

**AFRICAN DEVELOPMENT BANK  
AFRICAN DEVELOPMENT FUND**



**ERITREA**

**2006-2007 COUNTRY STRATEGY**

**COUNTRY DEPARTMENT  
NORTH, EAST AND SOUTH REGIONS  
MAY 2006**

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## ACRONYMS AND ABBREVIATIONS

ACORD	:	Agency for Co-operation and Research in Development
ADB	:	African Development Bank
ADF	:	African Development Fund
ADF IX	:	Ninth General Replenishment of ADF
AFRITAC	:	Africa Regional Technical Assistance Centre
AGOA	:	African Growth and Opportunity Act
AIBE	:	Agriculture and Industrial Bank of Eritrea
AIDS	:	Acquired Immune Deficiency Syndrome
APPR	:	Annual Portfolio Performance Review
BADEA	:	Arab Bank for Economic Development in Africa
CBE	:	Central Bank of Eritrea
CEDAW	:	Convention on Elimination of all forms of Discrimination Against Women
CFAA	:	Country Finance Accountability Assessment
CLS	:	Core Labour Standards
CDS	:	Comprehensive Development Strategy
COMESA	:	Common Market for Eastern and Southern Africa
CSP	:	Country Strategy Paper
DANIDA	:	Danish Development Agency
ECDF	:	Eritrean Community Development Fund
EDIB	:	Eritrean Development and Investment Bank
E-EBC	:	Eritrea-Ethiopia Border Commission
EEC	:	Eritrea Electricity Corporation
EIA	:	Environmental Impact Assessment
EMA	:	Eritrean Medical Association
EPLF	:	Eritrean Peoples Liberation Front
EPRDF	:	Ethiopia Peoples Revolutionary Democratic Front
ERN	:	Eritrean Nakfa
ERP	:	Economic Recovery Programme
ESDP	:	Educational Sector Development Programme
ESW	:	Economic and Sector Work
EU	:	European Union
FIU	:	Financial Intelligence Unit
FSS	:	Food Security Strategy
FY	:	Financial Year
GDA	:	Government Development Agenda
GDP	:	Gross Domestic Product
GNP	:	Gross National Product
GOE	:	Government of Eritrea
HAMSET	:	HIV/AIDS, Malaria, Sexually Transmitted Diseases and Tuberculosis Control
HCBE	:	Housing and Commerce Bank of Eritrea
HDI	:	Human Development Index
HDR	:	Human Development Report
HIPC	:	Highly Indebted Poor Countries
ICAO	:	International Civil Aviation Organisation
IDA	:	International Development Association
IDPs	:	Internally Displaced Persons
IGAD	:	Inter-Governmental Authority on Development
ILO	:	International Labour Organisation
IMF	:	International Monetary Fund

I-PRSP	:	Interim Poverty Reduction Strategy Paper
ISO	:	International Organisation for Standardisation
LSMS	:	Living Standards Measurements Survey
MDG	:	Millennium Development Goal
MTDP	:	Medium Term Development Plan
MTEF	:	Medium-Term Expenditure Framework
NBE	:	National Bank of Eritrea
NCEW	:	National Confederation of Eritrean Workers
NEPAD	:	New Partnership for Africa's Development
NEFPF	:	National Economic Policy Framework and Programme
NER	:	Net Enrolment Rate
NGAP	:	National Gender Action Plan
NGO	:	Non-Governmental Organisation
NICE	:	National Insurance Corporation of Eritrea
NPL	:	Non- performing Loans
NSEO	:	National Statistics and Evaluation Office
NUEW:		National Union of Eritrean Women
OPEC	:	organisation of Petroleum Exporting Countries
PBL	:	Policy Based Lending
PCR	:	Project/Programme Completion Report
PEM	:	Public Expenditure Management
PER	:	Public Expenditure Review
PFDJ	:	People's Front for Democracy and Justice
PFP	:	Policy Framework Paper
PPA	:	Participatory Poverty Assessment
PPAR	:	Project Performance Audit Report
PPP	:	Private-Public Partnership
PRSP	:	Poverty Reduction Strategy Paper
RWSSI	:	Rural Water Supply and Sanitation Initiative
SMCP	:	Savings and Micro Credit Programme
SME	:	Small and Medium-Scale Enterprise
TEGPRS	:	Transitional Economic Growth and Poverty Reduction Strategy
TFR	:	Total Fertility Rate
UA	:	Unit of Account
UNCDF	:	United Nations Capital Development Fund
UNDP	:	United Nations Development Programme
UNIDO	:	United Nation Industrial Development Organisation
USAID	:	Unites States Agency for International Development
US\$	:	United States Dollars

**EQUIVALENTS AND ABBREVIATIONS**

**CURRENCY EQUIVALENTS**

(MAY 2006)

Currency = Eritrean Nakfa (ERN)

UA 1.0 = 17.3244 Nakfa

US\$ 1.0=15.00 Nakfa

UA 1.0= US\$ 1.45186

**WEIGHTS AND MEASURES**

(Metric System)

1 Kilogramme (Kg) = 2.2 pounds (lbs)

1 metric tonne (MT) = 2, 205 lbs

**FISCAL YEAR**

January-December

## **EXECUTIVE SUMMARY**

**1. Introduction:** The Boards of Directors approved the 2002-2004 Country Strategy Paper (CSP) (Document ADB/DB/WP/2003/152-ADF/BD/WP/2003/191) in February 2004. The Country Strategy Paper for the period 2002-2004 was prepared in the context of Eritrea's transition from a socio-economic crisis aggravated by conflicts and a severe drought and the intention to build a foundation for a long-term development and poverty reduction. The focus of the Bank Group's assistance strategy was on Human Resource Development and was based on the Interim Poverty Reduction Strategy Paper (I-PRSP) of 2003. Education was delineated as the priority sector for the Bank Group intervention. In November 2004, the Bank approved an ADF loan of UA13.60 million and a grant of UA5.03 million for the Education Sector Support Project and negotiations for the loan were concluded in April 2005.

**2. The Country Strategy Paper (CSP) for Eritrea (2006-2007)** covers the entire period of ADF X Programming Cycle. The CSP analyses the country's economic development constraints and prospects, key elements of government agenda, and outlines the Bank's assistance program and medium term strategy. The assistance strategy was discussed during preparation and consultations mission in Eritrea in July/August 2005 between Government officials, Non-Governmental Organisations representatives, private sector, the civil society, and representatives of donors resident in Eritrea and during the dialogue mission in April 2006. The preparation of the current RBCSP has been affected by statistical and information deficiency and capacity constraints in the public sector. Moreover, it is also based on the I-PRSP of 2003 as the full PRSP has not been prepared.

**3. Economic Performance:** Since the last CSP, economic performance remain fragile and economic conditions continue to be affected by lingering war uncertainties, high defence expenditure, limited progress with implementation of economic reforms, and food shortages resulting from recurring droughts. Real GDP growth rate, which was 3.0 percent in 2003 stood at 1.8 percent in 2004. Government estimated the GDP growth rate at 4.8% in 2005. Annual inflation increased from 23 percent in 2003 to 25.1 percent in 2004, and was estimated to fall to 12 per cent in 2005. The budget deficit was 22 percent of GDP in 2004. The collapse of exports and sharp rise in imports, especially food imports, widened the external deficit (including official transfers) to 5 percent of GDP in 2003 and 5.8 percent of GDP in 2004.

**4. Domestic and External Debt:** The Government has resorted to domestic financing of the budget deficit due to inadequate resources with the ratio of government's domestic debt to GDP reaching 110.6 percent in 2003. The external debt also increased from US \$75 million in 1997 to \$548 million in 2003 and the net present value (NPV) of debt-export ratio stood at 300 percent in 2003 and 383% in 2004, more than doubling the HIPC threshold of 150 percent. However, the external debt is owed on concessional terms to multilateral and bilateral institutions and the external debt service/export ratio was 30.3 percent in 2004. The collapse of exports could further weaken debt servicing capacity.

**5. Poverty Situation:** Eritrea is one of the poorest countries in the world with a GNI per capita income of US \$180 in 2004, 66% of the population live below US\$1.0 a day and one third of the poor are extremely poor living below the food poverty line of 2000 calories per capita a day. The poverty situation has been compounded by the severe drought and impact of the border conflict, which displaced farmers and households from their homes. The frequent drought condition also directly reduces the availability of water for human consumption and livestock production. The problem of food security has exacerbated malnutrition, affecting more than 40 percent of under-five children in some regions. The depth and extent of poverty is worse in the arid areas.

**6. Government's Development Agenda:** The Government's Development Agenda (GDA) has not changed since the last CSP. The GDA is articulated in the Interim Poverty Reduction Strategy (I-PRSP) and other national planning documents. The overarching objectives are to attain rapid, sustainable, widely shared economic growth and reduction of poverty, led by the private sector in a sound conducive business climate. The government's strategy to achieve its objectives is stipulated in the I-PRSP, which is anchored on four pillars, namely (i) Reinvigorating economic growth; (ii) Creating income earning opportunities for the poor; (iii) Enhancing access to and utilization of essential services for human development; (iv) and promoting political, economic and social participation of the population. The strategy focuses on achieving macroeconomic stability and growth, attracting private sector investment and expanding exports, ensuring food security, expanding and modernizing infrastructure, particularly in the rural areas, and investing in human resource development. The MTDP and the MDG draft progress report recognize that substantial resources will be required to implement the GDA and to achieve the targets of the MDGs.

**7. Assessment of Implementation Progress of the Agenda:** In the past 18 months since the last CSP, progress with the implementation of the development and economic reform agenda has been slow. The full PRSP has still not been finalized. The development agenda in Eritrea has been hampered by the impacts of the border conflict, with significant resources, both human and financial, channeled to humanitarian assistance, reconstruction and demobilisation. The increased defence budget, heavy controls and involvement of the party and government in business have not provided an enabling environment for private sector development. Shortage of manpower in almost all sectors has also weakened the capacity to implement development programmes. Improved relations with development partners would also help in mobilizing the required resources for effectively implementing the GDA.

**8. Bank Group Portfolio:** The Bank Group commenced lending operations in Eritrea in 1992 and since then a total of nine operations have been approved as at April 2006. The operations consist of six projects, one institutional support and two studies. A total of UA 78 million has been committed, of which UA 69 million was in the form of ADF loans and UA 9 million was in the form of ADF grants. The total commitment was shared among several projects; 38.5 percent financed agriculture projects, 26.9 percent was utilized in multi-sector projects, 23.9 percent supported education and 10.7 percent funded public utilities. The Barentu-Ombajer road study financed by the TAF was cancelled because it was in the war area and could not be implemented. The road component of the Recovery and Rehabilitation Programme has been completed as well as the Economic and Financial Management Programme. The Central Highlands Irrigated Horticulture Development Project is also complete. Although the Bank's 2000 Annual Portfolio Performance Report (APPR) identified this project as a risk project, the 2004 did not and the May 2005 Agriculture Sector Portfolio Supervision Mission rated all agricultural projects implementation satisfactory. However, following training conducted by the Bank staff on project implementation in 2001 and 2005 performance of the projects has improved.

**9. Bank Assistance Strategy:** During the current ADF-X cycle, which ends in 2007, the Bank Group strategy will focus on an Integrated Rural-community Driven Development, encompassing support for rural Roads Infrastructure and Community Driven Social Development. The strategy is to enable rural population to access essential social services, means of production and income generating activities.

**10. Recommendations:** The Boards of Directors are invited to approve the proposed assistance strategy and the operational priorities for Eritrea for 2005-2007 period, based on the ADF-X allocation of UA 20.1 million in the form of grants.

## **1. INTRODUCTION**

1.1 The Country Strategy Paper (CSP) for Eritrea (2006-2007) will cover the entire period of ADF-X Programming Cycle. The Boards of Directors approved the 2002-2004 Country Strategy Paper (CSP) (Document ADB/DB/WP/2003/152-ADF/BD/WP/2003/191) in February 2004. The Country Strategy Paper for the period 2002-2004 was prepared in the context of Eritrea's transition from a socio-economic crisis aggravated by conflicts and a severe drought and the intention to build a foundation for a long-term development and poverty reduction. The focus of the Bank Group's assistance strategy was on Human Resource Development and was based on the Interim Poverty Reduction Strategy Paper (I-PRSP) of 2003. Education was delineated as the priority sector for the Bank Group intervention in 2004. Following this, the ADF Board approved an ADF loan of UA13.60 million and a grant of UA5.03 million in November 2004 for the Education Sector Support Project and negotiations for the loan were concluded in April 2005 and declared effective in December 2005.

1.2 During the discussion of the ADF IX CSP, the Board commended the Government for beginning to refocus its efforts from post conflict reconstruction to long-term development and poverty reduction. The Boards expressed concern about the extent of poverty estimated at two-thirds of the population, with one-third extremely poor. The Boards urged the Government to reduce military spending and to redirect resources to core poverty reduction expenditures, while addressing major constraints to Eritrea's socio-economic development. The Boards urged Government to adopt a Staff Monitored Programme with the IMF that would address key policy reform issues relating to transparency in fiscal management, high military spending, demobilisation, weak governance, and unfavourable private sector business climate. The Boards further encouraged the Government to improve relations with donors, so that development challenges facing Eritrea could be effectively addressed to the benefit of its people. The Boards also urged Government to take steps to improve performance of the Bank Group portfolio.

1.3 Since approval of the last CSP in February 2004, Government continued with the emergency reconstruction programme, mainly humanitarian assistance and rehabilitation of both economic and social infrastructure. The Interim Poverty Reduction Strategy, Food Security Strategy and the Medium Term Development Plan as well as the Education Sector Development Programme were all completed in 2004. Government further developed policies such as the National Water Supply Emergency Action Plan, Rural Electrification Programme, National Gender Policy, and secured funding for the Education Sector Development Programme, and started the second HIV/AIDS, Malaria, Sexually Transmitted Diseases and Tuberculosis (HAMSET II) project. In November 2005 Government agreed with the World Bank to do expenditure review in education and health and also with the IMF to programme a mission for the Staff Monitoring Programme in 2006.

1.4 In the past 18 months since the last CSP, while the Government has prepared several planning documents, progress with the implementation of its development and economic reform agenda has been slow. The full PRSP has still not been finalized. The development agenda in Eritrea has also slowed down as a result of the border conflict, with significant resources, both human and financial, channeled to humanitarian assistance, reconstruction and demobilisation. The increased defence budget, controls and involvement of the Front (party) and government in business have not provided an enabling environment for private sector development as articulated in the I-PRSP. Shortage of manpower in almost all sectors has also weakened the capacity to implement development programmes. In an effort to strengthen implementation, a new Ministry of National Development was created to oversee resource mobilization and coordinate and monitor implementation of national development programmes.

### **Box 1: Constraints to the CSP Preparation**

The 2006-2007 CSP is based on the 2004 I-PRSP due to lack of a full PRSP. However, Government maintains that the I-PRSP is still valid for its development agenda. The Government informed the dialogue mission in April 2006 that they have now adopted the I-PRSP as a full PRSP although without any major revisions and updates to data and indicators. The CSP covers 2006-2007 to coincide with the remaining ADF X lending programme period and also the I-PRSP whose projections covered up to 2006. The I-PRSP does not have data and indicators that could be used for monitoring progress, and thus hampering the preparation of the CSP. The pillars of the I-PRSP are however long term. The Bank will continue to dialogue with Government to complete a full PRSP. Efforts have been made by staff to obtain up to date data and indicators from other sources including international organizations such as the ADB, IMF and World Bank. Beyond the IMF estimated data for GDP, inflation and current account balance, other indicators were also not readily available. The East Africa Regional Technical Centre (AFRITAC) supported by the ADB, IMF and other donors, has been providing technical assistance to Eritrea on Modernization of the Inland Revenue Department, Bank Supervision and Regulation, Budget and Accounting, Treasury Reforms, National Statistics Office, and Cash Management. Eritrea has requested Bank's assistance on statistical capacity building.

1.5 Improving relations with development partners should help in mobilizing the required resources for effectively implementing the GDA. Relations with donors have been affected by controls on economic activities, high military spending, and lack of budgetary transparency. Although Government initiated Debt Sustainability Analysis was undertaken in November 2005, the recommendations of the IMF Article IV Consultations requesting for Public Expenditure Review have only been partly implemented through the review of education and health expenditure. The IMF Article IV Consultations of 2004 encouraged Eritrean authorities to: (i) establish an environment conducive to foreign direct investment and private sector development and to consider the scope for further privatization, which are currently hampered by business restrictions and controls; (ii) develop a debt management strategy and consider the possibility of seeking debt relief; and (iii) increase transparency of the public finances by publishing the budget and audited annual government accounts. In November 2005 Eritrea held Article IV Consultations with the IMF and agreed to participate in the Staff Monitoring Programme. The results of the consultations have not yet been published by the IMF.

