ERITREA
2017

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ERITREA

- **Real GDP growth slowed down to 3.8% in 2016 from 4.8% in 2015, reflecting challenges in the business and investment environment and capacity gaps in government institutions.**
- **The government's decision to access supplemental-support resources from the AfDB's Transition Support Facility (TSF) to scale up investments in agriculture should strengthen resilience and improve livelihoods for the majority of the rural population.**
- **Eritrea's rich entrepreneurial tradition, despite constraints including the energy-supply deficit, skills mismatch and poor telecommunication infrastructure, provides opportunities for private-sector growth and industrialisation.**

Overview

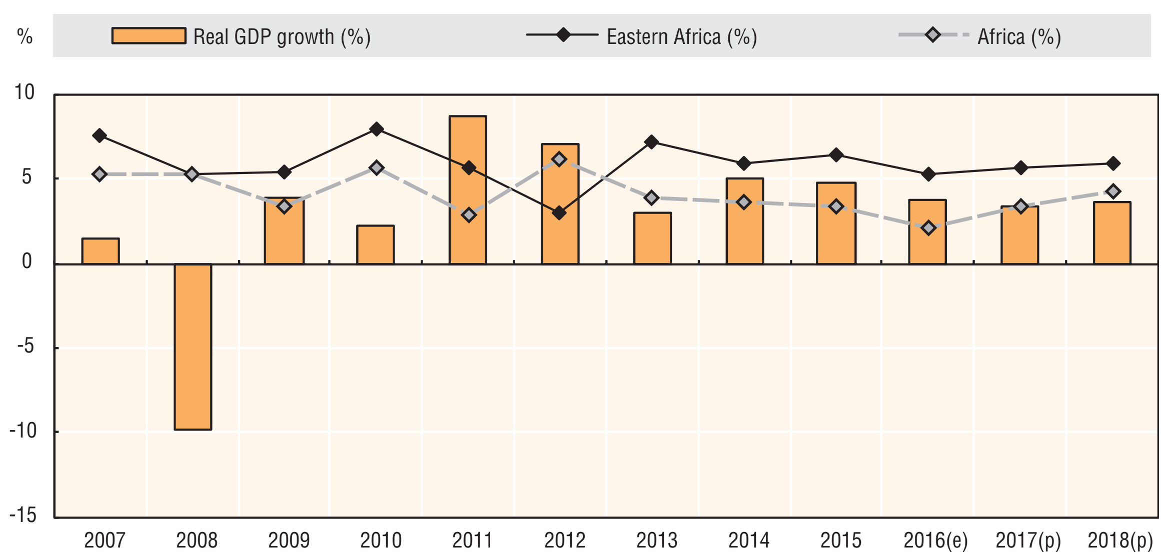
Real gross domestic product (GDP) growth is projected to decline slightly from 4.8% in 2015 to 3.8% in 2016 reflecting weak capacity in government institutions and a weak export sector. Growth will reduce also in 2017 to 3.4%. Over the medium term, the government sees further prospects in improved trade with Middle-Eastern and Asian countries, additional mining activities, growth in food production and fisheries development. Eritrea remains a country of immense economic potential but economic and policy reforms are necessary for growth to rebound. The GDP is heavily based on services (59%), with a very small manufacturing sector (5.9%). Agriculture, hunting, forestry and fisheries constitute 17.2% of GDP.

The budget deficit declined slightly to 13.9% of GDP in 2015/16 from 14.2% in 2014/15. This trend will continue to 12.7% in 2016/17 because of access to more grants and concessional resources, increasing revenue from mining projects and control of unproductive expenditures. Inflation remained at 8.9% in 2016 mainly because of food-supply insufficiency and scarce foreign currency to finance imports of essential goods. Although no official statistics have been provided, food-crop production in 2016 would appear to be slightly above its 2015 level. Depressed commodity and oil prices in 2015 and 2016 should also contribute to keeping 2015/16 inflation at an annual average of 12%. In spite of adverse conditions, the authorities have endeavoured to protect the most vulnerable segments of the population and to implement their long-term development policies. They maintain an extensive social safety net, and are investing in three priority areas: i) food security and agricultural production; ii) infrastructure development; and iii) human-resources development.

The growth of exports in 2015/16 is expected to have been driven by the expansion of mineral production at the Asmara Mining project and gold extraction by the Zara Mining Share Company. The current account deficit is forecast to decline to 0.1% of GDP in 2016 from 2.2% of GDP in 2015 and will become a slight surplus in 2017 despite the slowdown in export growth, reduced remittances and a drop in revenue from the 2% tax, commonly referred to as "development and recovery tax", levied on Eritreans in the diaspora. Supplemental-support resources under Pillar 1 of the AfDB's Transitional Support Facility (TSF) will support increasing agricultural productivity and improving food security through implementation of the government's minimum integrated agricultural programme designed to benefit the rural population and, especially, female-headed households. This programme will also generate socio-economic data on welfare levels of the population. The government has concluded a strategic partnership co-operation framework with the United Nations that will run from 2017 until 2021. The framework has four pillars: basic social services; resilience and disaster-risk management; public-sector capacity development; and food security and sustainable livelihoods. These interventions will strengthen resilience, improve the export base and strengthen food security.

