

The
Economist

INTELLIGENCE
UNIT

POST-CONFLICT TRADE

Case studies and lessons for Ethiopia and Eritrea

Commissioned by

DP WORLD 

Post-conflict trade: Case studies and lessons for Ethiopia and Eritrea discusses the findings from an Economist Intelligence Unit research programme sponsored by DP World. As part of the research, we interviewed the following people, listed in alphabetic order by affiliation. Their time and insights are greatly appreciated.

Luis Guillermo Plata Paez, former minister of commerce, industry and tourism of Colombia, and senior adviser, Albright Stonebridge Group

Marijke Verpooten, associate professor, University of Antwerp

Prema-chandra Athukorala, professor, Crawford School of Public Policy, Australia National University

Ravinder Rena, professor of economics, North West University, South Africa

Sebastian Nieto Parra, head of Latin America and the Caribbean Unit, OECD Development Centre

Thilanga Sumathipala, former deputy speaker of the Sri Lanka parliament and current representative for the Colombo district

This report was written by Chris Clague, global editorial lead for trade and globalisation, from The Economist Intelligence Unit.

Introduction

The peace treaty between Ethiopia and Eritrea, signed in July 2018, brought to an end a war that had been ongoing but intermittent for more than 20 years and that cost more than 100,000 lives, displaced more than a million people, and diverted resources and attention away from the task of lifting large swathes of people in both countries out of poverty. It is the most recent of the world's conflicts to arrive at peace, but as history has shown, a treaty alone is no guarantee that peace will hold.

Indeed, since the start of the millennium, 40% of the conflicts that have concluded with a peace treaty, or the defeat of one of the warring sides, have returned to violence within a decade.¹ The war between Ethiopia and Eritrea was one of those conflicts. The two sides, which had begun fighting over contested border territory in 1998, signed an agreement, brokered by the US and Rwanda, to cease hostilities on December 12th 2000. That peace didn't last. Border conflicts resumed, at varying degrees of intensity, in the years that followed and full-fledged fighting broke out again in 2012 when the Ethiopian army attacked an Eritrean base on the pretense that it was helping to support "military activities".²

Whether peace will hold this time is as uncertain as it was in 2000. One of the key determinants of a lasting peace, however, is sure to be the economic performance of both countries. Paul Collier, an academic economist and author of numerous books on development economics and the political economy of development, concluded in his 2009 book, *War, Guns, and Votes: Democracy in Dangerous Places*, that "economic recovery...is the only genuine exit strategy for peacekeeping."³ Mr Collier reached that conclusion after he and his team of researchers analysed all the other possible determining factors, including democracy and elections.

A key part of creating and sustaining economic growth in post-conflict countries is increasing trade. This is not an easy task, however, and it is not without risks.⁴ Most, if not all, post-conflict countries were at low levels of development when their conflicts began and are highly dependent on primary commodities exports for growth. Continued dependence on these products raises the likelihood that the country will revert back to conflict, as well as creating continuing opportunities for corruption at both the state and the local level. But moving up the

¹ Paul Collier, *War, Guns, and Votes: Democracy in Dangerous Places*.

² <https://www.globalsecurity.org/military/world/war/eritrea.htm>

³ Paul Collier, *War, Guns, and Votes: Democracy in Dangerous Places*.

⁴ <http://www.worldbank.org/content/dam/Worldbank/document/Trade/Trading%20Away%20from%20Conflict.pdf>

value chain is difficult. It requires hard infrastructure like roads, bridges and rail and electricity generation and transmission, and for the general population to attain education that endow them with basic skills. They also take time.

Ethiopia and Eritrea both face problems in these areas. To provide insights into their post-conflict trade and development environment, The Economist Intelligence Unit was commissioned by DP World to produce a series of three case studies on how post-conflict countries around the world have dealt with similar issues, for better and worse. The first case study looks at the coffee industry in Rwanda. Like Ethiopia, Rwanda is a landlocked country and coffee is one of its primary exports. In the aftermath of a civil war and the 1994 genocide, the government instituted a plan to move the country's coffee industry up the value chain, and compensate for being landlocked, by producing specialty coffee. The early results were mixed, but more recently the effort appears to be paying off.

