Asymmetric Benefits: The Ethio-Eritrea Common Market (1991-1998)

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Abstract

Economic theory suggests that a common market between two or more countries improves overall well-being, but it creates winners and losers in each country. Recent empirical findings also show that the overall impact of a common market on per capita income depends on the similarity of economic development between member countries. A common market among developed countries results in the convergence of per capita income while a common market among developing countries results in the divergence of per capita income. The difference in outcome, some economists suggest, is due to variations in comparative advantage between member states and the rest of the world. But the theory of comparative advantage does not fully explain the results of the *de facto* common market between Ethiopia and Eritrea (1991-1998). The empirical findings of this study demonstrate that the Ethio-Eritrea preferential trade arrangement benefited Eritrea and harmed Ethiopia. The main reason for these asymmetric consequences was acceptance by the Ethiopian government of the unfavourable terms of the preferential trade arrangement between the two countries.

Background

Economic theory suggests that a common market between two or more countries improves overall well-being, but such a market also creates winners and losers in each country because of the flow of capital, labor, goods, and services across the member countries (Venables, 2016). When capital flows from countries with a low rate of profit (capital-abundant countries) to countries with a high rate of profit (capital-poor countries), it reduces the difference in the rate of profit, and owners of capital in countries with a high rate of profit lose while owners of capital in countries with a low rate of profit gain. When labor migrates from low-wage countries (labor-abundant countries) to high-wage countries (labor-poor countries), it decreases the wage rate differential, and workers in the high-wage countries lose while workers in the low-wage countries win. The free flow of goods and services creates winners and losers as well. Owners of capital and workers engaged in export and related sectors benefit, while owners of capital and workers engaged in import-competing and related sectors generally lose, but it is unlikely that all industries suffer; companies and workers producing goods that complement imports benefit.

In a common market, because of duty-free and low-tariff imports, consumers in each country have more choices of goods and services at lower prices. Imports may also encourage domestic producers, especially those who face competition from these imports, to introduce technological change, resulting in economy-wide benefits. The increase in the production of exports enables some firms to realize economies of scale and to reduce their costs of production

that can be passed on to domestic and foreign consumers as lower prices. Thus, the creation of a common market improves welfare, but it also generates distributional inequities.

To make the distributional outcomes fair, economists suggest that the winners compensate the losers or that governments establish programs to mitigate the negative effects of trade displacement (Ehrlich & Hearn, 2013). In reality, however, the losers are rarely compensated nor are effective programs established for displaced workers; the winners enjoy the benefits, and the losers suffer the losses (Ehrlich & Hearn, 2013). Empirical studies illustrate that the overall effects of a common market on per capita income, despite the sectoral income imbalances that such a market creates, hinge on the similarity of economic development between member countries. "A common market among developed countries results in the convergence of per capita income while a common market among developing countries results in the divergence of per capita income" (Venables, 2003, pp. 747–48). Venables attributes this outcome to differences in comparative advantage between member states and the rest of the world. Let us apply his hypothesis to the outcomes of the *de facto* Ethio-Eritrea common market. Assuming Eritrea has a slight comparative advantage over Ethiopia in skilled manpower but a relatively abundant unskilled labour force vis-à-vis the rest of the world; and assuming that Ethiopia has a comparative advantage in agriculture over Eritrea and the rest of the world, Eritrea will be exporting manufactured goods to Ethiopia, and Ethiopia will be exporting agricultural goods to Eritrea. The difference in relative factor abundance between the two countries, the hypothesis suggests, will result in Eritrea's per capita income increasing at a faster rate than Ethiopia's; the gains for Eritrea will be higher than those of Ethiopia. The empirical evidence presented in this paper appears consistent with this proposition, but the benefits that Eritrea enjoyed from the common market extended far beyond the gains attributable to differences in relative comparative advantage between the two countries. To fully understand the economic consequences of the Ethio-Eritrea common market (1991 - 1998) for both countries, we must examine the nature of the economic relationship that existed between them.

Even though Eritrea seceded from Ethiopia in 1991 and became formally independent in 1993, it remained economically integrated with Ethiopia until 1998 when war broke out and formal economic ties ended. Prewar economic integration between the two countries included a free-trade area, a partial customs union, and currency and monetary unions (IMF, 1995; Tesfai, n.d.; Trivelli, 1998; Woldemariam, 2015). Following independence in 1993, the Eritrean government advocated an economic union with Ethiopia and wanted to harmonize fiscal, monetary, taxation, and other policies (Asrat, 2014; ESAT, 2015; Yohannes, 1993), but the attempt failed largely because the terms and implementation of the extant preferential arrangement favored Eritrea. Although the preferential trade arrangement between Eritrea and Ethiopia was extensive, it lacked a comprehensive formal agreement. To be sure, various attempts were made to formalize the arrangement, beginning from the time Eritrea became independent. In July 1993, Presidents Meles Zenawi of Ethiopia and Isaias Afeworki of Eritrea signed the Friendship and Cooperation Agreement, a broad outline for collaboration (IMF, 1995; Tesfai, n.d.; Woldemariam, 2015). In September 1993, the Asmara Pact, an agreement to harmonize economic policies, was signed in

Asmara (Tesfai, n.d.; Woldemariam, 2015). Throughout the 1990s, various ministerial and interparty committees signed additional agreements, almost all initiated by the Eritrean government (Asrat, 2014). The agreements covered a wide range of areas for economic, security, and political cooperation between the two countries, but none were fully implemented because of divergent views, mutual suspicion, and conflicting interests (Asrat, 2014; Iyob, 2000).

The two governments agreed in April 1995 to formally create a free trade area (IMF, 1996), yet a comprehensive accord was never signed. Although the Eritrean Peoples' Liberation Front (EPLF), now The People's Front for Democracy and Justice, and the Tigrayan People's Liberation Front (TPLF) signed a few agreements on behalf of their respective governments (the EPLF for Eritrea and the TPLF for Ethiopia), but none was ratified by the Ethiopian parliament. This, despite the fact that Article 54 of the Ethiopian constitution requires all international treaties signed by the government be ratified by parliament. Article 54, Section 12 reads, "It [parliament] shall ratify international agreements negotiated and signed by the Executive" (Constitution of the Federal Democratic Republic of Ethiopia, 1995). Had the agreements been introduced to parliament, the ensuing public discussion would have confirmed the widely-held perception that the Ethiopian government is ambivalent to Ethiopia's national interests. It is even possible that some members of the parliament controlled by the TPLF would have opposed the treaties. The TPLF, concerned about the negative public reaction to the terms of the agreements, decided not to bring any of the agreements to parliament for ratification. The lack of parliamentary ratification raises questions about the legality of the preferential arrangement between the two countries. The common market, although it lacked a legally binding comprehensive accord, lasted from 1991 to 1998. The lack of a formal treaty, more specifically, the absence of a dispute settlement mechanism, along with the EPLF's persistent violation of the agreements and engagement in contraband activities in Ethiopia, as pointed out by some researchers (Asrat, 2014; Kendie, 2005; Trevilli, 1998), was a constant source of friction between the two governments throughout this period. The unique economic relationship that Eritrea and Ethiopia formed after Eritrea became independent and the subsequent cessation of economic ties in 1998 has created a state of natural experiment in which researchers can analyse the "before" situation, the economic conditions under the common market, and the "after" situation, the economic conditions in the wake of the dissolution of the common market, in both Ethiopia and Eritrea. Despite this unique opportunity, there has been no empirical investigation of the consequences of the common market for both countries.