In addition to its efforts to strengthen food security, the AfDB has provided resources to support the Ministry of Lands, Water and Environment through a ground-water assessment and mapping project. This project will lead to the design of others that will help mitigate the effects of climate change and promote resilience in the rural economy. The AfDB-funded Public Financial Management and Statistics Project is under implementation and will introduce efficiency and effectiveness into Treasury management and budgeting, while generating fiscal data vital for the overall planning and budgeting process. Technical support and training from the IMF is being co-ordinated with other stakeholders and delivered through a dedicated multi-year, fiscal and financial capacity-building programme. Support under this programme is expected to focus particularly on the macroeconomic framework, fiscal management, revenue administration, public financial management, monetary operations, risk-based banking supervision and macroeconomic statistics. The industrial sector in Eritrea is still small and entrepreneurship is stagnant because of lack of basic infrastructure and an unconducive business and investment environment. Going forward, the government should work to provide the necessary infrastructure and undertake major institutional reforms to attract foreign capital flows.

Figure 1. **Real GDP growth**



Source: AfDB, Statistics Department AEO. Estimates (e); projections (p).

Table 1. **Macroeconomic indicators**

	2014/15	2015/16(e)	2016/17(p)	2017/18(p)
Real GDP growth	4.8	3.8	3.4	3.7
Real GDP per capital growth	2.5	1.5	1.1	1.4
CPI inflation	9.0	8.9	8.4	9.4
Budget balance % GDP	-14.2	-13.9	-12.7	-12.5
Current account % GDP	-2.2	-0.1	0.5	0.3

Source: Data from domestic authorities; estimates (e) and projections (p) based on authors' calculations.

Recent developments and prospects

Economic performance has been uneven in a challenging environment. Unstable weather, low commodity export prices, the absence of policy buffers, economic sanctions, and a weak business environment have all contributed to hold growth at 3.8% in 2016, only somewhat above 2015's 4.8%, although it is projected to nudge up to 3.4% in 2017. Against an increase in private investment in the mining sector in recent years and improvements in agricultural production in 2015, non-mining economic activity is estimated to have remained low. The government has prioritised investments in agriculture and infrastructure – particularly in energy and water – to support inclusive and sustainable growth through generating employment for young people and women. A major challenge for Eritrea is strengthening weak institutional and human capital, while energy supplies are insufficient to support the implementation of the government's development programmes. The National Indicative Development Plan 2014-20 (NIDP) thus foresees the allocation of substantial resources and investment to increase the supply and quality of the country's human capital in its broadest sense and within competitive standards. Over the medium term, the outlook is positive, underpinned by plans to scale up energy supply with assistance from the AfDB and the European Union (EU).

Agriculture, which accounts for 17.2% of GDP, provides the majority of the population with a livelihood and accounts for about 44% of commodity exports. Merchandise exports declined in 2015 by 24.7% reflecting weakening export capacity. The low performance of agriculture can, at least partly, be attributed to the arid or semi-arid climate with large fluctuations in rainfall that can lead to reductions in output and the availability of domestic food supplies. Even in good-rainfall years, domestic production is unlikely to fulfil the population's food-grain requirements. To realise agriculture's potential for growth through value addition, constraints such as inefficient and outdated farming practices, water scarcity and lack of rural infrastructure need to be addressed. The authorities have repeatedly affirmed a commitment to address challenges that impact heavily on attempts to relieve poverty and in 2016 designed a new programme to scale up the implementation of a drought-resilience programme including the construction of more check dams, the provision of improved seeds and measures to reduce post-harvest losses.

The weak business and investment regulatory framework, together with the energy-supply deficit, the scarcity of foreign exchange, UN sanctions and inward-looking strategies, have crippled the growth of the private sector. The current stock of entrepreneurial skills is under-utilised and the manufacturing sector is operating below capacity. The government, however, is attempting to address some of these issues through: changes to the legal and regulatory frameworks, especially in the mining sector; skills development both for employability and entrepreneurship; engaging the international community in efforts to lift sanctions; and diversifying the economic base. Eritrea is also receiving development support from the UN system, the EU and under bilateral arrangements with various individual countries. The government believes that its engagement with countries in the Middle East, such as Saudi Arabia and Qatar, and the Far East is important for achieving sustainable growth. Improving the business environment, modernising the infrastructure, easing access to finance, and facilitating public-private partnerships would provide an enabling environment for private-sector growth. The government is increasingly looking to agriculture to provide the population with new and better opportunities.

To strengthen its budgeting and treasury management as well as modernising and streamlining the generation of reliable macro data, Eritrea is implementing the Public Financial Management (PFM) and Statistics Project in the key ministries of Finance and National Development. In addition, new currency notes were introduced to curb corruption and promote confidence as part of the new strategies to stimulate investment in the private sector. In order to strengthen transparency and accountability in the governance of natural resources, the AfDB has provided technical support through the African Legal Support Facility (ALSF) to address the legal and regulatory framework as well as building capacity among relevant public employees. Building human and institutional capacity alongside reform in the Ministry of Trade and Industry (MoTI), while providing technical support to the Eritrean National Chamber of Commerce, could also provide opportunities for increasing state revenues through private-sector development.

Eritrea is slowly making efforts to address its development challenges. However, the results from current strategies are yet to impact the economy. Remittances have remained low, inflows of resources in the form of grants are stagnant and the poor overall business climate has left the country languishing among the bottom five countries worldwide.