1.6 This CSP analyses the country's recent economic developments since the last CSP, discusses the I-PRSP and outlines the Bank's assistance programme and medium term strategy. It assesses the major development challenges and related risks in the implementation of the Government's I-PRSP. The assistance strategy was discussed during consultations in Eritrea in July/August 2005 between Government officials, Non-Governmental Organisations representatives, private sector, the civil society, and representatives of donors resident in Eritrea. The preparation of the current RBCSP has been affected by statistical and information deficiency and capacity constraints in the public sector. The CSP is based on data and information collected during the CSP mission in August 2005. The CSP has drawn from documents available from Government, IMF, UNDP, World Bank and other bilateral and international organizations.

### **Box 2: Key Features of Eritrea**

Eritrea is located in the horn of Africa and is bounded by the Red Sea in the southeast with a coastline of about 1200 km, in the west and north by Sudan, in the south by Ethiopia and at the extreme southern tip by Djibouti. It is strategically located for export to the Middle East and Europe and both North and East Africa. Eritrea has a total land area of 124,432 square km. It has diverse physical and climatic formations. It has a rift valley that traverses it. There are four climatic zones: the cooler high lands which receive annual rainfall between 500-650 mm, the eastern and western lowlands with 200-400 mm of annual rains, and the Denakil desert in the south east. It has altitudes ranging from 60 metres below sea level to 3 000 metres above sea level. The rainy season is from June to September with the exception of the eastern lowlands, which is from October to February. In 2003, the population of Eritrea was estimated at 4.1 million with an average annual growth rate of 3.0 percent (1997-03). The urban population accounted for about 30% of the total population with a ratio of 50% male and 50% female. There are nine ethnic groups in Eritrea: the Tigrinya (the largest group), Afar, Bilen, Hedareb, Kunama, Nara, Rashaida, Saho and Tigre. Eritrea is a unitary State and PFDJ is the only party, although in January 2002 the Transitional National Assembly accepted in principle legislation on political pluralism but did not approve a law on political parties. The PFDJ does not define itself as a party but as a broad popular front mobilising the population through mass organisations such as the quasi-autonomous National Confederation of Eritrean Workers (NCEW) and professional associations such as the Eritrean Medical Association (EMA). The head of State is elected for a five-year term by the National Assembly. The executive branch of the Government is composed of 17 members of Cabinet. Eritrea's life expectancy at birth was 53.8 in 2003, adult literacy rate was 56.7 while combined enrolment rate was 35, infant mortality was 45 per 1000 live births while maternal mortality was 1000 per 100 000 births in 2003.

## 2. COUNTRY CONTEXT

### 2.1 POLITICAL CONTEXT

2.1.1 Following the end of the war of liberation in May 1991, the Eritrea Peoples Liberation Front (EPLF) dissolved itself and re-formed as the People's Front for Democracy and Justice (PFDJ) under the chairmanship of Eritrea's President Mr. Isaias Afewerki. A national assembly of 150 members comprising 75 members of the central council of the PFDJ and 75 others including Eritreans in the Diaspora, with 30% reserved for women, was constituted. The Assembly meets at the discretion of its members. A national Constitution was completed in 1994 and was ratified by a constitutional assembly in May 1997, but has not been formally adopted by the Government.

2.1.2 In May 1998, the border crises at the village of Badme degenerated into a full-scale war between Eritrea and Ethiopia. The two countries signed a ceasefire agreement in June 2000 and on 12<sup>th</sup> December 2000 they signed a Comprehensive Peace Agreement in Algiers assisted by mediators from the United States of America, the European Union and the Organisation of African Unity. Following the ceasefire, an international Ethiopia-Eritrea Boundary Commission (E-EBC) whose membership was agreed by both sides was established to investigate and delimitate the disputed border and both parties agreed and committed themselves to abide by the findings of the Commission. The Commission issued its findings in April 2002 and Ethiopia refused to accept the decision and since then the two countries have been in a heightened military readiness. The UN Peace Keeping Force is currently patrolling the disputed border and all communications between the two countries are closed.

#### **Box 3: Peace Process Humanitarian Assistance and Demobilisation**

The Algiers comprehensive peace agreement of 12<sup>th</sup> December 2000 provided for the establishment of an Ethiopia-Eritrea Boundary Commission (EEBC) to determine and demarcate the border and a claims commission. The EEBC pronounced its findings and ruling on the border in The Hague on April 13, 2002. Ethiopia rejected significant parts of the final, legally binding judgement of the EEBC on the 1000 kilometre border between the two countries on the grounds that it is illegal and unjust. The resolution of the border reached a stalemate and work on the proposed border demarcation has not been done to this date. Ethiopia reconfirmed, in November 2004, its agreement to uphold the EEBC ruling 'in principle' and insisted that there is need for negotiations on the implementation of the decision of the EEBC.

**Humanitarian Assistance:** Eritrea continues to face humanitarian crisis, which can be measured by the amount of the humanitarian resources that have been provided to the country. In 2000, food and non-food assistance were valued at US\$73.8 million and US\$26.3 million respectively. In 2001, 2002, and 2003 total humanitarian assistance to Eritrea was US\$79.7 million, US\$45.8 million, and US\$123.7 million respectively and the share of food aid was 63 percent, 42 percent, and 72 percent. In 2003 food assistance increased due to the worst drought in a decade in 2002. This level of dependence on food aid and imports is highly risky and a strategy to reduce food insecurity and vulnerability to the variable climate has been developed as a key objective for Eritrea's development. But its implementation is marred by lack of capacity and resources.

**Demobilisation:** The government planned a comprehensive demobilisation programme for combatants based on the cease-fire agreement. UNDP assisted Government in planning the programme starting in October 2000 with three components: 'demobilisation' of combatants, transportation to their home communities; including financial assistance to cover basic needs; and lastly, social and economic reintegration. It was planned that with technical and financial support from development partners, including the EC, Netherlands, USAID and the World Bank, the three-phase process would rehabilitate a total of 200 000 combatants at an estimated cost of US\$197 million. By November 2005 about 123 000 soldiers had been demobilised and most of them had received their transitional safety nets (allowances, clothes and transport) but few reintegration activities were implemented. The Mid Term Review (MDTR) of the programme extended IDA Credit of \$48.1 million closing date from December 2005 to December 2007 and modified some allocations to utilise the remaining \$28.521 million.

*Source: World Bank Interim Strategy Note for the State of Eritrea, March 2005 and MTR of the EDRP of Nov. 2005 and Government of Eritrea)*

2.1.3 Hopes for the resolution of the border conflict were raised when a meeting of the Witnesses of the 2000 Algiers peace agreement and the Eritrea-Ethiopia Border Commission were held in March 2006 with a view to discussing the impasse especially the border demarcation. Following a meeting of the mediators in March, 2006 a meeting with the Border Commission was scheduled for April 28, 2006 in London but the meeting has since been postponed. The no war, no peace situation is having adverse impact on economic, social and political reforms.

## 2.2 MACROECONOMIC AND STRUCTURAL CONTEXT

**2.2.1 Economic Growth:** At the trend level, economic growth of 1.5% in the five years period (2000 -2004) has been well below an average of 7% recorded during the five year period, 1993 to 1997, when the government formulated and implemented broad socio-economic policies immediately after independence. Real GDP growth rate, which was 3% in 2003, stood at 2.8% in 2004. While the GDP growth rate is estimated at 4.8% in 2005, it is projected at 1.5% and 1.3% in 2006 and 2007 respectively. Economic conditions continue to be affected by lingering war uncertainties, high defence expenditure, skilled labour shortage, state involvement in production activities, limited progress with implementation of economic reforms, and poor agricultural performance due to recurring drought.

**Table 1: Eritrea Selected Macro Indicators**

	2000	2001	2002	2003	2004	2005	2006*	2007*
Real GDP Growth rate (Annual %)	-13.1	9.2	0.7	3	2.8	4.8	1.5	1.3
GDP Current Prices (\$ billions)	0.635	0.671	0.623	0.575	0.624	0.954	1.076	1.185
GDP Current Prices (ERN) billions	6.098	7.593	8.697	10.292	12.795	14.787	16.674	18.36
GDP Constant Prices (ERN) billions	6.098	6.661	6.705	6.907	7.101	7.444	7.555	7.651
GDP Per Capita (\$ PPP)	746.522	814.638	813.957	834.582	850.462	857.976	858.427	858.569
GDP Per Capita (\$)	155.05	159.882	144.748	130.325	138.019	205.81	226.638	243.704
Inflation (Annual %)	19.9	14.6	16.9	22.7	25.1	12.4	10.9	10
Current Account Balance (US\$ billions)	0.003	0.028	0.023	0.03	0.036	0	-0.012	-0.014
Current Account Balance (% of GDP)	0.5	4.2	3.6	5.2	5.8	0	-1.1	-1.2
:* denotes projections.								
Source: International Monetary Fund, World Economic Outlook Database, April 2006								

**2.2.2 Fiscal Deficits and Inflation:** Although improving, Eritrea's fiscal operations remain largely unsustainable driven mainly by high levels of spending on defense, economic reconstruction and humanitarian needs. In 2003, total expenditure was estimated at 53.3% of GDP and 66.4% in 2004 while in 2005 was 49.3%. Defence expenditure remained high at 24.5% of GDP in 2003 and estimated to 18.9% of GDP in 2004. Total revenue amounted to 55.8 percent of GDP in 2003 and decreased to 45% in 2004 out of which 17.6% were grants. In 2005 total revenue (including grants) was 37.6% of GDP and grants amounted to 10.2%. Fiscal deficits (including grants), which had been reduced from 30.2 percent of GDP in 2002 to 17.4 per cent in 2003, rose to 25.8% in 2004 and 22.0% in 2005. High public expenditure, especially in defense without a related increase in production, as well as recurrent drought and increasing oil prices, have fuelled inflation, which increased to 17 per cent in 2002 and increased to 23 percent in 2003. In 2004, inflation stood at 25.1 percent. Increases in price of grain due to shortage of supply owing to the severe drought, state rationing of essential commodities, and increasing oil prices also contributed to a rise in inflation. However, inflation was estimated at 12% in 2005 and is projected to decline to 11% and 10% in 2006 and 2007 respectively.

**2.2.3 Domestic and External Debt:** The Government has resorted to domestic financing of the budget deficit with the ratio of government's domestic debt to GDP reaching 110.6 percent in 2003. The domestic debt service has been artificially kept low due to the low treasury bills rate of 2.5 percent per annum. The external debt also increased by seven fold from \$75 million in 1997 to \$548 million in 2003, representing 105.2 percent of GDP and 687.2 percent of the value of export of goods and services. In 2003, the net present value (NPV) of debt-export ratio stood at 297.6 percent and 383% in 2004, more than doubling the HIPC threshold of 150 percent. The external debt is largely owed on concessional terms to multilateral and bilateral institutions and the external debt service/export ratio was 30.3 percent in 2004. However, the collapse of exports could weaken debt- servicing capacity, at a time when the grace periods on concessional loans are expiring thereby increasing the full impacts of the external debt burden. Total external debt service

obligation rose from US \$0.6 million in 2000 to an estimated US \$24.2 million in 2004, of which US\$10.6 million was interest. It is expected to increase to US\$30.1 million in 2005, with projected US\$9.7 million in interest.

**2.2.4 External Sector:** The value of Eritrea's exports of goods and services declined dramatically from US\$200 million in 1997 to US\$80 million in 2003, owing to the border conflict with Ethiopia and recent border tensions with Sudan. The share of exports to Sudan fell from 83% in 2002 to 15% in 2003. Imports rose by 14% due to food aid and the external deficit (including official transfers) widened to about 5.8% in 2004 from 3.6% in 2002 and 5.2% in 2003. While the Government recognizes that the loss of exports of the Ethiopian market posed a major challenge in the short term, it created a major opportunity for the private sector in Eritrea to explore new markets and products for exports to the Middle East and Europe. Eritrea has a good prospect to increase the value of its exports beyond the level lost to Ethiopia. The key area where there is strong potential and encouraging investment that has taken place includes fisheries, fruits and vegetables and tourism. Moreover, policy reforms such as liberalization of tax regime, sound regulatory framework, export promotion programme and infrastructure investments that have been put in place to promote export and private sector development will take sometime to yield positive effects. Private transfers from Eritreans in the Diaspora have averaged about a third of GDP (paragraph 2.5.17). These transfers, supplemented by official grants for humanitarian purposes, foreign borrowing, and foreign reserves have financed external deficits. Donor assistance in the form of loans and grants averaged 24 percent of GDP in 2001-2003, while humanitarian assistance stood at 7 percent of GDP. At end of 2003, the international reserves amounted to only two weeks of imports, down from 1.2 months in 2001 and fell to 0.36 months of import cover by end of 2004.

**2.2.5** The foreign exchange situation worsened in 2003, and in July 2003 Government closed all foreign exchange bureaus except the one owned by the PFDJ party (Himbol). A dual exchange rate system was established in November 2003 with preferential buying rate of ERN 19.0 per US Dollar for all exports and transfers from the Diaspora and an appreciated official rate of ERN 13.5 per US Dollar for all other purchases of foreign exchange. The demand for foreign exchange for import purposes was effectively rationed through import licenses, those who did not get import permits resorted to the illegal parallel market, where the premium to the official rate was about 60 per cent. However, in April 2005, Government introduced stiff penalties for illegally holding and transacting or smuggling foreign currency.

**2.2.6 Structural Reforms:** The momentum of structural reforms undertaken in the mid-1990s has not been fully sustained as Government became pre-occupied with the border conflict and reconstruction programs. Prices of several imported and domestic commodities have been subjected to administrative control. The medium term objectives of the Transitional Economic Growth and Poverty Reduction Strategy (TEGPRS) are promotion of economic growth and poverty reduction up to 2006, through developing exports, increasing agricultural productivity, attracting private investment, developing a strong financial sector, turning Eritrea's ports into regional transshipment centers, increasing the length of the road infrastructure and planning and developing new dams. Progress has been limited in the implementation and achievements of the medium-term objectives.

**2.2.7 Civil Service Reform:** Government recognized that it is important to strengthen institutional capacity in order to implement and monitor I-PRSP, which would require a civil service with enhanced professionalism and service orientation in ministries and agencies. To this end, Government adopted a four pronged strategy: aimed at strengthening the civil service, training government officials, right sizing public service, and improving public service remunerations. A training programme has been developed based on the report and recommendations of the task force established to assess training needs, and training started in 2004. A new pension scheme for in-service and new entrants personnel has been introduced. Some of the civil service reforms

recommended by the task force including salary reforms are still under review. Currently the government is carrying out a study on restructuring of the civil service reform with the aim of strengthening and enhancing capacity building.

**2.2.8 Public Enterprise Reform and Privatisation Programme:** The Asmara Textiles was privatized in 2004 bringing to 36 the number of public enterprises privatized since 1991, while some 30 enterprises remain in the public sector. While privatization gained momentum immediately after independence, the recent heavy involvement of Government in business activities has crowded out the private sector. The army and the navy personnel have been deployed for core production including fishing and farming, displacing both foreign and domestic investors and labor. The government owns the largest commercial bank, with 80 percent of total deposits. The PFDJ controls the Red Sea Corporation, with substantial shareholding in more than 30 private companies. Government restated its commitment to not be involved in commercial and business activities in the I-PRSP. The strategy is to reinvigorate the process of privatizing the remaining public enterprises and enhance the efficiency of those that would be privatized.

### **2.3 PRIVATE SECTOR BUSINESS CLIMATE AND ISSUES**

#### **Private Sector Development**

2.3.1 As noted in paragraph 2.2.8, the government and the party, PFDJ, play dominant role in Eritrea's economy. Government and public sector borrowing from the banking system has crowded out the private sector, however government contends that lack of private sector participation is due to uncertain peace and security conditions resulting from the border conflict stalemate. Private investment increased from 7.3% of GDP in 1994 to 13.9% in 1997, but fell to an average of 5% for 2000- 2004, while foreign direct investment fell from 38.7% of GDP in 1997 to 11.1 percent of GDP in 2003, due in part to the uncertainty of peace and security in Eritrea. Critical constraints to private sector development are severe shortage of labour, unfavourable regulatory framework and lack of foreign exchange. Shortage of labour is due to the diversion of productive labour force to defence while shortage of foreign exchange is a reflection of the country's macroeconomic imbalances. Other constraints are unreliable electricity supply, poor telecommunication, high costs of sea and air transport and low levels of education, national service enrolment for 18 months, and skills in the labour force. In view of the uncertain border conflict, Government has put controls and participates in the economic activities and as a result crowded out the private sector, which has also been affected by the unfavourable regulations.

2.3.2 A comparison of Doing Business indicators for selected East African countries is shown in table 2 below. It takes a long time to start business in Eritrea than any other country in the table, as well as obtaining credit as is ranked 150 and 143 respectively on the two issues. Eritrea is ranked above average in almost all except hiring and firing workers and enforcing contracts.