The next example is Sri Lanka. After its long civil war concluded in 2009 with the defeat of the Tamil rebels, there was an opportunity to build on the export success of the apparel industry by improving the country's crumbling infrastructure, especially its roads. The government opted instead to borrow heavily to pay for two large projects that charitably could be described as underperforming expectations.

The last study is of Colombia. The decades-long conflict with the Fuerzas Armadas Revolucionarias de Colombia (FARC) guerrillas concluded in 2016 after a revised peace agreement was passed through the country's Congress. To deal with its infrastructure deficit, the country is seeking to increase foreign investment and promote more public-private partnerships (PPPs). While it is too soon to tell if the programme is effective, Colombia does present a strong environment for this particular policy approach.

The paper concludes with the lessons that Ethiopia and Eritrea can potentially draw from the case studies.

Rwanda

Counting the beans

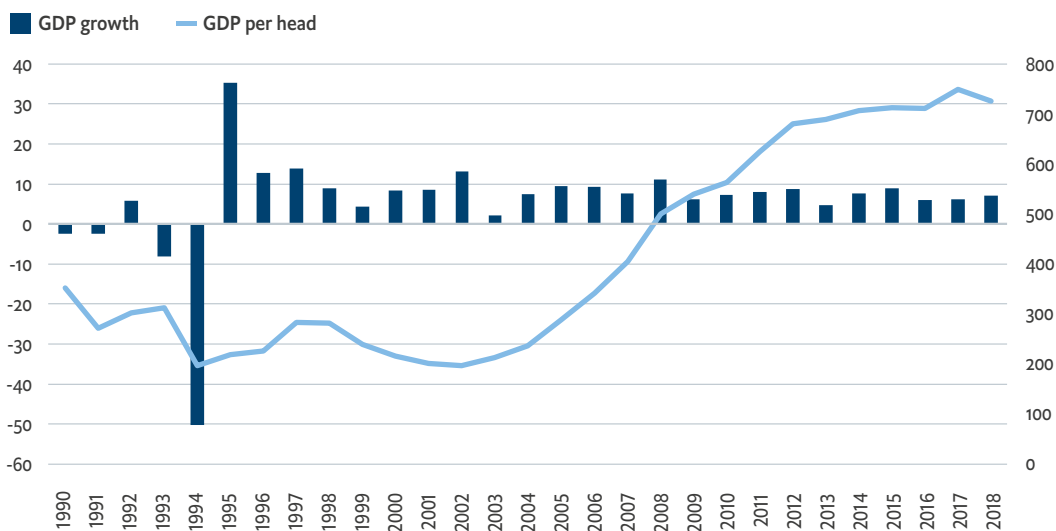
The 1994 Rwandan genocide, which came on the heels of a civil war, led to the direct deaths of more than 800,000 people in just 100 days and the indirect death, through lack of food, water and medical care, of many more. It was the third-largest genocide in the post-war era, behind only the 1964-65 genocide in Indonesia and the genocide that occurred in Cambodia in 1975-79.⁵

The economic toll of the conflict was likewise significant. The year before the genocide, GDP per head was US\$313. In 1994 that figure shrunk to US\$196 as real GDP contracted by half. It would take 12 years before incomes returned to pre-conflict levels and, as of 2018,

GDP per head is still very low, at an estimated US\$725, although Rwanda is now one of the fastest growing countries in Africa.

Rwanda already faced a number of challenges before the conflict, including a lack of natural resources. But one of the biggest problems, especially when it comes to trade, is that the country is landlocked, with nearly 1,100 km separating it from the nearest major ports, both in the east, of Dar es Salaam in Tanzania and Mombasa in Kenya. Being landlocked raises both the time and costs of transportation. One study, using World Bank data, concluded that the cost to export a container from a landlocked developing country like Rwanda is more than double

Figure 1: GDP growth and GDP per head 1990-2018



Source: The Economist Intelligence Unit

⁵ The precise death tolls in all three cases are a matter of dispute, but in general both the Indonesian and Cambodian conflicts are estimated to have resulted in more fatalities than Rwanda.

that of a coastal developing country and that the time to export is ten days longer.⁶ In other words, Rwanda found itself at a severe disadvantage for trading its way to a post-conflict recovery.

