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Editor's note

Horn of Africa is a region known for political instability, internal conflicts, incessant famine and food insecurity, and massive displacement. This condition in turn generated other threats and vulnerabilities impacting the lives of all in the region. Due partly to this problem, and conversely, the increasingly felt geopolitical importance it conjures up, it has caught the attention of many local and global actors. Among others, the role of USA and Turkey in the region clearly stands out. The USA has been engaged in what it called a fight against Islamic terrorism and radicalism in Somalia. However, realizing it could not carry out this solely, a staunch supporter and partner was sought after in the region. It was with Ethiopia under the EPRDF regime that they undertook joint military operations in Somalia, leading to massive chaos and counterproductive consequences. Turkey, on the other hand, took a different approach to engaging with the Horn. Unlike USA, Turkey has been actively engaged in humanitarian actions and economic investments in the Horn of Africa in general and Somalia in particular.

A relatively similar geopolitical fluidity characterizes other countries of the Horn, particularly Djibouti. With the increasing militarization of this country, arising out of its strategic location in the Red Sea, by many foreign political powers, such as Arabs, the West, and Asia, the future trajectory of countries in the region becomes more unpredictable and much less optimistic. It is in this geography of unpredictability, chaos, and incessant foreign actors' presence, the Horn of Africa Strategic Studies Center (HASS) was born. As a think-tank interested in the region, it hopes to conduct timely and directly relevant researches and analysis making policy-relevant contributions, especially in the areas of education, history and culture, religion, economy, and politics. Based in Ankara, Turkey, it plans to work on three major strategic directions: firstly, inform and influence through researches and policy recommendations; second, enhance and develop capacities at different levels; and finally, pave the way for more organic regional integration in the Horn of Africa.

Since its establishment in May 2016, HASS organized many conferences and seminars addressing the various challenges and opportunities surrounding the Horn of Africa. Furthermore, HASS, with a research funding from Turks Abroad and Related Communities (YTB), carried out a research on Turkey-Africa relation in the area of education. Particularly, it examined the effectiveness of Turkish scholarship scheme (Tukiye Burslari) in capacitating students, and thus, countries of the Horn of Africa.

As an outlet of its research engagements, HASS, with this first issue, begins to publish its quarterly bulletin. We hope that HASS Quarterly Bulletin will contribute to the ongoing social, cultural, religious, economic, and political debates and knowledge production in the Horn of Africa. The bulletin will typically include primary-empirical researches, book reviews, commentaries, review essays, and sometimes directly relevant interviews. In this first volume and first issue, the bulletin mainly included recent political and economic issues affecting the region. The essays in this asked salient questions: How does regional integration mutually benefit the Horn of Africa

countries? Can a shift in foreign policy tools address the deadly tensions of the Horn of Africa neighbors? Is privatization the perceived quick fix for Ethiopian economy? How did Ethiopia outperform Eritrea economically?

Through analyzing these questions, the authors set the contours of the future in terms of regional integration, mutual understanding, and economic rapprochement in Ethiopia and the Horn. In reference to the first question, Abdulkadir points out the importance of regional integration in mutually benefiting of the Horn of Africa countries. He also explains the remarkable role Ethiopia could play in this regard given its strong social, economic and political ties with countries such as Sudan, Djibouti and Kenya. Beginning with foreign policy debates and arguing the Ethio-Eritrea relations as a principal manifestation of antagonistic policy orientation in the past two decades, Muzeyen sees new hope for peace among the two counties, following the coming into power of the new PM of Ethiopia, Abiy Ahmed. Abdu Seid, in his part, explains whether privatization is a quick fix for Ethiopian economy. He deals with the theoretical and historical background of privatization in Ethiopia, the challenges that obstruct privatization, and finally, recommends the importance of amending business laws towards achieving private participation. At the end, Abdurezack compares the economic conditions of Ethiopia and Eritrea before and after the Ethio-Eritrean conflict in 1998. He expounds that the political conflict between the two countries, and the autocratic nature of governments in these countries, perturbed the two sisterly and brotherly people, severely hurting Eritreans though.

