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Ethiopia in the World Economy: Trade, Private Capital Flows, and Migration

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Abstract. Economic globalization can be evaluated with reference to at least three dimensions: trade, private capital flows, and migration. For each of these dimensions, pathways can be identified through which economic globalization can alleviate or contribute to poverty. This paper makes a preliminary examination of the pathways between globalization and poverty for the case of Ethiopia. As one of the world's poorest countries, Ethiopia's integration with the world economy takes on specific features. It is highly dependent on the exports of a few goods, has imported a large amount of arms, is largely excluded from global FDI flows, benefits from relatively large inflows of remittances, and is largely excluded from the evolving global regime of intellectual property. Despite a number of negative trends with regard to globalization and poverty, there is room for "small win" policies that would enhance the role of globalization in supporting poverty alleviation.

1. Introduction

Economic globalization can be evaluated with reference to at least three dimensions: trade, private capital flows, and migration. For each of these dimensions, pathways can be identified through which economic globalization can help or hurt poor people. For example, exports of labor-intensive goods have the potential of supporting the incomes of poor people, but imports of armaments can have disastrous impacts, especially for poor children. Capital inflows in the form of FDI can enhance employment and technological learning, but unwise bond finance and commercial bank lending can precipitate crises with devastating effects for poor people.[2] Sorting out the positive and negative impacts of increased globalization from the point of view of poor people is therefore of great importance. This paper attempts to do so using the particular circumstances of Ethiopia as a central reference point.

[2] As noted by Eichengreen (2004), an "average" or "typical" financial crisis can claim up to 9 percent of GDP. Some of the worst crises, such as those in Argentina and Indonesia, reduced GDP by over 20 percent, declines greater than that which occurred in the United States during the Great Depression. This has particular relevance for potential capital account liberalization in African countries since, as noted by Singh (1999), banking sectors in this region are notoriously fragile. Additionally, as documented by Stiglitz (2001) and Wade (2001), Ethiopia has in the past been under pressure by the International Monetary Fund to liberalize its capital account.

A few papers have taken up issues related to Ethiopia's involvement in the process of globalization. These include Asefa and Lemi (2004), Dercon (2003), Ramakrishna (2002), Tessema (2003), and Bourguignon et al. (2004). This paper will try to place these studies in the wider context of the globalization-and-poverty research agenda. The economic challenges facing Ethiopia tend to lead the observer to conclude that little can be done to positively affect Ethiopia's engagement with the global economic system. This paper will be *somewhat* more optimistic, suggesting that the strategy of a country such as Ethiopia in engaging the world economy is best engaged in terms of what Weick (1984) referred to as "small wins."[3] The paper will explore some potential small wins within Ethiopia's grasp in order to identify specific strategies to make its globalization more pro-poor.

2. Poverty

The most common measure of poverty is *income poverty*, a deprivation of goods consumption due to a lack of necessary purchasing power. Measured in terms of purchasing power parity (PPP), gross national income (GNI) per capita in Ethiopia was just over US$700 in 2003 (up from approximately US$400 in 1985). Figure 1 compares GNI per capita in Ethiopia with that of two other transitional economies, namely South Africa and Vietnam. What stands out in this figure is the "flat" nature of per-capita income in Ethiopia over time in comparison to these two other countries.

In the parlance of the World Bank, individuals who exist on less than one dollar a day (1985 purchasing power parity dollars) are known as the "extremely poor," while individuals who exist on less than two dollars a day (1985 purchasing power parity dollars) are known as the "poor."[4] In the case of Ethiopia, figures on the "poor" and "extremely poor" are available for only the year 2000. They indicate that approximately one quarter of Ethiopia's population is "extremely poor," but that over three quarters of the population is "poor."

[3] Weick (1984) noted that "Changing the scale of a problem can change the quality of resources that are directed at it. Calling a situation a mere problem that necessitates a small win moderates arousal, improves diagnosis, preserves gains, and encourages innovation" (p. 48).
[4] See Chen and Ravallion (2004).

There is a growing recognition that income poverty is not the only important measure of deprivation. With regard to *health poverty*, for example, infant and child mortality are key indicators. As is indicated in Figure 2, approximately one in six Ethiopian children do not live to age five. Again this figure compares Ethiopia with South Africa and Vietnam. While Ethiopia shows some improvement relative to South Africa, it falls far behind the gains of Vietnam where infant and child mortality was cut in half in 13 years. Short of mortality, a number of morbidity issues are of central concern for Ethiopia. For example, Christiaensen and Alderman (2004) refer to the "the sheer magnitude of child malnutrition in Ethiopia" (p. 288). In the case of stunting, for example, the rate is approximately 60 percent of all children, significantly above an average approximately 40 percent for sub-Saharan Africa.[5] Bourguignon et al. (2004) also note that, while down from its 1990 level, the 2002 maternal mortality rate (per 100,000 live births) was still over 600.

Education poverty, including gender disparities, is important both in its own right, as well as a factor contributing to health poverty.[6] The work of Bigsten et al. (2003) suggests that primary education does play an important role in translating growth into poverty reduction in Ethiopia, albeit more for the urban poor than the rural poor. Fortunately, it is here that we see a bit of good news. As presented in Figure 3, the gross primary enrollment ratio has been on a long-term, upward trend. More importantly, though, there has been a rapid increase in this enrollment ratio during the 1990s, with the 2002 ratio being just under 62 percent.[7] That said, however, as noted by Bourguignon et al. (2004), Ethiopia's primary completion rate is below the average for sub-Saharan Africa.

Whether from the perspectives of income, health, or education, poverty levels are of grave concern for Ethiopia. The orthodox view of the multilateral development institutions is that more domestic liberalization, growth, and globalization can help address this concern. Is this so? Dercon (2003) analyzes domestic liberalization and concludes that it is poverty alleviating overall, despite the fact that poor people in remote areas and with poor household endowments do not necessarily benefit. With regard to

[5] See also Silva (2005).
[6] On gender disparities in education, see Schultz (2002).
[7] The primary completion rate was just under 40 percent in 2003, up from 15 percent in 1993.

growth, Bourguignon et al. (2004) note that: "While the linkage between income growth and income poverty reduction is quite tight, so that high growth leads to significant reductions in income poverty, improvements in the other (human development measures are are) not readily achieved from growth alone" (pp. 1-2). With regard to globalization more broadly, we consider trade, private capital flows, and migration in the remainder of this paper.

3. Trade

Of all aspects of globalization, it is international trade that is held out as the great hope for poverty alleviation.[8] Trade can contribute to poverty alleviation by expanding markets, promoting competition, and raising productivity, each of which has the potential to increase the real incomes of poor people. But, as the recent histories of a number of countries demonstrate, it would be a mistake to rely on trade liberalization alone as a means of reducing poverty.[9] A more comprehensive approach is needed that addresses multiple economic and social challenges simultaneously and that emphasizes the expansion of poor people's capabilities, especially in the areas of health and education.[10] Nevertheless, trade has some vital roles to play.

International trade is a means of *expanding markets*, and market expansion can help to generate employment and incomes for poor people. Comparisons are often made between the wages of workers in poor-country export industries and the wages of workers in developed countries. In these comparisons, the wages of workers in developing-country export industries often appear to be very low. Consequently, trade has often been identified as poverty worsening. However, the more relevant comparison is between what people may have earned before and after trade opportunities were made available. From a poverty perspective, this could be between the wages of export sector

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[8] See Dollar and Kraay (2004), for example. An alternative view is given in Rodríquez and Rodrik (2001). A thorough review of trade and poverty is provided by Winters, McCulloch, and McKay (2004).

[9] The fact that the trade-poverty alleviation linkage is not automatic has been stressed by UNCTAD (2004) in the case of the least-developed countries.