It took six years from the end of the conflict, but the Rwandan government, in co-operation with external aid agencies, finally hit upon at least one solution: specialty coffee. Manufacturing, the usual focus of developing economies seeking to expand exports, had “long been a headache” for Rwanda, says Marijke Verpooten, associate professor at the University of Antwerp and a specialist on the Rwandan economy. “Besides being landlocked,” Ms Verpooten says, “there’s also the problem of providing reliable energy,” an obvious need for a robust manufacturing sector. Manufacturing was therefore not a viable option, at least not on a meaningful scale.

Specialty coffee, however, circumvents both the energy and port access issues. The washing machines that are required to move up the value chain from unwashed or semi-washed commodity beans to fully washed are not as energy-intensive as factory machinery. And specialty coffees, being a high-value crop, can be exported via air freight and still remain price competitive, in theory, on international markets as opposed to commodity coffees, which are subject to the vagaries of global markets and are therefore more price sensitive.

As Ms Verpooten describes in her study of the Rwandan coffee industry, “The Rwandan coffee sector: Out of the ordinary,” the switch to specialty beans was a success, though a qualified one and at the time (2012) she labelled it “fragile”.⁷ Rwandan specialty coffee did eventually begin earning recognition in the form of awards from international bodies like the Specialty Coffee Association of America, which in turn attracted the attention of high-profile buyers from around the world. And in 2008 it even hosted the first Cup of Excellence competition ever held in Africa.

Yet exports did underperform the expectations set forth in the Ministry of Finance and Economic Planning’s Vision 2020 plan, which was published in 2000. By 2011 specialty coffee exports still only represented a small share of the country’s overall coffee exports, leaving a significant amount of washing capacity unutilised. Research published in 2015 by the International Growth Centre (IGC), a development think-tank, concluded that only 30% of Rwanda’s coffee exports were washed, in other words specialty varieties, and that washing stations were only operating at around 50% capacity.⁸ The IGC identified a number of constraints that needed to be alleviated: contract enforcement, access to working capital and the improvement of management practices at washing stations.

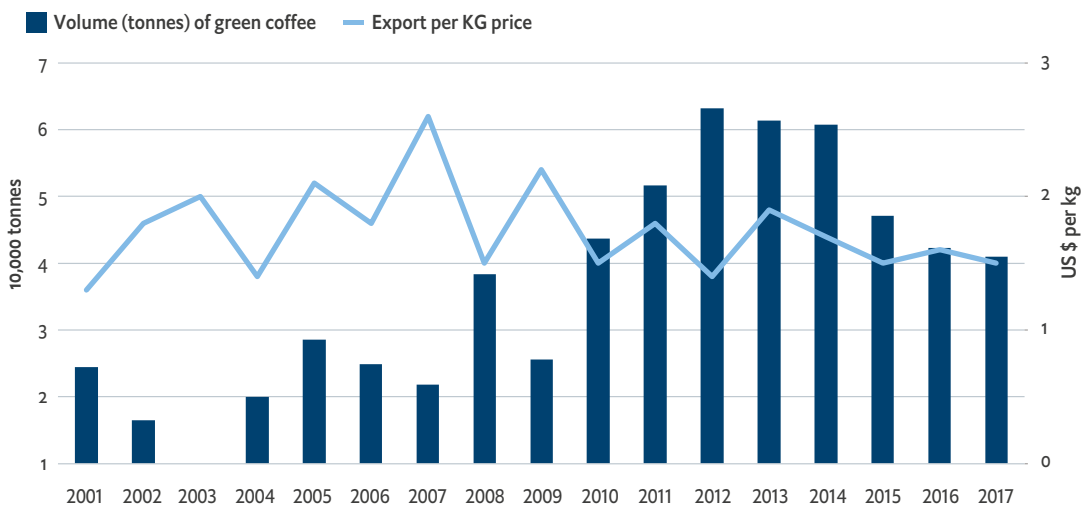
There continue to be positive signs for the industry, however. In September 2018 Rwanda’s National Agricultural Export Board held an internet auction for 28 lots of specialty