**Table 2: Doing Business Selected Indicators**

Country	Ease of Doing Business	Starting Business	Dealing with Licensing	Hiring and Firing Workers	Registering Business	Obtaining Credit	Protecting Investors	Taxes	Trading across borders	Enforcing Contracts	Closing Business
Eritrea	137	150	109	40	115	143	82	76	147	64	147
Ethiopia	101	94	57	47	140	114	137	26	129	71	48
Kenya	68	93	15	42	113	13	60	100	126	82	111
Sudan	151	68	0	77	0	123	0	0	144	151	153
Uganda	72	100	92	10	97	127	66	57	145	33	41
Average	105.8	101	54.6	43.2	93	104	69	51.8	138.2	80.2	100

Source: World Bank, Doing Business Report, 2005

2.3.3 Eritrea is ranked 137 out of 155 countries, behind only Sudan, (World Bank 2005 Doing Business Report) in terms of performance in doing business which looks at issues including starting a business, dealing with licences, hiring and firing, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and closing business. It estimated that it takes 13 steps and 91 days on average to launch a business while it takes 19 steps and 187 days to get a licence. Measures on getting credit are one of the lowest with legal rights index ranked 3 out of 10 while credit information index, public registry coverage and private bureau coverage estimated at 0 out of 6.

2.3.4 The Government's strategy is to develop a conducive environment for private sector development that would contribute to economic growth through lowering cost of doing business in the country, attracting foreign investors with emphasis on the Diaspora, and improving the functioning of the financial sector. At the moment private sector development is hampered by the war situation and its related effects. Eritrea's Investment Proclamation allows foreigners to enjoy equal treatment in terms of access to land, utilities and other production inputs.

### **Financial Sector Development**

2.3.5 A vibrant and solid financial sector is essential to private enterprise development. Eritrea's financial system comprises of the National Bank of Eritrea (NBE), which is the central bank, the Commercial Bank of Eritrea (CBE), the Housing and Commerce Bank of Eritrea (HBCE), the Eritrean Investment and Development Bank (EIDB), and the National Insurance Corporation of Eritrea (NICE). The HBCE is owned by the ruling People's Front for Democracy and Justice (PFDJ) and other financial institutions are owned by the Government, although as part of the privatization programme 60% of the shares in NICE were sold to Eritrean investors in 2004. NICE was established in 1991 and deals in a range of insurance products but 57% of its business are in motor insurance. There are no foreign financial institutions operating in Eritrea and the CBE maintains contact with 40 international banks around the world for money transfers. The involvement of Government in the financial sector has facilitated credit to public sector at the expense of private sector. The share of total domestic credit to private sector fell by almost half from 45% in 1997 to 25% in 2002.

2.3.6 The government sponsored Savings and Micro Credit Programme (SMCP) launched in 1996 as a pilot programme for the Eritrea Community Development Fund (ECDF) Project of the Ministry of Local Government aimed at supporting investment activities of enterprises at village level, create new income and employment opportunities in poor communities, and contribute to improving living standards and prosperity of communities. The programme uses the village banking model and offers group-guaranteed loans ranging from US \$75 to US \$10 000 to either individual members of solidarity groups or to associations at an interest rate of 16%. SMCP has a

substantial membership and village banks increased from 25 in 1996 to 146 in 2001 and by 2005 all the six regions and 30% of the 2800 villages were covered.

2.3.7 The Agency for Co-operation and Research in Development (ACORD), an International NGO operates in Eritrea using the village bank model to provide saving schemes and credit to individuals and groups. The saving scheme promotes and improves the livelihoods of economically and socially marginalized people. The saving and credit group scheme obliges members to save a minimum of Nakfa 5.00 (USD 0.36) per month and accepts savings from non-members. The credit scheme provides credit to clients who intend to engage in business activities like agriculture, trade, production, service and gives advice on business skills. It has established 31 village banks run by village banks and they get credit from ACORD and pay back according to the agreed rules.

## 2.4 POVERTY, SOCIAL CONTEXT AND CROSSCUTTING THEMES

2.4.1 **Poverty Situation:** Eritrea is one of the poorest countries in the world and was ranked 166 among 177 countries, while the Human Poverty Index ranked it 73 out of 103 developing countries in the 2003 Human Development Report (HDR). Population living below \$1.0 a day was estimated at 66% in 2005. The national poverty line was 53% according to the 2005 Human Development Index (HDI) report. The Gross National Income (GNI) per capita was estimated at US \$180 in 2004. The National Poverty Assessment undertaken in 2002 revealed that the poor constitutes about two-thirds of the population and slightly more than one-third are extremely poor, living below the food poverty line of 2000 calories per capita per day. The poverty situation has been exacerbated by the recent three-year consecutive drought and the border conflict, which displaced over one million people as well as the influx of deported and repatriated Eritreans from Sudan and Ethiopia all of which have put increasing strain on the dwindling national resources.

2.4.2 Table 3 compares selected countries of East Africa on key social indicators.

**Table 3: Selected Social Indicators for 2003**

	Eritrea	Ethiopia	Sudan	Djibouti	Kenya	Uganda
HDI Rank (out of 177)	166	170	141	150	154	144
Life Expectancy	53.8	47.6	56.4	52.8	47.2	47.3
Adult Literacy	56.7	41.5	59.0	65.5	73.6	68.9
Combined Enrolment rate	35	36	38	24	52	74
HPI rank out of 177	73	99	59	53	64	66
Population (Million)	4.1	73.8	34.9	0.8	32.7	26.9
Pop. Growth rate %	3.0	2.3	1.9	1.6	2.5	3.7
Infant Mortality	45	112	63	97	79	81
Maternal Mortality	1 000	870	550	74	590	510
HDI Index Value	0.444	0.367	0.512	0.495	0.474	0.508

Source: United Nations Human Development Report, 2005

2.4.3 The rural poor face constraints partly because their income sources are not diversified and they predominantly depend on rain fed agriculture, and face a high frequency of food insecurity. Physical infrastructure and access to social services are also inadequate. About 45 percent of the children of the extreme poor in rural areas were not attending school as they were engaged in various activities to support the family. Rural women are less likely to be literate and numerate about 40% leave school at an early stage due to marriage. Only 18 percent of rural inhabitants have access to clean water from public taps and sanitation facilities are almost totally absent.

2.4.4 While poverty is more pervasive in arid areas, and its depth and extent depends on the agricultural endowment of the area, the greatest number of poor people live in the more densely populated highland regions, relying primarily on subsistence agriculture for their livelihoods.

Currently only 5 percent of Eritrea's land is cultivated and agricultural production remains low and has never, even in the best years, exceeded 60 percent of total demand. Farmers have poor access to farm inputs, and very limited access non-farm activities. **According to the I-PRSP**, poverty in Eritrea is strongly related to lack of access to basic services such as health, education and cultivable land. In rural areas, poor households cultivate only 0.9 hectares of land, less than the average of 1.1 ha for each household; and they are less able to diversify their agricultural production and sources of income and are thus more susceptible to economic shocks. Women head 30% of households and on average have fewer household assets including livestock than do male-headed households.

2.4.5 Poverty is deepest in chronically arid areas such as the coastal plains and the northwestern lowlands compared to the situation in the wetter eastern and western escarpment, and central highlands. The semi-nomadic pastoralists constitute about 36% of the population and live in the arid areas and depend on livestock for food and income. They are harder to reach with social services such as health care and education and are expected to suffer higher rates of maternal, infant and child mortality as well as lower levels of life expectancies.

2.4.6 **Food Security:** In addition to the four pillars in the I-PRSP, Government prepared the Food Security Strategy (FSS) Paper, which aims at ensuring food security. The adopted strategies include enhancing the domestic food production capacity, increasing national capacity to import an adequate quantity of food supply, and enhancing the effective use of food assistance to fill the supply gap during emergencies. The strategy also includes increasing agricultural production so as to reduce dependency on food assistance. It further encompass enhancing agricultural productivity in high potential areas by expanding and modernizing rain fed cultivation farming in lowlands areas with good soils and adequate rainfall. The aim is further to increase agricultural production of high value cash crops and livestock by increasing areas under irrigation and development of the peri-urban dairy industry.

2.4.7 **Population:** There has not been a population and housing census since independence in 1991. According to Government published data, in 2003, the population of Eritrea was estimated at 4.1 million with an average annual growth rate of 3 percent (1997-03). Total fertility rate has gone down from 7.3% in 1980-85 to about 4.8% in 1997-03. The average population density is about 29 persons/sqkm, however the highlands are densely populated while the lowlands are sparsely populated. Out of the 70% of the population who live in rural areas, 25-30% were nomadic or semi-nomadic. It was estimated that 47.2% of the population was less than 15 years old in 2003, while people of 65 years and over were 2.2%. Dependency ratio was 90.2%, higher than Africa's 86.1%.

2.4.8 The characteristics of Eritrea's population pose several challenges. While the significant drop in fertility rate is encouraging, the population growth rate remains high, while other socio-economic indicators, including infant mortality, maternal mortality and life expectancy have not fared well. The high dependency ratio coupled with poor economic performance has worsened poverty level and increased the burden of diseases while straining resources for social development. Eritrea also has a large number of internally displaced people (IDP). Since 2001 about 104 000 Eritreans living in Sudan have been repatriated to Eritrea, while between 75 000 and 80 000 (some Ethiopians of Eritrean decent) were deported from Ethiopia from May 1998. As noted in Box 2, providing humanitarian assistance to the large number of internally displaced refugees have strained government resources. There is need for concerted efforts to ensure effective re-integration of the displaced people into the socio-economic mainstream.

2.4.9 **Social Context and Issues:** Eritrea's human development indicators are among the lowest in the world. Access to elementary education was 51.5% of the school going age children in 2004, and only 18.9% had access to middle school, 14.1% of them got access to secondary education. However, the draft progress report on the MDG for Eritrea by the Government puts the country off

track on its MDG target for primary education enrolment. About 54% of the adult population was literate in 2004.

2.4.10 The quality of education at all levels is unsatisfactory and was witnessed by 70% educational wastage in 2004 and low level of internal efficiency and inadequate facilities at all levels. The priority of Government in the sector is to improve education and health services. The objectives of education are: to produce a population equipped with necessary skills, knowledge, and culture for self-reliance; to develop self-consciousness and self-motivation in the population to fight poverty, disease, and all the causes of backwardness and ignorance; and to make basic education available to all. Major focus areas are: improving access and equity; enhancing quality and relevance; building capacity and developing partnerships.

2.4.11 The main objectives of the health sector for the short-term are: to rehabilitate the old and damaged and build new facilities, prevention of communicable diseases, reduce child mortality, reduce HIV/AIDS prevalence, and malaria. To this effect, Government has embarked on public health programmes, such as child health, immunization, reproductive health, nutrition, environmental health, and community health services. The results of prevention seem to be bearing positive results. The child immunization against tuberculosis and measles was estimated at 80% and 63% respectively, lower than Africa's 81% and 71.7% for the 2003 period. The Eritrea Government draft progress report on the MDGs puts Eritrea on track in all its health targets. Malaria deaths have been reduced to about 1.7% in 2004, which is the lowest in the last six years, due to prevention programmes implemented by the Ministry. The demographic Health Survey carried out in 2002 revealed that life expectancy at birth was 52 years in 2000 while sub-Saharan Africa average was 47. Life expectancy at birth is estimated at 52.8 higher than Africa's 50.7 in 2003. The 2005 United Nations (HDI) report estimated the infant and under fives mortality at 45 and 85 per thousand of live births, while maternal mortality was 1 000 for 1985-2003 and adjusted to 630 for 2000 per 100 000 live births. It also revealed that 4 out of 10 under 5 years children are stunted and nearly half suffer from anemia. There is a high prevalence rate of diseases of which 71% are communicable and preventable. There are many types of vulnerable groups that need protection and care, displaced, street children, prostitutes, etc. Government has through the Ministry of Labour and Social Welfare introduced some welfare programmes for different groups.

2.4.12 **HIV/AIDS and Communicable Diseases:** The prevalence rate of HIV is still low in Eritrea as compared to other African countries. According to the draft MDG progress report of 2005, the HIV/AIDS prevalence rate is 2.5% of the sexually active population, with rate among the military and national services at 6%. About 98% of the AIDS cases were in urban areas. The demobilization as well as the influx of returning refugees and movements of internally displaced persons could pose a threat in spreading the disease within the population. In 2000, the Government initiated measures aimed at preventing the disease from spreading mainly through the launching of a programme that seeks to control the spread of HIV/AIDS, malaria, sexually transmitted diseases, and tuberculosis (HAMSET). A national blood bank was also established in Asmara and at least 20 voluntary counseling and testing centers were opened throughout the country. A pilot project to provide anti-retroviral drugs to infected expectant mothers was also launched. Despite all these, the disease is still stigmatized which makes it difficult to engage in open discussions that are crucial for behavioural change.

**Table 4: Eritrea Millennium Development Goals**

	Latest Year	Target for 2015
<b>Eradicate extreme poverty and hunger:</b>		
Population living below food equivalent of 2000 kilocalories per day (percent) 2003	69	35
Children underweight for age (percent of children under 5), 1995-2001	44	22
Undernourished people (percent), 1998-01	58	29
<b>Achieve universal primary education:</b>		
Net primary enrolment ration (percent of school age population) 2000-01	41	100
Literacy rate (percent of population age 15+) 2001	58	100
Youth literacy (percent ages 15-24), 2001	71.6	100
<b>Promote gender equality and empower women:</b>		
Female literacy rate	--	1.0
Ratio of girls to boys in primary education 2000-01	0.82	1.0
Ratio of girls to boys in secondary education, 2000-01	0.67	1.0
Ratio of girls to boys tertiary education 2000-01	0.15	1.0
Ratio of literate females to males, ages 15-24, 2001	0.76	1.0
<b>Reduce child mortality:</b>		
Under-five mortality rate (per 1,000), 20001	111	37
Infant mortality (per 1,000 live births), 1995	72	24
One year olds fully immunized against measles (percent), 2001	88	
<b>Improve maternal health:</b>		
Maternal mortality rate (per 100,000 live births) 1995	1,100	275
Births attended by skilled health personnel (percent) 1995-2001	21	
<b>Combat HIV/AIDS, malaria, and other diseases:</b>		
Adult HIV/AIDS prevalence in major urban areas (percent), 1999-2001	1.3	Halt and begin to reverse spread of HIV/AIDS, incidence of malaria and other major disease
Malaria related mortality rate (per 100,000 all ages), 2000	74	
Malaria related mortality (per 100,000 children ages 0-4), 2000	391	
TB related mortality rate (per 100,000 people), 2001	46	
Malaria cases per 100,000 people, 2000	3,479	
TB cases per 100,000 people, 2001	249	
<b>Ensure environmental sustainability; land, air and water:</b>		
Land area covered by forest (percent), 2000	13.5	Integrate principles of sustainable development into policies and programmes, reverse loss of environmental resources
Ratio of protected area to surface area, 2003	0.04	
Carbon dioxide emissions per capita, metric tons, 1999	0.1	
Rural population with sustainable access to improved water source, 2000	42	71
Urban population with sustainable access to improved water source, 2000	63	82
Urban population with access to improved sanitation (percent), 2000	66	83
<b>Develop a global partnership for development:</b>		
Total debt service (percent of export of GNFS), 2001	4.5	With the private sector, make available benefits of few technologies, especially in information and communication
Population with sustainable access to affordable essential drugs (percent), 1999	50-79	
Telephone mainlines and cellular subscribers per 100 people, 2001	0.8	
Internet users per 100 people, 2001	0.2	
Personal computers in use per 100 people, 2001	0.2	

Source: UNDP, Human Development Report, 2003

**2.4.13 Gender:** In Eritrea, women comprise about half the population and head about a third of the households. Women made up to 40% of the liberation army and this increased their sense of independence and enhanced their participation in community and public affairs. Gender equality is enshrined in the Constitution and Government is committed to promoting it and empowering women in development activities. The Government has undertaken the following measures towards empowering women: (i) reserving a minimum of 30% of the seats in the national assembly and other government institutions, down to the village administration level, for women; (ii) appointing women to high political positions, including ministerial positions; (iii) encouraging the employment of women in the civil service and ensuring that they are treated equally in promotion and retention; and (iv) the establishment of institutional mechanisms to mainstream gender issues in public policy and resource allocation, particularly improving their access to education and productive assets, including land.

**2.4.14** By 2003 women were occupying 20% of the 150 seats in the national assembly (below 30% target) and there are three female Ministers in a Cabinet of 17 members. The National Union of

Eritrean Women (NUEW), the only women's organization, has its origins as the women's wing of the liberation movement which later transformed itself into an NGO. NUEW has been mandated by Government to lead Eritrea's fight for gender equity, and in the absence of an institution mandated with gender issues within government, it effectively represents both civil society and national machinery for the advancement of women. The organization has representatives in most government and village decision making structures and branches throughout the country.