Mohammed Ali, HASS Editorial Board chairperson

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Revitalizing Regional Economic integration in the Horn of Africa and the ongoing political changes in Ethiopia

Abdulqadir Adem

Countries in the Horn of Africa have been engaged in formal regional integration activities since the first half the 1980s, after the establishment of the Intergovernmental Authority for Drought and Development (IGADD), the precursor of IGAD. The initial purpose was to combat desertification, ensure food security, and maintain peace and security through coordinated and harmonized policies, programs, and actions. This was gradually developed and expanded through widening the scope and mechanism of integration from an environment and security-oriented approach to a full-fledged economic, political, social, and cultural integration. This reinvigoration in the region was inspired partly by the establishment of the African Economic Community (AEC) in 1994 by the Abuja treaty and regional and continental protocols that followed the AEC.

In the last 30 years, countries in the Horn of Africa have taken diverse political and economic measures to integrate, primarily, their economies. Bilateral and/or multilateral protocols signed to reduce or remove tariffs on commodities and services; ensure free movement of labour (talent mobility); developing cross-border infrastructure projects; harmonizing monetary and fiscal

policies; etc. Compared with the level and process of integration in other regions of Africa, the achievements in the Horn of Africa are very limited. The integration processes in the region has stalled for the last few years and were limited to the signing of protocols, which in many cases, are not ratified. Hence, regional integration endeavours did not deliver the high expectation of the people and governments of the Horn of African countries and that of the international community in mitigating poverty and ensure rapid economic growth.

Lack of strong political will is considered to be the single most important bottleneck to the regional integration in the Horn of Africa. The region has witnessed internal and cross-border conflicts and distractive wars in the last half a century. The Ethio-Somalia war in the late 1970s and early 1980s, the diplomatic row between Sudan and Ethiopia in 1995, the Ethio-Eritrean and Eritrea-Djibouti border conflict in 1998 and 2008 and other conflicts have slowed down the regional integration and cooperation and highly curbed achievements thereof. Moreover, the protracted civil wars in Ethiopia, Sudan and Somalia have diverted the attention of the regional governments towards conflict resolution and security issues at the cost of regional economic integration and specifically intra-regional trade and investment.

Factors driving regional integration

Regional economic integration is perceived as a policy instrument to contribute to economic growth and welfare through the enhancement of trade and other forms of economic cooperation. Theories of regional integration underline the multifaceted

economic and political benefits of integration. The static and dynamic effects of integration are believed to attract Foreign Direct Investment (FDI), boost employment, promote industrialization, maximize efficiency, and encourage macroeconomic stability through harmonized fiscal and monetary policies. These and other benefits are made possible by increasing the regional market, which are otherwise small and highly fragmented. Economic integration is considered a better policy option as long as its 'trade creation' is greater than its 'trade diversion'.

Countries in the Horn of Africa have weak economies which are mainly based on small holder farming and backward agriculture. The region has a lower level of infrastructural capability to allow accelerated and deeper trade and economic integration. Intra-region trade among the countries in the Horn is one of the lowest in Africa. The region has high product concentration which indicates the vulnerability of the countries to trade shocks. Similarly, the region has a high market concentration which signifies a risk of significant loss in export earnings if partners increase trade barriers of any type. Almost all the countries in the region suffer from food insecurity, recurrent drought and famine. Faced with these and many other economic and political challenges, countries in the region need to exert more effort to integrate their economies to create economic resilience and mitigate the negative impacts of globalization and unfavourable terms of trade.

Ethiopia's role in the regional integration

Ethiopia, one of the fastest growing economies in Africa and the second biggest

economy in the Horn of Africa after Sudan, holds a significant position in the political economy of the Horn of Africa region. Ethiopia constitutes more than 40% of the population and near a quarter of the land mass of the region. Geographically, Ethiopia is located at the centre bordering all the countries in the region except Uganda. In the last quarter, Ethiopia's annual average growth exceeded 8% which is the highest in Africa and also internationally. A landlocked country, highly dependent on neighbouring countries to meet its port demands, has a lot to offer to promote economic integration in the Horn of Africa region.