The extensive literature on the war between the two countries often mentions economic factors that contributed to or gave rise to the war, but none of the authors discuss the details or outcomes of the common market. Some researchers, without discussing the specifics of the economic relationship, have concluded that the arrangement benefited Eritrea disproportionately. Gilkes notes, "[I]t was Eritrea and Eritreans who had largely benefited at the expense of Ethiopia" (cited in Khadiagata, 1999, p. 5). Trevilli (1998) points out, "The various agreements between the TGE and the Government of Eritrea (GOE) were very advantageous for the Eritrean side" (p. 277). Abbink (1998) states that until 1997 the Ethiopian government followed a "[R]ather Eritrea-friendly economic policy" (p. 9). Asrat (2014) wrote an entire book that claims how the Meles

Zenawi government betrayed the national interests of Ethiopia and advanced those of Eritrea. Among the public, unsurprisingly, there is no consensus between Ethiopians and Eritreans on the distribution of the economic benefits of the common market. The debate on the distribution of the gains from the Ethio-Eritrean common market is not unique; it is a universal feature of the discussion on the distributional consequences of a common market, as the benefits of a common market can never be equally distributed between the participating countries (Burfisher, Robinson & Thierfelder. 2001). In general, although theoretically and empirically one country often benefits *more* than the other, *both* will gain, however small those gains may be for the relative "loser." Nonetheless, contrary to what economic theory suggests, the Ethio-Eritrea common market generated a skewed distribution of costs and benefits with the benefits going to Eritrea, and the costs falling on Ethiopia. The reason for this imbalance is that the Ethiopian government allowed the Eritrean government to transfer Ethiopia's resources to Eritrea without any reciprocal flow of goods, services, assets or obligations to Ethiopia. Given the welfare costs that Ethiopia suffered from the common market, why did the Ethiopian government agree to such an arrangement in the first place? To answer this question, I will briefly outline one plausible hypothesis.

Theoretical Discussion

Even though it is difficult to satisfactorily explain the preferential trade arrangement between Ethiopia and Eritrea within the existing theoretical framework of international trade agreements, a political economy approach based on rational choice theory ((Baldwin, 1989; Gilpin, 2001; Maggi & Rodríguez-Clare, 2007; Mansfield & Milner, 2012; Milner, 1999) which states that decision makers weigh the expected costs and benefits of each of the alternative options available to them and choose the one whose benefits outweigh the costs (Eggertsson, 1998;). To understand the pro-EPLF policy of the TPLF-controlled transitional government, we need to consider the two options that the TPLF leadership faced in its attempt to stay in power after it formed the government in 1991: allying with the EPLF or allying with the Ethiopian People's Democratic Revolutionary Front (EPRDF.) In 1991 when the TPLF assumed power in Ethiopia, it lacked a powerful domestic base within the coalition parties of the EPRDF or among the Ethiopian people. It had to turn to the EPLF for support. As Trivelli (1998) noted, "[U]ntil military victory had been translated into political hegemony, the EPRDF would need the alliance with the EPLF to be able to fully concentrate on securing its position within Ethiopia" (p. 276). Iyob (2000) writes about "[T]he TPLF-EPLF intelligence and security cooperation, which had ensured the supremacy of the TPLF in the EPRDF coalition…" (p. 677). Woldemariam (2015) acknowledges the crucial role the EPLF played in training and arming the TPLF army before and after the latter came to power. Sargo (2006) states that the EPLF even attempted to weaken the TPLF so as to make it more dependent on the EPLF, for example by blowing up arms depots in Addis Ababa and Dire Dawa when the joint TPLF-EPLF forces entered Addis Ababa in May 1991 and by ingratiating itself with the opposition throughout the early 1990s. The EPLF did this while simultaneously supporting the TPLF not just militarily but politically by using Eritreans living in

Ethiopia to mobilize the Oromos and the people in Southern Ethiopia to support the new government.

The EPLF, the TPLF's strategic ally during the struggle against the Derg, thus provided the support the latter needed in the early days of its assumption of power, but that support came at a price: the transfer of Ethiopia's resources. This support, mediated by their past friendly relationship (although at times conflictual) and shared anti-Ethiopian views, was based on mutual benefits. The TPLF required the EPLF's military and political support, and the EPLF needed resources to embark on its ambitious plan of turning Eritrea into the Horn of Africa's "Singapore" within two decades (Asrat, 2014; Giorgis, 2010). The reciprocal coincidence of needs resulted in the common market arrangement that benefitted the EPLF tremendously but hurt Ethiopia drastically.

So, rational choice theory surmises that as a result of the uncertainty the TPLF leadership faced during the early days of its rule, it opted to ally with the EPLF; ready to reward the EPLF with economic benefits in return for political and military assistance. But once the regime felt securely established in power in the late 1990s, a faction within the TPLF realized that it could appropriate, using the TPLF-owned companies, the benefits accruing to the EPLF, and persuaded the party to renegotiate the trade arrangement with Eritrea in 1997. To illustrate the fight between the two fronts over who should appropriate Ethiopia's resources, let's take one of Asrat's (2014) accounts. He relates a story of how the regional government of Tigray in 1992 caught thirty-eight trailer trucks loaded with sesame seeds, worth birr 38 million, attempting to cross the border to Eritrea. He alleges that this is a smuggling operation organized by the EPLF. He reports that the seeds were duly confiscated without telling us who confiscated them, but it is clear that it was the regional government of Tigray run by the TPLF under his rule. He also mentions other incidents in which the regional government of Tigray confiscated goods that were about to be smuggled into Eritrea from Ethiopia and goods smuggled into Ethiopia by the EPLF. Further, he argues that the regional government was concerned about the negative impact of imports from Eritrea on the nascent manufacturing sector in northern Ethiopia, primarily in Tigray. These narratives exemplify the motivation behind the decision to renegotiate the agreement: to redirect the appropriation of Ethiopia's resources from the EPLF to the TPLF. In essence, the renegotiation reflected the resolve by a faction within the TPF to restrict the EPLF's access to Ethiopia's economy and redirect the flow of rents to TPLF officials and to the TPLF-owned companies. There were a few factors that triggered the dissolution of the common market. Even though the common market lasted until 1998, it lacked effective dispute settlement mechanisms to deal with the issues, conflicts, and problems that the extant agreements failed to address satisfactorily for both parties. These included Eritrea's use of multiple exchange rates for the birr, the status of Eritreans living in Ethiopia, the distribution of petroleum products from the Assab Refinery, the EPLF's demand for parity between the birr and its newly issued currency, the Nakfa, in 1997, and its request for the free circulation of the Nakfa in Ethiopia, plus other concerns (Asrat, 2014; Trevilli, 1999).