2.4.15 Despite the political commitment for gender equity, women continue to suffer disproportionately from the effects of poverty and lack access to productive resources. Although there are no recent figures, the 2001 household survey revealed that, female headed households were generally poorer than those headed by males. Rural women in general are less likely to be literate and numerate since about 40% leave school at an early stage due to marriage or due to the perceived high opportunity cost of sending girls to school. The maternal mortality ratio in rural areas is very high, estimated at 998 per 100 000 live births and only 10% of children are delivered with the assistance of a health professional (64.7% in urban areas). Female genital mutilations remains high with prevalence rates of 89% from 95% in 1995, knowledge of family planning remains low, customs and tradition hinder the application of progressive legislation, such as the new inheritance and land laws, and women who are predominantly employed in agriculture, lack representation among contact farmers and face neglect of their special needs.

2.4.16 The Government in an effort to redress the gender inequities and raise the status of women in society drafted a National Gender Policy and in 2003 the NUEW drafted a National Gender Action Plan (NGAP) to provide guidelines for effective implementation and mainstreaming of gender related commitments made by Government. According to the Convention on Elimination of all forms of Discrimination Against Women (CEDAW) report of 2005, the number of women participating in the regional assemblies has increased from 20% in 1996 to an average of 30.5% in 2005 across the six zobas (region).

2.4.17 **Core Labour Standards:** Eritrea has ratified the seven Core Labour Standards (CLS) conventions relating to the rights of workers and prohibition of child labour and has incorporated them into its new labour laws of 1999. These CLS relate to: (i) freedom of association and protection of the right to organize; (ii) right to organize and collective bargaining; (iii) protection against discrimination in respect of employment and occupation; (iv) equal remuneration for men and women; (v) elimination of all forms of forced or compulsory labour; (vi) minimum age convention and (vii) abolition of child labour. However, compliance with the laws is difficult to monitor due to capacity constraint in the Ministry of Labour and Human Welfare. Furthermore, it is common for rural children who do not attend school to work on their family farms and the International Labour Organisation estimates that about 40% of children aged between 10 and 14 are involved in such activities. There is also concern about child soldiers, although there is no reliable information on the magnitude of the problem. Under the current circumstances of control on the economy and movement in and out of the country, due to the heightened military readiness, as well as suspension of the election law, political parties and free press, some of these labour laws are difficult to implement.

2.4.18 **Environment:** Eritrea's challenges in water resource and management are similar to those generally found in Sahelian Africa. The traditional Eritrea land tenure and inheritance system has throughout the centuries had a major influence on the deterioration of the environment. The general constraints include the low and erratic rainfall, the lack of permanent rivers, limited groundwater resources, very low volume of surface water storage per capita and hot and arid conditions. Particular aspects include the effects of the thirty-year war, 1961-1991, resulting in the deterioration of a once thriving economy, the destruction of transport and public utility infrastructure, the dispersal of much of the population, exacerbated deforestation due to the use of

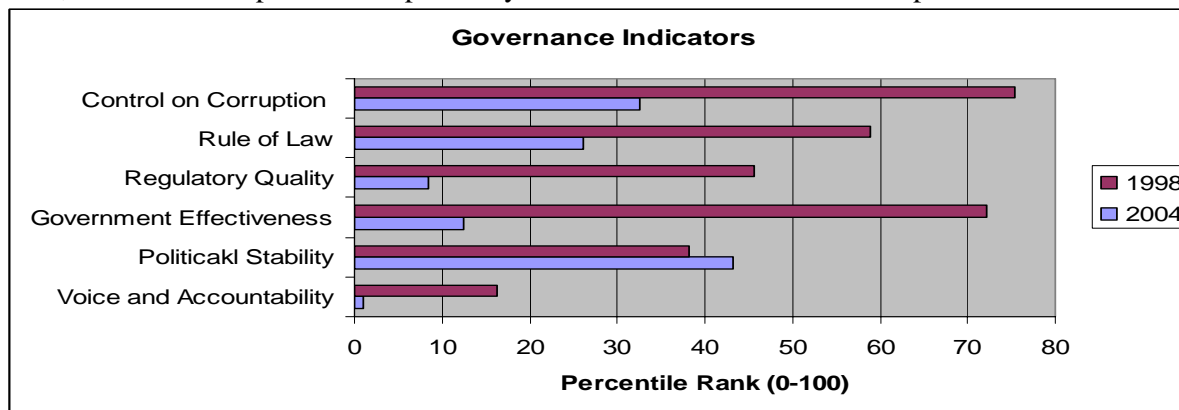
wood to line trenches as well as for fuel and shelter, and huge losses of soil from erosion. Government's objective is to integrate principles of sustainable development into country policies and programmes that would reverse the loss of environmental resources. National environmental assessments will be conducted for all the investment projects. The Government is currently developing an environmental legislation as well as a national biodiversity strategy and action plan. Eritrea is a signatory to two environmental conventions, the Convention on International Trade in Endangered Species of Wild Fauna and Flora and the Convention to Combat Desertification and is now working towards their implementation.

**2.4.19 Governance:** The human rights record for the country has generally been good until 2001 when several contraventions were reported. Some prominent personalities who were critical of Government policies have been arrested, the private press was banned and some journalists have also been arrested. Donors and the international human rights watchdogs raised concern about these developments and some even suspended budgetary support. Although the Constitution provides for separation of powers between the executive and the sole party (PFDJ), this has not been the case in practice. The Cabinet does not meet regularly and the National Assembly only meets when called into session by the President. However, a step in the right direction was made in December 2000, when two laws were drafted, one dealing with the reforms of electoral system and the other with the formation of political parties. Although the National Assembly approved the electoral law in early 2003 thereby paving the way for the country's first parliamentary and presidential elections to be conducted, a date has not yet been set. At local and regional levels, elections for local administrators, village councilors and regional assemblies were conducted in 2002 and 2005. In 2004 village judges were elected for 683 community courts and 22.5% of them were women.

**2.4.20** The bar charts below depict level of governance in Eritrea and in comparison with other countries in the region. 1998 status is depicted by the lower bar for each country. The thin black line depicts the statistically likely range of governance indicator. Eritrea shows high values in control on corruption at 75% while accountability is lowest at less than 25%. In comparison with other countries. Eritrea was doing well on Governance effectiveness in 1998 but has fallen below 25% in 2004. It is only above Somalia and Sudan on Governance effectiveness.

### Charts 1: Eritrea Governance Indicators

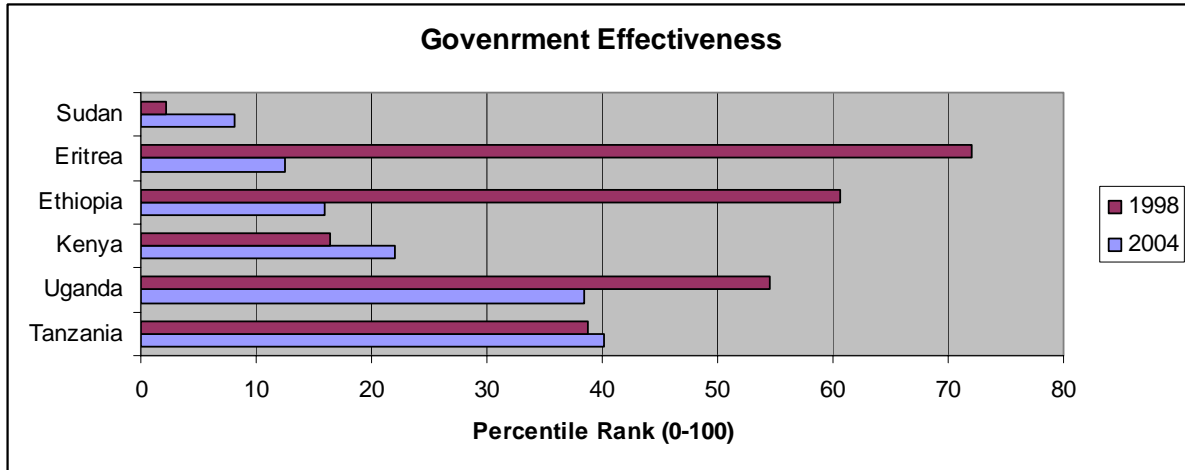
Below is a *bar chart* depicting the percentile ranking of six Governance Indicators for Eritrea in 2004, with 1998 comparator as reported by the World Bank Governance Report of 2005.



**Source:** Kaufmann D., A. Kraay, and M. Mastruzzi 2005: *Governance Indicators for 1996-2004*. The governance indicators presented here reflect the statistical compilation of responses on the quality of governance given by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries, as reported by a number of survey institutes, think tanks, non-governmental organizations, and international organizations. The aggregate indicators in no way reflect the official position of the World Bank, its Executive Directors, or the countries they represent. Country's relative positions on these indicators are subject to margins of error that are clearly indicated.

The chart below compares East Africa Countries on their Government Effectiveness for 1998 and 2004.

**Chart 2: East Africa Countries Government Effectiveness**



Source: Kaufmann D., A. Kraay, and M. Mastruzzi 2005: Governance Indicators for 1996-2004

*Note: The governance indicators presented here reflect the statistical compilation of responses on the quality of governance given by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries, as reported by a number of survey institutes, think tanks, non-governmental organizations, and international organizations. The aggregate indicators in no way reflect the official position of the World Bank, its Executive Directors, or the countries they represent. countries' relative positions on these indicators are subject to margins of error that are clearly indicated. Consequently, precise country rankings should not be inferred from this data.*

2.4.21 Eritrea is a member of the African Union but it has not acceded and signed the African Peer Review Mechanism (APRM), whose objective is to foster the adoption of appropriate laws, policies, standards and practices that lead to political stability, high economic growth, sustainable development and accelerated sub-regional and continental economic integration. Although the Government stresses popular participation, a strong and independent civil society has not yet developed. Moreover, the Non Governmental Organisations (NGOs) that exist lack adequate capacity to play their role effectively. Government has announced introduction of a new NGO Proclamation, which is meant to ensure effective operations by NGOs where government, private sector and NOGs have comparative advantages. Some of the requirements are that for an International NGO to operate in Eritrea it should have US\$2.0 million deposited in a local Bank and for national NGOs the required deposit is US\$1.0 million. Some NGOs who did not meet the requirements have been requested to close shop.

2.4.22 The Government has taken measures to criminalize money laundering and financing of terrorism. In this regard, the Government has established a Financial Intelligence Unit (FIU) to monitor suspicious transactions. On the other hand the dissemination of information on Government activities is rather inadequate. Furthermore, there are concerns over press freedom as electronic and print media is still state owned and controlled.

2.4.23 In the area of Public Finance Management, the Government recognizes that its economy is characterized by severe macroeconomic imbalances, with very high public expenditures, which is necessitated by the border situation. The aim of Government is therefore to substantially reduce high public expenditure within a short period of time and to restore macroeconomic stability. Defense spending, which is due to the border impasse and could be reduced if the border conflict is resolved and demobilization of soldiers is completed, is a major component of expenditure. Demobilisation and reintegration of soldiers into civilian life requires financial resources to support the economic development programme and benefit packages to the soldiers, which the Government does not have.

2.4.24 Development partners including the ADB, IMF and World Bank, have urged authorities to improve economic governance concerning transparency and accountability in public finance. Government committed itself to strengthen tax administration with a view to increase tax revenue and reduce the domestically financed fiscal deficits. Government's contention is that budgets are not published because of the security situation as well as events facing the country and the uncertainty of domestic and foreign receipts. The decision to finance budget deficit, domestic interest rates, and the exchange rate are made taking into account national economic and security concerns and would remain the prerogative of Government under the current circumstances.

2.4.25 **Regional Integration:** With a population of only 4.1 million and the GNI per capita income of US\$ 180 in 2004, while Gross Domestic Product (GDP) per capita at current prices was estimated at US \$205.81 in 2005 increasing from US\$138 in 2004. Eritrea has a fairly limited domestic market. It is, therefore, imperative for the country to look beyond its borders for its exports and investment. Government has embraced regional integration and economic cooperation in its development agenda. Eritrea is a member of the Common Market for Eastern and Southern Africa (COMESA) and the Inter-Governmental Authority on Development (IGAD), United Nations Industrial Development (UNIDO), and Sahel-Sahara Group and is actively working within these groupings to reduce barriers on trade, investment and movement of persons. This is important because the immediate neighbours have been the country's major trading partners. Prior to the border conflict, Ethiopia was the dominant trading partner, accounting for about 72% of the value of Eritrea's external trade in 1997, but this has fallen to zero since the border conflict in 1998. By 2002, Sudan had become the dominant partner and accounted for about 83% of the country's external trade, which fell below 11% due to the border tension. Eritrea stands to gain from its strategic geographical location as a transit country and gateway to markets in Europe and the Middle East through the ports of Massawa and Assab. However the border conflict with Ethiopia has dampened the momentum for Eritrea's economic integration and co-operation in the horn of Africa. Compared to other countries in the region, Eritrea has not benefited much from trade initiatives such as AGOA, the EU anything but Arms.

## 2.5 MEDIUM TERM ECONOMIC OUTLOOK AND EXTERNAL ENVIRONMENT

2.5.1 **Major Constraints to Sustainable Growth:** Government sees the major constraint in its development efforts as the border impasse (no war, no peace situation). Other constraints include macroeconomic imbalances, inadequate infrastructure, shortage of skilled labour, information deficiency and vulnerability to drought. Poor governance and heavy involvement in business activities by Government have also adversely affected investment in the country.

2.5.2 The **macroeconomic management** situation has not improved since the last CSP and stem from large internal and external imbalances reflected by severe shortage of foreign exchange, very low domestic saving and investment, and large fiscal deficits, and unsustainable domestic and external debt as noted in paragraph (2.2.3). The planning and implementation of development programmes to achieve the national objectives of government require a predictable macroeconomic environment. Planning by Government with an uncertain situation owing to the border conflict with Ethiopia, is done based on three possible scenarios, which are: (i) resolution of the conflict, which would release a lot of resources for development programmes; (ii) possibility of a second war, which could severely drain the country of its economic resources and may damage existing infrastructure; and (iii) the status quo which also is very costly and deprives important development programmes of the necessary resources.

2.5.3 **Information Deficiencies:** Eritrea does not have an efficient and functional statistical system. The achievement of key developmental objectives required collection, compilation and analysis of statistical data that is vital for planning, monitoring and evaluation of development

projects. These crucial data, some of which is not readily available, include population census, national accounts, fiscal and monetary developments, price movements, social indicators and food security. Some improvements have been made since independence and the establishment of the National Statistical and Evaluation Office (NSEO). The office is charged with the responsibility of collecting, analysing data and dissemination and publication of public data but is plagued with manpower shortage and cannot undertake regular surveys and produce annual statistical bulletins. Government is working with various donors to improve data collection and dissemination. Norway is assisting the NSEO by providing technical assistance and training on all aspects of data management including preparation and conducting population and housing census. Other sectors internally collect data for their own use. The East Africa Regional Technical Centre (AFRITAC) supported by the ADB, IMF and other donors, has been providing technical assistance to Eritrea on Modernization of the Inland Revenue Department, Bank Supervision and Regulation, Budget and Accounting, Treasury Reforms, National Statistics Office, and Cash Management.

**2.5.4 Vulnerability to drought:** Eritrea's climatic conditions are arid and semi arid and has low unreliable rainfall. This renders majority of its population who depend on agriculture to be prone to drought effects, and consequently, the country suffers from chronic food and animal feed shortages as well as potable water for human consumption. Eritrea can produce only 60% of its food requirement during good years and 15% or below during bad years. In 2003 domestic food production was 9%. On average, once every ten years the country is threatened with famine, and as a result Eritrea ranks among the countries with the highest food insecurity and higher levels of malnutrition in the world.

**2.5.5 Shortage of skilled labour:** Eritrea inherited a lowly educated labour force, with shortage of skills in all sectors. Despite efforts to improve the situation following independence, it was worsened by the border conflict which forced the country to mobilise the productive human resources into the military and this crippled all the sectors of the economy due to lack of skills. Young men and women have been mobilised including skilled personnel and the continued impasse affects performance of all the sectors due to skill shortage.

