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WAR-TORN ERITREAN ECONOMY – SOME ISSUES AND TRENDS

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Abstract: *The three decades of armed struggle, the subsequent drought, and deliberate policies of neglect and mismanagement by the last two regimes in Eritrea made growth of the Eritrean economy practically impossible. After independence, the country achieved a steady growth for some years. However, due to the border conflict with Ethiopia, the economy was characterised by severe macroeconomic imbalances and unusually high level of public expenditure. Poverty and inflation also increased many folds. Both domestic and external public debts reached unsustainable levels. Thus, an attempt is made in this paper to delve into some important trends of the Eritrean economy before and after 1998. The paper highlights some of the key economic issues like education, health, infrastructure, unemployment, poverty etc., and provides some concluding remarks.*

The three decades of armed struggle for independence, drought and deliberate policies of neglect and mismanagement by the last two regimes made the growth of the Eritrean economy practically impossible. Eritrea is one of the youngest nations, which assumed its independence from Ethiopia in 1991 following a debilitating war that lasted over 30 years. The country, with a total area of 124,432 square km is located in North East Africa. It is bordered in the North and West by Sudan, in the South by Ethiopia and Djibouti, and in the East by the Red Sea. It has a coastline of almost 1,000 km that runs along the Red Sea. The estimated population of Eritrea is about 4.3 million people. The population growth per annum is estimated to be 2.9 per cent. It has nine ethnic groups and six administrative provinces/regions (Rena, 2005^a).

The Eritrean Peoples Liberation Front (EPLF) helped Eritrea achieve its independence in 1991. However, the young country inherited a barren agricultural land with unpredictable agricultural production, out-of-date productive enterprises with limited production capacity, limited markets, and obsolete institutions and weak instruments for managing its economy. The new Government pursued prudent economic policies and investments that promoted rapid and equitable economic growth (World Bank, 2001; Rena, 2006). Meanwhile, the Tigray Peoples Liberation Front (TPLF) assumed power in Ethiopia in 1991. Eritrea and Ethiopia enjoyed good relations between 1991 and 1998. A number of friendship and co-operation agreements were reached between the two countries. With the aim of developing the economies and societies of both the nations, an agreement was also reached to gradually eliminate all trade barriers and harmonise economic policies. The agreement also included the free movement of goods for local consumption across the countries. It was also agreed that Eritrea would

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use Birr, the unit of currency in Ethiopia, until it issued its own currency. Ethiopia was also allowed to use Assab and Massawa as free ports. Thus, it becomes essential in this prism to analyse the events that eventually led to a border conflict between Ethiopia and Eritrea. Actually, both the governments had never thought that a full scale war would erupt as a consequence of complaints from people living in the border areas. The sudden eruption of the war between Eritrea and Ethiopia was described by one observer as "two bold men fighting over a comb" (The Economist, 1998: 48). In the period between 1994 and 2001, both the countries showed an improvement in terms of the key economic and social indicators illustrated in tables 1 and 2.

Table 1
Human Development Index (HDI) Value

	1994	1995	1997	1998	1999	2000	2001
Eritrea	0.269	0.275	0.346	0.408	0.416	0.421	0.446
Ethiopia	0.244	0.252	0.298	0.309	0.321	0.327	0.359
ADC	0.576	0.586	0.637	0.642	0.647	0.654	0.655
LDC	0.336	0.344	0.430	0.435	0.442	0.445	0.448
SSA	0.380	na	0.463	0.464	0.467	0.471	0.468

Source: UNDP, Human Development Report 1997-2003.

* ADC, LDC and SSA are abbreviations for All Developing Countries, Least Developed Countries and Sub-Saharan Africa. na stands for data not available.

Table 2
Human Development Index (HDI) Rank

	1994	1995	1997	1998	1999	2000	2001
Eritrea	168	168	167	159	148	157	155
Ethiopia	170	169	172	171	158	168	169
TNC	175	174	174	174	162	173	175

Source: UNDP, Human Development Report 1997-2003.