[10] Oxfam (2002a) notes that "In itself, trade is not inherently opposed to the interests of poor people. International trade can be a force for good, or for bad… The outcomes are not pre-determined. They are shaped by the way in which international trade relations are managed, and by national policies" (p. 28).

workers with agricultural day laborers, both in the same developing country. Here it can often be seen that it is the alternative of agricultural day labor that is much worse. It is precisely this type of income comparison that draws workers into export industries.[11]

It must be kept in mind that not all export activity is equal from the point of view of raising the income of poor people. Exporting can best contribute to poverty alleviation when it supports labor-intensive production, human capital accumulation (both education and health), and technological learning. In addition, the incomes of poor individuals depend on buoyant and sustainable export incomes, which in turn are dependent on export prices.

International trade is also a means of *promoting competition*, and in many instances, this can help poor people. Increased competition lowers the real costs of both consumption and production. For example, domestic monopolies charge monopoly prices that can be significantly above competitive prices. The competition introduced by imports erodes market power, lowering prices. These pro-competitive effects of trade can make tight household budgets go farther and lower costs of production. The latter can have knock-on employment effects advantageous to poor individuals by lowering non-wage costs in labor-intensive production activities. Pro-competitive effects can also arise in the case of monopsony power. Here, sellers (small farmers, for example) to the monopsony buyer are able to obtain higher prices for their goods as the buying power of the monopsonist is eroded.

There is some evidence that international trade can *promote productivity* in a country, and it is possible that productivity increases can in turn support the incomes of poor people.[12] It is not the case that exports *of all types* or *in all countries* generate positive productivity effects, but there is evidence that this is the case in certain instances. Export postures can place the exporting firms in direct contact with discerning international customers, facilitating upgrading processes. There is no consensus within international economics on the extent of these upgrading effects, but they nonetheless remain an important possibility including in natural resource intensive sectors.[13]

[11] On the case of Bangladesh, for example, see Zohir (2001) and Oxfam (2002a).
[12] For a review of the evidence on trade liberalization and productivity, see Winters, McCulloch, and McKay (2004).
[13] On the latter, see de Ferranti et al. (2002).

There are occasions where international trade can have direct health and safety impacts on poor individuals, impacts that can be beneficial or detrimental. Perhaps most importantly, improving the health outcomes of poor people usually involves imports of medical products. It is simply not possible for a small, developing country like Ethiopia to produce the entire range of even some of the more basic medical supplies, no less more advanced medical equipment and pharmaceuticals. However, many developing counties import large amounts of weaponry and export sexual services, both of which can have dramatically negative outcomes for the health and safety of poor individuals.[14] In addition, the production processes of some export industries can adversely affect the health of workers in those industries, and a small but important amount of trade involves hazardous waste dumping.

Ethiopia has increased its involvement in international trade, although less rapidly than other countries. Figure 4 plots the standard measure of the sum of exports and imports as a percent of GDP for Ethiopia, South Africa and Vietnam. Note that, in the mid-1980s, Ethiopia was slightly more engaged in trading activities than Vietnam, whereas in the most recent years, its total trade is less than half of Vietnam's, measured as a percent of GDP. In comparison with South Africa, however, Ethiopia has slowly achieved parity in this measure of trade openness.

Ethiopia's export profile is presented in Figure 5. What is immediately clear from this figure is Ethiopia's dependence on coffee exports. Primary commodity dependence of this sort has a number of drawbacks from the point of view of poverty alleviation. First is the secular, downward trend in commodity prices. Second is the escalating protection in primary commodity markets in developed countries.[15] Third is the monopsonistic pricing along commodity chains practiced by major coffee multinationals.[16] This dependence problem was apparent as coffee export revenues fell by over US$100 million between 1999 and 2001 as coffee prices fell to a 30-year low. As noted by Oxfam (2002b), this decline in export revenues more than offset the debt relief Ethiopia obtained

[14] This point is emphasized by Reinert (2004).
[15] To be fair, as noted by Oxfam (2002), "import tariffs into rich-country markets are not the main barrier for most coffee proucers" (p. 33).
[16] This issue was raised some time ago by Brown and Tiffen (1992) and more recently in the case of coffee by Oxfam (2002b). In the case of coffee, the main players are Kraft, Nestlé, Procter & Gamble, and Sara Lee. See also Talbot (2002).

from the Highly Indebted Poor Country (HIPC) initiative, and many Ethiopian coffee farmers have been forced to shift to the production of *chat*, a stimulant used in the region around the Red Sea.

We must be careful in interpreting data such as presented in Figure 5, however. Such descriptions exclude services trade, which is significant for Ethiopia. Figure 6 plots commercial service exports as a percent of total exports. This has been on a steady, if somewhat volatile, upward trend, reaching nearly half of total exports in 2002. As any passenger on Ethiopian Airlines will appreciate, the bulk of this service exports is accounted for by transportation services. It is therefore important to consider the full range of Ethiopia's trade engagement, not the traditional, commodity-only view.

Despite the pressing human development needs of the poorest countries such as Ethiopia, arms imports have at times composed a significant part of its total imports and government military expenditures a significant part of total government expenditures. This is illustrated for various years (determined by data availability) in Figure 7. The vertical bars in this figure plot government military expenditures as a percent of total government expenditures. For the years in which data are available, this ranged from just over 20 percent to nearly 55 percent. The line in Figure 7 plots arms imports in constant, 1990 US dollars. This peaked in 1998 at approximately US$200 million but has composed up to one fifth of total imports at times. Such trade cannot be conceived of as poverty alleviating. Indeed, in the case of Ethiopia (and Eritrea), it has been nothing less than a catastrophe, and it is difficult to conceive of a more perverse role for trade than in facilitating the death and injury of the very people it should be benefiting.[17]

4. Private Capital Flows

Private capital flows are an important resource for developing countries. Capital flows augment domestic savings and can contribute to investment, growth, financial sector development, technology transfer, and poverty reduction. However, there is also substantial evidence that capital flows entail potential costs that are both much larger than in the case of trade and disproportionately carried by the poor. Additionally, it has

[17] The author cannot resist relating the observation of an individual from the region that the border conflict between Ethiopia and Eritrea has been like "two bald men fighting over a comb."

become clear that not all capital flows are the same in their benefit and cost characteristics. For these reasons, a careful assessment of the impact of capital flows on poverty does not lend itself to across-the-board statements. Rather, the cost and benefit characteristics of distinct types of capital flows must be considered in some detail. Here we distinguish among foreign direct investment, equity portfolio investment, bond finance, and commercial bank lending.

The financial markets involved in equity portfolio investment, bond finance, and commercial bank lending are characterized by a number of market failures. In normal circumstances, these imperfections tend to contribute to a certain amount of market volatility. Under certain circumstances that are not fully understood (but are particularly important in emerging economies such as Ethiopia), they can lead to full-blown financial crises. Imperfections in financial markets appear to be particularly problematic when commercial banks in developing countries are given access to short-term, foreign lending sources.[18] The resulting problems have three causes. First, systems of financial intermediation in developing countries tend to rely heavily on the banking sector, other types of financial intermediation typically being underdeveloped. Second, developing countries have been encouraged to liberalize domestic financial markets, sometimes before systems of prudential bank regulation and management are put in place. Third, developing countries have sometimes prematurely liberalized their capital accounts.[19] Consequently, care must be taken in managing evolving financial systems and their access to international capital flows.

Foreign Direct Investment

Foreign direct investment can have positive impacts on poverty by creating employment, improving technology and human capital, and promoting competition. Not all kinds of FDI contribute in this way, however, and some can adversely impact certain

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[18] The World Bank (2001) notes that “If finance is fragile, banking is the most fragile part” (p. 11).