Table 2. **GDP by sector (percentage of GDP at current prices)**

	2010/11	2014/15
Agriculture, forestry, fishing and hunting	17.0	17.2
of which fishing	...	...
Mining and quarrying	...	...
of which oil	...	...
Manufacturing	6.1	6.0
Electricity, gas and water	1.8	1.8
Construction	16.2	15.7
Wholesale and retail trade; Repair of vehicles; Household goods; Restaurants and hotels	19.1	19.2
of which hotels and restaurants	...	...
Transport, storage and communication	12.2	12.3
Finance, real estate and business services	27.6	27.8
Public administration and defence	...	...
Other services	...	...
Gross domestic product at basic prices / factor cost	**100.0**	**100.0**

Source: Data from domestic authorities.

Macroeconomic policy

Fiscal policy

The fiscal system is still evolving. Low tax revenues and uncertainty around mining revenues have made the fiscal policy stance contractionary. Fiscal performance since independence has been strongly influenced by the legacies of the past, the economic structure of the country and the need for economic reconstruction and development. While the policy stance was generally prudent in the early years of independence it is now under increased pressure. Estimates and available data indicate that increased revenue from the mining sector and restrictive spending kept the fiscal deficit at about 13.9% of GDP in 2015/16 down from 14.2% in 2014/15 and this trend is expected to continue to 2017. The implementation of the Public Finance Management and Statistics Project will improve fiscal-policy management and improve overall budget formulation and reporting on execution with the eventual objective of establishing a Medium-Term Expenditure Framework (MTEF). In addition, the government is strengthening governance in the natural-resource sector through improved legal and regulatory frameworks, capacity building and support for data collection needed for evidence-based decision making.

Tax revenue, excluding grants, is estimated to have increased slightly to 14.4% of GDP in 2015 /16 up from 14.3% of GDP in 2014/15. The authorities maintain that the country has not been able to mobilise adequate resources to meet its needs so the expenditure stance is expected to remain tight in 2015/16 and 2016/17, suggesting continued prudence in undertaking capital investments in order to control recurrent expenditures while making efforts to achieve its objectives in the three priority areas as articulated in the NIDP. Despite these efforts, however, macroeconomic imbalances – triggered by the loss of three-quarters of remittances and the consequent decline in revenue from the 2% development and recovery tax – along with weak policies and UN Security Council sanctions, continue to constrain growth prospects. Domestic and international efforts to resolve border conflicts are yet to succeed and the general welfare of the population needs to be seriously reviewed and prioritised. Generally, the sanctions weigh heavily on the country's trade, investment and growth. Moreover, the absence of any progress towards resolving these challenges limits access to official external financing that is needed to reduce the financing gaps in the budget.

Further progress in domestic-revenue mobilisation is central to maintaining stability. Current domestic tax revenue collection significantly underperforms when compared to regional peers. The authorities remain focused on administrative reforms to boost tax collection and have requested AfDB support for strengthening PFM system.

Revenues and grants are expected to remain constant in 2016 and 2017, given the reluctance of the UN Security Council to lift the sanctions on remittances from Eritreans in the diaspora and allow transfers of the 2% development and recovery tax to the government. The current structure of the economy gives limited options for increasing the revenue base and the aim is to attract investments beyond the mining sector, which already benefits from inflows of foreign investment capital. There are also plans to address the energy-supply and skills deficit, and to maintain ceilings on public salary increases. Public financial management at regional and sub-regional levels is being strengthened through trainings conducted by E-Afritac, the IMF's training institute based in Dar as Salaam, Tanzania.

Table 3. **Public finances (percentage of GDP at current prices)**

	2007/08	2012/13	2013/14	2014/15	2015/16(e)	2016/17(p)	2017/18(p)
Total revenue and grants	**21.0**	**14.6**	**14.5**	**14.3**	**14.4**	**15.1**	**15.0**
Tax revenue	11.6	8.2	8.2	8.1	8.2	8.9	8.8
Grants	2.8	0.5	0.4	0.4	0.3	0.3	0.2
Total expenditure and net lending (a)	**43.5**	**28.1**	**28.0**	**28.5**	**28.3**	**27.8**	**27.5**
Current expenditure	32.5	22.4	21.9	22.2	21.9	21.3	21.1
Excluding interest	28.8	19.7	19.4	19.2	18.9	18.3	18.0
Wages and salaries	10.7	8.0	8.1	8.2	8.1	7.8	7.8
Interest	3.7	2.7	2.6	3.0	3.0	3.0	3.1
Capital expenditure	11.0	5.7	6.1	6.3	6.4	6.5	6.4
Primary balance	**-18.8**	**-10.8**	**-11.0**	**-11.2**	**-10.9**	**-9.7**	**-9.4**
Overall balance	**-22.5**	**-13.5**	**-13.6**	**-14.2**	**-13.9**	**-12.7**	**-12.5**

Note: a. Only major items are reported.
Source: Data from domestic authorities; estimates (e) and projections (p) based on authors' calculations.

Monetary policy

Monetary policy is designed to achieve the dual objectives of accommodating the government's large financing requirements and the need to promote economic growth. The reliance on monetary financing of the budget deficit has partly fuelled inflation but the government maintains that it has recently desisted from the practice. Broad money has been reduced from 17.5% of GDP in 2010 to an estimated 15% of GDP in 2016 by shifting from funding the budget through printing money to the pursuit of external grants and concessional loans. Shortages of foreign exchange, falling remittances and heavy government borrowing from the banking sector have been partly responsible for hindering the development of the private sector. In addition, negative real interest rates have discouraged financial intermediation (lending) and weakened the stability of banks. Current trends suggest that the exchange rate is overvalued, which is indirectly evidenced by an existence of parallel exchange rates.

