

# ERITREA

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Magidu Nyende / n.magidu@afdb.org  
Luka Okumu / luka.okumu@undp.org





## ERITREA

- Economic growth is estimated to have fallen sharply to 1.1% in 2013 from 7% the previous year and is projected to progress slightly to 1.9% in 2014, reflecting shrinkage of economic activities in many sectors, except in mining.
- Improvements are under way in the education and health sectors thanks to increased investments in those sectors, but significant challenges remain, especially with respect to creating an enabling business environment.
- Eritrea is currently not well-integrated into global value chains, but there is potential for an increased internationalisation of production and trade for mineral and agro-food exports.

### Overview

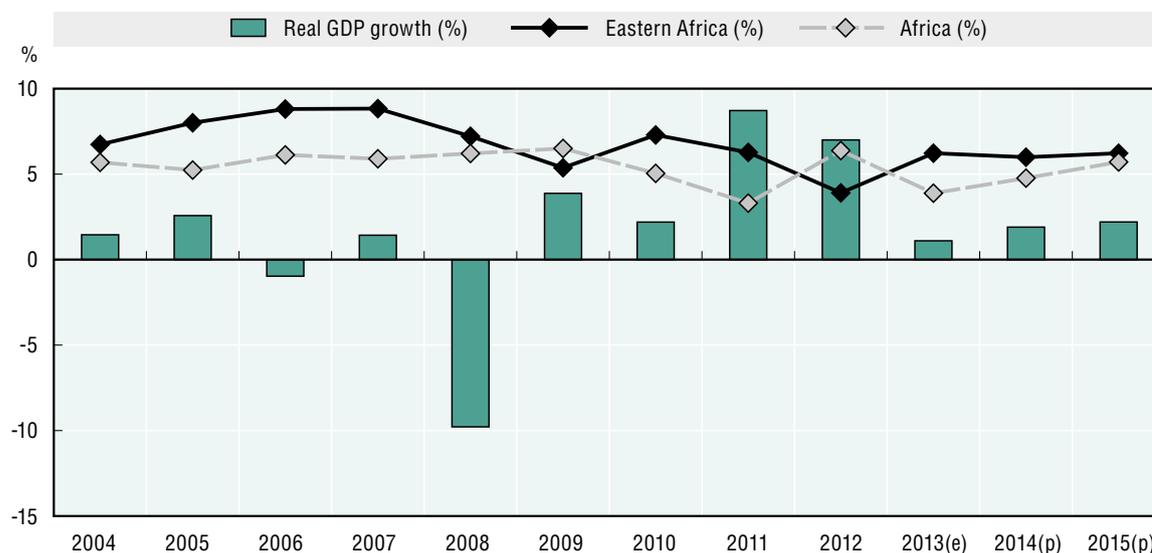
Eritrea has faced considerable challenges over the years, including variable climate conditions. This has been compounded by restrictive economic policies, political isolation, a significant decline in remittances and scarcity of foreign exchange. Reflecting these factors, estimated real GDP growth for 2013 fell sharply to 1.1% from 7% the previous year and is projected to increase marginally to 1.9% in 2014. This growth will largely be driven by: copper production at the Bisha mine; the start of gold production at the Zara mining project in 2014; and continued exploration activity and investment in the mining sector. In the medium term, Eritrea sees further prospects in oil production, fisheries and tourism.

The budget deficit improved to an estimated 10.3% of GDP in 2013 from 15.5% in 2010, and is projected to narrowly improve as a result of higher mineral revenues. Exports are projected to grow in 2014, driven by the onset of copper and gold mines. This may be offset by growth in imports as investments in mining boost demand for imported capital goods. Remittances from the Eritrean diaspora declined significantly, reflecting the impact of the 2011 United Nations Security Council sanctions restraining UN member countries from facilitating transfer of the 2% “recovery and development tax” paid by Eritreans living abroad. Taking these factors into consideration, the current account is projected to deteriorate from an estimated 0.3% of GDP in 2013 to -0.3% of GDP in 2014.

Eritrea has considerable potential to generate growth in agricultural production and agro-processing, livestock production, fisheries and fish processing, and mining, as well as through the development of small and medium-sized enterprises, tourism and related hospitality services and infrastructure. The country is currently focusing on developing its tourism industry around the Red Sea port of Massawa and the export potential of its mineral reserves. There is already one active mine, and two more mines are in advanced stages of development. In addition, geological studies have confirmed the presence of oil and natural-gas reserves in commercial quantities.

A number of factors will influence Eritrea’s medium-term economic prospects: i) regional insecurity, especially related to the unresolved issues between Eritrea and Ethiopia; ii) enforcement of UNSC sanctions; iii) recent confirmation that the country will participate in the AfDB’s Drought Resilience and Sustainable Livelihoods Program; iv) recent discovery of substantial mineral deposits in parts of the country and large foreign investments for their exploitation; and v) the country’s growing commercial relationship with Russia, the United Kingdom, China, India and South Africa.