* TNC is an abbreviation for Total Number of Countries.

Ethiopia and Eritrea are two of the poorest countries in the world. The above tables demonstrate that Eritrea was in a better off position, both economically and socially. The Human Development Index (HDI) indicates Eritrea's achievements in the dimension of human development.

Building a Nation

Post independence, peace prevailed in Eritrea. Despite huge damages suffered during the independence struggle, the country managed to achieve good results in rehabilitating the economy that grew at a rate of about seven to eight per cent per annum. The Government of the State of Eritrea (GSE) embarked upon an ambitious programme of economic liberalisation and democratisation marked by the articulation of a macroeconomic policy framework (1994) and the drafting and ratification of a new constitution in 1997. Between 1993 and 1998, the Eritrean Government focused on building a war-ravaged economy and social infrastructure, on ensuring the demobilisation of ex-fighters, and return of refugees from neighbouring countries. A significant progress was made in all these areas (GSE, 1994). The Government's investment, trade, fiscal and monetary policies were further articulated in 1997, and a

transition to a market economy was initiated. Nafka, was introduced as the national currency on November 8, 1998 to replace the Ethiopian Birr as the legal tender.

However, the two-year border war broke that out with Ethiopia on May 6, 1998, not only reversed the progress achieved, but also resulted in a humanitarian crisis (Rena, 2006). The growth of the Gross Domestic Product (GDP) fell to zero in 1999 and to -12.1 per cent in 2000 (Yamauchi, 2004). The May 2000 Ethiopian offensive into northern Eritrea damaged property worth 600 million dollars, including livestock worth 225 million dollars. Nearly 55,000 houses also suffered damages. The attack prevented planting of crops in Eritrea's most productive zobas (Gash Barka and Debub regions), causing food production to drop by 62 per cent.

On December 12, 2000, the war ended under the aegis of the United Nations (UN). After the Algiers Peace Agreement was signed in December 2000, the UN Mission for Ethiopia and Eritrea (UNMEE), deployed, and a 25-km temporary security zone established along the 1,000-km border between the two nations, the Border Commission delivered its verdict on April 13, 2002. Since then Eritrea has been focusing on many post-war recovery programmes. These include the reconstruction of the the damaged social and economic infrastructure in the war affected regions; besides assisting the remaining 70,000 internally displaced persons (IDPs) to return to their homes and restoring their means of livelihoods. Also, 1,80,000 refugees from Sudan, Djibouti and Yemen and 75,000 expellees from Ethiopia had to be rehabilitated; and 200,000 extra soldiers, recruited during the conflict, demobilised and helped integrate into civilian life. A National Mine Action Programme had to be implemented to reduce nearly 225,000 land mines and three million unexploded ordinances registered in the war-affected regions (World Bank, 2001). However, even during the war with Ethiopia, Eritrea managed to develop its transportation infrastructure. It asphalted new roads, improved its ports, and repaired the war damaged roads and bridges. Eritrea's economic future at this juncture depends upon its ability to master social problems such as illiteracy, unemployment, and low skills, and to open its economy to private enterprise so that the diaspora's money and expertise can foster economic growth.

Besides interrupting the process of economic recovery, the crisis delayed development and adoption of a long-term poverty reduction strategy. Today, Eritrea remains one of the poorest countries, with a per capita Gross Domestic Product (GDP) of 160 dollars in 1992, that subsequently increased to 786 in 2005 (ADB, 2003; Rena, 2005^a). The late 1990s and the post-border war period was an era of economic crisis. Even a review of the Eritrean economy, published by the International Monetary Fund (IMF) in 2005, has termed the post-border war period as an era of economic crisis. The last few years have particularly been difficult for Eritrea as a long-lasting drought (when did the drought occur) left its impact on agriculture. Moreover, regional isolation damaged trade. The economic performance of Eritrea indicates that the country is far from stepping out of the economic crisis. The economic detraction of the last eight years has been even greater than previously assumed. According to the newest IMF statistics on Eritrea, the economic downturn started in 1998. While the country had experienced solid growth in the preceding years, the real GDP growth in 1998 shrunk to 1.8 per cent, well below the population growth. In 1999, there was zero growth. The IMF mainly explains this economic crisis due to the border war with Ethiopia, which