Data Limitations

When undertaking the research, unsurprisingly, some data problems were encountered. As is generally the case, economic data supplied by government agencies in developing countries, especially those in Africa, are notoriously unreliable because of the lack of funds, lack of trained manpower, and inadequate statistical infrastructure, in addition to political considerations (Jerven, 2013). To obtain data, I used the various issues of the IMF's *Staff Country Reports* (1995 to 2003) on Eritrea for data on trade, monetary statistics, tax and nontax revenues, and the distribution of petroleum products between Eritrea and Ethiopia refined at the Assab Refinery. The IMF in turn obtained these data from various Eritrean government agencies, namely the Bank of Eritrea, the Customs Office, and the Eritrean Petroleum Corporation. Along with the systemic problem of data unreliability, it is highly likely that the Eritrean government took political considerations into account when providing some of the data to the IMF.

It is highly probable, for example, that the EPLF may have under-reported cash transfers from the National Bank of Ethiopia (NBE) to Eritrea, a cash gift from the Ethiopian government to the EPLF, while it may have overstated the monetary liabilities of Ethiopia to Eritrea. Asrat (2014), for instance, recounts that Meles Zenawi, without the approval of the Council of Ministers, ordered the NBE to transfer birr 1.2 billion to Eritrea in 1992. The transfer was later acknowledged, but the reported amount of the cash transfer from Ethiopia to Eritrea in 1992 was less than birr 1 billion (IMF, 1995).

Second, the data on Eritrea's imports from Ethiopia and Eritrea's exports to other countries, subject to the overall problems of data inaccuracies, have also been affected by political considerations. In the 1990s, there were persistent accounts in the Ethiopian media about how Eritrea became a leading exporter of coffee by re-exporting the coffee it imported from Ethiopia (*Ethiomedia,* December 2004). The media reports have been corroborated by Asrat (2014) who confirms that the EPLF bought Ethiopia's export commodities in large quantities, with the full knowledge of the Ethiopian government, then transported them across the border using donkeys, camels, and trucks, and sold them on the international market. Kendie (2005) also reports that throughout the years of the common market, the EPLF imported large quantities of agricultural products from Ethiopia and exported them. However, in all of its officially reported trade statistics, the Eritrean government has not indicated any coffee imports from Ethiopia or coffee exports to the rest of the world. Obviously, there are political reasons behind the Eritrean regime's lack of transparency on its coffee trade, including its fear of being accused of violating the 1993 Friendship and Cooperation Agreement that prohibited the re-export of Ethiopia's export commodities. The agreement forbade Eritrea from purchasing in birr any of Ethiopian export products and goods that were in short supply in Ethiopia (IMF, 1995). As specified in the agreement, Eritrea must pay for these goods in foreign currency, but the EPLF violated the agreement by purchasing these products with birr in Ethiopia and exporting them (Asrat, 2014). Despite the Eritrean government's non-reporting of its international trade of coffee, a comparison of the aggregate data on Eritrea's exports, during and after the dissolution of the common market, reveal a substantial decrease in Eritrea's total exports after Eritrea ended its economic ties with Ethiopia (World Bank, 2000). My

calculations indicate that Eritrea's exports, expressed as a percentage of GDP, decreased from 31 per cent in 1994 to 10 per cent in 2000, after Eritrea stopped exporting to and importing from Ethiopia. As will be shown later, Ethiopia was Eritrea's most important trading partner; and with the cessation of imports from Ethiopia, Eritrea could no longer re-export the agricultural products—oil seeds, pulses, leather, hides and skins, live animals, and coffee—that it imported from Ethiopia. These data limitations notwithstanding, this paper will reveal how the *de facto* common market benefitted Eritrea but harmed Ethiopia. The reason for the skewed distribution of the costs and benefits of the common market is that with the acquiescence, cooperation, and facilitation of the Ethiopian government, the preferential arrangement created transmission mechanisms, official and unofficial, legal and illegal, that permitted the EPLF to transfer Ethiopia's resources to Eritrea.

The official and legal transfer mechanisms included the following: cash deliveries from Ethiopia to Eritrea, Eritrea's export of manufactured goods to Ethiopia duty free, Eritrea's import of agricultural goods and food from Ethiopia duty free, purchased at domestic prices with Ethiopia's domestic currency. In addition, there were service fees paid by Ethiopia for its use of the "free" ports of Massawa and Assab, the subsidy Ethiopia provided to Eritrea when purchasing the petroleum products refined at the Assab Refinery, and the fees Ethiopia paid for using the refinery. As stated by Asrat (2014) and others, the EPLF's unofficial and illegal means of resource transfer included contraband trade, appropriation of Ethiopia's foreign exchange reserves by using multiple exchange rates for the birr, re-exportation of Ethiopia's export commodities, and the unrecorded remittances of Eritreans living in Ethiopia (IMF, 1995). Asrat (2014) reports that the EPLF was engaged in a two-way smuggling operation. It smuggled Ethiopia's export commodities out of Ethiopia. It also smuggled goods into Ethiopia, mostly electronic products but other goods as well, such as guns and whiskey, into Ethiopia using the provision of the 1993 agreement that allowed the transit of goods from Eritrea destined for other countries in East Africa (and vice versa) to pass through Ethiopia duty free and uninspected. Similarly, as reported by Kendie (2005), the EPLF imported different types of goods through Mombasa claiming that they were goods in transit, and sold them illegally in Ethiopia. To undertake its unlawful activities in Ethiopia, to purchase goods in Ethiopia that it smuggled to Eritrea or to distribute the smuggled goods in Ethiopia, the EPLF used, Asrat (2014) contends, Eritrean diplomats and its agents working at its embassy in Addis Ababa and its consulates in Mekele, Asayta, and other cities, as well as Eritrean and Ethiopian businessmen, including Meles Zenawi's' father (Asrat, 2014), along with its state-owned companies. Eritrea also benefitted in other ways from the EPLF's cordial relationship with TPLF in which the latter allowed the former to acquire all of Ethiopia's physical assets located in Eritrea without receiving any monetary compensation. What is more, the Ethiopian government cancelled Eritrea's share of Ethiopia's external and internal debt at the time of Eritrea's independence. The following sections will examine closely each of the mechanisms the EPLF used to transfer resources from Ethiopia to Eritrea with the explicit and implicit approval of the TPLF.

The EPLF's Expropriation of Ethiopia's Financial Assets

When Eritrea became *de facto* independent in 1991, the EPLF expropriated all of the physical and financial assets belonging to the eleven branches of the Commercial Bank of Ethiopia (CBE), one branch of the Agricultural and Industrial Development Bank (AIDB), and the Asmara branch of the NBE (IMF, 1995). Neither the EPLF nor the Ethiopian government has provided any data on the total value of bank assets in Eritrea that were expropriated by the EPLF, but there are IMF data that partially indicate the amount of cash seized by the EPLF, with the caveat that the source of the IMF data was the EPLF itself, as indicated previously.