**2.5.6 Inadequate infrastructure:** The liberation war and the border conflict destroyed most of the infrastructure along the disputed border with Ethiopia and displaced about 1.1 million people and also delayed planned investments. The road and telecommunications networks remain one of the least developed in the world with the former unable to provide market access to agriculture and livestock products. The road network in Eritrea is one of the least developed in the World, with a road network of only 1.9 kilometres per 1000 people and only about 10-25% of the road network is classified as in a fair or good condition. Eritrea has some 6 990 kilometres of roadways comprising 660 km of surfaced roads, 800 km of gravel roads and the rest are un-surfaced and of track standards. Efforts to rebuild the Asmara-Massawa segment of the 306-kilometre rail line linking Akordat with Asmara and the port of Massawa was shut down in 1976 because of the threat from Eritrean guerrilla forces and was largely destroyed in later fighting, began in 1999 and was completed in early 2003. There are plans to extend the line to Bisha, 150 kilometres west of Asmara, where gold and copper mining is expected to begin. A project to link Eritrea's rail lines to the Sudanese network at Kassala has been delayed by tensions with Khartoum. Flight information system and regional and international connections needs to be developed. The two main seaports of Massawa and Assab have been upgraded and are under-utilised due to low traffic.

**2.5.7 Access to electricity and clean water** is still low in all parts of the country. It is estimated that about 21.6 percent of rural inhabitants have access to clean water compared to 50 percent of the urban population. The current total national energy supply, is 65% from biomass, 32.3% from oil products and 2.7% from electricity. Only 30% of the total population has access to electricity. The total energy supply is 124 MW (40 MW from Asmara and 84 MW from Massawa) while the

current total pick demand is 50 MW, but there is need to connect other villages, which would deplete the excess supply. On telecommunications, between 1994-2000 digital switches were commissioned in 12 towns and Satellite dishes were also installed. By July 2005 there were 40 000 customers with a teledensity of 1%, which is one of the lowest in Africa. Internet service started in 2000 in Asmara, and now five cities have been connected. The mobile services started operations in 2004 by a Government owned company and five zobas have been connected with 28 000 customers.

## **Prospects for Growth**

2.5.8 The draft Medium Term Development Plan Framework 2004-2006 has identified long term planning objectives similar to those in the I-PRSP such as, rapid and widely shared economic growth with macroeconomic stability and a steady and sustainable poverty reduction. Overall economic growth rate of 7 percent is targeted. The strategy is investment in human resources development, infrastructure, competitiveness in trade, technology with emphasis on sectors where Eritrea has comparative advantage. The medium term objectives (2004-2006) include, (i) developing exports, (ii) increasing agricultural productivity, (iii) attracting investment in high potential growth centres, mainly fisheries, tourism, construction, manufacturing, and regional trade, (iv) developing a strong financial sector and (v) expanding and modernizing the country's basic infrastructure.

2.5.9 **Agriculture** has been the source of employment generation, export earnings, food security and economic growth. About 70% of the population live in rural areas and are dependent on agriculture for both crop and animal production. Eritrea's agricultural potentials remain largely unrealised. In 2003, the sector contributed about 14.7% of GDP and 13.9% in 2004 compared to 25 percent in 1998 due to the border conflict, which forced out farmers from their farming areas and the severe drought in 2002. Government figures indicate that there was an increase of agriculture to 22.6% of GDP in 2005. Total domestic food production was a tenth of the national requirement, while food deficit was 24 percent of the total requirement in 2003. In 2004, the country produced between 15 and 20 per cent of its grain requirements. Average crop harvest was 139 000 metric tonnes in 2001-2004, which was one third of the 1998 and 1999 harvest. Only a quarter of total land area is suitable for agricultural use, of which only 12.5% is actually cultivated. The country is currently exploiting 15% of its fish resources.

2.5.10 The major challenges facing the sector are inadequate arable land, inefficient traditional methods and technologies of farming, lack of infrastructure, research capability, processing capacity and shortage of skilled manpower. The objective of Government is to reduce poverty and ensure food security through implementation of the Food Security Strategy (FSS) that rests on three pillars (a) enhancing the domestic food production capacity; (b) increasing national capacity to import an adequate quantity of food supply; and (c) enhancing the effective use of food assistance to fill the supply gap during emergencies.

2.5.11 Agricultural output could be increased through increased cultivable land, use of irrigation and modern methods of farming, research services, improved drought resistant seeds, improved extension services, improved management of soil erosion and fertility, and disease control. Horticulture has great potential. Agro based industries could be developed that would create employment and increase national output hence reduce poverty and stimulate economic growth.

2.5.12 **Fisheries:** Eritrea has abundant fish and marine species that could be exploited to support growth in incomes and poverty reduction. Less than 50% of the total potential is being exploited and with road connection and the rehabilitated Massawa and Asseb ports, supported by the World Bank, production could be facilitated. ADB has funded the fisheries development project providing

fishing facilities in three places along the red sea. If these projects are made to good use they can provide income, food and export earnings, through fresh fish or canned fish sales, and contribute to poverty reduction, economic growth and reduction in trade balance.

**2.5.13 Industrial Development:** The share of industry in the GDP increased from 21% in 1998 to 26% in 2004 with an average growth rate of 3.0% but fell to 22.6% in 2005. Manufacturing accounted for 9.45% and 11.6% of GDP in both years, but declined marginally to 11.3% of GDP in 2003. The sector mainly consists of light industries which produces variety of goods including agro processed food, beverages, textiles, leather goods, chemical products, construction materials, glass, ceramics and metal products. The services sub-sector's accounted for about 62% of GDP, albeit growing at a very low rate of 1.5 percent. It comprises distribution, infrastructure services, public administration, and financial services.

**2.5.14 Tariffs on imports** currently range between 2% and 10% for industrial goods and food items. There are no tax incentives (e.g. tax holidays) except easy access to limited foreign exchange for export-oriented manufacturers. Closure of the border with Ethiopia affected trade and Eritrea lost some revenue. Trade and industrial future prospects could benefit from opening of the borders with Ethiopia and Sudan and opening trade in Europe and the Middle East. Constraints to industrial development, mining in particular, include lack of capital, high risks due to the no war, no peace situation that affects investment inflow, shortage of foreign exchange and manpower, and high cost of energy and fuel.

**2.5.15 Minerals** like gold, methane, potash, gypsum, silica, asbestos, barite and granite, including oil and gas if exploited could boost the industrial base of the country. Mining is a capital intensive operation and therefore would require financial resources and a conducive business environment. Although mining does not create large employment, backward and forward linkages could develop and Government could get revenue through royalties, company tax, shares and these if prudently reinvested could provide the much needed financial resources for other sectors of the economy.

**2.5.16 Tourism** is also another potential service that could boost the economic output. Places of interest are ancient sites of Adulite civilisation, Dahlak, key sites for the struggle for independence, such as the trenches and underground command of Nakfa; Red Sea coastline and offshore islands which offer beautiful and unspoiled scenery, and beaches; marine life of the Eritrean coast offering some of the best sites in the world for scuba diving; and magnificent mountain scenery dotted with picturesque traditional villages. To encourage tourism, the Government has developed a comprehensive national tourism development plan. The strategy identifies sites that are likely to attract tourism and specifies measures to upgrade attractions, restaurants and other tourist facilities and defines a strategy that market Eritrea as a tourist destination. The strategy also ensures that tourism does not negatively affect the environment.

**2.5.17 Human Resource:** There is a large number of Eritrea's citizens in the Diaspora whose skills and finances can be tapped for its development. Eritreans outside the country maintain close links with those at home and remit substantial sums of money to their relatives. Between 1998 and 2002 for example, private transfers averaged about a third of GDP. In 2004 the remittances dropped by 10% to US\$276 million from US\$308 million in 2003. The financial flows can promote investments if the Government can create and maintain a conducive policy environment. Social sector development especially education and training can make the country exploit the full potential of its people who are its resource. With funds, skills available, and good policy environment and regulations for exploitation of all the above resources, the country would create employment, reduce poverty levels and develop and maintain social infrastructure.

### 3. NATIONAL DEVELOPMENT AGENDA AND MEDIUM TERM FRAMEWORK

#### 3.1 KEY ELEMENTS OF THE GOVERNMENT'S DEVELOPMENT AGENDA

3.1.1 The Government's development agenda is articulated in the Interim Poverty Reduction Strategy Paper (I-PRSP), the Food Security Strategy (FSS) and the draft Medium Term Development Plan 2004-2006. The overarching objectives of the Government strategy are to attain rapid, sustainable, widely shared economic growth and reduction of poverty in an environmentally sound manner, led by the private sector. The strategy stipulated in the I-PRSP, is anchored on four pillars, namely (i) Reinvigorating economic growth; (ii) Creating income earning opportunities for the poor; (iii) Enhancing access to and utilization of essential services for human development; (iv) and Promoting political, economic and social participation of the population by putting in place the enabling environment. In addition to the I-PRSP, Government developed the Food Security Strategy and the National Water Supply and Sanitation Emergency Action Plan 2004-2007. Government has also undertaken to rehabilitate and improve road transport. Box 4 summarizes the key elements of the I-PRSP.

3.1.2 **Pillar I: Reinvigorating economic growth:** The goal is to adopt a sound macroeconomic framework that will stabilize the economy and stimulate growth. In this regard Government has developed a macroeconomic framework aimed at reducing budget and current account deficits, lowering inflation, restoring growth and increasing free service. The other goal is promoting investment in economic sectors like agriculture, fisheries, manufacturing, and tourism where the country has comparative advantage.

3.1.3 Developing infrastructure is another way government intends to stimulate the economy by developing communications, power, roads, railways, air transport and seaports. The Government's immediate strategy is to rehabilitate the infrastructure destroyed by the war and the medium to long term strategy is to improve infrastructure in order to promote private sector led growth and support improved service delivery. To this effect, Government wants to provide road infrastructure focusing on construction and rehabilitation of roads including rural roads based on conventional construction and labour intensive methods to link agricultural areas with urban consumption areas. Urban roads network in Asmara will also be prioritized from the ongoing study of the Asmara Infrastructure Development Study. The capacity of the Ministry of Works will be strengthened to act as a regulatory body and provide standards to the sub sector. Government intends to encourage the involvement of the private sector in the construction and maintenance of roads. Water drainage infrastructure investment in Asmara will be sought for priority projects prepared for implementation by the above mentioned study. In telecommunications, Government intends to improve with up to date technology, communication internally and with international community, and the strategy is to privatize the system and attract foreign investment to upgrade and operate it. Telephone, postal and internet services will be expanded to other towns and rural areas. In view of shortage of skills, Government intends to establish a training institution for telecommunication.

3.1.4 **Pillar II: Creating income generating opportunities for the poor:** The objective is to empower people and create opportunities for income earning in order to reduce poverty. The strategy is through enhancing the productive capability of traditional farmers and fishermen by increasing access to farmland, reorient the extension service and address concerns of subsistence farmers, build small dams for water supply and small scale irrigation, developing integrated agro livestock rangeland, and expand artisanal fishing. Government is also committed to enhancing opportunities in Small and Micro Enterprises, which will enhance income-earning opportunities through improving access to micro credit schemes.

**3.1.5 Pillar III: Human Resource Development:** Developing human resource is the key strategy for achieving MDG goals and objectives of economic growth and poverty reduction as espoused in the I-PRSP. Government has developed the Education Sector Development Programme (ESDP), which sets out a clear road map for developing the sector with a view to achieving the Millennium Development Goals (MDGs) and the Education for All Goals by 2015. The Government's objectives in the ESDP are to: (i) improve access and equity in basic education by encouraging equitable distribution of resources to access and priority in public spending, expand girl's education, provide better quality education at secondary level; (ii) improve the quality of education by consolidating teacher training programmes and strengthening in-service education, rehabilitation and construction of additional classrooms, and strengthening planning and monitoring; (iii) promote science and technology by intensifying vocational education and training, and (iv) expand provision of education by involving the private sector and by promoting and strengthening the formal and non-formal, distance and out of school learning education programmes. In the health sector, the main objectives for the short-term are: to rehabilitate the old and damaged and build new facilities, provide quality primary health care, prevention of communicable diseases, reduce child mortality, reduce HIV/AIDS prevalence, and malaria. Government also intends to continue to expand the immunization programme, nutrition and environmental health, and train core medical personnel.

**3.1.6 Pillar IV: Promoting an Enabling Environment for Participation:** The objective is to strengthen institutional capacity by developing public expenditure and financial management systems including procurement procedures as well as enhancing efficiency and accountability; improve public accounting and auditing by separating audit from accounts and adopt best practice accounting system; institute a procedure for systematic appraisal and approval of public investment projects by ensuring consistency with national priorities and objectives; and continue the zero tolerance policy on corruption. Strengthen and reform the civil service and devolve power and enhance popular participation by strengthening regional governments by institutionalizing financial decentralization to improve service delivery and efficiency at regional level.

**Box 4: Summary of key elements of government agenda**

<b>Key elements:</b>	<b>Strategies</b>	<b>Expected outcomes</b>
Reinvigorating economic growth	Pursue sound fiscal, monetary, trade and macroeconomic policies  Develop infrastructure	Reduced macroeconomic imbalances, positive economic growth, declining fiscal deficits  Efficient transport network, power supply, communications, and improved business climate, enhanced access to services
	Promote outward looking private sector led market economy; promote SMEs	Increased domestic and foreign investment; employment; and improved current account balance
Create income generating opportunities	Increase access to farmland, reorient extension service and enhance rural livelihoods Provide capacity and credit to SMEs	Increased income and access to social services and improved lives; improved capacity
Promoting and enhancing environment for participation	Strengthen and reform public service Institute systematic appraisal and accounting and enhance popular participation in regional Governments	Improved service delivery and ownership
Human Resource Development	Expand school facilities, improve teaching methods and professional support, improve curriculum delivery and pedagogy  Promote primary health care; provide Immunisation; programmes, child and maternal health, and nutrition	Increased literacy rate, low drop out repetition, increased enrolment rates, improved skilled labour  Reduced prevalence of communicable diseases, improved access and quality of public health services; reduced infant mortality and maternal rates
Poverty Reduction	Provide social safety nets and empower disadvantaged groups; Improve their capacity to deliver services and feed themselves	Disadvantaged group become reintegrated and productive part of the society; Improved service delivery and income generating activities

3.1.7 The current Government priority area for Bank's intervention is Integrated Community Development and is anchored upon one of the I-PRSP pillars of "Creating income generating opportunities for the poor" as stated in paragraph 3.1.4.

## **3.2 ASSESSMENT OF IMPLEMENTATION PROGRESS OF THE AGENDA**

3.2.1 The development planning in Eritrea, at the moment centers on the border conflict, which takes most of the resources both human and financial. The increased defence budget, low or close to non-existence of the private sector, heavy controls and involvement of the party and government in business are not a conducive environment for private sector development. High budget deficits, high external and domestic debts, low exports and restrictions on imports also affect investment, and therefore retard economic growth. Shortage of manpower in all sectors including the social sector also weakens the capacity to implement development programmes. The I-PRSP and the MTDP recognize that substantial resources will be required to implement the plan and even to achieve the current on track targets of the MDGs.

3.2.2 **Appropriateness of the Poverty focus Strategy:** The four pillars of the I-PRSP (para 3.1.1) adequately address the key elements of the national development agenda as articulated in the I-PRSP and MTDP. The poverty focus in the I-PRSP puts emphasis on human resource development, which is also a national development agenda. Provision of clean water supply and sanitation will improve people's health hence contribute to human development. The focus on growth is also relevant because sustainable growth is necessary for improving livelihoods of the poor and the road infrastructure will enhance the productive capacity of the economy. Community

driven social development ensures participation of the population in development. The key elements and the strategy for I-PRSP address crosscutting issues including gender and environment.

**3.2.3 Macroeconomic stability and growth:** The overall policy of macroeconomic stabilization and stimulation of growth are consistent with the country's goal for poverty reduction and broad based growth. Government recognizes that large macroeconomic imbalances are harmful to the economy since they pose a threat to growth and poverty reduction. There is therefore need for a vigorous effort to eliminate the fiscal and external account deficits and take back the economy to a high growth rate. In this regard, it is crucial to: (i) adopt a flexible exchange rate; (ii) accelerate implementation of demobilization programme; (iii) increase allocation to pro-poor sectors while maintaining fiscal discipline; (iv) enhance private sector participation in the economy; and (v) strengthen domestic savings mobilization. The limiting factor is that both the MTDP and I-PRSP have not costed the interventions necessary for achieving the goals. This would require linkage between the strategies and budget to ensure fiscal sustainability. When a full PRSP is prepared, priority areas should be rationalized with budget constraints. Domestic resources and gaps that could be filled by international donors would have to be identified at the preparation stage so that when the document is presented to donors they can easily identify shortcomings and gaps and identify their areas for intervention.

**3.2.4 Stakeholder Participation and Consultation:** The Government's policies are articulated in the I-PRSP, FSS and the MTDP and the preparation of the MDG draft progress report and was through a broad based participatory process involving all the key stakeholders, such as the National Assembly, representatives of local government and communities, community based organizations, civil society, the private sector and development partners. The broad based consultations enhanced local ownership of the strategy.