severely damaged the country's economic and social infrastructure and displaced over one-third of the population. The revised IMF data shows that when the Ethiopian-Eritrean border war was at its peak, the economy detracted by 13.1 per cent in 2000. The GDP growth stood at 9.2 per cent in 2001, but this was a short lived recovery, since it reduced to 0.7 per cent in 2002. The GDP grew at the rate of 3.0 per cent in 2003. All the estimates presented by the IMF's newest analysis are significantly lower than the previous data published by the Fund (IMF, 2005).

Even though independent estimates on Eritrea's economic performance in 2004 cite a positive GDP growth of 2.0 per cent, the IMF made no estimates on the developments in 2004. The annual population growth was estimated at 2.6 per cent, which means that Eritrea had a negative GDP per capita growth rate in 2004. The post-border war recovery was impaired by four consecutive years of drought. Domestic food production for 2004 was likely to cover only 17 per cent of domestic demand, resulting in an estimated 1.7 million people - almost half the population - requiring assistance for food. Malnutrition increased in many parts of the country, but there were encouraging signs in 2004-2005 and 2005-2006 that the drought may be over (IMF, 2005; World Bank, 2005).

The Eritrean Government after the war formulated a transitional development strategy. It established its priorities after taking the enormous damage caused by the war into account. However, since the end of the war, the internal situation in Eritrea has not evolved as positively as expected initially, particularly after September 2001 (Rena, 2006). Thus, an attempt has been made in this paper to discuss the economy of Eritrea after the border conflict. This paper is purely dependent upon secondary sources of data collected from the documents of the Eritrea government, IMF reports, World Bank Reports, and selected articles and books on Eritrea. The paper has been organised into five sections. The second part discusses the current economic situation which also includes poverty and unemployment. Section three deals with different aspects such as: education, health, and infrastructure in the post-war period. Section four delves on the issue of economic integration with neighbours and the final section provides concluding remarks of the paper.

Current Economic Situation

The Eritrean economy is currently characterised by severe macroeconomic imbalances, epitomised by unusually high level of public expenditures due to the impact of the war and the need to regain the growth momentum of the economy. The Government expenditure accounted for 97.7 per cent of the GDP in 1999. In 2000 it accounted for 101.4 per cent of the GDP, while in 2001 and 2002, it was reduced to 77.2 per cent and 85.9 per cent respectively. The public expenditure in 2003 was expected to be approximately 70.8 per cent of the GDP. The budget deficit (including grants) was correspondingly high, reaching 52.2, 43.4 and 38.1 per cent in 1999, 2000 and 2001 respectively. In 2002, the budget deficit was 29.0 per cent of the GDP, and, in 2003, it was expected to be approximately 25.0 per cent (Yamauchi, 2004: 7-11). The Eritrean government aims to reduce public expenditure through a drastic reduction in defence expenditures, which depends upon the successful demobilisation of soldiers. The inflation also shot up many folds during the last five years, with consumer prices rising consistently. The country faces a critical situation with widespread hunger prevailing

amongst the population. Therefore, the Government was reluctantly obliged to introduce special economic emergency measures with the result it almost froze economic liberalisation. At the end of 2005, the National Assembly approved an austerity budget for 2006, which had not been made public since 1991.

Both domestic and external public debt reached unsustainable levels during the five years following the outbreak of the war. Uncertainty about data and lack of updated information, such as the absence of a public budget, characterised the Eritrean economy. This also makes it extremely difficult to assess the sustainability of aid-financed investment projects and programmes. Besides, the gap between the public and the private sector has been developing. The governing single political party, the Peoples Front for Democracy and Justice (PFDJ), remains an active economic actor with quasi monopoly in many sectors, e.g. large scale public works, transport, tourism and hotels etc.