Along with the cash that it expropriated from the banks when it entered Asmara, the EPLF also received a number of cash deliveries from the transitional government in Ethiopia, mostly in 1992 and 1993, without providing any assets, goods, or services or assuming any obligations in return. The financial data provided by the IMF (1995), showed that, between 1991 and 1993 alone, the EPLF acquired almost birr 1.3 billion through its cash acquisitions and cash deliveries from the Ethiopian government. The actual amount of cash transfers from Ethiopia to Eritrea during this period was most probably higher than what was reported. It is most likely that the Eritrean monetary authorities under-reported the cash transfers from Ethiopia. As stated above, Asrat reports (2014) that in 1992 Meles Zenawi authorized the NBE to transfer birr 1.2 billion to Eritrea, but not all of this transfer was reported. Between 1991 and 1992, the reported total amount of cash held by the banks in Eritrea increased by only birr 673.6 million (IMF, 1995). Further, there have been persistent rumours in the Ethiopian media that the EPLF took cash and other assets from Ethiopia with the approval of the prime minister. For example, as reported by *Ethiomedia*, the EPLF flew birr 70 billion in 1994 (equivalent to US $32 million) in a Cessna airplane from Addis Ababa to Asmara (*Ethiomedia.* April 10, 2014). One of the EPLF's reasons for requesting cash deliveries from Ethiopia was that it needed the cash to cover the deposits of the CBE's former customers, but it is difficult to conclude if the demand is justifiable since there are no public data that suggest the CBE owed money to the Eritrean government; if anything, it is highly plausible that the Eritrean regime owed money to the CBE. As previously mentioned, the EPLF took all of the CBE's physical and financial assets, including the cash held in the bank's vault, and renamed it the Commercial Bank of Eritrea (CBER). Normally, when a government acquires a bank, it assumes all of the bank's assets and liabilities. Yet, when the Eritrean government seized all of CBE's assets in Eritrea and transferred them to the CBER, it demanded further cash deliveries from Ethiopia to cover the deposits of the previous customers of the CBE in Eritrea, to which the transitional government obliged. The IMF (1995) reports, "Between August 1991 and end-1992, the CBER [the Commercial Bank of Eritrea] received cash transfers amounting to birr 375 million to partially cover its deposit liabilities" (p. 25). In the absence of public data on CBE's deposits at the time that it was acquired by the EPLF, it is impossible to deduce if the transfer was justified or not. In fact, it was most unusual for the CBE to transfer any cash to cover, partially or wholly, the deposits of its former customers, when it did not receive full payment for its physical assets, cash in vault, or outstanding loans that the EPLF expropriated. As stated by the IMF (1995), in 1995 there was still birr 53 million under negotiations and concludes that "[T]here are unresolved issues

regarding the loans supplied by the Commercial Bank of Ethiopia to enterprises in Eritrea, prior to May 1991, which are unlikely to be recovered" (p. 25). In the early 1990s, there was also a continual flow of cash to Eritrea from Ethiopia, shown as positive entries in the "errors and omissions" component of Eritrea's balance of payments with Ethiopia; a cash transfer not officially accounted for. The IMF report (1995) says, "The errors and omissions component of the balance of payments with Ethiopia is affected by various factors, including, most notably unrecorded across-the border trade transactions as well as movement of private capital flows" (p. 31). The IMF report shows some of the cash that was recorded as "private capital flows" was actually cash deliveries from the NBE to Eritrea purportedly to cover the previous deposits of the CBE in Eritrea. For example, in 1992, this transfer amounted to US $58.9 million (IMF, 1995).

The legal, semi-legal, and illegal transfer of cash from Ethiopia, the IMF documents indicate, continued throughout the period of Eritrea's economic integration with Ethiopia, albeit at a lower rate in the later years, resulting in a large accumulation of cash in Eritrea. Some of the accumulated birr in Eritrea flowed back to Ethiopia, as indicated by the negative entries in Eritrea's balance of payments with Ethiopia, again under the category "errors and omissions," to buy more of Ethiopia's resources and assets. The reason for the flow of cash from Eritrea back to Ethiopia was the higher rates of interest and profit (IMF, 1996) in Ethiopia than in Eritrea. The amount of the cash transfers, even if we take only the officially reported cash transfers, were not inconsequential. In 1992, the amount of cash transferred from Ethiopia to Eritrea was so large that it alarmed the IMF; it reported in 1995 that there was, "Excessive liquidity in Eritrea's banking system accumulated largely during 1992…" (IMF, 1995, p. 24).

The impact of these cash transfers on the economies of Eritrea and Ethiopia was much larger than the transfers themselves because of the combined effects of the money multiplier and velocity of money. The money multiplier indicates by how much the amount of money in circulation increases when reserves increase, depending on the required reserves, cash drain, and the level of monetization in an economy. The cash transfers from Ethiopia to Eritrea constitute an increase in the monetary base of Eritrea's money supply. An increase in cash held by the banks, the monetary base, will result in a much larger amount of money in circulation, subject to the required reserve ratio and the variables mentioned above. In the 1990s, the IMF states that "[T]here are no statutory reserve requirements in place…" in Eritrea (IMF, 1995, p. 22). This means, with low or virtually no reserve requirements in the Eritrean banking system in the early 1990s, the cash transfers from Ethiopia resulted in a large increase in the amount of money in circulation in Eritrea. With the cash transfer that totalled close to birr 1.3 billion between 1991 and 1993 alone, if we assume a reserve ratio of 5 per cent, the increase in the money supply during this period would be close to birr 26 billion. This substantial expansion of Eritrea's money supply caused the IMF to issue a warning in 1995 that the increases could have harmful economic consequences for Ethiopia, specifying that "[E]xcess liquidity could prove inimical to financial stability in the birr area [Ethiopia]" (IMF, 1995, p. 24). Additionally, the velocity of money, defined as the number of times a unit of money changes hands, enabled the EPLF to acquire a higher amount of Ethiopia's resources than is reflected in the total of the transfers themselves. In economies such as those of

Ethiopia and Eritrea, with low levels of monetization, the velocity of circulation is low. As stated by the IMF (1998), the velocity of money in Eritrea in 1992 was 1.6, and if we assume a reserve ratio of 5 per cent, the cash transfer of birr 1.3 billion to Eritrea would have generated economic transactions of about birr 41.6 billion between 1991 and 1993 alone. This combined effect of the increase in the money supply and velocity of money in Eritrea allowed the EPLF to "buy" Ethiopia's goods, services, and assets worth much more than the initial cash transfers throughout the period of the common market, but the "purchase," at least a good proportion of it, involved no corresponding transfer of goods from Eritrea to Ethiopia. There were consistent rumors that the EPLF used counterfeit birr to acquire Ethiopia's resources. Validating these rumors, Kendie (2005, p. 357) writes, "Unscrupulous Eritrean merchants used forged Ethiopian birr and bought a variety of cereals from farmers in Gondar and Gojjam thus creating untold misery to the farmers." While the increase in the amount of birr in circulation, real or counterfeit, in Eritrea facilitated the EPLF's resource acquisition in Ethiopia, it also generated inflationary pressure both in Eritrea and Ethiopia.