According to the authorities, domestic and external debt levels are deemed unsustainable but no official data are available to verify this claim. Given the severe capacity constraints, the weak financial base of banks and the lack of tools to implement monetary policy, the authorities consider that the fixed exchange-rate regime mandated by the Central Bank Law is the best option. They consider that, if the exchange rate is set at a realistic level, it can serve as an anchor for prices. The Ministry of Finance (MoF), however, recognising that current policies are too costly for the budget and the economy, carried out a currency reform in 2015. In 2016, private consumption and infrastructure construction are expected to moderate due to the limited availability of credit and the scarcity of building materials. Food harvests in 2016 were reported to be good, but are still below self-sufficiency levels, which kept pressure on food prices. Inflation was 12% during 2016 but is projected to drop to 11.7% in 2017 or slightly lower due to expected food-supply improvement through the implementation of the drought-resilience programme and an improving business environment with trading partners in Asia.

While low inflation and limited year-to-year variability in economic growth create certainty for businesses and should encourage them to invest and create jobs, over the past five years macroeconomic volatility has been high. The official policy, therefore, is to liberalise the exchange and trade systems to mitigate the foreign currency shortage, dismantle all internal trade controls, revive remittances and reinvigorate private-sector activity.

Economic co-operation, regional integration and trade

Eritrea has a public commitment to regional integration and economic co-operation, arguing that a small country needs external markets for its goods and services, as well as imports of essential goods. Its geostrategic location, with a long stretch of coastline, is advantageous because it enables the country to have easy access to countries in the Middle and Far East. Moreover, Eritrea is also engaged with countries in East and Central Africa and is a member of various regional trading blocs including the Inter-governmental Authority on Development (IGAD), the Common Market for Eastern and Southern Africa (COMESA), and the Community of Sahel-Saharan States (CEN-SAD). The government argues that over 60% of its goods and services used to be consumed by its neighbours but that the regional geopolitics in the Horn of Africa have affected trade, rendering most enterprises below capacity. Eritrea has in the past been accused of undermining stability within the region, although recent reports do not provide evidence of this leading to a possible rapprochement with the international community.

The trade balance is projected to remain at -5.6% of GDP in 2015/16 but with a marginal decrease of 0.8 percentage points of GDP in 2017 due to low commodity prices and weak economic activity. Trade is currently somewhat regionally imbalanced, with exports to developing countries accounting for 33.8% of the total, against about 63.7% with the United States and 2.5% with European Union. The majority of imports are manufactured goods accounting for about 60% of the total. To ensure that Eritrea derives maximum benefits from regional integration and co-operation, it would need to undertake urgent reforms to strengthen institutions and remove structural imbalances as well as eliminate the infrastructure backlog to facilitate effective competitiveness.

Eritrea has not been able effectively to enjoy enhanced trade benefits with countries in the Middle East and East Africa, despite its strategic location. This can be attributed to its poor infrastructure including roads and railways, as well as its rudimentary ICT system. The 2016 World Bank Logistics Performance Index global rankings place Eritrea at 144th out of 160 countries with a score of 2.17 out of 5, which places Eritrea above nine other African countries, and is a slight improvement over rank 156 and a score of 2.08 in 2014.

Table 4. **Current account (percentage of GDP at current prices)**

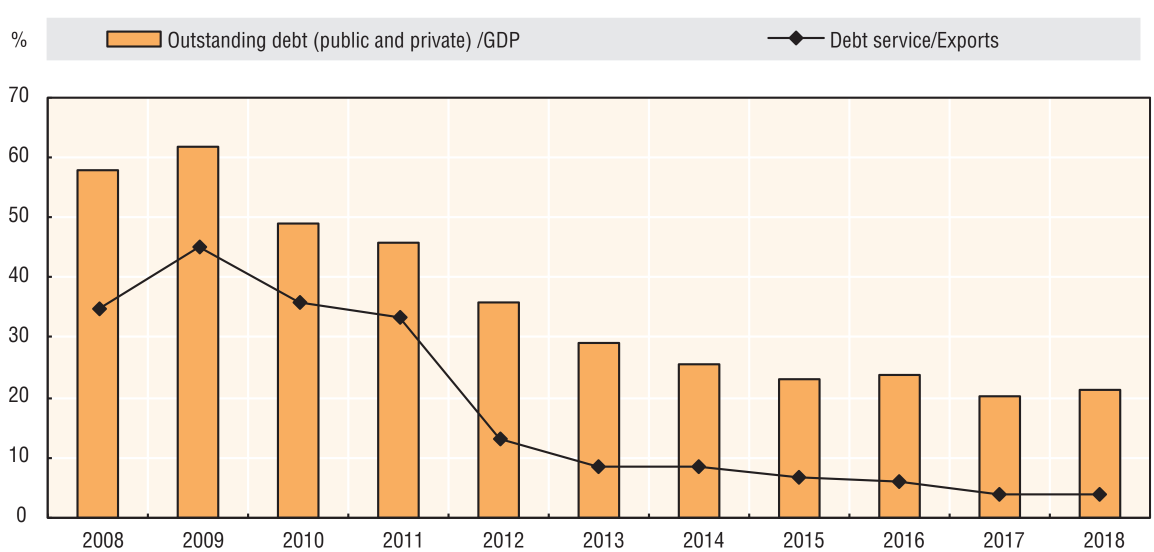
	2007/08	2012/13	2013/14	2014/15	2015/16(e)	2016/17(p)	2017/18(p)
Trade balance	-22.0	-5.7	-4.2	-6.4	-5.6	-4.8	-5.1
Exports of goods (f.o.b.)	1.0	13.2	14.4	9.9	9.5	9.8	8.9
Imports of goods (f.o.b.)	23.0	18.9	18.6	16.3	15.1	14.6	14.0
Services	0.3	0.6	0.3	0.1	0.8	0.9	0.9
Factor income	-0.9	-0.9	-0.7	-0.4	-0.2	-0.2	-0.2
Current transfers	17.1	5.9	5.1	4.5	4.9	4.6	4.6
Current account balance	**-5.5**	**-0.1**	**0.6**	**-2.2**	**-0.1**	**0.5**	**0.3**