[19] For a critique of premature capital account liberalization, see Stiglitz, (2000). As the World Bank (2001) notes, “Poor sequencing of financial liberalization in a poor country environment has undoubtedly contributed to bank insolvency” (p. 89). Hanson, Honohan, and Majnoni (2003) also note that “the riskiness of capital account liberalization without fiscal adjustment… and without reasonably strong financial regulation and supervision and a sound domestic financial system, is well recognized” (p. 10). On pressures for premature capital account liberalization in Ethiopia, see Stiglitz (2001) and Wade (2001).

dimensions of poverty through unsafe working conditions and environmental degradation. Nevertheless, if we were to identify the most promising category of capital flows from the point of view of poverty alleviation, FDI would be it.[20]

Many developing countries lack access to the technologies available in developed countries, and hosting MNEs from developed countries is one way to potentially gain access to that technology. There are limits to technology transfer, however. First, MNEs will employ the technology that most suits *their* strategic needs and not the development needs of host countries. For example, MNEs can employ processes that are much more capital intensive than would be desired on the basis of host-country employment considerations.[21] Second, there is a strong tendency for MNEs to conduct their research and development in their home bases rather than in host countries.[22]

Despite these general limitations, in some important cases, MNEs do transfer technology and establish significant relationships with host-country suppliers via *backward linkages*. If foreign MNE begins to source inputs locally rather than by importing them, the host country can gain a number of important benefits. First, employment can increase since the sourced inputs represent new production. Second, production technologies can be better adapted to local conditions since suppliers are more likely to employ labor-intensive processes. Third, the MNE can transfer state-of-the-art business practices and technologies to the local suppliers. Fourth, it is possible that the local suppliers can coalesce into a spatial cluster that supports innovation and upgrading.[23]

[20] The present paper is in broad agreement with Singh (1999) that "The experience of many Asian and Latin American countries with portfolio capital flows… indicate that the African countries would benefit from using their efforts and institutional resources to attract FDI rather than portfolio flows" (p. 356). It does, however, distinguish between portfolio flows in the form of equity investment and those in the form of bond finance, with a preference for the former.

[21] Caves (1996) noted that "Survey evidence indicates that MNEs do some adapting (of technologies to labor-abundant conditions), but not a great deal, and it appears that the costs of adaptation commonly are high relative to the benefits expected by individual companies" (p. 241).

[22] Dunning (1993) noted that "With the exception of some European-based companies, the proportion of R&D activity by MNEs undertaken outside their home countries is generally quite small and, in the case of Japanese firms, negligible" (p. 301).

[23] For the role of clusters in natural resource-based development, such as might be important to Ethiopia, see Ramos (1998).

Another avenue through which MNEs can positively affect host economies is through "spillovers" to other sectors of these economies. The evidence to date suggests that such spillovers do occur in some circumstances and can be significant. However, in the words of Blomström and Sjöholm (1999), they are not "guaranteed, automatic, or free." What determines whether positive technology spillovers will occur? Many factors are involved, and these include host country policies, MNE behavior, and industry characteristics. One key factor is the capacity of local firms to absorb foreign technologies. Blomström and Kokko (2003) suggest that *learning* is a key capacity that is responsive to various host country policies, and evidence presented in Tsang, Nguyen and Erramilli (2004) in the case of Vietnam support this view.

There is some evidence that MNEs in Africa offer higher wages than domestic firms.[24] This effect is more predominant for skilled than unskilled workers. FDI can therefore have differential impacts that exclude unskilled workers. This can result in what te Velde (2001) refers to as the "low-income low-skill trap." All of these considerations point to the role of basic education and skills development in making the most of FDI for poverty alleviation.[25]

The low-income countries as a whole are largely excluded from global FDI flows. For example, in 2002, low-income countries received only two percent of total FDI flows, with nearly half of this going to India and Vietnam alone. Figure 8 compares Ethiopia with South Africa and Vietnam and illustrates the fact that, with the exception of a few years in the late 1990s, FDI flows into Ethiopia have been nearly non-existent. This poses a serious challenge to the country. As we discuss below, the country might be able to make better use of its diaspora to stimulate inflows of FDI, since these individuals will be better able to overcome information gaps regarding the investment climate in the country. A regional approach to FDI under the Common Market for Eastern and Southern Africa (COMESA) is another possibility.

[24] See te Velde and Morrissey (2003).

[25] Borenszteirn, De Gregorio, and Lee (1998) find that it is the *combination* of FDI and education that has a statistically significant impact on growth.

Equity Portfolio Investment

There is evidence that capital inflows in the form of equity portfolio investment might be more beneficial than both bond finance and commercial bank lending. For example, Reisen and Soto (2001) have examined the impact of all four capital inflows considered here on growth for a sample of 44 countries. They found that FDI, considered above, did indeed have a positive impact on economic growth. The most positive growth impact, however, came from equity portfolio flows. Bond finance, considered below, did not have any impact on growth, and commercial bank lending, also considered below, had a negative impact. These results suggest that equity inflows, along with FDI, could play an especially positive role in growth, development, and poverty alleviation.

Why can equity portfolio investment play a positive role in growth and development, at least under some circumstances? Rouseau and Wachtel (2000) summarize research on this question with four possibilities: equity portfolio inflows are an important source of funds for developing countries; the development of equity markets helps to provide an exit mechanism for venture capitalists, and this increases entrepreneurial activity; portfolio inflows assist developing countries to move from short-term finance to longer-term finance and help to finance investment in projects that have economies of scale; the development of equity markets provides an informational mechanism evaluating the performance of domestic firms and can help provide incentives to managers to perform well.

With regard to volatility, there is some evidence that institutional investors managing equity flows are less likely than banks to engage in herd and contagion behavior.[26] However, in general, equity markets are underdeveloped in much of the developing world. For example, nearly the entire net portfolio equity inflows into Sub-Saharan Africa are accounted for by one country alone: South Africa. The World Bank (2004) summarized the features of developing-country equity markets as follows:

> Market capitalization as a share of GDP in low-income countries is about one-sixth of that in high-income countries…. Stock exchanges in developing countries also tend to lag technologically behind developed markets. Technology plays a major role in the trading, clearance, and

[26] This evidence is reviewed in Chapter 1 of Dobson and Hufbauer (2001). Singh (1999), to some extent at least, contests this conclusion.

> settlement processes; problems in those areas can discourage sophisticated investors. Institutions that supervise and support the operation of the stock exchange also tend to be weaker in developing countries (p. 95).

The development of equity markets in low- and middle-income countries is more complex than it might first appear, however. This is due to the increased globalization of financial services. Observers have pointed to a set of domestic factors as being particularly important in equity market development. These factors include sound macroeconomic policies, minimal degrees of technology, legal systems that protect shareholders, and open financial markets. However, as pointed out by Claessens, Klingebiel, and Schmukler (2002), these are precisely the factors that tend to promote the "migration" of equity exchange out of developing countries to the major exchanges in financial capital of developed countries. This migration process complicates standard notions of equity market development. Steil (2002) has argued that the way forward is to link local markets with global markets. However, there might remain medium-sized firms with local information needs that could benefit from some kind of domestic equity market. This is an area that requires urgent attention for the development of novel approaches.

At present, inflows of equity investment into Ethiopia are essentially non-existent. As in the case of FDI, then, this represents a significant challenge to Ethiopian policymakers. We take up this challenge below.

Bond Finance and Commercial Bank Lending

In the minds of the financial world, there are significant differences between portfolio equity investment and debt. This shows up in the fact that, in the case of bankruptcy, debt is given priority over equity. This tends to support the preference for debt over equity in markets, a preference that appears to be misplaced from a development and poverty alleviation perspective. At present, inflows of bond finance into Ethiopia are non-existent. From a poverty perspective, this is not a cause of great concern at present. Greater benefits would be attained from increases in FDI and equity portfolio inflows.