Figure 1. Real GDP growth



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

Table 1. Macroeconomic indicators

	2012	2013(e)	2014(p)	2015(p)
Real GDP growth	7.0	1.1	1.9	2.2
Real GDP per capita growth	3.7	-2.1	-1.3	-0.9
CPI inflation	12.3	12.3	12.3	12.3
Budget balance % GDP	-10.3	-10.3	-10.7	-9.4
Current account balance % GDP	2.3	0.3	-0.3	-1.5

Source: IMF.

## Recent developments and prospects

Economic growth in Eritrea has been irregular. Soon after its official declaration of independence in 1993, the country enjoyed rapid economic growth averaging 7% per annum. Recent trends reflect a downturn in real GDP growth and this is of great concern. The real GDP growth rate slowed from 8.7% in 2011 to 7.0% in 2012, largely attributed to major crop failures and foreign-exchange shortages, which restricted imports of intermediate goods. The negligible foreign investment (other than in the mining sector) and declining aid inflows driven by Eritrea's policy of self-reliance and isolation have since severely constrained the country's economic performance. Growth performance is unlikely to be affected by the latest round of UNSC sanctions, which require that states take the necessary measures to ensure that companies involved in mining in Eritrea exercise due diligence. Despite the fact that the economy is agriculture-based, with about 70% of the population relying on this sector for income and employment, the sector's contribution to GDP has been moderate and declining, reflecting challenges that include recurrent drought in the Horn of Africa, rudimentary farming methods and effects from the country's unresolved conflicts with its neighbours Somalia, Ethiopia and Djibouti (Table 2). The growth outlook could improve substantially provided structural reforms are made to open up the economy and natural resources are utilised in a creative manner. These considerations underscore the urgent need for the government to undertake the structural reforms to promote broad-based economic growth and promote private-sector participation.

In recent years, the government has actively engaged both national and foreign investors to scale up investments, particularly in the mining sector. The findings of the feasibility study for



the Asmara Project – mining the four advanced deposits that make up the project (Emba Derho, Adi Nefas, Gupo Gold Deposit and Debarwa Mine) and processing of the ore near the large Emba Derho deposit – demonstrated that the project was economically robust. The capital-intensive nature of mining and weak linkages with the other economic sectors has however limited its impact on job creation. Eritrea will therefore need to implement well-tailored policies and strategies to manage its mineral resources and the proceeds therefrom, and to promote adding value on mining products in order to make growth more inclusive and increase the resilience of the country’s medium-term growth prospects.

The government has continued to prioritise infrastructure development in order to promote private-sector investments. Infrastructure projects in Massawa and Assab have been completed. The country is also expanding the road network, particularly in the mining sites and in the free-trade zone, as well as the housing sector in Asmara. This is expected to diversify the economy, increase youth employment and make growth more resilient and broad-based. In addition, the geostrategic location of Eritrea could serve as a bridge between the Middle East and the countries in East and Central Africa.

Politically, the country has remained isolated in the region due to its alleged involvement in activities undermining peace, security and stability in the region. The impact of the second round of sanctions by the UNSC is reflected in the critical challenges facing the economy but will not necessarily affect the mining sector in any significant way. The UNSC also expressed its concern over the potential use of the Eritrean mining sector as a financial source to destabilise the Horn of Africa region. It called on Eritrea to show transparency in its public finances, including through co-operation with its Monitoring Group, in order to demonstrate that the proceeds of these mining activities are not being used to violate relevant resolutions.

The collection of a 2% tax on income earned by all Eritreans in the diaspora was suspended as it was considered unlawful by the United Nations. Eritrea’s decision to join the IGAD and confirmation of its participation in the DRSLP is a welcome development that benefits all countries in the region.

Table 2. GDP by sector (percentage)

	2008	2012
Agriculture, hunting, forestry, fishing	17.4	16.9
of which fishing		
Mining		
of which oil		
Manufacturing	6.8	5.9
Electricity, gas and water	2	1.7
Construction	18.1	15.5
Wholesale and retail trade, hotels and restaurants	18.1	19.4
of which hotels and restaurants		
Transport, storage and communication	11.6	12.4
Finance, real estate and business services		
Public administration, education, health and social work, community, social and personal services	26.1	28.1
Other services	17.4	16.9
<b>Gross domestic product at basic prices / factor cost</b>	<b>100</b>	<b>100</b>

Source: United Nations Statistics division.