⁶ <https://www.ictsd.org/bridges-news/bridges-africa/news/addressing-landlocked-developing-countries-challenges-the-role-of>

⁷ <https://www.uantwerpen.be/images/uantwerpen/container2143/files/Publications/Annuaire/2011-2012/18-Verpooten.pdf>

⁸ <https://www.theigc.org/project/fully-washed-coffee-exports-in-rwanda/>

Figure 2: Coffee exports and prices (per kg) 2000-16



Source: The Economist Intelligence Unit

coffee (a lot being between five and 100 bags of beans). Eighty-seven coffee traders from across the globe bid on the lots. The highest bid, US\$41.22 per kilogram, came from Maruyama, a high-end Japanese coffee trader, followed by a bid of US\$40.12 per kilogram from an Australian trader. In total, more than 24 tonnes of coffee were sold at the auction, generating nearly US\$360,000 of revenue for Rwandan growers and processors.⁹

⁹ http://naeb.gov.rw/index.php?id=24&tx_news_pi1%5Bnews%5D=383&tx_news_pi1%5Bday%5D=15&tx_news_pi1%5Bmonth%5D=1&tx_news_pi1%5Byear%5D=2019&cHash=d3208336fa2bc2b57a74548dbdde861b

Sri Lanka

Beware white elephants

In 2017 total ship arrivals at the Port of Colombo, Sri Lanka’s main port and among the 25 busiest ports in the world, totalled 5,126 and container throughput was 6.21m twenty-foot equivalent units, a standard industry measure of port traffic.¹⁰ By contrast, at Hambantota, a port completed in 2012 in the south of the country, just 183 ships arrived, with local authorities reporting that figure to have risen to 300 in 2018.¹¹

Hambantota Port is estimated to have cost at least US\$1bn, with financing provided by Chinese institutions.

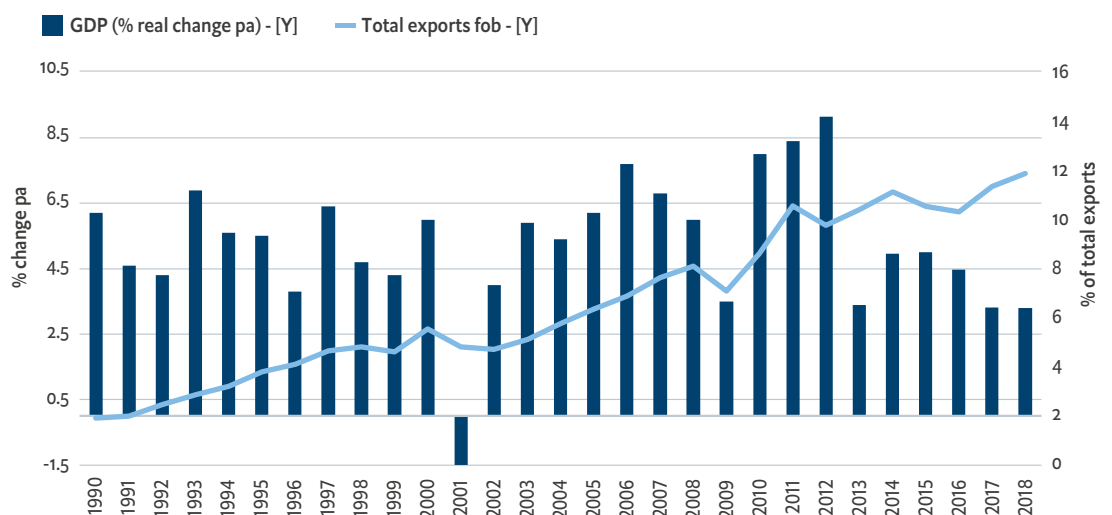
Not far from Hambantota Port is Mattala

Rajapaksa International Airport, named after Sri Lanka’s former president, Mahinda Rajapaksa, who hails from the area. It opened in 2013 at an estimated cost to the government of US\$275m and was also financed with loans from China.