Ethiopia has strong economic, political and social ties especially with Sudan, Djibouti, and Kenya. Relations with Eritrea remained hostile since 1998 due to a border clash. Similarly, relations with Somalia remained antagonistic after Ethiopian forces crossed to Somalia under the disguise 'self-defence against some forces which are threats to national security'. The Ethio-Sudanese relation is tied eternally to the Nile River and different areas of cooperation. The annual trade between the two countries is increasing due to better trade facilities and the currency swap agreements made in 2017. Ethiopia uses Port Sudan for its international trade and imports oil from Sudan. Movement of people between the two countries is increasing especially for investment and tourist purposes. Alongside the formal trade, the countries have high rate of informal cross-border trade especially in cattle.

Similarly, the Ethio-Djibouti bond is strong. Djibouti Port is the lifeblood of the Ethiopian economy given the fact that most of Ethiopia's imports and exports are made.

On the flip side, Djibouti depends on Ethiopia for electricity, water, and other industrial and agricultural products. Number of tourists is increasing between the two countries. The growing bilateral economic and social relations are further strengthened by air and land transportation, including the recently upgraded 756 Km long Addis-Djibouti passenger and cargo electrified rail way.

The first week of April 2018 marked a paradigm shift in Ethiopian political and economic travesties with the coming to power of Abiy Ahmed Ali as the 16th Prime Minister of the country. He came to power following years of domestic political and social turmoil having political and economic impacts at the regional level and beyond. PM Ahmed inherited a government that ruled the nation for 27 years with iron fist policy and indulged in gross human right violation. Ahmed took swift measures to calm domestic politics and to promote economic stability. Within a period of three months, the primer has paid maximum attention to regional cooperation and integration issues. His staunch support for regional integration is demonstrated by his visits to all neighbouring countries and his enthusiastic expression of Ethiopia's renewed interest for regional integration in the Horn of Africa. To this effect, Ethiopia made agreements with Djibouti and Sudan aiming to jointly develop sea ports and foster invest on joint infrastructure projects. Similarly, Ethiopia and Somalia agreed to work towards a free trade and the gradual move for full economic integration.

In his regional tours, PM Ahmed clearly communicated messages of peace, cooperation, and brotherhood was warmly received by the people and governments of the region and the international

community. His regional tours reshaped the longstanding hostile attitudes of the Ethiopian political elites on the strategic importance of neighbouring countries. Ethiopia's renewed interest for more intra-regional trade can be taken as a harbinger for accelerated and deeper regional integration. There is a growing optimism for higher intra-regional trade in goods and services through lower tariff rates and free flow of people. If it can be backed up with cooperative political will, Ethiopia has the economic, geographic, and demographic potential to promote the ongoing economic integration in the region.

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Can a Shift in Foreign Policy Tools Address the Deadly Tensions of the Horn of Africa Neighbors?

Muzeyen Hawas

The recent rapprochement between Addis Ababa and Asmara is a remarkable move to address the long-survived border conflict through negotiation. The reconciliation, if it is accompanied by genuine efforts, can enhance stability in the exceptionally unstable regions of the Horn of Africa.

There is an ongoing debate among foreign policy analysts regarding the nature of the tools that assure states' national interest effectively. Some experts argue for the central role of power, particularly military power, in furthering the nation's socio-economic and political expectations. For this group, states should focus on maximizing power in their foreign affairs. The magnitude of states' economic and military power rests on the principal variable of national interest. Many other foreign policy commentators, on the other hand, argue that relations among states cannot be defined only by narrow realpolitik. States promote their national interest through cooperation. States can identify their common concerns and provide appropriate solutions together. Mutual cooperation among states is noted as a principal instrument to promote nations' economic and political wellbeing.

