the \$254-million project will bolster economic integration not only among Kenya, South Sudan and Ethiopia but also with central and western African countries. Financing such a big project will be a challenge, but commitments have already been made. In May 2012, the African Development Bank agreed to contribute \$12 million. It is scheduled for completion by 2016.

In May 2014, while Chinese Prime Minister Li Keqiang was visiting Kenya, an agreement was signed in Nairobi between the Chinese government and the governments of Kenya, Uganda, Rwanda, Burundi and South Sudan to build a new railway line in East Africa. The plan also includes a line connecting Addis Ababa with the bigger East African railway.

Figure 2: New East African railway (forming part of the LAPSET Corridor)



Source: BBC, 2014, <http://www.bbc.com/news/world-africa-27368877>

CONCLUSION

Amid complex political and security dynamics, Ethiopia has actively sought to enhance economic co-operation with its neighbours. Over the past decade, the country has recorded impressive economic growth in all sectors, with the service sector taking a leading role. Exports have grown by 24% a year over the past few years, and imports by 20%. Imports have been dominated by capital goods, which are essential for economic growth.

Although Ethiopia has not yet joined the COMESA FTA, it is a member of COMESA and has helped to establish and develop COMESA. COMESA was established with the broader objective of enhancing development among member states, and not just trade liberalisation. Joining the COMESA FTA has been a major policy issue in Ethiopia, and the government, along with its development partners, commissioned two studies to assess the potential impacts. Some of the results are reflected in this paper.

In general, trade among Ethiopia and COMESA member states has increased, with new trade avenues opening and strong potential for further growth. The commissioned studies show that most COMESA member states have small and underdeveloped manufacturing sectors, and that Ethiopia is among them. Its manufacturing plants are uncompetitive and inefficient, which means that the sector is not ready to export quality goods at competitive prices or face sudden competition.

The studies also show that trade liberalisation will lead to both a loss of jobs and job creation, although the loss will not be fully offset and de-industrialisation may occur. Overall welfare will be enhanced by cheaper imports, which may lead to higher levels of consumption. However, the government will lose a significant amount of revenue due to a reduction in tax revenue from imports.

In sum, the studies found that although membership of the COMESA FTA would enhance general welfare, the negative impacts on the manufacturing section as well as job and revenue losses would threaten economic growth. While these findings need to be triangulated against other indicators, they do identify the correct trends. These studies are, however, not exhaustive.

Besides trade, Ethiopia's bilateral relations with neighbouring countries are resulting in projects that enhance economic integration; relations with South Sudan in the areas of trade and investment are particularly significant. Ethiopian businesses are investing in South Sudan in anticipation of rapid economic growth due to new oil revenues. Ethiopia plans to source petroleum mainly from South Sudan, which makes it important to maintain good diplomatic relations with that country. It also plans to sell hydropower to Kenya and South Sudan. South Sudan, Kenya and Ethiopia have expressed their commitment to LAPSET, which will significantly enhance economic integration among these three countries.

To conclude, while trade liberalisation will have costs and benefits, Ethiopia is already bolstering regional development by initiating more sustainable projects that will enhance regional economic integration. Any benefits to be gained from joining the FTA would largely depend on the specific FTA agreements between Ethiopia and other member states. As noted above, the agreements should take into account changing comparative advantages and sensitive products. Measures should also be taken to mitigate the negative impacts on the manufacturing sector.

In addition to these specific measures related to trade, Ethiopia needs to consider the co-ordination of development plans with the economic integration measures implied by COMESA membership. This includes long-term plans for progressively liberalising the different sectors (finance, transport and communication) in a way that achieves both the goal of reducing the cost of doing business and the development objectives. On the positive side the development of bilateral and multilateral infrastructure projects should be strengthened to further reduce transaction costs and enhance the volume of trade between the member states.

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