The other financial transfer mechanism the EPLF used for acquiring Ethiopia's resources was its use of multiple exchange rates for the birr — the official exchange rate, the auction rate, and the "preferential exchange rate"— depending on the transaction, while Ethiopia retained only one exchange rate, the official exchange rate until 1995 and the auction rate in the subsequent years, as noted by the IMF (1996). What the IMF calls the "preferential exchange rate" is actually the illegal exchange rate that the EPLF established without the consent of the NBE, the only monetary institution authorized to determine the exchange rate for the birr. The IMF observes that the EPLF used the "preferential rate" for "equilibrating" (IMF, 1995) its dollar holdings. What this IMF statement means is that the EPLF used the illegal rate for accumulating US dollars. For buying US dollars and selling the birr, the EPLF utilized the "preferential rate" and used its embassy in Addis Ababa, supporters, and party members (Asrat, 2014) and its companies, especially the Red Sea Trading Company and the Finance Commission (IMF, 1995), to carry out the transactions. Implementing a triple exchange rate regime, while Ethiopia was using only the official exchange rate, permitted the EPLF to siphon off Ethiopia's foreign exchange, resulting in Eritrea's "[C]omfortable foreign exchange reserve position" (IMF, 1995, p. 34) in the early 1990s. To demonstrate the extent to which the EPLF profited from establishing the illegal "preferential rate" for the birr, I calculated the difference between the auction rate and the preferential rate, expressed as a percentage of the auction rate for the period 1992 to 1997. The calculations show that the difference in the two rates was significantly high in the early years of the common market, particularly in 1992, but gradually declined and disappeared altogether after Eritrea introduced its own currency, the Nakfa, in 1997. Using multiple exchange rates allowed the EPLF to profit in the foreign exchange market, to accumulate foreign exchange, to ration foreign exchange, and to divert foreign exchange from Ethiopia. While the Eritrean government was pursuing a policy of multiple exchange rates for the birr, it was simultaneously advancing the "harmonization" of economic policy between the two countries (Asrat, 2014; ESAT, 2015; Tesfai, n.d.).

Service Charges at the "Free" Ports of Massawa and Assab

Isaias Afeworki and EPLF supporters repeatedly assert how Ethiopia used Massawa and Assab as "duty free" ports for its exports and imports between 1991 and 1998, but this assertion overlooks the substantial port fees Ethiopia paid and the sizeable petroleum subsidy it provided to the Eritrean government, worth millions of US dollars. The service charges Ethiopia paid contributed to a large proportion of the EPLF's nontax revenue between 1991 and 1998. An examination of the difference in port service fees during the common market and post-common market periods demonstrate that Ethiopia was an important source of port service revenue for the Eritrean government. In 1993, when the two fronts were close allies and Ethiopia was heavily dependent on Eritrea's ports for its international trade, the port service fees accounted for close to 10 per cent of Eritrea's GDP, but after Ethiopia stopped using the ports in 1998, their share declined precipitously to 1.8 per cent in 1999 and to 1 per cent in 2000 (IMF, 1998, 2003). The data show that between 1993 and 1997 Ethiopia paid close to birr 1 billion in port fees.

The Assab Refinery

The Assab Refinery was built with a loan of birr 41.5 million from the USSR to the Ethiopian government to be paid in twelve years and with a further contribution of birr 2 million by the Haile Selassie government for consultation services (Aakalewld, 1966). The construction of the refinery started in 1964 and was completed in 1967. At the time, it was considered Ethiopia's most important infrastructure project. When Eritrea seceded from Ethiopia in 1991, the transitional government of Ethiopia transferred the ownership of the refinery to the EPLF, without any recompense; however, the Friendship and Cooperation Agreement allowed Ethiopia to continue using the refinery and Assab as a "free" port, but required that it allocate 30 per cent of its refined petroleum products to Eritrea (IMF, 1995; Trevilli, 1998). Under the agreement, the Ethiopian Petroleum Corporation (now the Ethiopian Petroleum Enterprise) would pay for crude oil in US dollars and ship it to the refinery. The refinery would refine the oil and deliver the refined products to the Ethiopian Petroleum Corporation, and the corporation would then sell predetermined quantities in birr to the Eritrean government. Through this complex, arcane, and unfair arrangement, the IMF (1995) reports that Eritrea fulfilled all of its needs for refined petroleum products without spending foreign currency, at highly subsidized prices, and almost for free since the EPLF paid for the products with some of the money that was transferred from Ethiopia. Although the 1993 agreement specifies that Eritrea's share of the refined petroleum products would be 30 per cent, the actual proportion of the products that Eritrea received increased steadily during the common market years from about 17 per cent in 1992 to more than 54 per cent in 1997 as illustrated by Figure 1.

Given the differences in the sizes and the rates of growth of the economies of the two countries, there is no justification for the steep increase in Eritrea's share. Nor is there any convincing argument for the allocation of 30 percent of the products to Eritrea in the first place.

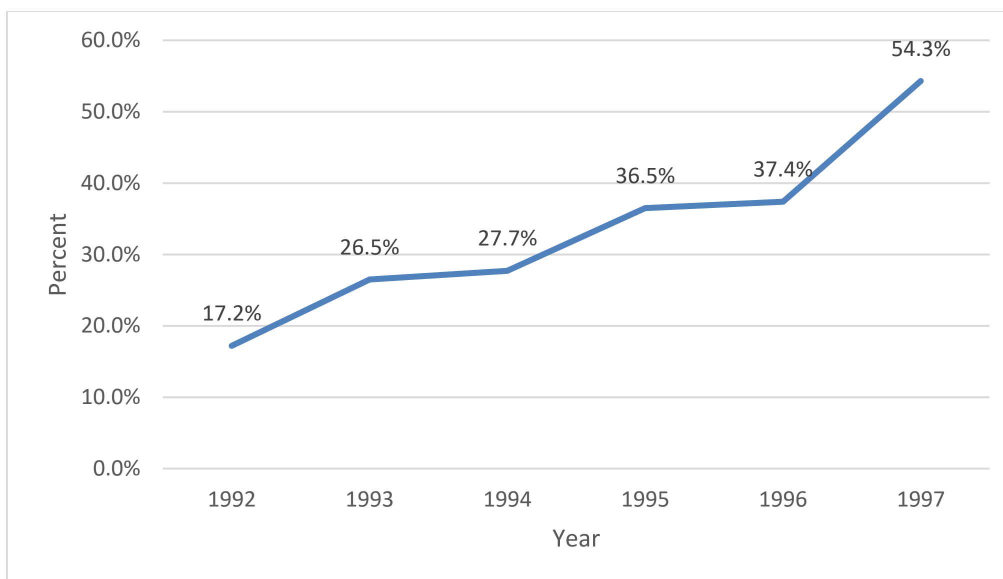

Figure 1. Eritrea's Share of Petroleum Products (1992-1997)
Source: IMF, *Staff Country Report*, 1995 to 1998.