This debate has had its implications in the making of many foreign policies in the world today. The Ethiopian case is by no means different. One can observe that the foreign policies and strategies of many of the past Ethiopian governments were founded on 'siege mentality' 'siege mentality', the tendency to view neighbouring countries as a national threat. This mentality had its impact not only on the type of Ethiopia's foreign policy partners but also on its policy instrument. During the past two decades, Ethiopia and its Horn neighbors tried to protect their interests by destabilizing and endangering the security of one another. Pressurizing each other by sponsoring subversive activities had served as a means to impose ones socio-economic and political interest on the other. Addis Ababa and Khartoum, for instance, were funding rebel movements against each other during the past several decades.

Similarly, past Ethio-Eritrea relations can be seen as a principal manifestation of the prevailed antagonistic policy orientation of the time. Despite the fact that the 1993 referendum resulted in Eritrea's independence from Ethiopia, the two states could not come up with conducive neighbourhood policies. In the years after Eritrea's separation, Addis Ababa and Asmara soon emerged as contending actors due to disputed territorial boundaries. The border dispute later evolved into a full-scale war which turned out to be one of the deadliest territorial conflicts in the recent history of the Horn of Africa.

The 1998-2000 Ethio-Eritrea war comes to an end following the Algiers Peace Accord in 2000. However, the accord remained unrealized, failing to implement the decisions of the Eritrea-Ethiopian boundary

commission and demarcate the disputed territories for about two decades. This stalemated the peace process and led to tension that sometimes grew up into small-scale border conflicts causing the death of hundreds. Furthermore, during the past two decades, Ethiopia and Eritrea had made interferences on the internal affairs of one another. These interferences endangered the effort to promote mutual respect for national sovereignty and equality of regional states. Addis Ababa frequently accused Asmara accused of arming Ethiopia's opposition groups and thereby destabilizing the country. Similarly, Eritrea also blamed Ethiopia funding anti-peace forces aiming to create disorder and instability. These accusations spread suspicion and hostility between the two neighboring states and lowered the possibility to address their differences through diplomatic channels.

Substituting Military Confrontation with Negotiation

Despite the various approaches that Ethiopia and Eritrea applied during the past two decades to safeguard their interests using realpolitik, the result was not as expected. The stalemated boarder conflict severely constrained the economic and political stability of the two neighboring countries. This compelled the need to look for other strategies that can relax the existing tensions. After 18 years of mutual distrust and antagonism, Ethiopia's new Prime Minister, Abiy Ahmed, has presented a new peace offer to address one of Africa's protracted and bloodiest border conflict through dialogue and negotiation.

Taking into account the multidimensional crisis caused by the conflict and the

deadlocked peace talk on June 6, 2018, Ethiopia showed its readiness to accept and implement the decision of the Ethio-Eritrea Boundary Commission. In his speech to members of parliament, Abiy asserted that "We are fully committed to reconcile with our Eritrean brothers and sisters and extend an invitation to the Eritrean government to start a dialogue and establish rapport". Furthermore, Addis Ababa also noted the critical importance of expanding economic ties with Asmara to maintain a long-lasting peace and stability in the region.

The course of maintaining sustainable peace and order in the region, however, requires collective efforts of all governments of the Horn of Africa. In doing so, regional powers should abstain from looking one another with suspicion and threat. Rather, they need to consider as partners for achieving mutual development. In his inaugural address, Prime Minister Abiy Ahmed highlighted that Ethiopia's foreign policy towards its neighbors should be based on mutual benefit and strategic cooperation; Ethiopia's recent peace offer to Eritrea practically proven this principle. As foreign policy analysts comment, if it is accompanied by genuine measures, the recent rapprochement will have a remarkable role in enhancing peace and stability in the Horn of Africa.