Mattala Rajapaksa International Airport now receives, at most, five to six flights per day, which is actually an improvement from recent years, when one or no flights were landing.

When the decades-long Sri Lankan civil war was brought to an end in May 2009 with the defeat of the Liberation Tigers of Tamil Eelam, the country appeared well positioned to reap the peace dividend. In the five years leading up to the end of the conflict, the economy had

Figure 3: GDP growth and exports (value) 1990-2018



Source: The Economist Intelligence Unit

¹⁰ <https://lloydslist.maritimeintelligence.informa.com/LL1123839/24-Colombo-Sri-Lanka>

¹¹ <https://www.hellenicshippingnews.com/last-year-183-ships-arrive-at-sri-lankas-hambantota-port/>

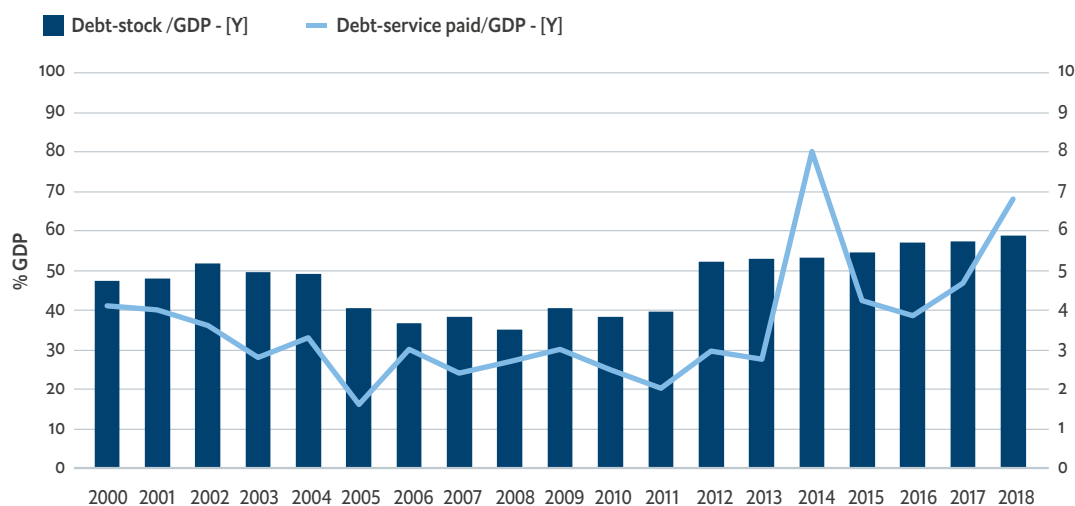
been growing on average at a rate of 6.4% per year and, at 9.6% per year, exports had been growing even faster in terms of value. With the global financial crisis in full swing, 2009 was a bad year to be expecting a peace dividend, and growth did slow, to 3.5%, but it quickly picked up, coming in at above 8% on average in 2010-12.

Economic growth has cooled off since then, and exports have become more volatile. In part, this was due to the tepid recovery of the world economy from the financial crisis. But there are domestic reasons, too, and the kinds of white elephant projects described above were an important factor for at least two reasons, according to Prema-chandra

Athukorala, professor of economics at the Crawford School of Public Policy, Australia National University, and an expert on the Sri Lankan economy. "When huge amounts of money came in for these projects," says Mr Athukorala, "corruption became rampant, growing at a very rapid rate." This was especially true in the central organisations purposed with attracting foreign investment. As a result, many potential foreign investors stayed away from the country, including firms in the high-tech sectors that the government has been seeking to attract.

The other problem was that projects like Hambantota Port and Mattala Rajapaksa International Airport drew resources and

Figure 4: Sri Lanka government debt to GDP 2000-18



Source: The Economist Intelligence Unit

attention away from the types of infrastructure investment Sri Lanka was actually in need of. The country's rail system hasn't been upgraded in decades and cargo usage is stagnant. The road system is not much better, with major congestion in cities and commercial areas.¹² The more than US\$1bn that together was spent on a sea port where relatively few ships dock and an airport where few planes land could have done much to address the inadequacies in Sri Lanka's overland transportation infrastructure.