## Macroeconomic policy

### Fiscal policy

Evidence-based assessment of fiscal policy in Eritrea is severely constrained by lack of transparency and availability of basic information on fiscal operations and management, including, of course, the budget. Estimates by various sources, including the IMF, however, indicate a continued improvement in the overall fiscal deficit (after grants) from about 13.2% of GDP in 2011 to an estimated 10.3% in 2013, reflecting improved tax collection from the 2012 level, lower expenditure on safety nets and a contraction in public investment (Table 3). The authorities argue that the fiscal balance will improve further with continued inflows of the proceeds from the Bisha mine.

The fiscal deficits, however, need to be brought further under control. The government has been adhering to a tight budget for several years by reducing expenditure and prioritising investments, especially under the development budget. It has made respectable efforts to streamline expenditure, in particular by reducing defence outlays and by focusing increasingly on improving food security, human-capital development and infrastructure investments. As a share of GDP, total expenditure and net lending was estimated at 28.6% in 2013, compared to 56.5% in 2005. The expenditure projection for 2014 puts the figure at 29.5%, which may be boosted, however, by increased revenues from the mining sector.

Total revenue including taxes, non-tax and grants fell from 32.3% of GDP in 2005 to an estimated 18.4% in 2013. The decline in overall revenue with respect to the period from 2005 to 2010 is largely attributed to a reduction in grants and shrinkage in economic activities. Tax revenue is projected to increase to 11.2% of GDP in 2014 from 10.7% in 2013. The government is optimistic about the impact of the mining investments as they present new opportunities for Eritrea to generate revenue. Fiscal inflows should however be invested in sectors considered to have the greatest impact on the population's living conditions and the economy as a whole.

Remittances and financial inflows from a 2% "diaspora tax" were an important source of revenue before declining drastically to less than 10% of GDP in 2012 as countries began to implement the 2011 UN sanctions and scrutinise the methods used to collect this tax. The decline in financial inflows was also caused by the suspension of imports of consumer goods, which authorities considered to be misuse of the foreign currency required for critical imports. It should be noted that imports of goods such as fuel, food, major building materials, etc. are made with direct involvement of the government.

Table 3. Public finances (percentage of GDP)

	2005	2010	2011	2012	2013(e)	2014(p)	2015(p)
<b>Total revenue and grants</b>	<b>35.3</b>	<b>20.8</b>	<b>18.4</b>	<b>18.4</b>	<b>18.4</b>	<b>18.7</b>	<b>18.8</b>
Tax revenue	14.9	8.7	8.3	10.2	10.7	11.2	11.7
Grants	9.3	6.9	4.5	1.9	1.2	1.0	0.9
<b>Total expenditure and net lending (a)</b>	<b>56.5</b>	<b>36.3</b>	<b>31.6</b>	<b>28.6</b>	<b>28.6</b>	<b>29.5</b>	<b>28.2</b>
Current expenditure	40.3	25.4	23.3	22.0	22.8	23.1	22.3
Excluding interest	37.1	22.2	20.3	19.2	20.1	20.4	19.6
Wages and salaries	19.6	10.6	9.5	8.7	8.4	9.0	9.2
Interest	3.1	3.2	2.9	2.8	2.7	2.7	2.7
Capital expenditure	17.9	10.9	8.3	6.7	5.8	6.4	5.9
<b>Primary balance</b>	<b>-18.1</b>	<b>-12.3</b>	<b>-10.2</b>	<b>-7.5</b>	<b>-7.5</b>	<b>-8.0</b>	<b>-6.7</b>
<b>Overall balance</b>	<b>-21.2</b>	<b>-15.5</b>	<b>-13.2</b>	<b>-10.3</b>	<b>-10.3</b>	<b>-10.7</b>	<b>-9.4</b>

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 has mainly been geared to accommodating the public fiscal deficits. Broad money supply increased sharply to 119% of GDP in 2011 and 2012. Due to exceptionally high deficits in the previous years, the authorities had to resort to central-bank financing. Credit supply to the private sector grew at much lower rates, between 1% and 4%, over 2009-11. Inflation, which has stood at double-digit rates over the last decade, was a high 12.3% in 2012, the same rate that was estimated for 2013 and is projected through to 2015, owing to scarcity-induced food-price increases.

In February 2013, the government liberalised the foreign-currency regime in order to ease foreign-exchange shortages. The corresponding proclamation allows institutions and individuals to open foreign-currency deposits and to use foreign exchange for international transactions without limitation. Although the nakfa (ERN) has been pegged to the US dollar at ERN 15 per USD 1 since 2005, the black-market exchange rate reportedly exceeds the official rate by a wide margin of up to 240% or more. Considering this overvaluation of the official exchange rate, a comprehensive reform package is needed to reverse the negative effects the policy is having on the country's economy and development efforts. Under the new regulations, the government relaxed some controls on the declaration and accountability of all the foreign currency brought in and taken out of the country. It is hoped that the current foreign-currency inflows through investments, revenues from the gold mines and official development assistance will strengthen the currency. Further development of the mining sector will make a substantial impact on the performance of the economy over the medium term thanks to emerging investment opportunities in oil and gas. Although it is still early to notice key changes in the economy, the government's decision to liberalise the foreign-currency regime is a welcome reform measure. If fully implemented, it could unlock the foreign-currency shortages and exchange-rate overvaluation; these will induce private investment, hence boost growth and create employment in the country.