**3.2.5 Monitoring and Evaluation:** Government identified monitoring and evaluation as an important factor in the implementation of the national development agenda. To this effect, Government has set up a Ministry of National Development whose role among others is to coordinate development planning and implementation of national policies and programmes. Monitoring and evaluation would assess the effectiveness of policies, programmes and interventions. Government has further recognized that lack of statistical data hamper monitoring and evaluation and has established the National Statistic and Evaluation Office with assistance of some development partners. In regard to the I-PRSP, priority monitoring measures to be undertaken are: generate information and increase capacity to analyze and disseminate it; monitor progress in implementation of the policies and programmes as part of the poverty reduction programmes with a view to identify the key constraints that impede progress and draw lessons of experience; and help to determine whether key actions (policy instruments, institutional frameworks, investments) being implemented have or achieve the intended impact on poverty reduction.

**3.2.6 Promoting Governance:** Given the conditions prevailing currently in Eritrea, with an uncertain border conflict whose resolution is also uncertain, and the military readiness of the country, promotion of governance may be far fetched due to security controls dictated by the war situation. However, there is a challenge of promoting governance in Eritrea by inclusion of appropriate governance policies in the national development agenda. National development planning documents do allude to promotion of governance but it is important that the Government translates governance policy agenda into action. Among the key issues that Government will have to address in this regard, include strengthening the democratic process, improving transparency in the budgetary process, improving its relations with international partners, strengthen the role of civil society and freedom of the press.

### 3.3 THE PARTNERSHIP FRAMEWORK

**3.3.1 Aid Co-ordination, Harmonisation and Alignment:** There is an aid coordination mechanism led by the UN Resident Coordinator that provides donors with a forum to meet regularly to inform each other of their activities and to assess the humanitarian situation. Government undertakes programme/project implementation through project implementation/management units, which are charged with the responsibility of overlooking implementation of donor-funded projects. Ministry of National Development is responsible for development assistance coordination. While donors avoid duplication or concentration in one area, some areas like emergency, humanitarian, health and education have benefited from donor support through the Education Sector Development Programme (ESDP), Emergency Reconstruction Programme (ERP) and HIV/AIDS, Malaria, Sexually Transmitted Disease and Tuberculosis Control (HAMSET) programmes, yet others like telecommunication have not enjoyed donor support. Despite adoption of the Paris Declaration, donors have not harmonized their procedures, funding programmes to ascertain release of funds and combined their missions. Government still has to write several reports to each donor and attend to different missions even when they are in the country during the same time. Government's efforts to establish a harmonized sector-wide approach including all development partners have not progressed much. This has resulted in Government undertaking portfolio reviews with each donor and recommendations are in place to improve cooperation. The Bank in line with its Vision will encourage donor cooperation towards harmonization of their procedures among themselves. The sector wide approach was used in the education sector where an elaborate Government and donor coordination process has evolved, which could be an example for other programmes. Government has set up a Debt Management Unit in the Ministry of Finance to record and monitor the overall external debt situation and donors assistance.

#### Box 5: Donor Support by Sector

**Education:** Government has developed the Education Sector Development Programme, which will provide the basic framework for coordinating and harmonising interventions in the sector. In June 2003 the World Bank approved a credit of US \$45 million to jump-start the programme. The Bank Group approved in April 2005 a credit of UA 13.6 million and grant of UA 5.03 million. Other donors in the sector include Norway, Italy, and EU.

**Health Sector:** The largest donor providing support in the sector at the moment is the World Bank. However World Bank intends to shift to strengthening public sector policy and transparency, initiation of credible reform agenda in priority areas and alleviation of poverty and containment of deterioration of rural livelihoods. World Bank is involved in the areas of HIV/AIDS prevention, reproductive health, and health research. Other donors include WHO, USAID, Italy, and UNFPA. USAID is focusing on primary health and HIV/AIDS services. UNFPA programmes are focused mainly on reproductive health and HIV/AIDS.

**Agriculture and Rural Development:** Major donors in the sector include the World Bank, ADB, EU, USAID, UNDP, FAO, Italy and DANIDA. ADB supported the Central Highlands Irrigated Horticulture project, Fisheries Infrastructure Development and National Livestock Development.

**Infrastructure:** The major donors providing support in the water sector are World Bank, EU, UNDP, and ADB. In the road sector, major donors include World Bank, EU and Italy. Active donors in the energy sector are World Bank and Japan. Saudi Arabia, OPEC, BADEA, and Kuwait Fund are providing support for development of water resources infrastructure. The Bank provided support in the Asmara Infrastructure Rehabilitation Study, Emergency Reconstruction Programme, and the road recovery and reconstruction programme.

**Multi-Sector and Cross Cutting Issues:** Donors that supported macroeconomic management are the IMF, World Bank, and UNDP. The Government is currently benefiting from AFRITAC programmes to strengthen monetary and fiscal management. Norway, IMF, UNFPA and UNDP are donors supporting capacity building in the National Statistics Office to improve data collection, analysis and dissemination. Currently the major donor for governance programme is UNDP. Environmental support is supported by GEF.

### 3.4 CHALLENGES AND RISKS

**3.4.1** The immediate challenge facing Eritrea is the resolution of the border conflict with Ethiopia which would release resources both human and financial to other sectors of the economy. The short term challenges are; meeting the needs for emergency humanitarian assistance; settling the displaced and disabled population, deportees and refugees; demobilizing about 200 000 ex-combatants and reintegrating and rehabilitating them into the society; rehabilitating water and transportation infrastructure; restoring social services and completing economic and political

reforms that were initiated before start of the border conflict. The medium term challenges are to attain rapid broad based sustainable economic growth and poverty reduction led by the private sector.

3.4.2 The Government will need to put in place effective institutional structures and implement sound macroeconomic and social policies that would stimulate economic growth and restore economic stability and attract investment. These efforts would need to be complemented by the implementation of the food security strategy in order to have a meaningful effect on poverty reduction. The other challenge is the development of the human resource needed to support economic and administrative institutional structures. Clean water supply and sanitation is also an emergency and long-term challenge that Government has to address. Pro-poor rural development is another major challenge for the country. Access to rural areas for social benefits is also important and requires attention. Private sector development is also necessary to diversify the economy and reduce state participation and control in the productive sectors. The I-PRSP and the Food Security Strategy documents are major steps towards poverty reduction, but there is need for substantial resources to be able to implement the strategies.

3.4.3 In accordance with the ADB sovereign ratings, Eritrea is among the high risk rated countries with sovereign rating of 5 and ranked 42 in Africa. Its macroeconomic framework instability is rated very high with a weak socio-political situation and moderate debt sustainability and business environment. Its historical rating reached 6 in 2000 and has been 4 for the last years and expected to reach 5 in 2005.

3.4.4 **Border Conflict:** The refusal by Ethiopia to accept the decision of the Border Commission and the continued non-resolution and uncertainty of the conflict, forces Eritrea to remain in a state of military readiness. The risk associated with this is that, planning centers around the conflict because all scenarios are possible. i.e. the current situation can continue for some time and Eritrea will continue to spend most of its resources (both human and financial) on defence and therefore leave almost nothing for investment in productive sectors; the situation can deteriorate into a full-scale war, which would divert yet more limited resources to defence and may cause serious damage to both public infrastructure and human lives; the last scenario is the resolution, which would release productive labour and financial resources to social investment and productive sectors. Other than in the latter situation, Eritrea would not be able to implement its desired programmes due to shortage of financial and human resources.

3.4.5 **Democratic Process and Governance:** The Government needs to address outstanding governance issues including conducting presidential and parliamentary elections that were initially scheduled for December 2001, and enacting the Constitution that was ratified in May 1997 so as to enable the development environment and restore donor confidence. Implementation of the electoral law that was enacted in 2003 should also be undertaken. Donors including IMF, World Bank, ADB, European Union and other bilateral donors are concerned about transparency and non-publication of the Government annual budget. They are also concerned that the following have not been done; Public Expenditure Review, and enactment or formal adoption of public documents. However, a positive step has begun, in November 2005 government agreed with the World Bank to do expenditure review in education and health which would be completed in 2006. Government also agreed with the IMF to programme a mission for the Staff Monitoring Programme in 2006.

3.4.6 **Resource Availability:** The I-PRSP and FSS programmes are huge and require substantial resources. Gross national saving was estimated at 11.8% in 2004 while Gross domestic investment was estimated at 22.2% of GDP. In regard to allocation of resources, national defence takes the largest share and therefore intended programmes contained in both the I-PRSP and FSS will not get enough resources for implementation. This will further reduce the country's chance of alleviating

poverty and not achieving the MDG goal of reducing the proportion of people living below the poverty line from 66 % in 2003 to 33% in 2015. There is therefore an immediate need for the resolution of the border conflict with the assistance of the international community and improvement on governance to build investor confidence to enable the country to attract foreign direct investment.

**3.4.7 Government Spending:** The main challenge facing the Eritrean authorities over the medium term is to reduce government spending and the associated large primary budget deficits and high public debt to sustainable levels, while creating the fiscal space to accommodate rising social safety net expenditures and the cost of key economic reforms. Over the medium term, efforts are also needed to place the country on a sustainable growth path by moving toward a market determined foreign exchange system, protecting the visibility of the banking sector, removing restrictions on the allocation of resources, and securing grant based donor financing.

## **4. BANK GROUP COUNTRY ASSISTANCE STRATEGY**

### **4.1 COUNTRY CONTEXT AND STRATEGY SELECTIVITY**

4.1.1 The long term planning objectives of the country are articulated in the I-PRSP and other planning documents and centre on achieving a rapid and widely shared economic growth and sustainable poverty reduction. Preparation of the I-PRSP process involved various national and international stakeholders including sector ministries, government agencies, private sector, non-governmental organizations, development partners and community representatives. In this process, Government adopted a framework for participation with the following goals: (i) to ensure country ownership; (ii) to allow the various stakeholders to exchange views and expectations; (iii) to ensure that the strategy addresses the priority needs of the poor and reflect local realities; and (iv) to enhance the chances that key stakeholders, including development partners, buy-into the process and overall direction and content of the strategy. In view of this, Government ensured full participation and ownership of the process and its final outcome (I-PRSP) in its development agenda.

4.1.2 In an effort to achieve the overall goals of poverty reduction and stimulation of growth based on Pillar II of the I-PRSP on Creating Income Generating Opportunities for the Poor, the Bank's intervention over the ADF-X lending period will focus on an Integrated Community Driven Development. The proposed intervention will enhance rural community capacity by building social capital and fostering empowerment of these communities. Empowering poor people to participate in development is crucial for creating income generating opportunities for the poor. This strategy will offer rural communities access to delivery of social services and lower the cost of delivering basic infrastructure. Community Driven Development is an approach to development that promotes integrated multidimensional and multi-sectoral interventions to poverty reduction.

4.1.3 The Country Strategy Paper is based on the Bank's guiding principles of focus on poverty reduction, selectivity, participation and ownership by the client member country. The strategy is to select programmes and activities that would stimulate growth and benefit a large portion of the population. These principles link well with the goals of the I-PRSP particularly Pillar II, as well as the process that led to the production of the document, which involved all stakeholders. The Bank's ADF X assistance strategy will focus on integrated community development through road infrastructure and participatory social sector intervention. Rural road infrastructure is necessary to access all rural areas and for economic growth, reconstruction and improved access to agriculture, education and health as well as other equally important social services. Community Driven Social Development will assist communities to improve capacity for service delivery and fight poverty.

Women's capacity and empowerment will be enhanced and that will boost their participation in economic activities. Community projects and programmes will generate employment through micro credit schemes and improve living standards of the communities and will be fully owned and managed by the communities hence ensure continuity and sustenance of the programmes.

## **4.2 PORTFOLIO MANAGEMENT AND LESSONS FROM PREVIOUS CSP**

4.2.1 The Bank Group commenced lending operations in Eritrea in 1992 and since then a total of nine operations have been approved as at April 2005. The operations consist of six projects, one institutional support and two studies. A total of UA 78 million has been committed, of which UA 69 million was in the form of ADF loans and UA 9 million was in the form of ADF grants. The total commitment was shared among several projects; 38.5 percent financed agriculture projects, 26.9 percent was utilized in multi-sector projects, 23.9 percent supported education and 10.7 percent funded public utilities.

4.2.2 A total of five projects are ongoing: National Livestock Development Project, scheduled to close on 31 March 2007; Fisheries Infrastructure Development Project closing in December 2006; Support to Education Sector Development planned for completion in 2009; Asmara Infrastructure Development Study scheduled to close in September 2006; and the Emergency Reconstruction Programme to be completed in June 2007. A Country Portfolio Review has not been done and is planned for 2006. However, disbursement rate is 81.3% for ongoing projects excluding the recently approved Education Project. When the education project s included, the disbursement rate falls to 35.2%.

4.2.3 While the Bank's 2000 Annual Portfolio Performance Report (APPR) identified 2 out of 6 projects, representing 40% as projects at risk, the 2004 APPR did not and the Agriculture Sector Portfolio Supervision Mission of May 2005 rated them as satisfactory. The three agriculture projects took an average of eight years to complete, while others took on average five years to complete. The National Livestock Development Project which started in October 1997 will complete in March 2007 and will have close to ten years of implementation. Among others, the main factors that lead to slow implementation are weak institutional capacity, complex procurement procedures including insistence on following International Competitive Bidding (ICB) procedures, low threshold levels requiring Bank approval for small contracts, long delays on procurement and no objection request, frequent changes of Task Team Leaders (TTLs), and short supervision missions. However, following training conducted by the Bank staff on project implementation in 2001, project implementation and monitoring have improved.

4.2.4 The Bank Group Audit Report of May 2005 also concluded that project management in Eritrea has improved in the areas of accounting, procurement and compliance with loan conditions. However, some of the key findings raised in the previous audit report still persist and have not been fully addressed. The Asmara Infrastructure Development Project Study, which is nearing completion, is expected to recommend projects that would require further support in the second stage of construction of water supply and sanitation as well as the road network within the city.

4.2.5 **Lessons Learned:** As noted in par. 1.1, the ADF IX Country Strategy Paper was prepared in the context of Eritrea's transition from a socio-economic crisis aggravated by conflicts and the intention to build a foundation for a long-term development and poverty reduction. The focus of the Bank Group's assistance strategy was on Human Resource Development and was based on the Interim Poverty Reduction Strategy Paper (I-PRSP) of 2003. Education was delineated as the priority sector for the Bank Group intervention. In November 2004, the Bank approved an ADF loan of UA13.60 million and a grant of UA5.03 million for the Education Sector Support Project, which became effective in April 2005.

4.2.6 The previous CSP clearly underlines the need for selectivity, while anchoring its strategy on the I-PRSP. The Bank's intervention emphasise the need for careful selectivity of strategy, approach, sector, and projects. In view of limited resource allocation, there is also the need to scale up the Bank's activity, preferably with single intervention with clearly defined output and indicators that will have maximum impacts. Moreover, in view of the limited human resource and institutional capacity in Eritrea, the Bank's intervention should be limited to one operation even if it could be multi-sectoral in order to make effective use of the existing limited capacity. The Bank's intervention during ADF IX also ensured synergy with the other development partners, working in the education sector. The Bank and other development partners should remain actively engaged with the Government on key policy issues of governance and private sector development.

### **4.3 CSP AREA OF FOCUS**

4.3.1 To ensure greater selectivity, development effectiveness, and bearing in mind the limited institutional and human capacity, and the need to scale up activity, the Bank's strategic area of focus will emphasis an integrated rural community-driven development. This area of focus is anchored on the government's strategy stipulated in the I-PRSP, which is based on creating income generating opportunities for the poor and the desire by Government to attain rapid, sustainable, widely shared economic growth and reduction of poverty in an environmentally sound manner.

4.3.2 The area of focus for the CSP is in Integrated Community Driven Development encompassing rural road infrastructure and participatory social sector intervention. The integrated approach is in compliance with the priorities spelt out in the I-PRSP and the Bank's priority areas for support specified in the Strategic Plan 2003-2007 as well as the ADF X Lending Policy. The choice is based on the analysis of the constraints and potentials for the development of Eritrea as spelt out in their development agenda. Within the identified framework, the Bank will focus on broad based rapid economic growth that will benefit a large portion of the population and reduce poverty.

4.3.3 Government of the State of Eritrea (GSE) has pursued a number of interconnected strategies since independence, which have built on the long history during the independence struggle of community participation and cohesiveness, on a decentralisation of decision-making to Zoba, sub-Zoba, Kebabi and community levels. The adoption of an integrated rural development approach which seeks to combine capacity building, supply of affordable social services and appropriate micro-credit based on group guarantees to stimulate diversification, agricultural modernization, and off-farm income generation is found appropriate for poverty reduction. Other strategies include the intensification of agricultural production, the extension of arable land through small-scale irrigation systems, and community based service delivery and encouragement of community based environmental protection, such as soil, water and energy conservation and forestation, and a reduction of workload.