Poverty: As a result of six years of economic crisis, poverty in Eritrea remains pervasive, defence spending large and fiscal deficit stood at unsustainable levels. The border conflict with Ethiopia and successive droughts have weakened the socio-economic life, and increased the vulnerability of the population. Eritrea remains one of the poorest countries in the world, with a per capita GDP of about 130 dollars. It is to be noted that more than half of the population lives on less than 1 dollar a day and about one third lives in extreme poverty - meaning that they have access to less than 2,000 calories per day. Structural factors have also affected Eritrea's capacity to respond to crisis. The Government of Eritrea carried out qualitative and quantitative poverty assessments in 2003. A Poverty Reduction Strategy Programme prepared in mid-2004 indicated that overall poverty incidence stood at 66.4 per cent (GSE, 2004).

The IMF report (2005) highlighted "the adverse impact of the widespread use of administrative controls, the expanding role of the State into commercial activities, and the lack of a transparent regulatory environment, which undermine investor confidence and private sector development." The Fund urged Asmara authorities to "return to their post-independence liberalisation strategy as a basis for sustainable growth and poverty reduction."

Unemployment: Perhaps, the most charged economic challenge for the Eritrean Government is the prevailing unemployment. Many people work in the national service for low payments ranging from Nfa 150 to 450. The official rate of unemployment which prevails at 10 per cent is acknowledged as unrealistically low. There is considerable underemployment in farming, defence, and the service sector etc. The unemployment appeared particularly after about 100,000 deportees from Ethiopia and 50,000 refugees from Sudan settled in the urban areas particularly in Asmara and its vicinity (Rena, 2005a). Continuously high unemployment can undermine the social, economic and political support for reforms. Immigration can harm a native's job opportunities. Once Eritrea attains peace and stability, Eritreans should be welcomed in the European Union, America, Canada, Australia and the regions where population is declining.

The agriculture sector accounts for 75 per cent of all jobs, but only 16 per cent of the GDP. If the work force was reduced to match the sector's contribution to the economy, at least 40-45 per cent jobs would have to be found elsewhere. The authorities have produced an Interim Poverty Reduction Strategy Paper and a National Food Security Strategy, which together set out plans aimed at increasing rural incomes and raising productivity in the country (Rena, 2006).

Education and Health: Since independence, there has been significant progress in human resource development in Eritrea, particularly in the education sector. Schools and colleges have been built and the number of students enrolled has increased substantially. There has been a marked improvement in female enrolment, which is now approaching 45 per cent of the total students enrolled. This is a significant step, especially since numerous social and cultural factors inhibited female participation in education. In order to build on the progress made in the first decade of independence, the Government declared that it plans to increase the share of public expenditure towards the social sector. The Government recognises the financial and institutional capacity problems. The demand for elementary and secondary education is high, and continues to grow steadily. The rate of illiteracy is high, standing at nearly 70 per cent of the population (Rena, 2006:18-21). The shortage of skilled human resources poises a key challenge to the country's development. The comparison of expenditure on education as per cent of the GDP shows that expenditures in Eritrea are close to the average for sub-Saharan Africa. As a percentage of the total Government spending, educational expenditures ranged from 8.8 per cent in 1997 to approximately 6.5 per cent in 2002, with an average of 7.4 per cent during the period 1997-2002. Most developing countries spend about 15 per cent of their total expenditure on education. In 2003, the Government launched a 200 million dollar five-year Integrated Education Development Programme that would increase access to quality education for Eritreans (World Bank, 2003). In line with this, the Eritrea Institute of Technology was established in February 2004. This institute has four colleges inside the campus, and four more colleges are being set up in different parts of the country. They offer education in various disciplines such as science, technology arts and social sciences.