Source: Data from domestic authorities; estimates (e) and projections (p) based on authors' calculations.

Debt policy

Eritrea is vulnerable to shocks and to a declining trend in private remittances. The government has been trying to maintain the public debt-to-GDP ratio at sustainable levels through financing selected primary sectors of the economy, the elimination of wasteful expenditures and seeking grants and concessional financing from development partners. As a result of fiscal deficits, the overall public debt-to-GDP ratio is estimated at 105.8% of GDP in 2016 with domestic debt estimated at 83.9%. The available fiscal data indicate that the bulk of the domestic debt is from the banking institutions, which account for over 75% of the total. The debt has been driven by the growing need to develop key infrastructures, such as roads and energy in the mining areas of Massawa, the provision of education and health services, as well as strengthening food security and raising agricultural productivity. The government has said that it had discussions with World Bank and IMF in 2016 with a view to undertaking a debt sustainability analysis (DSA) leading to the renewal of possible "Article IV" consultations and a thorough professional analysis of the country's overall economic health and stability.

Figure 2. **Stock of total external debt (percentage of GDP) and debt service (percentage of exports of goods and services)**



Source: IMF (WEO & Article IV).

Economic and political governance

Private sector

The private sector, consisting principally of informal businesses and small trading activities, is constrained by the unattractive investment and business climate. The country suffers from an energy-supply deficit, poor telecommunication and information infrastructure and a skills mismatch. Eritrea remains second to last in the 2017 World Bank *Doing Business* rankings. Essential challenges cited in the assessment include cumbersome procedures in registering business and long processes of background checks. Other problems include the scarcity of foreign currency, labyrinthine fiscal regulations and the difficulty of retaining skilled personnel. The abundant potential of the private sector is currently underexploited. The Ministry of Trade and Industry has conducted business surveys to be able to assess and address some of the challenges faced by the business community. A specialised centre within the MoTI is in charge of investment and is supposed to offer advice on the privatisation of non-performing companies and enterprises while addressing the key business challenges. Two investment conferences and associated meetings were held in 2016 but the process is slow because of existing investment and business-environment barriers that the government needs to dismantle in order to attract potential investors. At the same time, the government has continued to demonstrate its commitment to the mining sector by holding annual mining conferences where companies are consulted and engaged on development priorities to ensure that constraints in the sector are identified and addressed. The results from these consultations are being communicated to the Eritrean Chamber of Commerce and to the Ministry of Trade and Industry.

Addressing constraints to private enterprise by streamlining regulations and liberalising trade and foreign-exchange markets would, together with macroeconomic stability, encourage greater private-sector investment and job creation for young people and women. Furthermore, better public infrastructure (including water and electricity provision) and improved human capital would further support private-sector development, strengthen growth, and help address the persistently high unemployment rate. The government has noted the need to develop the capacity of the Eritrea Development and Investment Bank (EDIB) so that it can be able to meet the growing and anticipated demands for business capital. The country is already connected to the Middle East through international flights composed of Flydubai, Qatar, Egypt air, and Turkish Airlines in addition to domestic flights by local companies.

Financial sector

The popular economy is cash-based, with limited use of demand deposits and almost no term deposits. In 2014, estimates by the IMF put the ratio of M2-to-GDP at about 14.3%, which is well below the sub-Saharan African average (36%). Banking-sector assets are equivalent to just 18.4% of GDP. The financial sector, dominated by the state-owned banks, is in poor condition. Officially, the financial sector mainly consists of the central bank, two commercial banks with 28 branches across the country, EDIB and one insurance company. Most of the operations in the banking sector are manually executed which results in significant inefficiency in the business-delivery system. Reforms in 2016 brought in an automated payment system and the old Nakfa (ERN) banknotes were replaced. The combined effect of these actions has been to reduce the size of the black market and hinder human trafficking, while corruption via the local currency has been brought under control. All individual citizens have been encouraged to transact their business through the banking system and withdrawals of large sums of money are being regulated.