Asmara's response to Addis Ababa's peace offer is also another important development that can further the current peace deal attempt. On June 26, 2018, Eritrea sent a high-level delegation to Ethiopia. The delegation discussed with Ethiopian officials and agreed to commit practical measure to achieve complete peace and cooperation. This was soon followed by another important and historic event. On July 8, 2018,

Ethiopia's Prime Minister made a landmark visit to Asmara for the first time after twenty years. In this event, the two neighboring countries agreed to fully address their disagreement and revive their bilateral relations. A week after, on 14 July 2018, President Isaias Afwerki made a landmark visit to Ethiopia. As many analysts observed, Isaias's three day visit further cemented the ongoing peace deal of the two neighboring countries. These high-level visits, in turn, paved the way to reopen embassies, develop ports, and restart flights between Asmara and Addis Ababa.

Regional Implications of the ongoing Peace deal

Apart from furthering inter-state peace and stability, the Ethio-Eritrea peace deal has also a wider regional implication. For about two decades, the conflict between the two neighbors affected the political economy of many regional countries such as Somalia, as the later served as a proxy in the conflict. Addis Ababa and Asmara were sponsoring rival groups in Somalia to further their socio-economic and political agendas. This, in turn, severely constrained the overall peace and security of the wider Horn of Africa. Hence, the effort to address the long-survived Ethio-Eritrea conflict can positively influences regional peace and stability.

In addition, promoting peace between Ethiopia and Eritrea enhances the geo-political significance of the Horn of Africa. Following the war in Yemen and the deepening rivalry between Iran and the Saudi-led coalition, the strategic importance of the horn of Africa has been mounting. Other powers such as Turkey and Qatar have been also taking series of measures to consolidate their presence in the strategically important regions of the

Horn of Africa. Hence, addressing the protracted Ethio-Eritrean boarder conflict strengthens the bargaining power of the states of the Horn of Africa, especially in their negotiation with non-regional powers.

To conclude, although it can be early to predict the final output of the rapprochement between Ethiopia and Eritrea, with the active participation of governmental and non-governmental actors, current developments may lead to calm the long-survived tensions of the Horn of Africa neighbors. This, in turn, will assure a long-term and strategic partnership between Addis Ababa and Asmara.

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Is privatization the perceived quick fix for Ethiopian economy?

Abdu Seid

The involvement of the private sector and the role of government in the production of goods and services in the economy have been contested for ages. The nature and role of individual companies and private business in the economy largely remains blurred and unsettled. This is despite the fact that privatization is one of the major economic events in both developing and developed countries for nearly four decades. It encompasses the decline of state's ownership of assets or properties and stakes in the institutions and the transfer of it to private individuals, companies or similar undertakings directly or through the help of other entities (Estrin and Pelletier, 2015). This shrinkage can be in the form of handing over the whole stake, fractional sale, franchising, leasing, operational control, and the like.

As a policy, privatization can be influenced by a number of dynamics and constituents. Farazmand (2001) argued that economic and commercial, ideological, globalization, and what he labeled as "other forces" namely populist movements, academic circles and giant intergovernmental organizations are the major forces behind privatization and prominently shape our understanding of this policy. Akin to other economic policies, it has both proponents and opponents. The merits of privatization were abridged to four essential parts by López-Calva (1998), as a means to attain sophisticated efficiency, build up private

sector's partaking in the economy, advance the wellbeing of public sector's finance, and enable the apportionment of resources to other priority areas of governments. The proponents of privatization policy contend that through supply-side economic theory, private firms can supply goods and services to the market that would ultimately engender employment, boost consumption, and encourage saving that again cause the production and supply of goods and services.

On the other angle, opponents of the privatization policy oppose the above arguments on the ground that if the basic public goods and services are owned by private corporations, not only the poor and the low-income families, but also ordinary citizens cannot afford to pay for goods and services in the market. The very assumption of individual businessmen and corporations is to maximize profit and their market share enables them to dictate and delude the market. In this article, privatization policies are discussed briefly with the aim of creating a fair, efficient and inclusive private sector in Ethiopia.