4.3.4 In Eritrea, about 70% of the population lives in rural areas and 66% of the total population is poor (living below poverty line) and 65% of the poor are in rural areas. It is therefore imperative that for any meaningful impact to be made by the Bank's intervention, it should target the rural areas and design a comprehensive programme that targets all aspects of rural livelihoods and issues related to food security. The Bank's strategy will mainstream cross cutting issues like environment on which the people depend for their livelihoods; gender equity, which hardly exist in rural areas due to strong traditional beliefs which disadvantage girls in all life skills; local governance and capacity building particularly at regional level (Zoba, Sub-Zoba and Kebabis) in order to enhance capacity to provide social services and promote the public and productive sectors.

## **Community Driven Rural Roads Infrastructure**

4.3.5 The fifteen year (15) road sector development programme prepared by Government lays out plans for the sector and institutional reforms, identifies measures to strengthen management of the road network, defines priority investments in trunk, feeder and rural roads, and specifies arrangements for mobilizing sufficient, timely and sustainable financing for construction, rehabilitation and maintenance of roads. The programme calls for the involvement of the domestic private sector in construction and maintenance of roads and includes proposals for enhancing road safety, increasing female employment in the road sector, and preventing the spread of HIV/AIDS among construction workers, road users and people living nearby improved roads.

4.3.6 The Bank Group assistance strategy in road infrastructure aims at poverty reduction, through access of the poor to basic facilities and improved economic infrastructure that will enhance expansion of economic activities, investment promotion and food security. The programme would upgrade roads linking the main agricultural production areas to urban consumption centers combining conventional and labor-intensive construction methods to generate employment opportunities for the communities along the roads being developed. The purpose is to provide the isolated poor communities with access to markets, social and extension services and at the same time facilitate social integration in addition to improving their standards of living resulting from incomes generated from road sector related employment and improved agricultural practices.

## **Community Driven Development**

4.3.7 The objective of the community driven development is to involve communities in the process of planning, implementation and management of programmes and projects intended to improve their livelihood. The programmes will be designed to include communal and individual environmental protection such as soil and water conservation, small scale communal irrigation schemes, promotion of energy saving stoves and labour reducing implements and techniques, promotion of income generating activities through provision of micro-credit and training, improvement of health facilities, promotion of small-scale agric-processing, improvement of health facilities, improvement of access to water supply and sanitation in rural areas.

4.3.8 The overall strategy will be to ‘contribute to government’s policy to eradicate poverty in Eritrea’. Its specific objective will be to increase the capacity of community based institutions and communities to identify priorities, plan, implement, manage, monitor and evaluate activities related to food security and poverty reduction. The expected result of the strategy will be an improved provision of and access to basic social services and means of production by the rural poor and enhanced environment. The proposed strategy will focus on: (i) Capacity building, provision of training and technical assistance to strengthen the capacity of community-based institutions to provide services to the rural population, and general support to community initiatives, such as through technical advice, provision of materials or equipment and renewable energy for example; (ii) Support to Community driven initiatives which will be aimed at supporting small-scale community based initiatives targeting food security and environmental protection (such as water and soil conservation, afforestation, catchment area management, small-scale collective irrigation), and improving access to means of production, income generation, and labour saving devices etc., such as micro-credit, and agricultural equipment; (iii) Advocacy, support to initiatives which aim to raise the awareness of community members about the integrated nature of food-security which stress environmental protection, increase in agricultural efficiency and yields, gender equity, health, water and sanitation and other cross –cutting issues.

4.3.9 Community driven Social Infrastructure is anticipated to empower communities to prioritize their needs and to implement both communal and individual measures to improve their livelihood in an integrated manner that respects and improves degraded environment, gender equality, the special needs of destitute community members and promotes the concept of self reliance.

#### 4.4 CSP FRAMEWORK

4.4.1 Table 5 provides an overview on the linkage between the area of interventions by the Bank and key elements for the development agenda of the country, whose overall objectives are economic growth and poverty reduction. The Bank Group will support Pillar II of the GDA which is to Create Income Generating Opportunities for the Poor. In order to monitor progress towards achieving the set objectives, expected outcome and CSP outcome indicators will be used in relation to the required activities/actions to achieve the objectives.

Global Objective: **Economic growth and poverty reduction**

**Indicators:** Proportion of people living below poverty line reduced to 50% by 2015; Economic growth reach 7 % by 2007.

**Pillar II:** Creating Income Generating Opportunities for the Poor.

**Bank area of focus:** Integrated Community Development

**Table 5: CSP Framework and linkages between selected focus area and activities for Income generating opportunities and poverty reduction.**

Long-term Development Goals		Priorities for ADB during CSP Period	
Activities to achieve outcomes	Constraints for achieving Country outcomes	Expected CSP Outcomes	CSP outcome Indicators
<p><b><u>Roads:</u></b> Establish an efficient and adequate road network connecting cities to population centers and high potential areas.</p> <p><b><u>Water Supply.</u></b> Increased access to reliable water supply and sanitation</p> <p><b><u>Agriculture</u></b> Enhance domestic food production</p> <p><b><u>Gender Equity</u></b> Advance the status of women to actively participate and take a leadership role in nation building</p>	<p>-Shortage of financial and human resources -Nor war, no peace situation (border conflict) Lack of skills to develop and enforce roads transport and safety regulations Shortage of resources</p> <p>Lack of resources and use of traditional farming methods</p> <p>Dependency of agriculture production on poor rainfall</p>	<p>-Improved connection of main rural population centers and villages of Debub and Anseba to national roads. - Improved access of rural population of Debub and Anseba to basic social services.</p> <p>Main health centers, primary and secondary schools and market areas in Debub and Anseba equipped with safe water supply systems and solar energy.</p> <p>The productive capacity of small traditional farmers enhanced - Food production and incomes of poor households increased</p> <p>Opportunities for accessing the means of production increased</p> <p>Lives of women participating in social economy improved.</p>	<p>- Number of kilometers of suitable feeder roads in Debub and Anseba increased by 25% in Dec 2012. - % of rural population attending social services or using market areas increased</p> <p>50% of health centers and schools and 30% of market areas in Debub and Anseba equipped with safe water supply system by Dec 2012.</p> <p>Water catchments and storage rehabilitated - Post harvest losses and soil erosion reduced by 25% in Debub and Anseba by Dec 2012. - Access to means of production (micro-credit, land, equipment) by rural households (m/f) increased by 25% in Debub and Anseba</p> <p>Number of women with access to means of production (micro-credit, land, equipment) increased by 25% by Dec 2012. - Number of women trained by the project increased by 25% by Dec 2012. % of women attending public activities increased by 25% in Debub and Anseba by Dec 2012</p>

<p><b>Civil service reform</b> Develop a civil service with enhanced profession and dedication to public service</p>	<p>Weak democratic and governance institutional framework</p>	<p>Effective and efficient service delivery of local governments (Zobas, sub-zoba and Kebabi) improved. - Institutional capacity of local governments to formulate, implement and monitor local strategies related to food security and poverty reduction strengthened.</p>	<p>50% of local governments in Dehub and Anseba trained in financial governance and management methods by Dec 2007. - 25% of local governments in target areas have adopted and implemented local development strategies related to food security and poverty reduction by 2012</p>
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#### 4.5 REGIONAL DIMENSIONS OF BANK GROUP INTERVENTION

4.5.1 The Bank's mandate includes the promotion of regional integration and cooperation among Regional Member Countries (RMCs). The Bank has been actively participating in the implementation of regional integration initiatives, including NEPAD and the African Union. While there has been no direct multinational project financed by the Bank for Eritrea, the country has benefited indirectly from non-lending activities of regional institutions supported by the Bank in the areas of capacity building. For, example, the African Capacity Building Foundation (ACBF) and the Government of the State of Eritrea signed Grant Agreement that will help to build economic policy and development management capacity in Eritrea. This is the first capacity building support by ACBF in Eritrea. The project, which will be known as the Eritrean Capacity Building Project for Economic Policy Analysis and Management (EPAM), aims to improve the performance and efficiency of the public sector in the management of the economy of Eritrea. The Africa Regional Technical Assistance Center (AFRITAC) is also providing support for capacity building.

4.5.2 The Bank is currently preparing a regional assistance strategy paper that would identify programs and projects to assist the East African Region and the Horn of Africa. For Eritrea to benefit from such regionally-based programs and projects, it is important to enhance political and socio-economic relations with its neighbours. With entrenched peace and stability, Eritrea's port facility and transport network could be developed to link countries with large population such as Ethiopia and Sudan.

#### 4.6 BANK GROUP ASSISTANCE STRATEGY

4.6.1 On the basis of the selected strategic priorities defined in the Government's I-PRSP and the Bank assistance to Eritrea, the Bank will use the ADF X resources to support a single and comprehensive intervention based on the integrated rural community driven development. For the 2006-2007 period, the ADF X resources will be used to finance activities to support this integrated community-driven development approach, with emphasis on Rural Roads Infrastructure and Community Driven Social Development. The roads infrastructure would link up the countryside with the main centers and create access to inputs and markets, and create employment opportunities for rural people. It would also create access to urban areas and eliminate constraints, which hamper access to education, health facilities and other social services with cost effective outreach.

4.6.2 The total allocation for Eritrea under the ADF X, following evaluation of its performance, is UA 20.1 million for the 2006-2007 cycle and is 100% grant. The allocation of the first two years will be determined by the country's overall performance, which depends on the annual Country Policy and Institutional Assessment (CPIA) rating which was 2.50 in 2004 and the 2005 CPIA rating is 2.55. The annual performance will determine the allocation for the following years and the country will receive the maximum amount if it maintains its current CPIA rating. The allocation will depend on the country's performance in the annual CPIA ratings, the amount of overall available ADF resources, changes in the list of active ADF eligible countries and the terms of the financial assistance to be provided. This means that failure to pursue the reforms could result in

lower annual allocation and success in meeting the benchmarks could result in higher annual allocation. The Bank will pay particular attention to monitoring weaknesses identified during the last evaluation of the country's performance.

**Table 6: CPIA Benchmarks to Monitor Improvement of Country Performance**

2005 CPIA Weaknesses Identified	Structural Reforms Envisaged	Benchmarks 2007
Macroeconomic management	Enhance macroeconomic stability by adopting and implementing growth stimulating and poverty reduction policies	Adoption and implementation of the IMF Staff Monitoring Programme, and implementing recommendations of both SMP and Article IV Consultations
Fiscal Policy	Reduce fiscal deficits and improve financial management, business regulations and exchange rate policy	Exchange rate determined by the market and improved business regulations. Enhanced business policies and regulations for private sector
Quality of budgetary and financial management	Improve budgetary and expenditure transparency and align it to poverty reduction policies	Published public budget and undertake expenditure review in other sectors which has started with education and health by World Bank
Trade	Improve regional and international cooperation and trade policies. Enhance benefits from regional programmes and projects	Established cross border trade within the region and other African countries as well as the Middle East and Europe.
<b>Bank Group Portfolio</b>		
Slow implementation of projects due to loan conditions, rigid procurement procedures and delay in responding to correspondences from implementing agencies.	Ensure timely fulfillment of loan conditions and response to request as well as relax procurement procedures based on prevailing conditions	Loan conditions for all projects fulfilled in one year Prompt response to correspondence Review procurement procedures to enhance quick and improved implementation

4.6.3 Weaknesses in CPIA performance are in structural policies and economic management which are both less than the overall rating in both years. High macroeconomic imbalances and low trade performance due to the closed border with Ethiopia and undeveloped trade links with the rest of Africa, Middle East and Europe countries contribute to the low performance. However trade opportunities need to be exploited to improve economic performance. Macroeconomic imbalances are linked to high defence expenditure and can improve if peace can be achieved in Eritrea. Eritrea needs to improve on the following in order to increase its performance rating, transparency and accountability, economic management, financial sector, and budgetary and financial management, which fall on the lowest rating of 2. Comparing 2004 and 2005 there has not been any significant improvement on performance in these very areas.

4.6.4 The Bank Group's assistance to Eritrea will be delivered through the Integrated Community Development encompassing Roads Infrastructure and Community Driven Social Development. The Bank's ADF X assistance will be provided through a grant to the Government and will be geared toward priority areas identified by Government and the CSP in line with the Bank's strategy. In line with the Bank's overall assistance strategy focus will be on poverty reduction and economic growth, through supply of roads infrastructure and community development and should benefit a large proportion of the population.

4.6.5 The Bank will integrate cross cutting issues in the implementation of the programme. On environment, an environmental assessment for all projects will be undertaken and people will be educated on how to conserve their environment. New methods of production that conserve soil and improve productivity will be encouraged. Issues of gender equity, which are still evident in rural areas, will be addressed at all levels and implementation stages in order to improve the lives of women.

4.6.6 The Bank plans to undertake an Economic Sector Work, Country Portfolio Review, Country Governance Profile while encouraging the preparation of a full PRSP. This would complement the Public Expenditure Review that the World Bank is launching in the education and health sectors. These studies would enhance success of future operations as well as improve the quality at entry of project design, appraisal, implementation and review of the CSP and preparation of future CSPs.

## **4.7 PARTNERSHIP AND HARMONISATION**

4.7.1 There are no regular donors and Government consultations meetings as well as the dialogue on alignment and harmonization. Portfolio reviews are done with each donor annually. Development partners are keen to harmonize and align their procedures to that of the country but lack of transparency and non-adoption of public documents constraint their efforts. However Government has indicated that it is open to discussions with donors and consults them on major national development initiatives.

4.7.2 The African Development Bank Group has participated in co-financing projects and programmes with other development partners. Examples of such programmes are the Emergency Reconstruction Programme and the Education Sector Development Programme where other partners like World Bank, European Union, United Nations Agencies are taking part. The Bank is committed to continue to participate in such activities where they are in line with its strategic plan.

## **5 RESULT-BASED MONITORING AND EVALUATION**

### **5.1 MONITORING OF CSP OUTCOMES AND BANK GROUP PERFORMANCE**

5.1.1 Monitoring the Bank Group's effectiveness will take place at project and programme as well as the overall assistance levels. The intervention areas of the Bank, the expected outcomes and outcome and progress indicators are derived from the national development agenda articulated in the I-PRSP, FSS, and MTDP and as discussed in 4.3.1 (table 1) above. The benchmarks for measuring the performance reflect the key elements and selected areas of Bank Group's intervention during the CSP period. The CSP outcome indicators should be achieved in the long term as a result of the Bank's intervention in the country. During the period of the CSP the Bank will review the indicators and targets in order to assess progress in implementing the assistance programme, and adjust the Bank's strategy as necessary. It is expected that the successful implementation of the Bank Group Strategy would have a positive impact towards the achievement of the Government's development targets I-PRSP, FSS as well as the Millennium Development Goals.

5.1.2 The successful implementation of the I-PRSP will depend on the strength of the Government institutional mechanism to track poverty related indicators and necessary inputs. Collection and analysis of data is important for monitoring and evaluation to detect any diversion from the agreed target and strategies. It is doubtful whether within the near future the country will be able to perform this task given its current situation of human capacity constraint. Government has adopted a policy to establish monitoring and evaluation mechanisms for the I-PRSP, FSS and MTDP and would require assistance to improve capacity of the Central Statistics and Evaluation Office. In view of inadequate capacity, it would be necessary that at project identification and appraisal levels issues of capacity receive an in-depth analysis so that monitoring and evaluation systems and structures could be put in place before implementation starts.

### **5.2 MANAGING RISKS**

5.2.1 The risk analysis undertaken in section 3.4 revealed that the achievement of the overarching goals of poverty reduction and economic growth faces a number of political, economic, governance and external factors risks. There are also a host of challenges that government has to deal with in order to achieve the intended goals of poverty reduction, access to clean water, road infrastructure, and community development.

5.2.2 The main and immediate risk is the uncertainty of the border conflict, which at the moment can go either way, thus full resolution and border demarcation; continued stalemate; and the worst scenario of deteriorating into a full-scale war. Other than resolution, which is desired, the other two will drain the economy of its hard earned resources and utilize majority of them into defence, as well as destroy lives and social infrastructure. The resolution of the border conflict is not on the hands of Eritreans but require assistance of the international community.

5.2.3 Unfavourable weather condition is also a major constraint for water supply since Eritrea is prone to drought and has inadequate rainfall. This would render the goals set out in the I-PRSP, FSS and MTDP and the Bank's strategy unachievable. To this effect, the Bank would continue to support the Government on efforts to develop programmes that are geared toward harvesting and providing clean water to the general population.

5.2.4 Governance is another risk that Government has to deal with if it expects the international community to continue providing development support, which it needs most, since its ability to generate resources for development has many constraints including high unsustainable budgets deficits. Transparency is one issue that development partners are grappling with in Eritrea. It is becoming difficult for donors to support programmes when they do not know the strength and weaknesses and allocations of the Government revenues. It is important for Government to publish annual budgets, not only for donors but also for anybody interested to know the financial gaps that exist between Government budget and expenditure. The Bank Group would continue with other development partners to urge Government to open up and be transparent as stated in its development agenda.