How Eritrea's share of petroleum products was determined remains a mystery, considering that Eritrea's population was about 6 per cent of Ethiopia's and its GDP about 10 per cent of Ethiopia's in the 1990s. Particularly striking is Eritrea's share of more than 54 per cent in 1997; such a disproportionate and exploitative allocation is indefensible by any criterion. Moreover, Eritrea's share of certain key petroleum products was inexplicably much higher than Ethiopia's throughout the years of the common market. In 1996, for example, Eritrea received, 51 per cent of the jet fuel, 76 per cent of the automobile diesel, and more than 78 per cent of the kerosene (used by households) produced at the refinery (IMF, 1998); this, despite the fact that Ethiopia had many more airplanes and vehicles than Eritrea and a population about fifteen times greater. Having supplied most of these products to Eritrea at low prices, Ethiopia was forced to buy the shortfall it needed for domestic consumption on the international market. Furthermore, Ethiopia had to pay for the spare parts of the machinery used at the refinery in US dollars, on top of the refinery fees, the costs of maintenance, the replacement of chemicals, and the salaries of the Eritrean employees in birr (IMF, 1995). Given that Ethiopia incurred other costs such as constructing the refinery, buying crude oil, transporting the oil to the refinery and refining the products, there was no rationale for giving Eritrea such a high proportion of the refined products. The arrangement not only supplied Eritrea with all the petroleum products it needed, but allowed the EPLF to pay low prices for the petroleum products at the refinery and to sell them at high prices to distributors throughout Eritrea, generating considerable revenue for the regime, as shown by the data on production, distribution, and wholesale price of petroleum products at the refinery, and the retail price of petroleum products in Asmara (IMF, 1995, 1997, 1998). Along with generating profit for the EPLF, Ethiopia, by selling the refined products to Eritrea in birr, saved the EPLF a large amount of foreign exchange during the years of the common market. Between 1992 and 1997, my

calculations show that Eritrea spent a total of birr 5.7 billion, saving about US $200 million when converted at the prevailing average auction exchange rate for each year.

Ethiopia's use of the "free" ports of Massawa and Assab, while generating direct and indirect economic benefits for Eritrea, was costly for Ethiopia, and when the EPLF demanded that its share increase to 40 per cent and that Ethiopia pay an additional birr 56 million for using the refinery (Trevilli, 1998) in 1997, the Ethiopian government eventually started looking for alternative sources of refined petroleum products on the international market. Predictably, the government found it much cheaper to buy the refined products on the international market than to incur the exorbitant cost in cash and kind to the EPLF. Ethiopia's decision to stop using the Assab Refinery delivered a major financial blow to the Eritrean regime.

Remittances of Eritreans Living in Ethiopia to the EPLF

Remittance, comprising the 2 per cent income tax that the EPLF levies on Eritreans living abroad and the cash they send to support their families in Eritrea, have been a major source of revenue and foreign exchange for the Eritrean government. Styan (2007) claims that remittances account for about one-third of Eritrea's GDP. The IMF, on the other hand, estimates remittances amounted to 50 per cent of Eritrea's gross national income in the early 1990s (IMF, 1996), by far the largest proportion in the world. Remittances have been particularly important in financing imports for Eritrea.

In the early 1990s, the IMF reported that the ratio of remittances to imports was 60 per cent, again one of the highest ratios in the world (IMF, 1996). Given the importance of remittances to Eritrea's economy, how much did Eritreans living in Ethiopia contribute to the Eritrean government between 1991 and 1998? To understand the magnitude of their contributions, first we need to know how many Eritreans were living in Ethiopia in the 1990s, along with their average income. The number of Eritreans migrating to Ethiopia increased after the new government assumed power in 1991 (Kidane, 1999). Kidane, an EPLF official, claims that there were 550,000 Eritreans living in Ethiopia in the late 1990s. How much did they contribute to the Eritrean government? Since there are no data on the remittances of Eritreans living in Ethiopia during the common market years, one is forced to estimate the amount relying on different data sources. When the Ethiopian government deported 70,000 Eritreans in 1998, declaring that they posed security threats to Ethiopia, they lost their businesses, livelihoods, and assets. Kidane (1999) asserts that in total they lost US $800 million worth of assets, which implies that on average, every deported Eritrean was a millionaire with an average asset of US $11.43 million, a highly-exaggerated assertion. To illustrate approximately how much cash Eritreans living in Ethiopia contributed to the Eritrean treasury, assuming that out of the 550,000 Eritreans (Kidane, 1999) living in Ethiopia only one-fourth contributed birr 100 per month (not a heavy burden for a relatively well-off individual), the EPLF collected an estimated amount of birr 165 million per year between May 1991 and May 1998, for a total of more than birr 1.3 billion.

The Flow of Labor, Goods, and Services

The agreements signed by the Meles Zenawi and Isais Afeworki governments provided for the free flow of labor, goods, services, and capital between the two countries, with the assumption that these would result in mutual benefits, as postulated by economic theory and supported by empirical findings from other countries; yet, in reality the benefits accrued mostly to Eritrea. Let's start with the migration of people between Eritrea and Ethiopia. Although there had been inter-migration of people between Eritrea and Ethiopia when it was part of Ethiopia, more Eritreans crossed over into Ethiopia because of better economic opportunities in the rest of Ethiopia. In the 1980s, the war for independence reduced the net migration of Eritreans to other parts of Ethiopia (Kidane, 1999), but after Eritrea became independent, the close alliance forged between the two fronts improved the political, social, and economic standing of Eritreans living in Ethiopia, attracting many to migrate to Ethiopia until the outbreak of the war in 1998. The TPLF, in its determination to stay in power through practicing ethnic politics, viewed the Tigrigna-speaking Eritreans as its natural allies (Tesfai, n.d) and treated them favorably; so much so that under the TPLF-controlled government, Eritreans living in Ethiopia enjoyed more privileges than Ethiopians, many holding high positions in the government and owning lucrative businesses (Abbink, 1998; Kidane, 1999*)*. While Eritreans were migrating to Ethiopia after 1991, the EPLF was busy deporting Ethiopians living in Eritrea. The exact number of Ethiopians deported by the Eritrean authorities is unclear; the reported figure varies between 126,000 (Yohannes, 1999) and 150,000 (Gilkes as cited in Khadiagat, 1999).

The precise figure for the number of deportees may be lacking, but there is no lack of information on the mistreatment of the deportees by the Eritrean government. Abbink (1998) reports that these people were expelled "[W]ithout any of their possessions" (p. 560). Woldemariam (2015) notes, "The expulsions took place in June of 1991 and caused a serious humanitarian crisis within Ethiopia that was only averted through emergency assistance from the US government" (p. 177). The US government may have provided some humanitarian aid, but the assistance was inadequate as the deported Ethiopians remained destitute (Abbink, 1998). Although these Ethiopians lost their homes, property, businesses, livelihoods, and dignity, the transitional government of Ethiopia was conspicuously silent about their plight; it provided no moral, social, or financial support. Abbink (1998) reports, "Many thousands of them today still live in the streets of Addis Ababa in self-built shanties of plastic, stones and corrugated sheets, jobless and without government support" (p. 560). The Eritrean government abused them, the Ethiopian government snubbed them, and the international community ignored them. (There was no Amnesty International report on their inhumane treatment.) Because of the close relationship between the two regimes in 1991, as Abbink (1998) writes, "[S]tories about maltreatment, abuse and killings of Ethiopians in Eritrea at that time [were] suppressed for seven years" (p. 560). Ironically, Isaias Afeworki was advocating the free flow of labor between Ethiopia and Eritrea and facilitating the migration of Eritreans to Ethiopia by demanding that they be treated like Ethiopians, while deporting thousands of Ethiopians (Trevilli, 1999; Asrat, 2014).