## Economic co-operation, regional integration and trade

Regional integration is critical for Eritrea's quest for peace, food security, economic growth and infrastructure development. Eritrea is currently a member of the Common Market for Eastern and Southern Africa (COMESA), the Community of Sahel-Saharan States, New Partnership for Africa's Development, and the IGAD. It has also signed bilateral investment agreements with Italy, the Netherlands, Qatar and Uganda, as well as a Memorandum of Understanding with Sudan for its minerals to be refined there.

Eritrea is also gradually renewing its engagement with the wider international community. In the summer of 2013, the Eritrean Permanent Representative to the UN stated that the Government of Eritrea recognised the current Somali Government. In November 2013, Eritrea submitted its second Universal Periodic Review on human rights to the UN and expressed commitment to implement the recommendations of the report. It also received a high-level Global Fund to Fight AIDS, Tuberculosis and Malaria mission as well as a high-level United Nations Development Group mission in December 2013, and it renewed relations with the European Union, which had been strained since 2011.

The country is also participating in a regional financial-integration programme under COMESA and is beneficiary of the Generalized System of Preferences with a number of industrialised countries and regions (including the United States and the European Union). Eritrea's geostrategic proximity to the Middle East (Saudi Arabia, the United Arab Emirates, Yemen and Israel) and to the East and Central Africa economic area offers the country significant opportunities. Eritrea is easily accessible given its long coastline and numerous ports. Consequently, the government has initiated trade and investments that would enable the country to serve a potential regional



market of more than 400 million consumers. There are, however, significant infrastructure challenges that the country has to overcome to take advantage of these opportunities.

Eritrea's international trade has been characterised by large deficits. The main constraints include infrastructural deficiencies, institutional-capacity weaknesses, governance challenges, political isolation, and unresolved regional instability and conflict issues. These constraints have resulted in Eritrea's having little interregional trade with COMESA countries (only 20% of total trade according to the UNCTAD). The country's return to IGAD is thus considered a welcome development in the Horn of Africa and the rest of Eastern Africa. In 2009, Eritrea launched a free-trade zone in Massawa to attract foreign investment, within which it has removed all potential trade barriers such as taxes and quotas, and facilitated favourable regulatory procedures.

The composition of Eritrea's exports is changing, and is now being dominated by mineral resources (gold and copper, with exploration for potassium taking place). As indicated in Table 4, the value of exports rose markedly in 2011 and has been relatively stable since then, and the outlook is equally stable as long as economic conditions remain favourable in the main destinations of exports. Imports, amounting to a high 45.5% of GDP in 2005, have stabilised in the neighbourhood of 20% of GDP since 2010 and are projected to remain at that level in 2014 and beyond, with a slight decline estimated for 2013. A slight current-account deficit is expected in 2014, largely due to higher imports of machinery associated with investments in the mining sector.

Table 4. Current account (percentage of GDP)

	2005	2010	2011	2012	2013(e)	2014(p)	2015(p)
Trade balance	-44.2	-19.6	-10.3	-4.6	-5.6	-5.5	-6.2
Exports of goods (f.o.b.)	1.2	1.1	10.0	15.1	13.2	15.1	13.0
Imports of goods (f.o.b.)	45.5	20.7	20.3	19.7	18.8	20.7	19.2
Services	-4.5	1.0	1.5	0.9	0.7	0.5	0.4
Factor income	-0.9	-0.9	-1.1	-1.3	-0.9	-0.7	-0.6
Current transfers	50.0	13.9	10.5	7.3	6.1	5.5	4.9
<b>Current account balance</b>	<b>0.3</b>	<b>-5.6</b>	<b>0.6</b>	<b>2.3</b>	<b>0.3</b>	<b>-0.3</b>	<b>-1.5</b>