5.2.5 There is scarcity of resources including human resource, which could be used for achieving the national development goals. The capacity of the country to generate the needed resources, which is lacking at the moment, will determine whether the goals will be achieved or not. Substantial resources are needed but adequate resources are not being realized from the international community and domestic resources.

### 5.3 COUNTRY DIALOGUE ISSUES

5.3.1 Until the border conflict erupted in 1998, Eritrea had made tremendous progress in social and economic transformation and in creating an enabling environment for private sector investment. Although there is currently a seize fire, the situation is still uncertain because of the unresolved border dispute. This has led to slow implementation of the Government's policy commitments in areas such as private sector development, participatory governance and transparency in budget management. While recognizing that the prevailing peace is fragile and that Eritrea may have legitimate security concerns, it is important that the country regains the reform momentum quickly and implements the demobilization programme. In light of the foregoing, the Bank Group will pursue active dialogue with Government on a number of institutional issues.

5.3.2 **Macroeconomic and Structural Reforms:** To this end, the Bank will dialogue with Government on improving and deepening macroeconomic reforms. The focus will be on efforts to reduce external and domestic debt, in view of the falling exports and increasing imports. The Bank will encourage Government to provide conducive environment for private sector, privatize public enterprises and introduce financial sector reforms. The Bank will work closely with the IMF and World Bank in assisting with some of the needed reforms like financial sector, public expenditure review and the debt sustainability analysis.

**5.3.3 Governance:** The Bank would like to prepare a detailed Country Governance Profile for Eritrea as there are concerns that good governance needs to be strengthened. There have been some reported contraventions of the human rights. Separation of powers between the Legislature, Judiciary and Executive and the Party, although provided for by the Constitution, has not been the case in practice. Freedom of speech and press does not exist. Since independence there has never been any presidential elections and all the electronic and print media are state owned. The Bank will try to identify resources that could be used to assist in governance issues by undertaking a Country Governance Profile. The Bank will propose to the Government as soon as resources have been secured.

**5.3.4 Military Spending and Demobilisation:** The current military spending is not sustainable. The country needs to step up appeals to the international community for assistance on the resolution of the border conflict since defence expenditure is tied to the border demarcation stalemate and is not easy to reduce in the prevailing circumstances. Demobilisation is necessary to release productive labour to other productive sectors. The Bank would therefore encourage Government to accelerate demobilization and to be cautious and reduce military spending to increase expenditure in long-term investments.

**5.3.5 Aid coordination:** The Bank and other development partners and the Government of Eritrea will continue to dialogue on ways to improve donor coordination, harmonization and alignment in order to improve aid effectiveness. In this regard each partner will play its role, donors will work towards harmonizing their procedures and Government will improve institutional structures that donors would align their procedures with. Government would also be encouraged to coordinate donor's activities within sectors and within the country.

**5.3.6 Private Sector Development:** The Government is aware of the role the private sector is capable of playing in the development of the country. The Bank, aware of the setbacks due to the border conflict had on private sector reforms, would encourage Government to reinvigorate private sector development initiatives. This would require leveling playing fields between public sector enterprises and the private sector and deregulate the banking sector. Other donors will be engaged in these policy dialogues with Government.

**5.3.7 Statistical Capacity Building:** The Bank's International Comparison Programme for Africa (IPC-Africa) which Eritrea could have benefited from and had a capacity building component, started in 2004 and will end in December 2007 in participating member countries. The Government of Eritrea has recently requested for assistance in this area and the Bank is prepared to assist the government in many aspects of statistical capacity building. The Bank will dialogue with the Government of Eritrea on the area of Statistical capacity building

## **6. CONCLUSIONS AND RECOMENDATIONS**

### **6.1 CONCLUSIONS**

6.1.1 The Government of Eritrea had put in place economic policies that support economic growth and focus on poverty reduction following independence. The border conflict has reversed all economic efforts and progress that were achieved before the war, due to mobilized manpower to defend the country resulting in high expenditure on defence. The preparation of the I-PRSP demonstrates the Government's commitment towards broad based economic growth and poverty reduction. The document was prepared with the hope that the impasse on the demarcation of the border will be resolved and the economy will go back to its development programme that was initiated before the war with Ethiopia. The Bank Group 2005-2007 RBCSP has been designed within the framework of these documents and has taken into account the development challenges of the country.

6.1.2 The Government's immediate priority is to provide humanitarian needs for the displaced, disabled and drought affected people as well as rehabilitate both social and economic infrastructure that was destroyed by the war and construct new ones. However, the country does not have enough resources and need assistance from the international community. The major challenge for the country is to mobilise resources for the emergency needs and for the short to long-term developments. To this effect, the Bank Group strategy will focus on Integrated Community Development (capacity building at local level and access to means of production as well as roads infrastructure and other community driven social infrastructure), which would improve people's lives and stimulate economic growth and reduce poverty. The strategy will concentrate on capacity building, community infrastructure and construction of feeder/rural roads across the country. The Bank will complement its lending activities by engaging in dialogue with Government on the need to create favourable private sector environment and to do Economic Sector Work, Country Governance Profile, full PRSP, Public Expenditure Review and Debt Sustainability Analysis as well as the need for annual budget publication.

### **6.2 RECOMMENDATION**

The Boards of Directors are invited to approve the proposed area of focus of intervention in Eritrea for the period of the RBCSP 2005-2007. The main area of focus is Integrated Community Driven Development including roads infrastructure and community driven social development, which are in Government's development agenda and also in line with the Bank's overall focus on economic growth, community development and poverty reduction. It is proposed that the total ADF X allocation of UA 20.1 million be utilized in the area of focus.

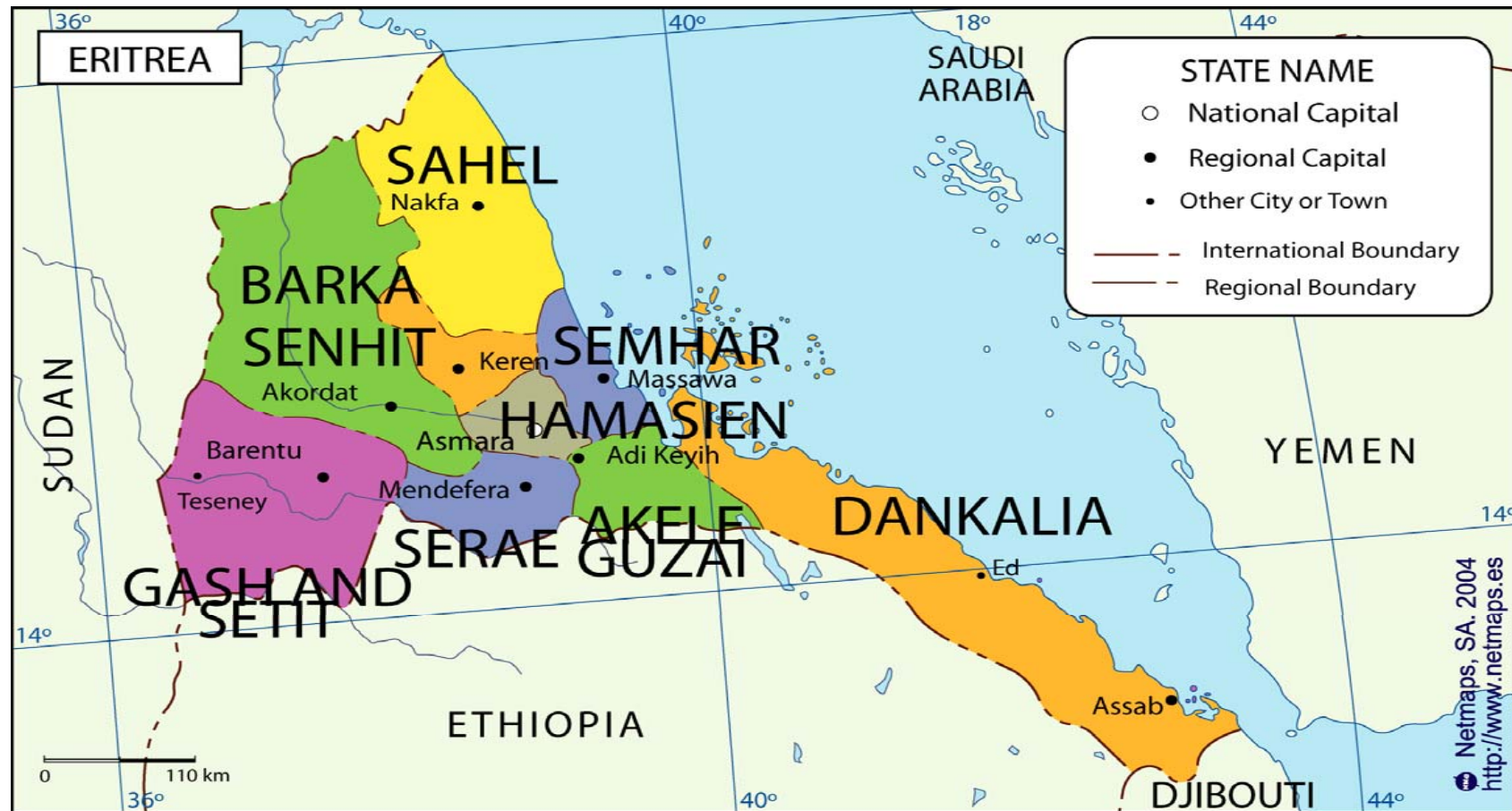
**Annex 1: ERITREA SUMMARY OF BANK GROUP OPERATIONS**  
(As at 31.03.2006)

<u>ONGOING OPERATIONS</u>	Source	Date Approval	Date Signed	Date Effective	Closing Date	Last Disbursement Date	Amount Approved UA Mill	Net Loan	Amount Disbursed UA Mill	% Disbursed
<b><u>AGRICULTURE</u></b>										
National Livestock Development	ADF	19-Nov-97	16-Feb-98	17-Sep-98	31-Dec-05	31-Dec-05	10.02	10.02	10.02	100.1
Fisheries Infrastructure Development	ADF	19-Nov-98	16-Feb-98	24-Nov-98	31-Dec-05	31-Dec-05	11.5	11.50	10.500	91.3
<b>SUB-TOTAL</b>							<b>21.520000</b>	<b>21.52</b>	<b>20.52</b>	<b>95.35</b>
<b><u>PUBLIC UTILITIES</u></b>										
Asmara Infrastructure Rehabilitation Study		14-Dec-00	5-Feb-01	02-Jun-00	31-Dec-05	31-Dec-05	1.93	1.93	1.209	62.64
<b>SUB-TOTAL</b>							<b>1.93</b>	<b>1.93</b>	<b>1.209</b>	<b>62.64</b>
<b><u>MULTI-SECTOR</u></b>										
Emergency Reconstruction Programme	ADF	10-May-01	30-May-01	16-Aug-01	31-Dec-05	31-Dec-05	19.90	19.90	13.469	67.68
<b>SUB-TOTAL</b>							<b>19.90</b>	<b>19.90</b>	<b>13.469</b>	<b>67.68</b>
<b><u>EDUCATION</u></b>										
Education Sector Development	ADF	10-Nov-04	02-03-05	N/a		31-12-09	18.63	18.63	0.00	0.00
<b>TOTAL ONGOING OPERATIONS</b>							<b>61.98</b>	<b>61.98</b>	<b>35.198</b>	<b>56.80</b>

\* =Cancelled

N/A = Not Available

Annex 2: MAP OF THE STATE OF ERITREA ANNEX II



**Disclaimer:** This map was provided by the African Development Bank exclusively for the use of the readers of the report to which it is attached. The names used and the borders shown do not imply on the part of the Bank and its members any judgment concerning the legal status of a territory nor any approval or acceptance of these borders.

**Annex 3: BANK GROUP COUNTRY STRATEGY FRAMEWORK MATRIX 2005-2007**

Country Challenges	Government Agenda	Bank Strategy	Bank Ongoing Activities	Proposed Bank Activities	MDG Goals	RBCSP Outcomes	Outcome Indicators	Progress Indicators
<b>Focus Area : Community Driven Social Development</b>								
Improve transport network and communication and access to rural areas	-Put in place sound macroeconomic and prudent financial policies -Provide roads infrastructure -Provide essential infrastructure Provide all weather roads in rural areas and across the country	-To dialogue with Government on macroeconomic policy implementation  Dialogue with Government on the roads infrastructure  Support economic and social infrastructure programmes	Assistance in roads construction and upgrading  Urban infrastructure study  Emergency reconstruction programme  Education sector development programme National Livestock Development	Assist in capacity building and aid coordination  Assistance in road infrastructure development Implement recommendations of the Asmara Infrastructure study and provision of rural roads	Broad based sustainable growth  Reduce number of people living below poverty line  Increase access to clean water supply and sanitation  Increase net primary school enrolment  Reduce mortality rates,	Increased economic output Increased all weather road network  Improved health  Increased economic activity  Improved transport network  Reduced regional disparities	GDP growth rate  Improved road network  Mortality rates  Improved access to essential services  Reduced poverty due to increased economic activity  Improved marketing and business climate	No of roads constructed  Number of education and health facilities accessible by all season road  Number of people employed by the project  Time spent traveling on roads
Improve capacity for service delivery at local level and provide access to means of production for improved livelihoods	Provide means of production to poor people in rural areas Provide water and sanitation to rural areas Enhance food production	Support infrastructure and access to essential services  Coverage of large population	National Livestock Development Project Asmara Rehabilitation Infrastructure Study	Establish essential services with community participation Provide capacity training at local level Provide access to means of production	Improved access to essential services Environmental resources Poverty reduction Reduce prevalence of water borne diseases  Increased food production	Easy access to services within and outside regions Increased access to essential services	Food production increased  Transport network and cots reduction Participation by local people in decision making	Number of people utilizing social services  Inter regional visits  Number of marketing and business links

**Annex 4: SELECTED MACROECONOMIC INDICATORS**

<b>Indicator</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
GDP at current market prices (million Nakfa)	4,974	5,530	5,982	6,200	7,771	9,031	10,417	12 748	14,787
Real GDP Growth Rate (%)	7.7	3.9	0.3	-12.0	8.7	-1.2	3.0	1.8	4.8
Inflation (Annual) (%)	7.7	9.0	10.6	19.9	14.6	16.9	22.7	25.1	12.4*
Gross National Saving/GDP (%)	34.0	3.0	6.2	2.3	10.1	10.9	12.0	11.8	
Gross Domestic Investment./GDP (%)	31.9	26.6	34.1	18.5	28.5	26.3	22.4	22.2	
Private Investment/GDP (%)	13.9	6.3	4.9	6.8	8.4	9.1	9.8	5.0	
Domestic Revenue/GDP (%)	40.7	30.5	31.7	34	25.6	25.4	36.4	27.9.0	27.3
Expenditure/GDP (%)	51.4	76.3	91.4	66.7	58.5	57.3	53.3	53.7	49.3
Fiscal Deficit/GDP (%)*									
-Excluding Grants	-11.4	-47.4	-62.1	-51.5	-52.5	-42.5	-17.4	-25.8	-22.0
-Including Grants	-5.6	-38.0	-53.9	-32.1	-34.8	-30.2	2.5	-8.2	-11.7
Domestic Bank Financing/GDP (%)	4.0	33.5	44.5	23.9	18.8	20.2	12.4	15.0	15.6
Defence Expenditure/GDP	12.7	35.0	37.2	35.8	24.2	24	25	22	18
Broad Money Change (%)	30.6	18.2	40.9	13.0	26.4	18.5	15.1	21.4	
Exports/GDP (%)	7.7	3.8	2.7	5.7	2.8	8.0	4.7	9.4	
Imports/GDP (%)	85.3	70.2	67.4	72.8	75.3	82.4	77.5	62.7	
Ext. Current Account Balance/GDP (%):									
-Excluding Grants	-5.4	-31.5	-38.4	-32	-35.4	-27.8	-36.5	-33.9	
-Including Grants	2.1	-23.6	-27.9	-16.2	-18.4	-15.4	-15.3	-9.9	
Gross Reserves (months of Imports)	5.0	1.4	1.1	0.9	1.1	0.7	0.4	0.36	
External Debt/GDP (%)	11.0	18.8	37.5	54.1	76.6	78.6	105.2	99.4	
External Debt Service/Exports (%)	0.3	0.8	5.7	6.2	7.6	15.1	29.7	30.3	
Public Domestic Debt									
Million Nakfa	1517.2	3220.7	5786.1	7805.6	9317.9	11127.5	12454.5	13321.7	15,674
% of GDP	30.5	58.2	96.7	128	108	116	111	105	106
Exchange Rate (Nakfa per US Dollar)**	7.2	7.4	8.2	9.6	10.9	14.0	13.9	15.0	

Source: ADB, WB, IMF, Eritrea Government