Privatization in Ethiopia

Subsequent to the downfall of the socialist-oriented and centrally planned economy of the Derg regime in 1991, market-oriented and mixed economy approach accompanied by structural adjustment reform program had emboldened privatization in general and private property in particular in Ethiopia. Established in 1994 by proclamation No.87/1994 and 146/1998, the Ethiopian Privatization Agency (EPA) oversees the overall privatization process in general and revenue generations, bolsters

private sector expansion, and identify the essential role of government in the economy. As of January 2018, EPA has transferred 377 state-owned enterprises to private investors and collected 47 billion birr. The majority of those enterprises (87%) were conveyed to the local entities whereas the remaining to foreign firms. EPA claims that relocating state owned companies shore up local investors to engage in business and safeguard capital flight even though some assert that the core intention of recent privatization moves is to satisfy the financial demand for gigantic hydropower dam and sugar industries.

Though the move seems promising, the private sector has been dominated by a few well-heeled individuals and companies that are close to the ruling party and bureaucracy. Wodajo and Senbet (2017) categorized the heavyweight players in the private sectors in Ethiopia into three main groups. The first group constitutes endowment funds supported by the ruling party whereas the second camp is companies owned by a billionaire of Ethiopian and Saudi origin. The third category which the authors branded as "the rest" consists of private individuals and companies which are struggling to fill the gap at mercy of the two economic goliaths.

Amid chronic foreign exchange shortage, skyrocketing national debt and other economic adversities, the executive committee of the ruling party Ethiopian Peoples' Revolutionary Democratic Front (EPRDF) led by the new Prime Minister Dr. Abiy Ahmed announced to partially privatize some state-owned enterprises (SoE) in airline, telecom, railway, power and energy and sugar industries. This decision was welcomed by some and snubbed by

others citing a number of justifications. Those who are apprehensive allude that the success of privatization depends on inclusive and participatory political scheme and the current economic rudiments and configurations favor the tiny portion of the economic elites while turning a blind eye to the majority (Alemu, 2018). In addition, lack of access to finance due to underdeveloped financial sectors and absence of capital market makes capital formation challenging. The other pressing issue is the ambiguity of the regulatory framework in the business environment which is prone to misinterpretation and manipulation.

As it was stated above, efficiency and productivity of privatized firms are one of the chief advantages of the privatization policy. Privatized enterprises are assumed to undertake several improvements in management, internal control, profitability, technological changes, and product and market diversification and so on. Empirical literature regarding these issues produced diverse results. In some countries and industries, studies showed that companies have done great in terms of efficiency and productivity in post-privatization period whereas in others privatization moves have been deficient in attaining efficiency to enterprises during few years after transfer. When we refer to empirical literature related to privatization in Ethiopia most recent studies affirm that post-privatized firms failed to achieve efficiency and productivity. Precisely deteriorating technical efficiency, lack of productivity (firm output per employee), decay in profitability, net income efficiency, capital investment, liquidity and trivial increment in sales efficiency, leverage and number of employment following privatization, downsizing number of employees and

dwindling investment, daunting capital accumulation; and adverse effect on investment were some of the empirical studies which are skeptical about the efficiency, productivity and further investment of post-privatized companies. On the other hand, though few, some empirical studies argued that, based on three surveyed privatized enterprises, the performance of these firms measured by profitability, operating efficiency, capital investment capacity utilization, and employment level was noteworthy.

To sum up, any economic policy including privatization ought to be implemented taking into account of a number of perspectives. Several empirical studies point out that implementing privatization significantly vary from countries to countries bearing in mind the country's political, economic, social and other factors. Though privatization is considered as one of lucrative venture for government to keep it's the financial health and enables to get money to fund developmental projects, it is customary to accomplish it harmonizing the revenue motive alongside the long-term efficiency, productivity, competition, investment and overall growth of the economy. Therefore, political and economic circumstances which favor some businessmen and companies and obstruct others cannot achieve privatization in full scale. In addition, without inclusive financial institutions, the private sector cannot raise capital and participate in investment and development undertakings of the country. Amendments and revisions of business and commercial laws and procedures are vital to ameliorate the stumbling block of private participation. The last but not least, while applying policies, it should not be overlooked that the great majority of the people live in rural areas where there is a

lack of basic infrastructure and poverty reduction schemes. Therefore, the role of government in these areas is immense and can make a deep-seated change if corruption, embezzlement, inefficiency, squandering, lack of transparency and other malfunctions abated from state-owned enterprises.