With regard to commercial bank lending, Dobson and Hufbauer (2001) note that "Bank lending may be more prone to run than portfolio capital, because banks themselves are highly leveraged, and they are relying on the borrower's balance sheet to ensure repayment" (p. 47). The World Bank (2001) notes that "Incentives are key to limiting undue risk-taking and fraudulent behavior in the management and supervision of financial intermediaries—especially banks that are prone to costly failure" (p. 3).

What can be done to support the safe development of banking sectors in low-income countries such as Ethiopia? Some of the necessary steps can be thought of in terms of information, institutions, and incentives. With regard to *information*, it is important for banks to embrace internationally-sanctioned accounting and auditing procedures and to make the results of these assessments available to the public. In the case of *institutions* or the rules of the "banking game," risk management practices (both credit and currency) must be sufficiently stringent, and prudential regulation systems must be well developed. With regard to currency risk, the World Bank (2004) notes that "particular care should be taken to ensure that foreign-currency liabilities are appropriately hedged" (p. 30).[27] These information and institutional safeguards are no small task and inevitably cannot be achieved in the short term. Consequently, they should be buttressed with *incentive* measures in the form of market-friendly taxes on banking capital inflows.

To summarize, debt flows in the form of bond finance and commercial bank lending appear to have different properties than equity flows in the form of FDI and portfolio equity investment. They are more prone to the imperfect behaviors that characterize financial markets and do not appear to have positive growth effects as large as those associated with equity flows. Consequently, utilization of debt finance must be cautious and sufficiently hedged against exchange rate risks.

[27] Mistakes made in these areas have proved to be too costly to the poor in the past for countries to relax their vigilance. Prasad et al. (2003) conclude that: "The relative importance of different sources of financing for domestic investment, as proxied by the following three variables, has been shown to be positively associated with the incidence and the severity of currency and financial crises: the ratio of bank borrowing or other debt relative to foreign direct investment; the shortness of the term structure of external debt; and the share of external debt denominated in foreign currencies" (p. 49).

5. Migration

Historical analysis demonstrates that international migration can offer an effective means for poor people to escape poverty, while promoting economic growth and technological progress.[28] Communities can be lifted out of poverty via remittance flows from the country's diaspora. Also, when migrants are successful in business endeavors, the diaspora can become involved in trade and capital flow networks that facilitate market access, investment, and technology transfer. That said, however, migration can also be devastating to those left behind. Migrants can take with them critical skills, especially in the area of health. Further, the loss of household heads, innovators, and social leaders can cause a broad array of costs, including to social cohesion. As stated by OECD (2005), "emigration of highly skilled workers may adversely affect small countries by preventing them reaching a critical mass of human resources, which would be necessary to foster long-term economic development." Since highly-skilled workers tend to generate the largest share of tax revenues, emigration can also have detrimental impacts on the tax base, with knock-on effects in the areas of public services and infrastructure. Some governments have attempted to offset these losses by taxing remittance inflows, but these attempts are not generally successful.[29] The net impact of migration on source countries is therefore uncertain.

The loss of high-skilled workers is a significant issue for Ethiopia. Migrating involves incurring private costs that can be significant. Consequently, migration rates tend to be higher for high-skilled individuals who can better overcome these costs.[30] African countries have been hard hit in this process of "brain drain," and Ethiopia has not escaped this phenomenon. For example, El-Khawas (2004) points out that there are more Ethiopian doctors in Europe and North America than in Ethiopia. More generally, Aredo (1998) estimated that, between 1968/69 and 1995/96, more than one third of Ethiopian students who went abroad for graduate study did not return. As pointed out by Beath, Goldin, and Reinert (2006), a brain drain does increase the rate of return to education. However, since the skills lost are often crucial ones, it seems unlikely that this would offset the losses involved in the Ethiopian case. The Ethiopian government, having

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[28] This section draws on Beath, Goldin, and Reinert (2006).
[29] See Lowell (2001).
[30] See, for example, Carrington and Detragiache (1999).

hosted the Regional Conference on Brain Drain and Capacity Building in 2000, is obviously aware of these problems.

On the positive side, Ethiopia receives a significant amount of remittances from its migrants. In discussions of globalization and poverty, the role of remittances is often underestimated. Figure 10 plots Ethiopia's remittances as a percent of FDI inflows. As this figure demonstrates, though smaller, remittances are on the same order of magnitude as FDI, even reaching over 90 percent of FDI in 2001. As empirically demonstrated by Aredo (2005), Ethiopians use remittance income as a risk-sharing mechanism for self insurance against shocks of various kinds.[31] A key challenge for the country, then, is to make better use of these remittance flows, while harnessing the diaspora for increased FDI flows. We address these issues below.

6. "Small Win" Policy Recommendations

Globalization does not represent a panacea for the poor citizens of low-income countries like Ethiopia. However, it is worthwhile to inquire into whether there are any opportunities for what Weick (1984) referred to as "small wins" via policy changes and endeavors. It must first be said that the most important policies are in the area of universal primary education and the fight against infectious diseases. For example, Silva (2005) has identified the externalities associated with basic environmental services such as water and sanitation on child malnutrition in Ethiopia, and health advances can be made by training that falls short of fully-certified doctors and nurses.[32] With regard to globalization, however, we consider some policy recommendations for trade, capital flows, and migration, respectively.

International Trade

The trade challenge facing Ethiopia from the point of view of poverty alleviation is to promote labor-intensive exports in order to support a widely-dispersed expansion of incomes. This will not occur through an automatic comparative advantage process, and it is more productive to think in terms of potential *competitive* advantages in narrow product categories. It is also important to be alert to any potential cluster effects among

[31] Similar evidence for risk sharing was found in the case of Mali by Gubert (2002).

[32] See Dugger (2004). This has the advantage of preventing brain drain of health-sector personnel.

these product categories. For example, Ethiopia's export profile suggests that it is possible to think about the emergence of cotton products and leather clusters. Given the success of the African Cotton Initiative in the World Trade Organization dispute settlement process, the future of cotton might be brighter than in the past. With the right marketing and documentation, Ethiopia has potential in organic cotton product niches in Europe and the United States. More generally, it could be possible to take advantage of China's increase in demand for cotton that is accompanying its rapidly-expanding clothing exports. With regard to leather products, the presence of the COMESA Leather and Leather Products Institute (LLPI) in Addis is a positive sign. Such institutes are often at the center of emerging clusters. With regard to both cotton and leather products, the Ethiopian Ministry of Trade and Industry's involvement in the 2004 UNIDO workshop on these two sectors is a very positive step, particularly with regard to the strengthening of the leather supply chain.[33]

In the case of coffee, the promotion of "fair trade" certification would ensure the maximum value for developing country producers in the face of export price declines.[34] For example, as noted by Oxfam (2002b), "At the Oromiya Coffee Farmers Cooperative Union in Ethiopia, farmers can get 70 percent of the export price for coffee that sells as Fair Trade, while those in the Jimma zone of Ethiopia's Kafa province, selling in the open market, get only 30 percent" (p. 41). Given the magnitude of the coffee crisis, it is difficult to disagree with Oxfam's assessment that "whether or not Fair Trade can be applied in the mainstream, the lack of alternatives and the absence of government safety nets for poor producers make this sort of support to farmers an entirely justifiable and appropriate attempt to cope with the human cost of the rigors of the free market" (p. 42). Expansion of fair trade opportunities for Ethiopia's coffee farmers is therefore a key priority, especially in light of the difficulties outlined by Talbot (2002) in attempting forward integration along the coffee commodity chain.[35] Although forward integration

[33] UNIDO is also supporting the role of Ethiopia in the International Network for Bamboo and Rattan (INBAR), and this could also have some future promise.
[34] See Raynolds (2000) and references therein.
[35] Given the nature of coffee production, the only real room for forward integration is into instant coffee production.

along the tea commodity chain is easier than for coffee, promoting fair trade opportunities for the expanding tea sector is also important.