Eritrea ranks low in Africa in terms of loan access and information on borrowers (such as credit history and credit risk). The lack of collateral registries and difficult contract enforcement constrain bank lending to the private sector. Eritrea is at 185th in the ranking of 190 economies in terms of the ease of obtaining credit. Notwithstanding some positive developments, access to traditional financial services remains difficult, particularly for certain demographic groups. The share of the population having an account at, or borrowing from, a financial institution is low. Moreover, financial markets have not evolved in ways that allow individuals and firms to diversify their savings and enable firms to raise money through stocks, bonds, and foreign-exchange markets. Financial reforms in the pipeline and exploration of ways of recapitalising the EDIB to allow small and medium enterprises to access affordable loans may reinvigorate private-sector growth and generate employment, especially for young people who are the majority of the population.

The authorities recognise the need to build capacity in banking supervision. Risk-based supervision requires risk analysis and supervisors' capacity needs to be enhanced to allow for the implementation of Basel III requirements. The mandated capital adequacy ratio requires strict implementation among all banks, along with the continuous enforcement of the Central Bank Law. Financial-sector reform should aim at improving access to finance and enhancing financial-sector competition, including a movement towards gender balance. Financial inclusion implies a focus on Eritreans who do not currently have access to funding. Microfinance has been in operation since 2005 and has served the rural poor, particularly women, at the zoba and sub-zoba level. Despite the potential of this mode of financial operations, its reach is limited by the rudimentary ITC network currently available, including mobile telephone penetration that is among the lowest in the region, perhaps because there are stringent regulations for individuals to register a mobile line.

Public sector management, institutions and reforms

The government has continued to undertake reforms to strengthen institutional and human capacity in order to deliver on the three declared priority areas of food security, infrastructure development and human-resource development. These reforms include recruiting graduates to fill staffing gaps in public-sector institutions, mobilisation of resources on concessional terms to strengthen public financial management and macro-statistics, and measures to increase agricultural productivity. The quality of macroeconomic data suffers from several shortcomings that hinder effective planning and evidence-based decision making. With the exception of consumer prices, monetary and exchange-rate data, other available macroeconomic data have serious weaknesses in terms of quality, periodicity, and timeliness. Strengthening statistical capacity in key ministries and regional offices, therefore, will promote sound macroeconomic analyses, policy formulation and better information for effective planning and evidence-based decision making, as well as the design of appropriate policy responses.

Efforts to update the NIDP are under consideration by the government to address other emerging issues including the improved political landscape, the increased mobilisation and allocation of resources by AfDB, EU and elements of the UN system, and provision of technical assistance to various public-sector institutions. The assessment of capacity gaps is a continuous process and the government is proposing a number of interventions to sustain private-sector development, to scale up the drought-resilience programme and to strengthen regional government offices to support the implementation of development programmes in a more efficient and effective manner. The skills-development project for employment and entrepreneurship is one of these programmes. Its objective is to create employable skills and competencies relevant to the labour market and to enhance participation of the private sector in development. In 2016, the IMF training institute based in Dar es Salaam provided several capacity-building programmes to regional public employees and at the Central Bank in public financial management and risk-based supervision, respectively.

The Ministry of Finance and the Ministry of National Development bilaterally co-ordinate development initiatives for the government and their co-operation has allowed the implementation of drought-resilience programmes in zobas that were initially not covered under phase II of the

NIDP. A capacity-building programme launched by the government in October 2016 is designed to address challenges in producing macro-statistics and strengthen the public financial-management system, particularly in the Treasury and budget departments. These efforts will be supplemented by the support provided by the EU to statistics collection and by UNDP on public administration over several ministries. However, a key challenge hindering the smooth implementation of such programmes is the existing weak human-resource capacity, together with poor ICT systems and power disruptions. The government has announced that it will co-ordinate with E-Afritac and development partners currently resident in Asmara to continuously address challenges in public-sector management.

Natural resource management and environment

Climate change affects the performance of the economy and the general livelihoods of the rural population. Its impact has been observed on important economic sectors particularly agriculture, tourism and fishing, while pressures on national ecosystems could exacerbate poverty and drive emigration. The natural resources on which agriculture is based – land and water above all – are becoming degraded and there is growing competition for their use. Climate change is already exacerbating this situation, making agriculture more risky, and it will have an even greater impact in the future. Hence, the main environmental concerns relate to degradation of the soil and of forest and water resources, in part resulting from the growing mining sector as well as climate change. Two-thirds of the population do not have access to modern commercial energy supplies and are consequently reliant on biomass (wood and charcoal), while the commercial sector depends on imports for all modern energy supplies. These include refined petroleum products for the transport, industrial- and domestic-power sectors, as well as for electricity generation, which is wholly based on oil-burning plants.

The NIDP recognises that access to electricity is still limited to 38% nationally, ranging from 8% in rural areas to 98% in the capital Asmara, whereas the sub-Saharan African average for rural electrification is 13%. The available statistics indicate that all sub-zobas have some electricity supply but access is highly variable. Zoba Ma'ekel (Central Region and the location of Asmara) enjoys 15% of electrification, followed by Zoba Debub, on the Ethiopian frontier, with only 0.33%. The rest of the rural areas in all 4 other zobas are practically without electricity; only 1 in 10 000 rural households have access. The authorities are already aware that lack of access to modern energy supplies not only aggravates poverty but contributes to its perpetuation. Moreover, most municipal sewerage plants and industries in the country discharge partially treated or untreated wastewater containing high levels of organic materials, metals and other toxic substances directly into surface watercourses. Open sewage systems contaminate groundwater resources. Improving the living conditions of the Eritrean people, particularly the rural poor, will thus require providing them with access to affordable, clean and sustainable energy. It is, therefore, critically important to incorporate the planning and management of pollution-control systems by identifying, controlling and regulating sources of pollution to safeguard the quality of the nation's water resources.