Since April 2018, Ethiopia has been witnessing new aspiration both in political arena and economic activities through foreign currency supply. Once the political and economic reforms embarked on, not only privatization and private property will have promising developments but also public enterprises will ramp-up their services in getting rid of corruption and other unnecessary bureaucracies.

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How Ethiopia outperformed Eritrea economically

Abdurezack Hussein

A surprise call for secession of hostility by the Ethiopian PM Abiy Ahmed ended the two decades long enmity between the two brotherly Horn of African countries: Ethiopia and Eritrea. The independence of Eritrea from Ethiopia in 1993 had lasted only five years before it crumbles to an all out war claiming tens of thousands of innocent lives. When the Algiers Agreement ended the war, the two nations were already bitter rivals. Their rivalry obliterated the life of many citizens on both sides of the boarder. Their active war was replaced by a state of no-peace no-war where both sponsored opposition movements against each other and engaged in proxy wars in neighbouring countries. The sum of all of this was nothing more than stabilizing instability in the Horn of Africa region.

The secession, as well as the two year-long war in 1998-2000 has immensely impacted the development trajectory of the two countries. Ethiopia and Eritrea embarked on two different contrasting development paths that could constitute a good textbook example in the comparative political economy literature.

Trends in the standard of living

According to World Economic Outlook Database, when Eritrea seceded from

Ethiopian in 1993, it had an income per capita of 1160USD at purchasing power parity compared to 558 USD in Ethiopia. Eritreans embarked on a stunning rise in their income level while Ethiopians largely stagnated for a decade to come. The income gap reached its peak in 1999. From this year onwards, the level of income in Eritrea started to deteriorate persistently until Ethiopia surpassed Eritrea in 2013.

Eritrea started as a new country with better resource endowment. This advantage had helped the country to further improve the living standard of its citizens' in the first few years after independence. When the war erupted on May 1998, however, the limit of the Eritrean economy came into light. The significant decline in living standard in the post-war period clearly shows the over-dependence of their economy on Ethiopia. Ethiopian market was both the major supplier and consumer of Eritrean goods and services. Although Eritrea provided the cheapest access to the sea and a significant portion of the Ethiopia's external trade was passing through this route, the Eritrean economy was the one to suffer the most. After the turn of the new millennium, when Ethiopia embarked on an impressive development path, income growth in Eritrea remained stagnant.

In many aspects, Eritrea started in a better position to build an economically strong country. Nonetheless, what we see after twenty-five years of independence is a nation that has a living standard lower than it had in the late 1990s. A comparative study of how Ethiopia managed to maintain an impressive growth for the past fifteen years and the stagnation in the Eritrean economy requires a closer look at the nature of institutions in the two countries.