The movement of natural persons (WTO Mode 4 of services trade) offers large potential benefits to a country such as Ethiopia. While Ethiopia is not a member of the WTO, it needs to make as much use of this services trade mode as possible through bilateral arrangements. As Winters et al. (2002) have shown, the gains for developing countries from an increase of only 3 percent in their temporary labor quotas would exceed the value of total aid flows and be similar to the expected benefits from the Doha Round of trade negotiations, with most of the benefits to developing countries coming from increased access of *unskilled* workers to jobs in developed countries.[36]

Ethiopia's export of tourist services remains largely untapped, and the potential for cultural tourism and ecotourism is great, especially so given the country's airline and its diaspora's involvement in travel agencies. In a related area, Ethiopia is largely excluded from the evolving global regime of trade-related, intellectual property. The government needs to follow the lead of India and begin to construct a Traditional Knowledge Digital Library (TKDL) containing a formal inventory of all cultural property that its citizens might exploit in the future.[37] This is important to prevent future theft of the country's cultural patrimony. One important area is that of music copyright, but there are others as well.[38]

As has been recently noted by a number of researchers, developing countries play a role in trade as nodes in global production networks (GPNs).[39] GPNs refer to refers to the process whereby the production of a final good having previously taken place in a single country is broken down into a number of discrete steps each taking place in different countries. The evolution of GPNs has responded to: technological progress in transportation, technological progress in communications, technological progress in data processing, reduced restrictions on FDI inflows, and trade liberalization. As noted by the

[36] As pointed out by Puri (2002), there is an important gender element here: "For the majority of women, Mode 4 provides the only opportunity to obtain remunerative employment with temporary movement to provide services abroad. It has been found to have a net positive effect on the economy and poverty reduction in the home country" (p. 8).
[37] See Sahai (2003) and Das (2006), for example.
[38] The contributions to Silverman (1999) are relevant in this regard.
[39] See, for example, Bair and Gereffi (2001), Clancy (1998), Henderson et al. (2002), and World Bank (2003).

World Bank (2003), to date, Africa has been largely left out of this important globalization process, and UNCTAD (2002) has questioned the benefits involved in GPN participation. It is not clear whether Ethiopia will achieve the necessary policy and infrastructure prerequisites to be a potential GPN participant, but sustained trade-related capacity building supported by multilateral financial institutions could potentially change this.

Capital Flows

Both the Ethiopian government and the Addis Ababa Chamber of Commerce have investigated the possibility of organizing an equities exchange.[40] This is no small endeavor. Although the presence and upgrading of the Nairobi equities exchange in Kenya indicates that it might be possible, the first priority with regard to capital flows would be to ensure the prudential regulation of the emerging banking sector, with care given to strenuously conditioning its borrowing in foreign currencies. Given this first step, one possibility would be to link any nascent exchange to the one in Johannesburg in order to tap into existing technology. More realistic still would be to give serious consideration to the suggestion of Mwenda and Muuka (2001) for cooperation within COMESA to form a *regional* equity market in order to promote multiple listings and cross-border equity investments. Given the liquidity requirements of equity exchanges, this would appear to be a wise option.

With regard to direct investment, the Ethiopia Investment Authority (EIA) could make better use of the country's foreign population in order to better facilitate FDI flows. In addition, it makes sense to tightly link the EIA to the proposed COMESA Regional Investment Agency. As discussed above, it is simply a characteristic of modern, global production that it involves international and regional networks. Attempting to "go it alone" with regard to investment projects is therefore shortsighted.

Migration[41]

Improving the benefits of migration includes strengthening the financial infrastructure supporting remittances. New e-commerce technologies, including in foreign exchange markets and in electronic cards, offer great potential to reduce the

[40] See Tessema (2003).
[41] Some of the suggestions here draw from Beath, Goldin, and Reinert (2006).

overall transactions costs. The availability of accessible remittance services in expatriate communities and near the destination of the people to whom the funds are to be transferred, which offer simple processes in languages understood by the migrants, can greatly facilitate remittance flows. It will also encourage the movement of remittances from unofficial and unregulated networks into regulated flows, which is important to address security as well as poverty concerns. Before recommending tax measures, official savings associations, and other government-led mechanisms to increase the beneficial impact of remittances, care must be taken to ensure that these will be welcomed by the diaspora itself. Otherwise, they will reduce their remittances or revert to unofficial channels.

To some degree, governments can influence the decisions of skilled people to leave and to keep their capital in the country by shaping the overall environment for skilled people, by providing a safe and secure working environment, by reaching out to skilled people, and seeking their involvement in decision making. However, given the gaps in earning power and the attractions of cosmopolitan environments, this holding power is limited, particularly for poor countries such as Ethiopia. Some countries have also implemented programs to better direct remittances into development-oriented investments. For example, the Mexican government has assisted Mexican emigrants in establishing "Home-Town Associations" that support infrastructure and enterprise in home communities and "Economic Development Funds" in which contributions are matched by the Mexican government. This effort has spawned similar policies by El Salvador and its emigrant community.[42]

Within the context of the African continent, the South African Network of Skills Abroad (SANSA) offers a model for harnessing the skills of expatriates.[43] A primary purpose of SANSA is to gather information about expatriate South Africans in order to assess how their skills can be best matched to local needs. Modes of contribution by expatriates include: participation in training programs, technology transfer activities,

[42] See Stalker (2001). As pointed out by Kiggundu and Oni (2004), Ethiopia did benefit for some time from the International Migration Organization's Return and Reintegration of Qualified African Nationals (RQAN). It has been some time, however, since this program has been in existence.

[43] SANSA is a joint project of the South African National Research Foundation and Department of Science and Technology.

research result dissemination, and facilitation of business contacts and development.[44] Since both South Africa and Ethiopia share the characteristic of having diasporas concentrated in relatively few countries, the SANSA model holds out some promises for Ethiopia and could perhaps be replicated. For example, highly-skilled migrants could be tracked through a data bank and catalogued for future consultation assignments. This data-gathering exercise could be achieved through voluntary, web-based registration, passenger surveys on Ethiopian Airlines, and inquiries by embassy staff.[45]

7. Summary

While globalization is not a panacea, there are aspects of Ethiopia's trade, capital flows, and migration where "small win" policy changes can be made that would have beneficial impacts for its poor citizens. Trade, FDI, and migration can be harnessed in a synergistic manner to deliver at least of modicum of benefits from the inevitable process of globalization the country confronts. Leveraging fair trade and promoting natural resource clusters can provide potential gains in export expansions. Of all capital flows, it is FDI and equities that hold the most promise with regard to long-term poverty reduction. Ethiopia should give serious consideration to regional efforts within COMESA both with regard to a Regional Investment Agency and with regard to the development of a regional equities exchange. To prevent future crises, prudential regulation of commercial banking is also a priority. As a country with a large diaspora containing highly-trained and motivated individuals, it must exploit the potential of this network. This is particularly the case because the country's unusual position in air transportation services can effectively tie it into this network.

In two respects, the focus of this paper is too narrow. First, as the work of Bourguignon et al. (2004) makes clear, progress on an inclusive set of poverty measures in Ethiopia will depend on foreign resources not just in the form of private trade incomes, capital inflows, and remittances, but in the form of public or quasi-public foreign aid. Properly securing and managing these flows is crucial for poverty reduction but involves

[44] See http://sansa.nrf.ac.za and Kaplan (1997) for further information.

[45] The Ethiopian North American Health Professionals Association is already involved in such activities. See www.enahpa.org.

yet another set of considerations beyond the scope of this paper. Second, any amount of "small win" policy changes in Ethiopia, important as they are, will not change the external environment that remains, in many crucial respects, antagonistic to the success of low-income countries. Protectionism, agricultural subsidies, inappropriately-defined protection of intellectual property, and resistance to the temporary movement of labor-intensive service providers all remain a constraints to success. For these reasons, the challenges facing Ethiopia are numerous indeed.