Land degradation is a major challenge and the government has joined global efforts to address desertification by ratifying the 1994 United Nations Convention to Combat Desertification (UNCCD) and allocating resources to address some of the climate-change challenges in some of the most affected zobas. Strategies and policies will be reviewed to ensure that they are consistent in all the selected key sectors. The government has supported reforestation by involving students in tree-planting programmes during the holiday seasons and the Ministry of Agriculture is supporting water-conservation programmes that involve the construction of check and micro dams at zoba level through community participation.

Rampant power-supply failures and mechanical breakdowns have forced the business community to operate individual generators, a situation that is unsustainable and make locally produced goods and services less competitive. The sufficient, reliable and sustainable production and supply of affordable energy throughout Eritrea is the main objective of the government's policy in the energy sector. Hence, the government has requested support from the AfDB and the EU to develop the energy sector as part of its strategy of lowering operating costs and encouraging private-sector development. Meanwhile, the AfDB has given the Ministry of Energy and Mines responsibility for designing and refining policies, strategies and regulatory options in the energy sector. Formulation of an energy strategy is already underway as the basis for guiding infrastructure development and addressing other constraints.

Political context

Since independence in 1993, institution building and development have been hindered by a number of factors, including unresolved border issues with Ethiopia, UN sanctions and regional instability in the Horn of Africa. Eritrea is a one-party state. The People's Front for Democracy and Justice (PFDJ) emerged from the Eritrean People's Liberation Front (EPLF) in 1994 and has ruled the country ever since, although a new constitution was ratified in 1997 and local elections have been held, most recently in 2010 and 2011. Governors are appointed by the President to administer regional (zoba) administrative offices. However, no elections have been conducted at the national level. In 2014, the government announced the drafting of a new constitution but no information is available to ascertain its status.

As part of the transparency and accountability reforms promised by the government, the Ministry of Information has been restructured and more information is flowing about the progress of development programmes. Regional instability and political tensions in the Horn of Africa continue to shape development strategies. With support from the EU, the government has proclaimed its full commitment to engaging with the UN system in addressing human-rights issues, in addition to the gradual process of implementing recommendations from a number of sources. The unresolved border issues between Eritrea and Ethiopia continue to undermine the development initiatives of both countries, as human and financial resources are allocated away from vital sectors of the economy. UN sanctions have hurt the country's development agenda by forcing the authorities to adopt less effective policies and inward-looking strategies. However, the long-awaited strategy of recruiting graduates into public-sector institutions has begun and its continuous implementation will address both the youth unemployment problem that has forced emigration and the human-resources shortage that has dogged public institutions.

Eritrea is gradually re-engaging with the international community as one of the strategies to improve its profile and address its challenges in a broader environment. For example, Eritrea has been admitted to the International Organisation for Migration (IOM) council. The government has submitted its second Universal Periodic Review (UPR) report to the UN Human Rights Council (UNHRC) and accepted 92 of the UNHRC's 200 UPR recommendations on which it has already commenced work on implementation. Eritrea is part of an initiative launched by the Kingdom of Saudi Arabia to form an alliance against terrorism and the so-called Islamic State (ISIS), and there is a new openness to foreign journalists. These developments are seen as positive indicators of the government's openness and willingness to build partnerships and engage with development partners to strengthen mutually beneficial co-operation.

Social context and human development

Building human resources

Eritrea has continued to make progress in education and health. For instance adult literacy – the share of the population aged 15 years and above that can both read and write – improved from 52.5% in 2002 to 73.8% in 2015. Child mortality – the probability of dying between birth and five years of age, expressed as a rate per 1 000 live births – improved from 89.1 in 2000 to 46.5 in 2015. Other indicators that have shown significant improvements are: secondary school enrolment; maternal mortality; antiretroviral therapy (ART) provision; and public-health campaigns. This progress is critical for the implementation of the global agenda for Sustainable Development – especially the goals of ensuring healthy lives and promoting well-being for all at all ages, ensuring inclusive and equitable quality education and promoting lifelong learning opportunities for all.

Poverty reduction, social protection and labour

The latest poverty estimates date back more than two decades to 1993 when the Eritrea Poverty Assessment was completed. Obtaining updated data and statistics remains a challenge and impedes the undertaking of gender, spatial and temporal analysis of poverty. In the absence of specific reliable data on poverty, evidence of sustainable economic opportunity can indicate progress on poverty reduction. Notable examples include: the ease of doing business; access to land and water for agriculture; agriculture input and produce markets; and household access to mobile phones, computers and internet. These have largely improved since 2000 and continue to do so – although they could be accelerated. For instance, cell phone subscriptions increased from 1 to 17 per 1 000 inhabitants between 2000 and 2015.

Labour protection is enshrined in the constitution that ensures that no person shall be held in slavery or servitude nor shall any person be required to perform forced labour not authorised by law. The constitution further provides for the National Assembly to enact laws guaranteeing and securing the social welfare of citizens, the rights and conditions of labour and other rights and responsibilities.