Eritrea's Trade with Ethiopia

The free flow of goods and services constituted an important aspect of the *de facto* Ethio-Eritrean common market, as outlined in the 1993 Friendship and Cooperation Agreement and the subsequent pacts. To assess the direction, volume, and value of the flow of imports and exports between the two countries, it was to necessary to rely on data supplied in IMF reports, but most of the trade between the two countries was unrecorded and conducted through the informal sector, as is the case with most international trade taking place among developing countries, especially in Africa. Even though there are no estimates on the volume of informal trade between the two countries, the IMF (1995) states that it was much larger than the official trade statistics indicated.

Eritrea's Imports from Ethiopia

During the common market period, Eritrea imported agricultural inputs duty free from Ethiopia for its manufacturing sector, principally leather, but among Eritrea's imports from Ethiopia, food was the most important item. The official data demonstrate that Eritrea imported a large proportion of its food from Ethiopia; between 1992 and 1997, 30 per cent of Eritrea's food imports came from Ethiopia (IMF, 1995–1998). If we take into account the unrecorded food imports from Ethiopia, Ethiopia should account for at least 50 per cent of Eritrea's total food imports. Although both countries have not achieved self-sufficiency in food production, food imports from Ethiopia supplemented Eritrea's food supply, especially during drought. Other than contributing to Eritrea's food supply, food imports from Ethiopia benefitted Eritrea's economy in other ways as well. Food imports from Ethiopia at relatively low prices, paid in birr, saved Eritrea foreign exchange, reduced the trade deficit (because of the informal food imports), kept the rate of inflation low, decreased the cost of manufacturing, and enabled Eritreans to enjoy a higher standard of living than they do today.

Eritrea's Exports to Ethiopia

Eritrea's manufacturing sector has been integrated with Ethiopia's economy ever since its inception during Italian colonialism; the Italians established light manufacturing in Eritrea to sell their products mostly in Ethiopia. The integration of Eritrea's manufacturing with Ethiopia's economy accelerated after Eritrea became part of Ethiopia, and was affected by the economic policies of the previous governments in Ethiopia. To promote industrialization in Ethiopia the Haile Selassie and Derg governments followed a policy of import substitution in which they protected domestic manufacturers from foreign competition by imposing high tariffs on imported goods (Aberra, 1987). Since Ethiopia's manufacturing sector in the 1960s and early 1970s was concentrated in Addis Ababa and Asmara (Gilkes, 1975, p.147), Ethiopia's import substitution policy benefited factories located in Eritrea as well (Aberra, 1987; Gilkes, 1975). After Eritrea became independent, the transitional government extended the tariff protection to Eritrea's manufacturing sector, as though Eritrea were still part of Ethiopia. The Eritrean government took advantage of the tariff protection and the common market arrangements, exporting virtually all of Eritrea's manufactured goods to Ethiopia, as shown in Table I below.

Table 1
Ethiopia's Share of Eritrea's Export of Manufactured Goods (1992–1997)

Exports	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**Average**
Beverages and tobacco	70.4	87.5	90.4	90.2	98.1	95.8	**88.7**
Crude materials	86.8	86.4	55.8	73.9	74.8	73.0	**75.1**
Animal and vegetable oils	NA	NA	NA	100	96.2	97.1	**97.8**
Chemicals and related products	100	48.8	90.4	91.7	85.1	67.8	**80.6**
Manufactured goods	99.4	32.9	54.7	68.1	67.3	59.9	**63.0**
Machinery and transport equipment	101.5	85.7	87.4	68.8	74.7	53.3	**79.3**
Misc. manufactured articles	99.8	84.1	90.6	87.5	71.5	97.1	**88.4**
Total	**93.0**	**70.9**	**78.2**	**82.9**	**85.1**	**77.7**	**81.9**

Note: Numbers in Percent.
Source: IMF, *Staff Country Reports*,1995 -2003.

Using the trade data provided in the IMF reports, I have reproduced in Table 1 the proportion of Eritrea's export of manufactured goods to Ethiopia between 1992 and 1997. The table shows that between 1992 and 1997, on average, Ethiopia accounted for close to 82 per cent of Eritrea's total exports of manufactured goods. If we examine specific products, we realize that during this period, on average, Eritrea exported close to 90 per cent of its beverages and tobacco, more than 75 per cent of its crude materials, close to 100 per cent of its animal and vegetable oils, and more than 80 per cent of its chemicals and related products to Ethiopia. Moreover, the EPLF acted as an intermediary for some of Ethiopia's international trade. It imported manufactured goods from abroad and sold them to Ethiopia at a higher price, making a profit on the transaction. The IMF data indicate that not all of Eritrea's exports to Ethiopia were produced in Eritrea; some were manufactured elsewhere and re-exported to Ethiopia. It is not unusual for countries to re-export products, and so the question is not why the EPLF bought foreign goods and sold them to Ethiopia at a profit, but why the Ethiopian government would use a middle trader and pay high prices when it could have imported the products directly from the producers itself.

Estimating the Physical Assets Appropriated by the EPLF

The favourable treatment of Eritrea by the Ethiopian government extended beyond the common market arrangement. The transitional government allowed the EPLF to assume the ownership of all of Ethiopia's physical assets located in Eritrea without proper accounting, public consultation, or fair compensation. When Eritrea seceded from Ethiopia in 1991, the EPLF

inherited the physical assets and infrastructure in Eritrea such as hospitals, schools, government buildings, airports, seaports, highways, roads, and the buildings and factories of state-owned enterprises, all belonging to Ethiopian and Eritrean taxpayers. The EPLF also acquired the physical assets of the Ethiopian military, the Ethiopian Air Force, the Ethiopian Navy, Ethiopian Airlines, and Ethiopian Shipping Lines. The total value of the physical assets appropriated by the Eritrean regime may be billions of dollars, but the exact amount is unknown since there has been no official report from either government. With no public data available on the value of the physical assets that the EPLF inherited at the time of Eritrea's independence, one is forced to estimate it. I have estimated the total value of physical assets in Eritrea at the time of independence and Ethiopia's share of those assets. As the extensive literature on capital evaluation underscores, there are a few theoretical and measurement problems in estimating the value of capital (Sen, 1974; Pasinetti, Fisher, Felipe, McCombie & Greenfield, 2003). To avoid these estimation problems, it was necessary to use a simple statistical technique that economic historians like Piketty (2014) and development economists use in estimating the value of capital: the historical capital-output ratio. I realize that using the capital-output ratio does not solve the problems associated with measuring capital; it simply assumes it away.

Still, these theoretical and data limitations notwithstanding, to get an idea of the value of physical assets in Eritrea at independence required estimating the average capital-output ratio on the basis of a simple Harrod-Domar growth model. The model shows that the capital-output ratio can be computed, given the savings rate and GDP growth rate. Using this equation, the estimated average capital-output ratio for Ethiopia between 1982 and 1992 is 2.4. Instead of using the data for only 1992, the savings and growth data for Ethiopia between those years was used to obtain a representative average capital-output ratio. This ratio is consistent with what one expects for a typical least developed country, one of the stylized facts of developing countries.