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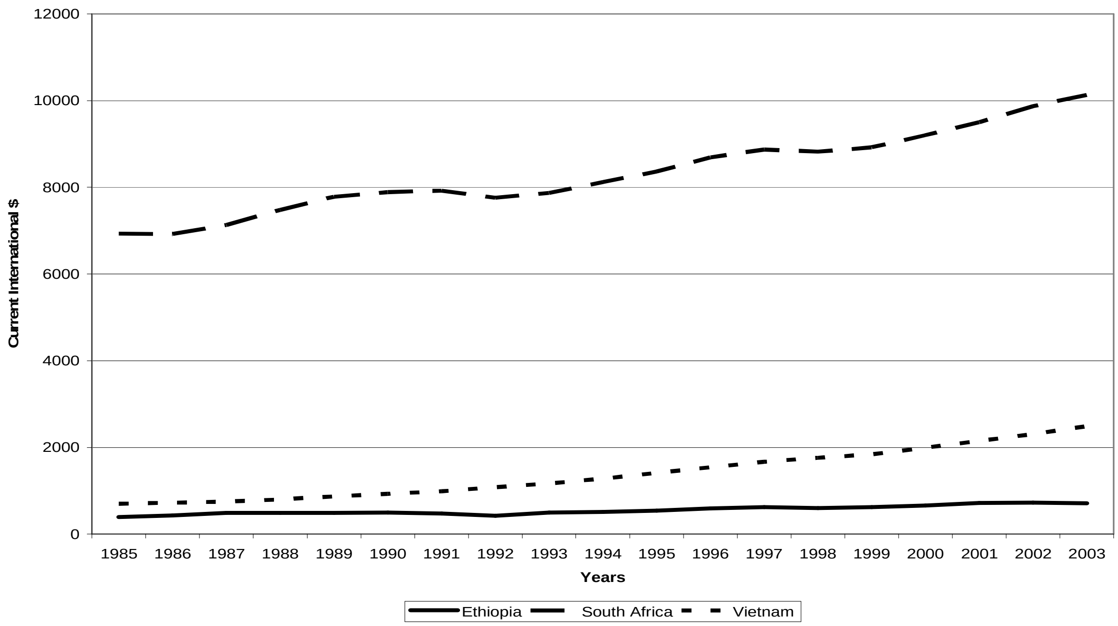
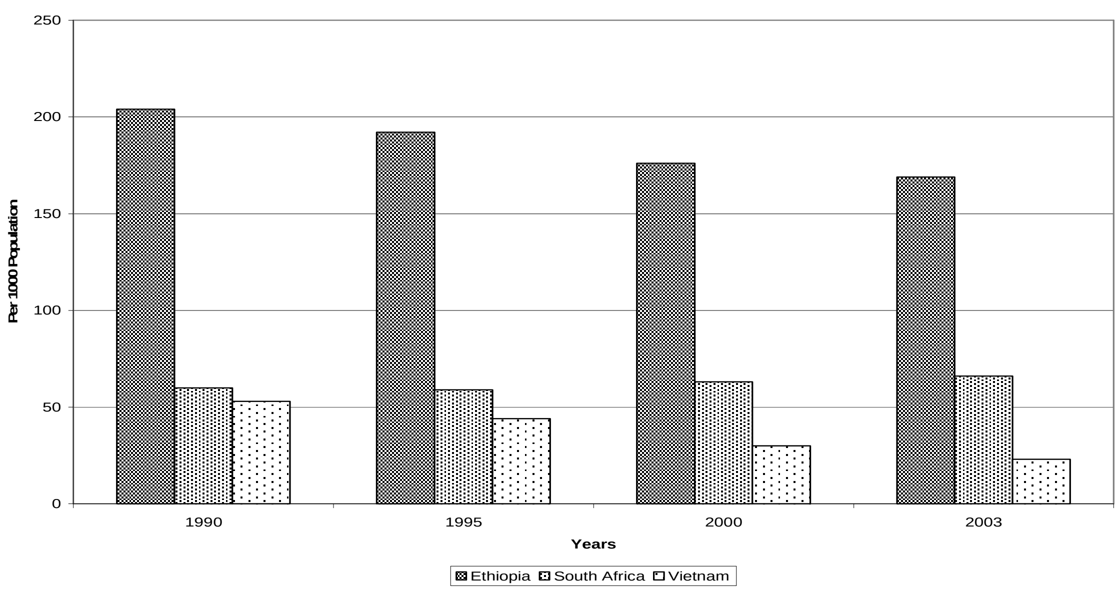
Figure 1 Gross National Income Per Capita, PPP (current international $)



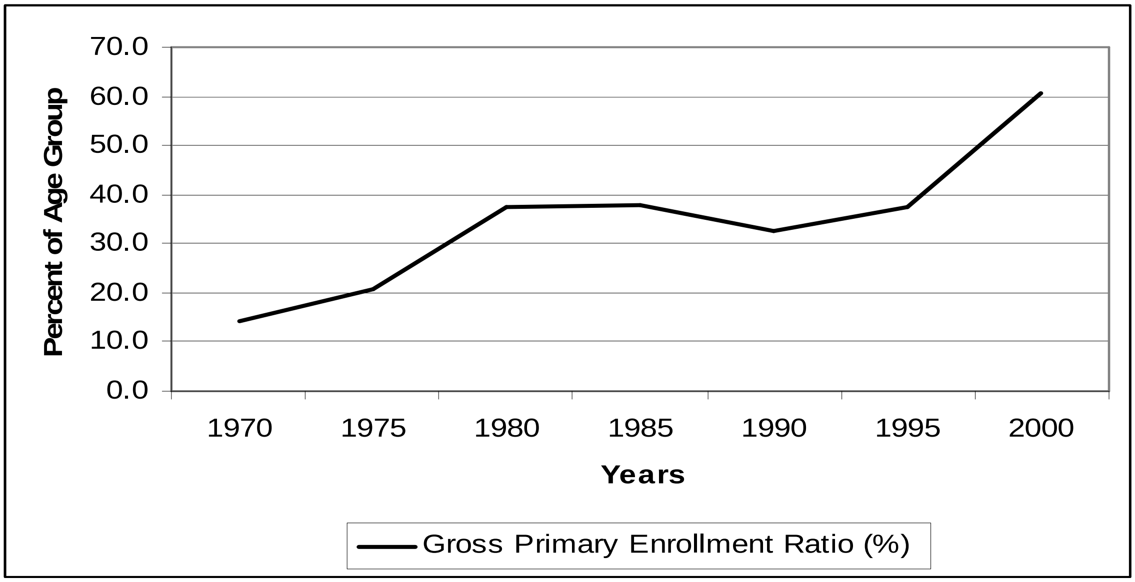
Source: World Bank, *World Development Indicators*

Figure 2 Under Five Mortality Rate (per 1,000 population)