Yet at the same time policymakers have also recognized that apparel manufacturing, and the small number of other industries on the island that attract investment because of low labour costs, are not likely to prove viable in the long term. "Sri Lanka will not survive on labour alone," says Thilanga Sumathipala, former deputy speaker of Sri Lanka's parliament and current representative for the Colombo district. "We are next to India, which has 1.2 billion people and in the same region as China, which has another 1.2 billion people. Given our neighbourhood, [Sri Lanka] needs to concentrate on continuing to develop a skilled labour force through improvements in education and training."

Put another way, that means moving up the value chain. Sri Lanka has already found some success in this regard by positioning itself in niche links in global supply chains. Lanka Harness Company, for example, makes sensor switches for seat belts and air bags for companies that supply major car

manufacturers, including Takata, a major vendor for Toyota, the world's second largest car maker. In 2016, its monthly output of sensors increased from 1.2 million to 2 million.¹³ Sri Lanka is now also home to the world's largest supplier of weighing components for neonatal incubators and, having stepped up from commodity rubber production, it has become one of the largest exporters of pneumatic tyres.

¹² EIU Risk Briefing Model, Sri Lanka, January 2nd 2019

¹³ <https://core.ac.uk/download/pdf/6554215.pdf> http://pure.diis.dk/ws/files/69933/PB2008_10_Brain_Drain_and_Fragile_States_2_.pdf

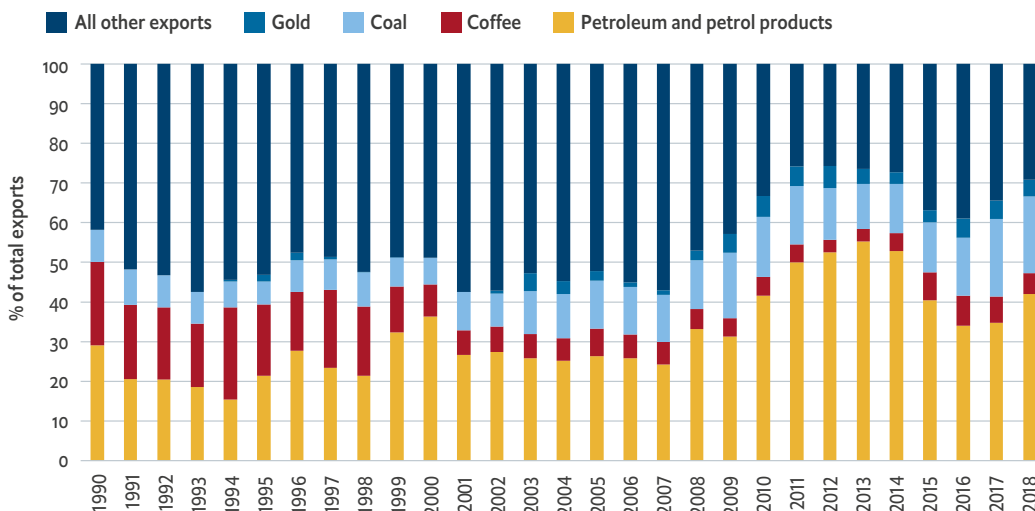
Colombia

Building on peace

It's been less than 18 months since Colombia's congress passed the revised peace treaty with the Revolutionary Armed Forces of Colombia, known by its Spanish-language acronym FARC. The conflict with FARC, a leftist guerrilla group, had lasted more than 50 years, making it one of the longest running conflicts in the post-war era. And it is estimated by Colombia's Centre for Historical Memory to have cost more than 260,000 lives, making it one of the deadliest.¹⁴ The centre also concluded that most of those deaths were civilians, making the reconciliation process one of the most difficult among post-conflict countries.