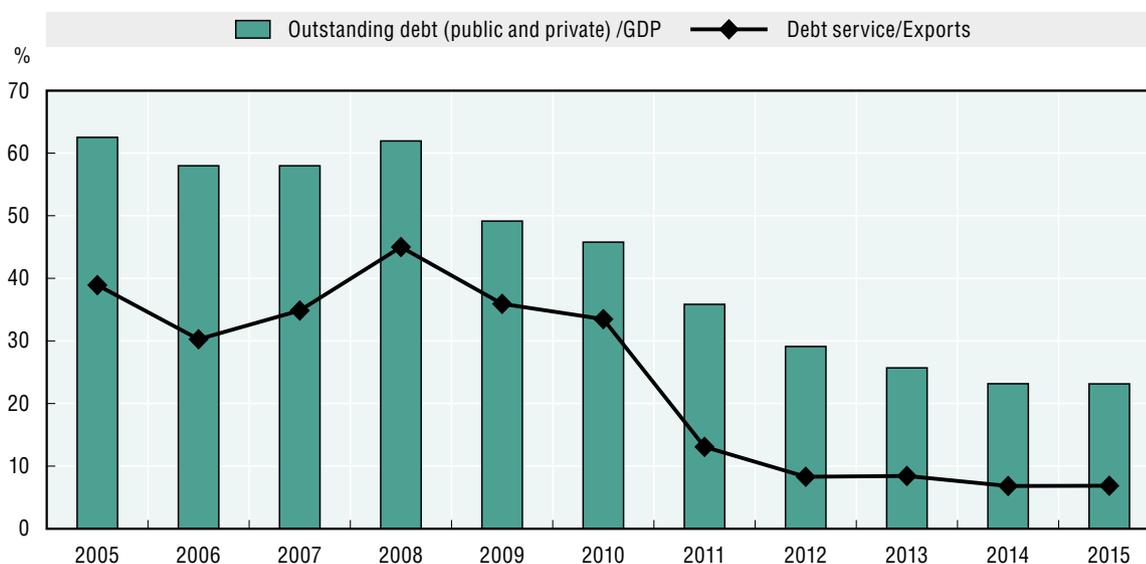
Source: IMF.

## Debt policy

According to the Eritrean authorities and IMF staff estimates and projections, the level of Eritrea's public debt is estimated to remain unsustainable at 111.1% of GDP in 2013 after having reached 118.3% in 2012. At the end of 2013, the central government's domestic debt stood at 85.9% of GDP and external debt at 25.7% of GDP. Increases in revenues from mining activities, notably at the Bisha mine, high gold prices and the related increases in the tax base are lightening the debt burden. Nonetheless, the second round of UN Security Council sanctions and the decline in remittances from Eritreans in the diaspora has weakened the country's financial position. According to the IMF, Eritrea is classified as a Pre-Decision Point country for HIPC initiative eligibility. Moreover, Eritrea has so far not committed to concluding an IMF Staff Monitored Program, thereby foregoing the opportunity to reduce its external indebtedness through the HIPC initiative and the MDRI mechanism. The country needs to build broad partnerships and multiple pathways to tap different financial sources in order to address its debt problem.



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

A combination of restrictive government policies, shortages of foreign exchange, declining remittances and heavy government borrowing from the banking sector has severely inhibited private-sector activity and development. Consequently, the private sector remains small, underdeveloped and crowded out by the state's growing role in the economy. The private sector is also constrained by an underdeveloped financial and banking sector characterised by low access to credit and poor saving incentives. The problem of low access to financial services, especially credit, is undermining the private sector's efforts to participate in the government's privatisation programme. It has also curtailed the growth of both formal and informal trade along the border areas, thus lowering the potential impact of regional spill-over effects. In the World Bank report *Doing Business 2014*, Eritrea was ranked 184<sup>th</sup> out of 189 countries. To improve the business climate, the government has invested in developing human skills and major physical infrastructure, including the establishment of the Massawa free-trade zone. It has further taken measures to provide a more business-friendly environment through easing the conditions for business registration, approval of plans and establishing a project in the free zone, as well as easing access to and use of foreign exchange. Recently, the government has selectively sought investment in the mining, energy, fisheries and tourism sectors. In 2013, it adopted Proclamation No. 173/2013 allowing privatisation of state-owned enterprises as well as institutions and individuals to hold and use foreign exchange for international transactions without limitation. Similarly, state manufacturing companies were being turned into share companies. These measures are hoped to boost trade and investment.

### Financial sector

The Eritrean financial system remains significantly underdeveloped with a limited supply of financial services, which fall far short of demand, including project finance for both the public and private sectors. There are currently six financial institutions comprising the central bank (Bank of Eritrea), one commercial bank, one housing and commerce bank, one development bank, one insurance company and one foreign-exchange bureau. As a result of the shallow and



narrow financial system, the average level of credit extended to the private sector is quite low and the government pursues administered interest rates, which discourages private savings and increases the cost of borrowing. When not subsidised by the government, the borrowing rates have tended to be prohibitively high at around 30%. Moreover, under the regional financial-integration arrangement with COMESA, Eritrea remains one of the countries still unable to meet the essential precondition of attaining macroeconomic stability, partly due to its underdeveloped financial system. The low level of financial development in Eritrea has continued to limit investment opportunities in sectors like agriculture, mining, tourism and fisheries, which have potentially high regional spill-over effects to spur economic transformation and foster inclusive and sustainable growth.