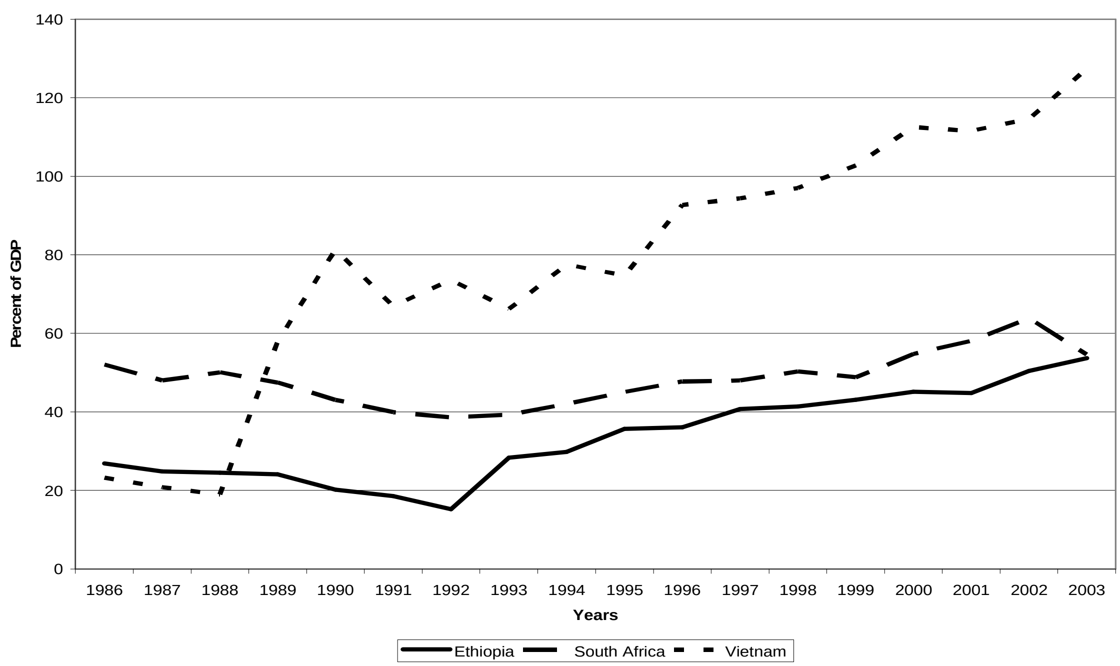
Source: World Bank, *World Development Indicators*

Figure 3 Gross Primary Enrollment Ratio (percent of relevant age group)



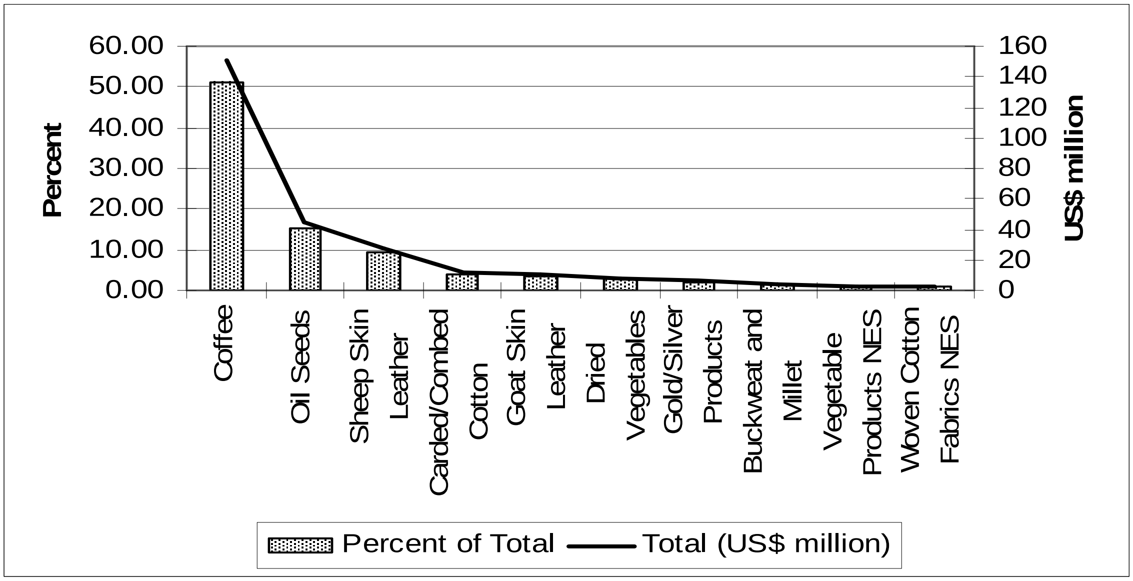
Source: World Bank, *World Development Indicators*

Figure 4 Total Trade as a Percent of GDP (percent)



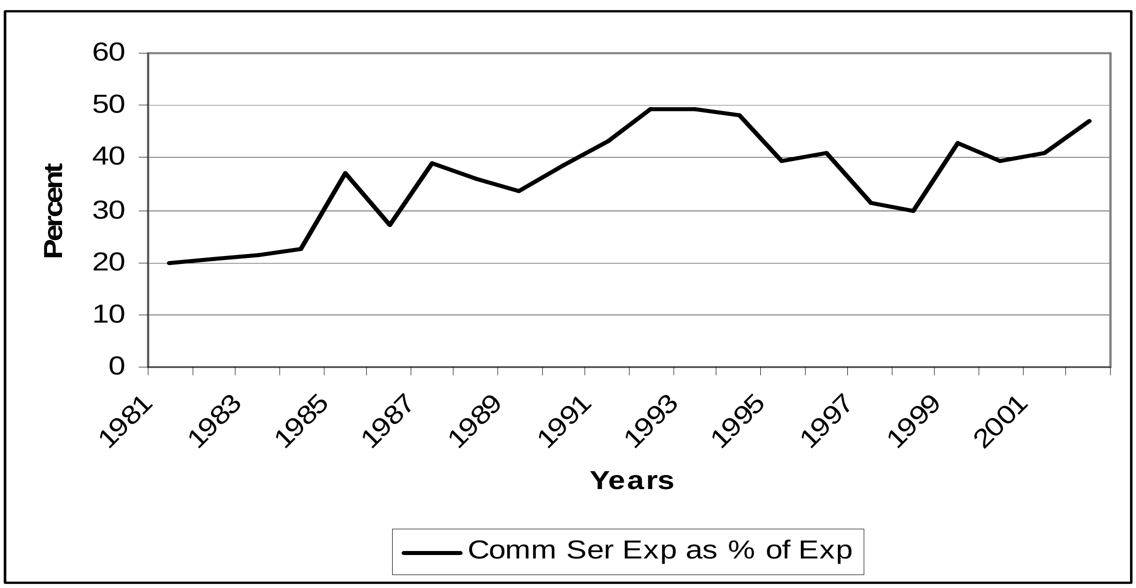
Source: World Bank, *World Development Indicators*

Figure 5 Ethiopia’s Exports by Product Group, 2003 (percent and US$ million)



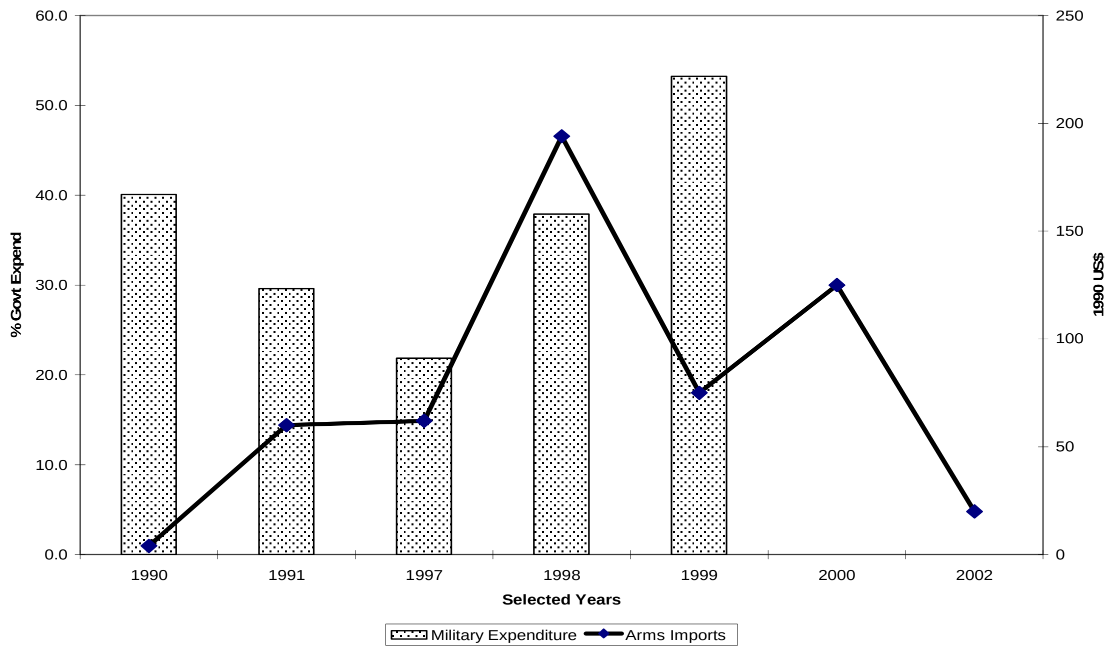
Source: International Trade Centre

Figure 6 Commercial Service Exports as a Percent of Total (percent)