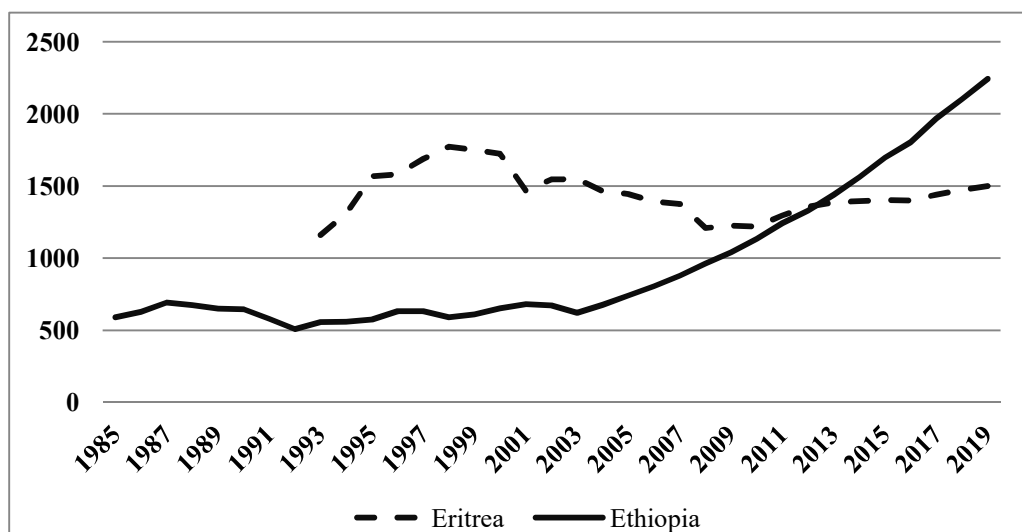
The story of bad and worse dictators

There is this famous line graph that depicts the income per capita of North and South Korea. The two Koreans were from the same culture, living in the same geographical area, and were indistinctly similar in many aspects. The bloody war fought in 1950 gave rise to two nations: the North aligning with communist camp and the South with the capitalist world. Their difference in living standard was not exaggerated until the 70s. A military coup brought Park Chung-hee to power in 1961. As repressive as his rule was, his market-oriented economic policy transformed South Korea while the standard of living stagnated in the communist North for decades to come. With the transformation of South Korea into a full democracy, the monumental economic progress earned more momentum. Half a century after the separation of the two Koreans, a South Korean on average earns 18 times more income than a North Korean citizen. In attempting to explain these divergences, Acemoglu and Robinson in their bestseller "Why Nations Fail" reiterate "neither culture nor geography nor ignorance can explain the divergent paths

of North and South Korea. We have to look at institutions for an answer. Inclusive economic institutions foster economic activity, productivity growth, and economic prosperity". The divergent paths of Ethiopia and Eritrea since their separation in 1993 abundantly tell the same story in a more profound manner.

Both Ethiopia and Eritrea were ruled by autocrats who led the rebel fighting that toppled the Socialist regime in Ethiopia. Meles Zenawi in Ethiopia and Isaias Afwerki in Eritrea established dictatorial regimes in their respective countries. Although the two leaders were comparably repressive against any political dissent, the scope of Isaias's oppression goes beyond politics to the economic sphere. He built a repressive system that paralyzed the functioning of the market and exterminated market incentives.

The World Bank's *Doing Business* report clearly shows these distinctions. The report ranks economies according to how easy is to do business in the country. It takes into account a range of variables related to the status of market institutions and the



availability of infrastructures. According to the 2008 report, Eritrea was ranked 175 out of 190 countries. The ranking further deteriorates and reached as low as 189 for four consecutive years from 2014 to 2017. On the other hand, the report demonstrated the superiority of market institutions and infrastructure in Ethiopia. The country was ranked 111th in 2008 and further improved her ranking to 104th in 2010. The presence of a functioning market and institutions that reward innovation and provide an incentive for more investment unquestionably boosts economic growth and prosperity. And it is this relative advantage that Ethiopia had against Eritrea that tells much of the story of the difference in their income trajectory depicted in the line graph above. The story of the two countries is an epitome of how, even within autocracies, nations with better market incentive and institutions outperform others. This is the story of bad and too bad autocrats.

The economics of the rapprochement

Looking at how the Eritrean economy quickly contracted after the severing of ties with Ethiopia, the re-installment of the relation will benefit the Eritrean economy immensely. The large and growing Ethiopian economy inevitability provides an impulse to the stagnant Eritrean economy. On the Ethiopian side, the peace deal opens another market for produces and, more importantly, ensures a cheaper access to the sea rout.

Exploiting the full economic benefit of the opportunity the historic reconciliation brought to the two countries largely depends on the type and depth of political and market reform they are willing to undertake. Unless the rapprochement is

followed by institutional reforms promoting market incentives and reward innovation, the blessing will undoubtedly be underutilized. The opening of the political space, the building of inclusive institutions, and further investment on infrastructure will determine how the income trajectory will look like in the coming years and decades.

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