Several institutional and risk factors contribute to the financial development gap. High macroeconomic and regional security instabilities and threats prevent the implementation of well-intended government programmes. This is the context in which needed key economic reforms such as the gradual privatisation of enterprises are being pursued by the government to generate an enabling environment for private-sector development.

### **Public sector management, institutions and reform**

The government is moving towards implementing reforms pursued under the Proclamation for the Establishment of Regional Administrations No. 86/1996. These initiatives aim to improve governance through the decentralisation of fiscal and administrative functions. The reforms are aimed at strengthening the roles and responsibilities of the regions (zobas) and sub-regions (sub-zobas) in order to achieve results in a more effective and transparent manner.

To improve and strengthen fiscal management, several structural measures have been considered. These include: the adoption of an IMF-designed chart of accounts; modernisation through computerisation of the inland revenue and customs divisions; strengthening of enforcements; and adoption of a robust risk-based management system. These measures are further accompanied by successive reforms to the budget and treasury systems aimed at ensuring that budget financing by zobas and sub-zobas is fully tracked and accounted for on a timely basis.

While achievements have been significant, a substantial reform agenda is still pending. Its implementation will be essential for addressing the remaining weaknesses in public financial management (PFM) and the entire planning process both at sector and national levels, especially in terms of developing evidence-based development plans. Additional challenges include the shortage of adequately trained human resources, lack of basic infrastructure, scarcity of equipment and required software. These capacity constraints are preventing the country from further improving its PFM through the introduction and adoption of robust systems, such as a performance or a programme-based budget system, and its long-term planning through the roll-out of a three-year Medium-Term Expenditure Framework (MTEF). Failure to introduce an MTEF will undermine the effective monitoring and evaluation of sector-development plans.

### **Natural resource management and environment**

The National Environmental Management Plan for Eritrea, adopted in 1995, emphasises the need for an integrated approach involving all relevant sectors to improve understanding of scientific and human interactions and integrated management. In this approach all stakeholders are encouraged to promote environmental protection as well as to take active measures to upgrade the environment such as planting trees and terracing, activities sometimes performed by national-service conscripts. As mining activity increased, the government set up a department within the Ministry of Mining and Energy to ensure that impact assessment would be conducted for all investment projects in order to maintain a safe and healthy environment. The government's focus on increasing production and productivity in the eastern and western lowlands will have a negative impact on the environment. In addition, about 70% of the population derive their livelihoods from the use of natural resources and this is reflected in increased use of wood and charcoal for cooking purposes.



The grid system is limited and cannot fully respond to general energy demand, and some towns are getting power only from isolated generators. Eritrea has about 88 MW of electricity-generation capacity, mainly from diesel/heavy-oil-fired plants. The extension of the thermal Hirgigo Power Plant will benefit inhabitants of Asmara, who have endured multiple power cuts by the Eritrean Electric Authority. There are many reasons for the shortage in supply. First, current output at Hirgigo, the largest power plant in the country, and that at Beleza (17 MW) account for 90% of all supply in Eritrea and lose 18% of the power they generate. Second, the mandatory halts for maintenance reduce available capacity by half. By comparison, well-maintained systems can guarantee a regular supply of about 85% of optimum capacity. Third, Asmara's electricity headache has also worsened since the summer of 2013 by a rise in demand from the Massawa Cement Factory, which exports part of its output to Qatar.

### Political context

Since its official declaration of independence in 1993, Eritrea has had a centralised one-party political system under the ruling party, the People's Front for Democracy and Justice. Transition towards political pluralism was initiated in 1994 with the drafting of a national constitution, which was ratified by a Constituent Assembly in May 1997. The constitution allows for multiparty democracy but has yet to be formally adopted. To date, parties cannot organise legally, and the country has had no national elections since independence. The country's relations with its neighbours in the region have also been problematic. The war with Ethiopia (1998-2000) left much suspicion and tension between the two neighbours and although there is no longer any overt conflict, relations remain tense. The Eritrean government cites as a major source of aggravation the fact that portions of the Algiers Agreement, which ended the war, remain unimplemented. The decision made in 2003 by the Organization of African Unity special commission on the border issue and the failure of the international community and the UNSC to compel Ethiopia to comply with this decision has shaped Eritrea's political landscape.

The government is wary of the objectives of the governments of other countries in the region, which it perceives as being supportive of Ethiopia, and is also suspicious of the role played by the international community. Eritrea's response to what it saw as lack of support from the international community in compelling Ethiopia to comply with the special commission's decision was to place restrictions on UN peace keepers that led to their withdrawal in 2008 from the demilitarised zone between the belligerents. The Eritrean and Ethiopian governments have since then been embroiled in proxy warfare. Eritrea also has border issues with Djibouti that have led to outbreaks of conflict.