Colombia's formal economy has long been dependent on a small number of commodities exports for growth, in particular oil and coal. Like most countries with similar economic structures, post-conflict or otherwise, Colombia is seeking to diversify away from extractive industries and into other sectors, such as agro-industries, tourism and higher value-added manufacturing. For that to happen, says Sebastian Nieto Parra, head of Latin America and the Caribbean Unit at the OECD Development Centre, the key challenge the country faces is the level of co-operation between the public and private sectors and its citizens. Private-sector firms, both foreign and domestic, have legitimate

Figure 5: Composition of Colombia exports 1990 to present



Source: The Economist Intelligence Unit

¹⁴ <https://www.cbc.ca/news/world/colombia-guerrilla-farc-death-toll-1.4771858>

concerns about the risk of conflict returning; as noted at the outset, this happens in about 40% of cases.

One key area of co-operation Mr Nieto Parra points to is PPPs, particularly foreign-invested PPPs. As the name suggests, PPPs are “long-term contract[s] between a private party and a government entity for providing a public asset or service in which the private party bears significant risk and management responsibility.”¹⁵ The agreements are not without risks, as the World Bank and other organisations have pointed out.¹⁶ But for Colombia, which does not have a well-developed capital market and lacks capacity in key areas to undertake massive projects on its own, PPPs can offer solutions to these problems.

They also offer a solution to one problem that will put severe constraints on efforts to diversify the economy and increase non-extractive exports: the quality of Colombia’s infrastructure. Colombia performs poorly on every comparative global measure of infrastructure quality. In the Kiel Institute for the World Economy’s infrastructure index, it ranks 96th out of 140 countries, falling between Ecuador and Jamaica, and comes 107th in the transport infrastructure category.¹⁷ In the infrastructure category of the World Economic Forum’s Global Competitiveness Report, it comes 83rd, and in the World Bank’s

Logistics Performance Index, it ranks between the Maldives and Lebanon.¹⁸

The linkages between infrastructure and trade are well established. Where roads, rail and ports are poor it increases transports costs and time to market, rendering unviable locations that might have otherwise been attractive investment destinations for the availability of labour. In many cases, and especially in post-conflict countries, these are precisely the areas that need the investment—and resultant employment—the most. Studies have shown the transport costs related to poor infrastructure can even outweigh tariffs as barriers to trade.¹⁹ And that’s just hard infrastructure. Soft infrastructure, in the form of information and communications technology, has become increasingly vital for countries that want to integrate into the regional and global economy.²⁰

Fortunately for Colombia, it provides a strong enabling environment for PPPs. In a 2017 study published by The Economist Intelligence Unit, it came first among 18 regional peers in Latin America and the Caribbean on its environment for PPPs, with an overall score of 76 out of 100, putting it one point ahead of Chile and far ahead of countries like Argentina (43) and neighbouring Venezuela (9).²¹ The study measured countries across five categories related to PPPs: regulations, institutions, maturity, investment and business climate,

¹⁵ <https://ppp.worldbank.org/public-private-partnership/overview/what-are-public-private-partnerships>

¹⁶ <https://ppp.worldbank.org/public-private-partnership/overview/ppp-objectives>

¹⁷ https://www.ifw-kiel.de/fileadmin/Dateiverwaltung/IfW-Publications/Peter_Nunnenkamp/a-new-global-index-of-infrastructure-construction-rankings-and-applications/KWP_1929.pdf

¹⁸ https://lpi.worldbank.org/international/global?order=Infrastructure&sort=aschttp://reports.weforum.org/global-competitiveness-report-2018/competitiveness-rankings/?doing_wp_cron=1548579400.7196469306945800781250#series=GCl4.A.02

¹⁹ “Infrastructure and Trade,” H Kyvik Nordas & R Piermartini, WTO Staff Working Paper Series, August 2004

²⁰ <https://www.adb.org/sites/default/files/publication/177093/adbi-wp553.pdf>

²¹ <https://infrascope.eiu.com/>

and financing. Colombia performed well in the regulations category, which assessed issues such as PPP selection criteria and coordination among government entities, and in the maturity category, which evaluated countries based on their experience with PPP contracts, the risk of expropriation and termination of contracts.

Mr Nieto Parra points out that a vital part of the post-conflict process in Colombia, as elsewhere, is “helping to integrate people who were involved in and affected by the conflict.” That integration can happen in a variety of ways, but the main one is economic. Without infrastructure, however, economic integration is almost impossible. PPPs are not the only means by which that infrastructure can be built, but for countries without deep capital markets and experienced firms, they are among the best options.