It was assumed that the capital-output ratio in Eritrea in 1992 was the same as it was in Ethiopia; an assumption that reflects the economic realities of a country with a similar low per capita GDP, low capital investment, and low capital productivity. To estimate the amount of Eritrea's physical assets at independence, based on a capital-output ratio of 2.4, it was important to know Eritrea's GDP in May 1991, but since there are no macroeconomic data for Eritrea in 1991, Eritrea's GDP of 1992, US $5.9 billion (in constant 2005 US dollars) (World Bank, 2015), was used. This suggests that, with the assumed capital-output ratio of 2.4, the estimated total value of physical assets in Eritrea in 1992 was US $14.2 billion.

But since physical capital includes land and non-land capital, the estimated amount of total capital has to be divided between the two categories of capital. If we take the IMF's estimate that in the early 1990s agriculture contributed to about one-third of Eritrea's GDP (IMF, 1995), and if we assume that the distribution in the value of land and the value of other assets was proportional to their share of Eritrea's GDP, the estimated total value of land in Eritrea was close to US $4.3 billion in 1992; and the remaining US $9.9 billion was the estimated value of the non-land physical capital. In the absence of data on the net flow of funds between Eritrea and the rest of Ethiopia, it is reasonable to conservatively assume that at least 30 to 50 per cent of the funds spent on capital

expenditures in Eritrea came from the rest of Ethiopia. The moderate figures suggest that the estimated value of physical assets in Eritrea belonging to the Ethiopian people varied between US $3 and $5 billion in 1992. It is understood that one may dispute the exact value of the assets seized by the EPLF, but one cannot dispute that the EPLF owes money to the Ethiopian taxpayers for the assets it appropriated in Eritrea.

Military Assets Acquired by the EPLF

While one can debate as to what proportion of Ethiopia's physical assets in Eritrea was seized by the EPLF, there is no question about how much of Ethiopia's military assets the EPLF captured in Eritrea: almost all of them. If we assume that Eritrea contributed on average 13 per cent of the revenue collected by the previous regimes in Ethiopia, the same proportion as its share of Ethiopia's GDP in 1992, and that tax revenues were proportionally used to pay for military equipment, hardware, and other assets, only 13 per cent of the military assets captured by the EPLF belonged to Eritrea. In reality, the Derg allocated more than 13 percent of its budget to military spending and borrowed the money to finance its military expenditures, some of which has already been paid back and some of which will be settled by Ethiopian taxpayers. Once again, neither government has provided such data, but there is no question that the EPLF acquired a large amount of military assets when the Ethiopian army was defeated in Eritrea. To the victor belongs the spoils of war.

Estimating Eritrea's Share of the External Debt

When a country disintegrates into separate states, as Yugoslavia and Czechoslovakia did, the successor states agree, usually under the auspices of the IMF and the World Bank, on how to equitably divide the assets and outstanding debts of the former country on the basis of a mutually acceptable formula (Stahn, 2002; Williams, 1994). The criteria for sharing the assets, debts, and other obligations among the successor states could include the relative share of the successor state's contribution to the former country's GDP, population, tax revenue, government expenditures, or other variables (Stahn, 2002; Williams, 1994). When Eritrea separated from Ethiopia in 1991 and later declared independence in 1993, there was no official agreement on the division of Ethiopia's assets and national debt between Eritrea and Ethiopia. In fact, in the words of Abbink (1998), "[N]othing was negotiated" (p. 562). There was only a private discussion between Meles Zenawi and Isaias Afeworki in which the Ethiopian autocrat agreed to transfer Ethiopia's assets in Eritrea worth billions of dollars to the EPLF, and to cancel Eritrea's share of Ethiopia's national debt. Further, Meles Zenawi agreed to share Ethiopia's foreign aid with Eritrea between 1991 and 1993 (Woldemariam, 2015).

Meles Zenawi forgave Eritrea its share of Ethiopia's outstanding external and internal debt, without any authority from the Ethiopian people or the Ethiopian parliament, and, thanks to this generosity, Eritrea started its nationhood debt free. Unlike estimating the value of physical capital that the EPLF inherited, computing Eritrea's share of the external debt is relatively straightforward since there are official records of the debt with the lending countries and international institutions.

To give the reader an idea of Eritrea's share of the national debt when it became independent, one of the most frequently used criteria in settling such disputes was utilized: a successor state's share of the former country's GDP (Stahn, 2002; Williams, 1994). In 1992, Eritrea's share of Ethiopia's GDP was 13 per cent, and this proportion can be used to estimate Eritrea's share of Ethiopia's national debt. The national debt includes domestic debt, but only Ethiopia's external debt was taken to estimate Eritrea's share. When Eritrea became formally independent in 1993, as indicated by data from the World Bank, Ethiopia's external debt was US $9.7 billion in current dollars. If we assume Eritrea's share of the debt was equal to 13 per cent of the total debt, the same as its contribution to Ethiopia's GDP, its share of the debt in 1993 was US $1.25 billion, a conservative estimate because the calculation is based on equating the proportion of Ethiopia's external debt spent in Eritrea with Eritrea's share of Ethiopia's GDP. The previous governments considered Eritrea strategically important and allocated proportionally more of the national budget to Eritrea than to any other province. If we assume they spent between 25 and 33 per cent of the national debt in Eritrea, its share of the debt becomes much higher; it varies between US $2.4 billion and US $3.2 billion, a huge birthday gift given to a breakaway province by a generous Ethiopian government.

It is true that Ethiopia, as one of the most heavily indebted countries, had some of its external debt written off, and it is possible that Eritrea's share may have been written off as well, but that is not the point. The point is equity, fairness, and accountability in sharing assets and liabilities, as acknowledged by the former governor of the National Bank of Eritrea (Welde Giorgis, 2010). Why would an Ethiopian government, least of all an unelected, unrepresentative government, take it upon itself to forgive 100 per cent of Eritrea's share of the external debt while transferring a huge amount of Ethiopia's wealth to Eritrea without any authority from the Ethiopian public or its representatives? Meles Zenawi's unprecedented act of generosity raises serious questions about his stewardship of Ethiopia's national economic interests.

Conclusion

The decision of the transitional government to enter into a preferential trade agreement with the EPLF that benefitted Eritrea was not due to its carelessness, negligence, indifference, naiveté, hubris, or incompetence. It was a rational political decision that the TPLF leadership made to consolidate its grip on power in the early 1990s, but it resulted in a net economic loss for Ethiopia and a net economic gain for Eritrea. The common market allowed the EPLF to transfer a large amount of Ethiopia's resources, worth billions of dollars, to Eritrea over eight years. The transferred resources generated income, foreign exchange, and employment for Eritrea. Khadiagata (1999, p. 43), for example, asserts that the common market produced some 300,000 jobs in Eritrea. Beyond the common market, the strategic alliance that the two fronts forged in the early 1990s, in part based on their shared negative attitude if not outright enmity towards Ethiopia, enabled the EPLF to acquire Ethiopia's physical assets in Eritrea and to forego Eritrea's share of Ethiopia's national debt without any compensation or obligation to Ethiopia. The preferential treatment of Eritrea at the expense of Ethiopia by the TPLF-controlled government is emblematic

of its resolve, even today, to stay in power by pursuing policies that undermine Ethiopia's economic interests, national unity, and political transformation to democratic governance.

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