## Social context and human development

### Building human resources

The unmet social needs in the country are reflected in the human-development challenges that are evident in human-development statistics. In 2012, Eritrea's Human Development Index (HDI) at 0.351 was below the average of 0.466 for countries in the Low Human Development group and below the average of 0.475 for countries in the sub-Saharan Africa region. This estimate indicates that between 2010 and 2012 there was an increase of 2.8% overall in the country's HDI, from 0.342 to 0.351, or an average annual increase of about 1.3%. The Government of Eritrea is determined to diversify its economy by making it less dependent on natural resources and more dependent on the quality of its human resources in order to boost growth and reduce its vulnerability to swings in world market prices. There is however a shortage of highly skilled professionals in public and parastatal organisations in various sectors including education, engineering, science and health.



In the education sector, the government has rolled out an ambitious programme to expand basic education and literacy, and secondary as well as technical and vocational education and training. According to the Education Sector Development Plan (2013-2017), the country's expenditure in the sector has accounted for 8%-10% of the total national budget, or 2.6%-3.7% of GDP. The country will be able to count on support from the AfDB, which in its 2014-2016 rolling plan and budget is supporting skills development for job creation in Eritrea.

In spite of its relatively high level of investment in education, Eritrea continues to face significant challenges, namely: low access and high disparities, low quality and relevance, high wastage and drop-out rates, and limited institutional and financial capacity. In 2011/12, the gross enrolment ratios reached 99% at the elementary level, 68% at the middle level and only 34% in secondary education. There are disparities in access and attendance to schooling by location and by gender, which exacerbate the problems of inequality and poverty. The gender parity index was 45%, 44% and 43% for elementary, middle and secondary levels, respectively, indicating that the deficit of female students increases with levels of education. These female deficits and unsatisfactory levels are partly attributed to poverty, social and cultural obstacles, lack of female teachers, inadequate education infrastructure, community attitudes, and limited accessibility to schools, especially in sparsely populated areas.

According to the Africa Research Institute, Eritrea is on track to achieving six of the eight UN Millennium Development Goals (MDGs). Immunisation and vaccination of children and adolescents against killer diseases like tuberculosis, diphtheria, pertussis, tetanus and measles is estimated at 90% and malaria, which used to be endemic in the country, has been reduced substantially as a result of aggressive control measures since a programme was launched to combat it in 1999. These achievements have translated into a steady increase in life expectancy at birth from 52.5 years in 1995 to 61.6 years in 2011. Notwithstanding these achievements, the country is faced with significant challenges to reduce poverty as well as participation in global partnerships for development.

### **Poverty reduction, social protection and labour**

No population census has ever been carried out in Eritrea and official statistics on the prevalence of poverty in the country is limited. Based on data provided by the National Health Management Information System and the Ministry of Health, the total resident population of Eritrea was estimated at 3.84 million in 2011. The population is essentially rural with about two-thirds of the population living in the countryside and semi-urban areas.

The government supports the families of fallen fighters through the Martyrs' Trust Fund, which is managed by the Ministry of Labor and Human Welfare. Although a law introducing a state-organised pension system was approved in 2005, it has not been implemented. Social safety nets remain based on extended family networks and are steeped in customary law. The remittances from Eritreans in the diaspora remain an indispensable source of income and subsistence for a large number of Eritreans.

### **Gender equality**

Despite equal rights and opportunities by national law, women are still disadvantaged in terms of access to economic opportunities and decision making. Gender equality is enshrined in the country's legal frameworks. The government has ratified and passed legislation related to gender-sensitive issues such as land legislation, prohibition of female genital mutilation, gender-based violence, and underage marriage. Generally speaking, access to health services has greatly improved but is still unequal in some parts of the country. Heterogeneity in female literacy rates across zobas is also significant. Through the National Union of Eritrean Women (NUEW), the



government approved a National Policy on Gender (2004), the National Gender Action Plan (2003-2008), a separate strategy for female education, a gender-awareness strategy of the communities and an initiative to strengthen collection of disaggregated data for effective monitoring. Eritrea has also adopted a Female Circumcision Abolition Proclamation since 2007.

Beyond “soft infrastructure”, the NUEW has embarked on a programme of providing “hard infrastructure” by establishing a Resource Centre in each sub-zoba including Asmara city. There are established structures from the village to national level. An estimated 25% to 30% of the fighting force during the liberation struggle was female. Moreover, according to expert reports a substantial share of leadership positions is filled by women, including ministerial positions (4 out of 17 ministers are women), and directors and unit heads. In 2009, women held 27.2% of all government posts and in 2013, 42% of civil service employees were female. Notwithstanding these achievements, challenges still remain as a result of which progress on MDG 1 (eradicate extreme poverty and hunger) and overall national development has been stalling. Most of these challenges relate to women’s empowerment as most women are engaged in unregulated and informal activities with low and unpredictable returns.