Potential lessons for post-conflict countries

Every country in a post-conflict situation finds itself facing different problems. The scale and nature of the conflict matters greatly. How much destruction was caused to the country's physical capital? How much of the population was displaced as a result of the conflict and will they be able to return? Can trust in institutions and civil society be re-established among the combatants?

Nevertheless, there are basic and generalisable lessons that can be drawn from countries that have been or are going through the process of post-conflict recovery. These lessons form a baseline for that recovery. This paper, which looked at three such cases, provides the following lessons:

1. Identify sensible opportunities for moving up the value chain.

Being ambitious is important to post-conflict development, and development in general. But it must be tempered by reality. Rwanda wanted to develop a manufacturing sector, as do most countries seeking to climb the economic ladder. And it still might be able to do so, despite being landlocked and short of (at least at the time) reliable power. In the short-term, however, it wasn't a realistic option. What made more sense was to identify existing industries where there were possibilities to add more value rather than start from scratch elsewhere. For Rwanda that meant building a specialty coffee industry off the back of its production and trade in commodity coffee.

Sri Lanka has done likewise by developing a tyre industry on the strength of its domestic rubber output, but it has also found success by leveraging the relatively higher levels of education and skills in its labour force to position itself in niche links in global supply chains, such as the manufacture of weighing components for neonatal incubators.

2. Beware white elephants. Right now there is a significant amount of capital available for funding infrastructure projects in Asia and Africa. On its face, this is a welcome development. Almost all of the countries in the two regions, post-conflict or otherwise, are in dire need of paved roads that reach rural areas, upgrades to

creasing railways and additional, and reliable, power generation capacity. Were Ethiopia and Eritrea to focus on these more quotidian types of infrastructure projects, it would do much to improve their export capabilities.

Yet the temptation to build big and shiny airports and other types of facilities where ground can be broken with a golden shovel, and the new building unveiled with a ribbon-cutting photo op, is hard to resist. But it must be. The case of Sri Lanka and its nearly-empty airport and sleepy new seaport is illustrative of the problems caused by white elephant projects. It is just one example among many, however.

- 3. Create an enabling environment for PPPs.** These are not without problems, but for many countries PPPs can be the best available option. Most, if not all, post-conflict countries lack the domestic capabilities to build the kind of hard and soft infrastructure economic recovery requires. Bringing in foreign firms as partners with the government can help to overcome this constraint, as well as transfer knowledge and expertise to the local populations in a range of areas, such as in digitisation, data analytics and integrating production with global supply chains.

The local environment needs to be conducive for these agreements to be effective, however. Colombia performs well in this regard. Many countries don't, especially those where good and consistent governance and clearly defined laws and regulations are in short supply.

To a certain extent, however, improvement only comes with experience, but there are areas where quick gains can be made, such as co-ordination among government entities when developing and awarding contracts, creating high-level political support for PPPs and ensuring transparency during the bidding process.

LONDON

20 Cabot Square
London, E14 4QW
United Kingdom
Tel: (44.20) 7576 8000
Fax: (44.20) 7576 8500
Email: london@eiu.com

NEW YORK

750 Third Avenue
5th Floor
New York, NY 10017
United States
Tel: (1.212) 554 0600
Fax: (1.212) 586 1181/2
Email: americas@eiu.com

HONG KONG

1301 Cityplaza Four
12 Taikoo Wan Road
Taikoo Shing
Hong Kong
Tel: (852) 2585 3888
Fax: (852) 2802 7638
Email: asia@eiu.com

GENEVA

Rue de l'Athénée 32
1206 Geneva
Switzerland
Tel: (41) 22 566 2470
Fax: (41) 22 346 93 47
Email: geneva@eiu.com

DUBAI

Office 1301a
Aurora Tower
Dubai Media City
Dubai
Tel: (971) 4 433 4202
Fax: (971) 4 438 0224
Email: dubai@eiu.com

SINGAPORE

8 Cross Street
#23-01 Manulife Tower
Singapore
048424
Tel: (65) 6534 5177
Fax: (65) 6534 5077
Email: asia@eiu.com