Gender equality

While gender equality and empowerment has received government support since independence, challenges still persist. Over time, there have been modest improvements in many areas. Labour-force participation and parity in learning has been sustained at high levels and should create momentum for parity in other spheres of society. The labour-force participation rate, the proportion of the population aged 15 and older that is economically active has consistently remained well over three-quarters since 2000 and is estimated at 80% for women and 90% for men (ILO 2014 estimate). Gender relativity in labour-force participation for the younger generation (15-24 years) is lower at 74% for women and 80% for men. There is approaching gender parity in literacy, especially for the young generation.

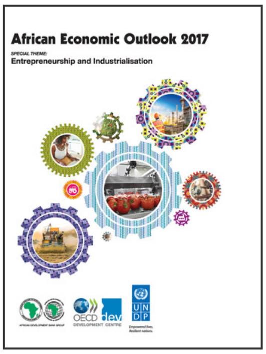
Thematic analysis: Entrepreneurship and industrialisation in Eritrea

The industrial sector is still relatively small with some 25 000 employees. The main industrial sub-sectors are: food and beverages; textiles, leather and garments; paper, printing and publication; chemicals, paints, pharmaceuticals; plastics and rubber; construction materials; metal; and furniture. A range of intermediate goods has been introduced over the past ten years but the range continues to be limited because of slow economic growth overall. Small and medium-sized enterprises continue to account for well over 45% of total industrial output. The bulk of enterprises were historically located in the Asmara area and still are. The Ministry of Trade and Industry is responsible for providing overall guidance and fostering an enabling environment for export-led manufacturing. Current industrial policy emphasises the initial development and promotion of light consumer-goods industries and enterprises based on agricultural resources and the specific factor endowments of the country leading to competitive, high-tech and export-oriented industries. These industries include textiles and garments, leather products, general agro-processing, metal fabrication, plastics, construction materials, and other resource-based industries.

Eritrea has enjoyed a rich entrepreneurial tradition that suggests ample opportunities for industrialisation. Industry currently accounts for 25% of GDP and 10% of principal exports. The sector faces four main problem areas. Industrial production is based on a narrow resource base, centred on few sub-sectors, namely agro-industry (textile, leather-based industries, food processing, beverage and alcoholic drinks), building materials and chemicals. Second, it suffers from old and outdated equipment, underutilised production capacities and a shortage of skilled manpower. Third, production is heavily dependent on imported inputs, requiring scarce foreign exchange and, fourth, the domestic market is relatively small and there is a lack of diversification in export markets (in the past Ethiopia was the most important export market).

The level of entrepreneurship is currently low or stagnant because of the lack of basic infrastructure and prevailing unconducive business and investment environment. In addition, the once abundant skilled manpower for basic industries has largely evaporated through 30 years of neglect, lack of training and shortage of business opportunities. With the exception of the food-processing sector where the state is major investor in the medium and large enterprises, most firms are privately owned (95.6%) and located in major urban areas (39.7%). The 2015 industrial survey reveals that 69.3% of Eritrean enterprises are in sole proprietorship, 14.7% are partnerships, 5.6% are government-owned, 5.6% are public share-holder companies and 2.5% are other types of joint ventures. Eritrean women are entrepreneurial, although this is not reflected in the share of firms with female participation in ownership. Surveys tend to suggest that women entrepreneurs are running microenterprises in the informal sector, engaging in low-value-added activities that reap marginal returns. They tend to be entrepreneurs of necessity, rather than opportunity, driven into small business by the lack of other options. Only 15% of formal-sector firms have a woman as the managing director, while 32% have some degree of female ownership. Eritrean women are already highly active as producers and entrepreneurs. They form the core of the agricultural labour force, producing an important share of the country's food. They own and operate the majority of businesses in the informal sector, and have generally high rates of participation in the labour force.

There are no multi-sector opportunities for dialogue on entrepreneurship or effective engagement between the Eritrean Chamber of Commerce and other development partners. The Ministry of Trade and Industry, however, is mandated to co-ordinate priorities, as set out in the policy framework. The 1994 Eritrean Investment Proclamation established a general framework for investment, with the objectives of encouraging investment, expanding exports and employment and encouraging new technology. It also provided tax incentives for investors and a limited framework for dispute resolution. The government established the Eritrea Investment Centre within the Ministry of Trade and Industry to deal with investors and the sale of public enterprises through a privatisation process that, however, has stalled due to economic factors. Commercial laws designed to facilitate conduct of private enterprise are not adequately enforced. The laws aim to achieve self-sustaining growth, facilitate the rapid expansion of exports, expand employment, and promote and protect foreign investment. Given the constraining factors on investment and the poor business environment, the government has not established monitoring and evaluation frameworks to assess the impact of its policy measures. However, the government is attempting to draw lessons from the country's past experiences as a foundation for its industrial and investment policies. Among these lessons, the authorities should address the problem of infrastructure gaps and improve the business and investment environment while undertaking major institutional reforms to attract foreign private-capital flows.



From:

African Economic Outlook 2017

Entrepreneurship and Industrialisation

Access the complete publication at:

https://doi.org/10.1787/aeo-2017-en

Please cite this chapter as:

African Development Bank/OECD/United Nations Development Programme (2017), “Eritrea”, in *African Economic Outlook 2017: Entrepreneurship and Industrialisation*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/aeo-2017-30-en