### **Thematic analysis: Global value chains and industrialisation in Africa**

The Government of Eritrea considers global value chains as one of the main engines for reducing economic volatility and improving growth. Major activities within the value chain are currently performed in the provision of ancillary services, production of agricultural goods, processing, natural-resource extraction, and sales and marketing. The mining sector has been the biggest area of attraction with more than 14 mining and exploration firms from Australia, Bermuda, Canada, China, Libya, the United Arab Emirates and the UK involved.

In the agricultural sector, China-based firms are increasingly investing in the construction of cold food-storage facilities, an aluminium-tin manufacturing plant and a high-quality PVC agriculture drip-irrigation pipe-production line. The government is strongly encouraging companies and individuals to invest in building residential housing, roads, airports, ports and hospitals. In the housing sector, Gruppo Italiano Costruzioni, an Italian firm, is constructing 1 680 housing units in the capital city, Asmara, as well as several housing projects and a resort in Massawa. The main drivers of the development initiatives are embedded in the country’s commitment to development through a self-reliance policy.

The Eritrean Investment Centre has been reaching out to potential investors and has provided assurances of protection to investors in the country. The government also introduced a crash programme for export take-off designed to penetrate the European and US markets (through the US Africa Growth and Opportunities Act, 2000). Eritrea was thus able to export textiles/garments to the United States free of duty and free of quota restrictions up to 2008.

Overall, the impact of the country’s participation in the value chain is noticeable, particularly in job creation, infrastructure and capacity development and in increased revenue inflows. Direct and indirect employment associated with the Bisha mine only is expected to amount to as many as 700 jobs when in full operation.

The growth potential of agriculture has not been fully exploited mainly due to low connectivity of the production locations, low levels of value addition and low productivity. The fishing value chains are relatively well-developed, but there is considerable room for improvement. Key investment opportunities in the fisheries subsector provide a potential of 90 000 km<sup>2</sup> of fishing grounds, with an estimated annual production potential of between 65 000 t and 70 000 t of fish and other marine produce. Demand for fish exceeds supply in urban areas and there is latitude for increased domestic consumption. In addition, the Eritrea fisheries sector has the potential to contribute significantly to Eritrean food security, foreign-exchange earnings and job creation.



The tourism sector has huge potential based on the scenic and topographic diversity of the country as well as on its history, in addition to a long coastal line of pristine sandy beaches, many islands and clear water with abundant marine life. There are also good investment opportunities in developing the historical and cultural heritage of the country.

Investment in exploration activities for reserves of oil, natural gas and other minerals provide a potential source for the expansion of export receipts. Offshore-oil and natural-gas exploration are specific areas of potential investment.

In spite of these investment opportunities, the country faces many challenges, amongst which low productivity in agriculture attributed to archaic farming practices and a land-tenure system that vests ownership of land to the government.

Exploitation of the existing economic opportunities in Eritrea will require not only the commitment of the Government of Eritrea and its people, but also regional integration and international trade. The country therefore needs to undertake effective policy reforms, including regional co-operation and integration policies, and develop a strong infrastructure base in addition to the provision of sufficient energy, transport, communication and physical marketing facilities, as well as adequate institutional and human-resource capacity and incentives. For example, with adequate policy reforms and investment, there is ample room for accelerated agricultural development. By using modern cultivation, fertilisation, plant-protection and water-conservation techniques, large quantities of food crops, exports and raw materials for industrial enterprises can be produced. The development of irrigated agriculture in the lowland river basins is highly promising.

In the medium-term, Eritrea should consider the following key measures:

- Actions to deepen the value chain must be driven by market opportunities and demands. Here, the Government of Eritrea must address barriers such as high infrastructure costs, lack of access to finance (capital) and the limited availability of skilled workers and appropriate incentives. In particular, it must address barriers facing small and medium-sized firms, as these provide greater opportunities to deepen the value chain within the major economic sectors.
- Policies aimed at supporting private-sector development in manufacturing and primary input processing are also useful. There is great potential for Eritrea in processing agro-food products for export.
- The government's forthcoming development plan emphasises the move into higher value-added activities. The government needs to consolidate these plans into one national plan and detail out synergies across sectors. It should further develop a business environment through the creation of supply-chain linkages between foreign and local firms in formal manufacturing in order to foster the emergence of local manufacturing firms capable of subcontracting tasks and subsequently competing with foreign firms. This will encourage domestic firms to become more innovative and raise labour productivity in order to work with multinational enterprises.
- To improve the country's business climate, the government should make efforts to develop human skills further and provide appropriate incentives in order to respond to labour-market demands. The government, with assistance from the AfDB, is developing the required skills and technical expertise through a vocational and technical training programme. The government has asked the AfDB to support the programme continuously over the medium term in order to close the skills gap in the country.