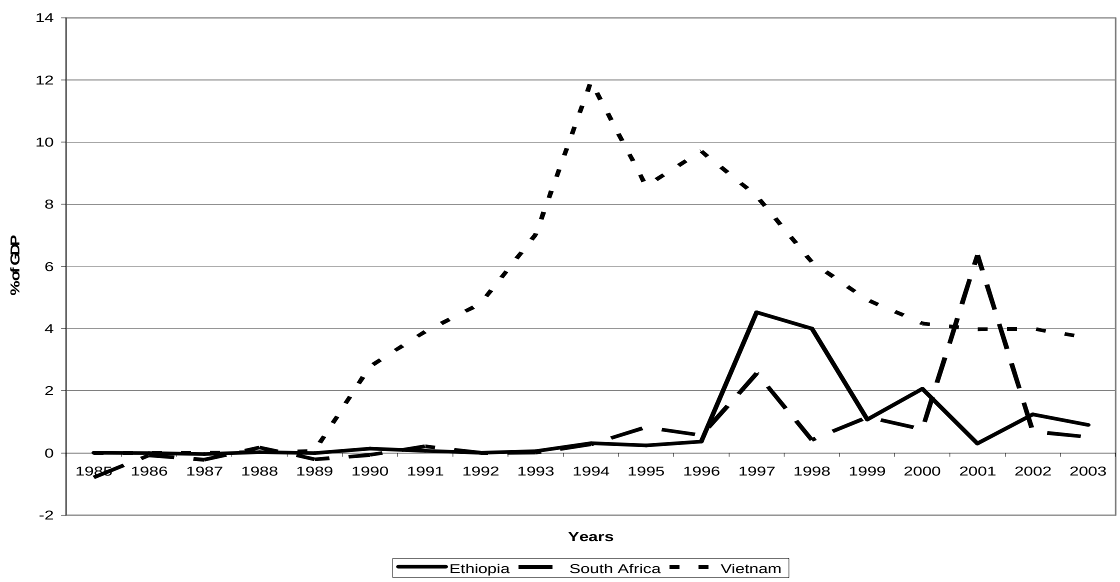
Source: World Bank, *World Development Indicators*

Figure 7 Arms Imports as a Percent of Total Imports, 1999 (percent)



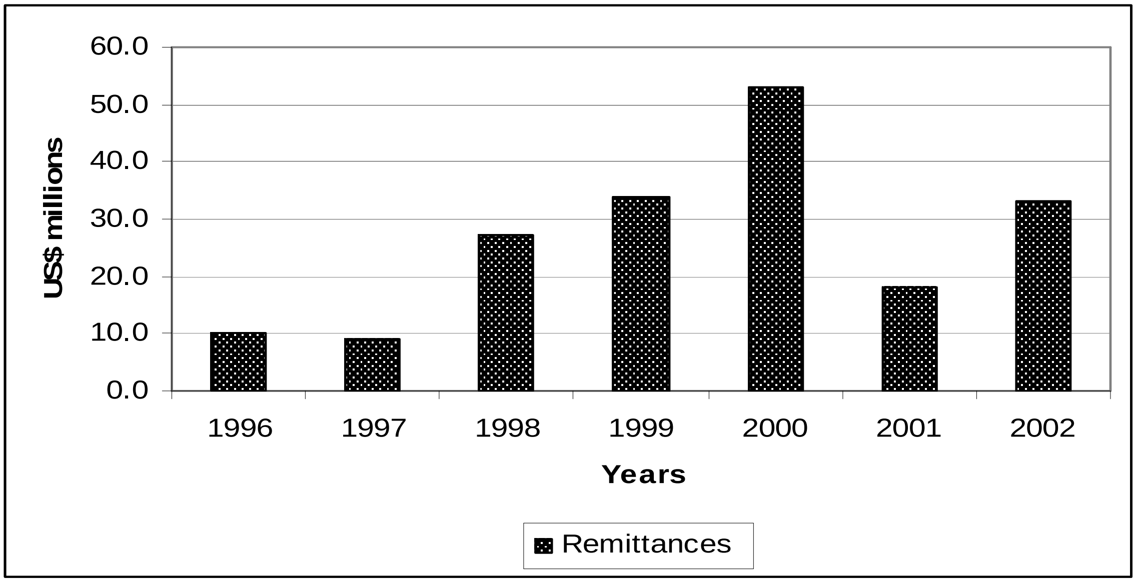
Source: World Bank, *World Development Indicators*

Figure 8 Net Foreign Direct Investment as a Percent of GDP (percent)



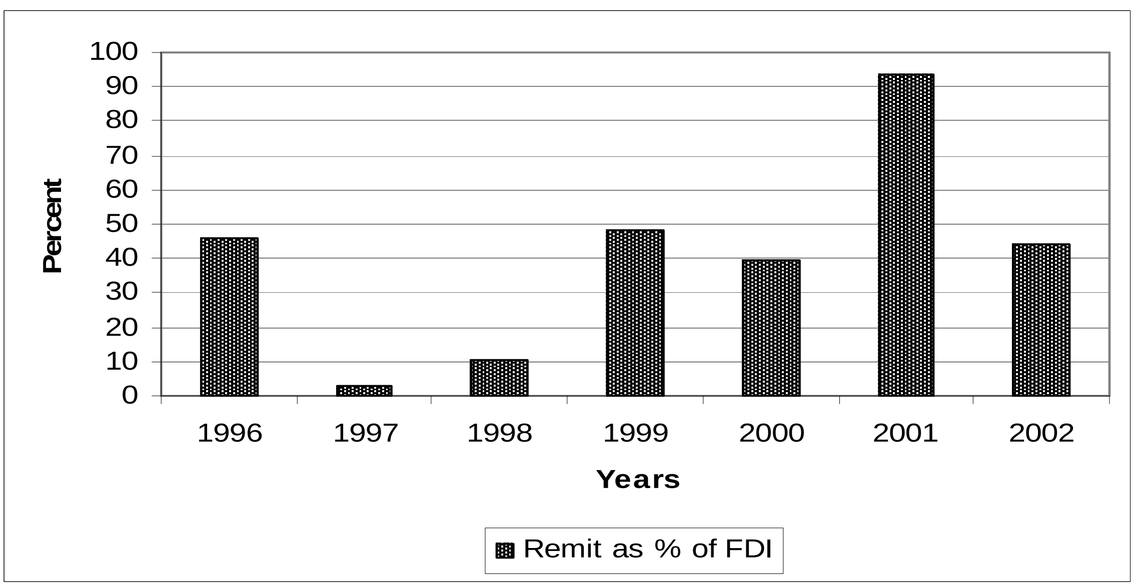
Source: World Bank, *World Development Indicators*

Figure 9 Foreign Remittances (current US$ millions)



Source: World Bank, *World Development Indicators*

Figure 10 Foreign Remittances as a Percent of FDI (percent)



Source: World Bank, *World Development Indicators*