Besides education, the Government plans to improve health services. Eritrea's health indicators also level with sub-Saharan averages. It plans to tackle factors that help reduce the spread of diseases. These include improving health services for rural and nomadic populations, tackling the shortage of physicians and health care professionals, besides improving sanitation facilities. The Government has also built clinics, health centres and hospitals in various zobas and sub-zobas of the country. In 2006, Referral Hospitals were opened at Mendefera (Zoba Debub), Ghinda (Zoba Northern Red Sea), Berentu (Zoba Gash Barka) and Assab (Zoba Southern Red Sea). The focus will now be towards strengthening the manpower and the equipment to make these facilities effective in delivering adequate health services. Since early 2004, Orrotta Medical School has been offering various diploma and degrees in medical sciences (Rena, 2006: 19-22).

Significant progress has also been made in rehabilitating Internally Displaced People as a result of a border war with Ethiopia, demobilised soldiers, refugees mainly from Sudan, and war orphans. For the first time in independent Eritrea, a public sector

pension scheme was launched in 2004. The major drought that occurred in 2003 had a significant impact on production of food and availability of water. The drought led to malnutrition, water borne diseases and even displaced the population.

It is reported that under-nourishment stands above 50 per cent, life expectancy is 55 years, the under-five mortality rate is 75 per 1,000 children and maternal mortality is 1,000 per 100,000 live births. HIV/AIDs stands at 2.7 per cent, and the problem is not so severe in Eritrea as in other African countries. A new National Nutrition Surveillance System was developed in 2003. It yields precise and timely information on malnutrition and other health related issues in Eritrea. Humanitarian and food crises are becoming structural components of Eritrea's economic social life. Conjectural and structural causes, such as progressive impoverishment as a result of the war, drought and famine conditions, lack of manpower and productive assets in rural areas, inappropriate domestic policies, shaky economic situation and closure of the borders have virtually eliminated regional trade,. The Government has not succeeded in tackling these problems. However, despite these problems the Government has been making efforts to accomplish food security. In line with this it has desisted the operations of International Non-Governmental Organisations like World Food Programme, and changed its policy from "not food for work programme to cash for work programme." However, there is still a serious lack of coordination within the UN system which has created confusion among donors. In reality, neither the Government nor the donors have the information necessary to calculate the needs of the people.

Infrastructure Development: Infrastructure renovation and development involve construction of highways and small roads, airports, bus stations, bridges, dams, ports, hospitals, schools, and playgrounds in educational institutions. This also involves the setting up of telephone and electrical lines, railway tracks, electrical power generating plants, transmission structures, and rural electrification, communication and transport services. The housing sector has seen progress in the country. A number of infrastructure projects have been completed, and the remaining are underway. Work is in progress, particularly in roads like Massawa – Assab and Sheib-Gahtalay. The 29 km Dekemhare-Teraimni road, 66 km Serejeka-Shebah, and 17 km Balwa-Kercha-Iratahtay road projects have been developed. The Eritrean Railway is yet another example in this direction. Besides, power, there has been a modest improvement in water supply, and initial progress has been made in telecommunications (Rena, 2006: 12-14).

Economic Integration

The Eritrean Cabinet in its October 2005 meeting underlined that there was a need to focus on trade and investment partnerships rather than look towards external assistance. Thus, the Government has been taking measures to promote economic integration in the region. This include incentives and facilities to promote border trade between Eritrea and its neighbours, reduction of tariffs for goods from the rest of Sub-Saharan Africa and the removal of restrictions on investment.

Indeed, Eritrea benefited largely from Cotonou and African Growth and Opportunity Act (AGOA), besides agreements with the European Union and the United States. However, since the past four years overall trade with the European Union has decreased

considerably. As part of the Eastern and Southern African group of 16 countries, Eritrea opened negotiations on Economic Partnership Agreement to strengthen regional integration and tackle trade barriers. However, despite the critical economic situation, Eritrea remains free of corruption, and civil servants have shown a high level of dedication and commitment (Rena, 2005^b).

Eritrea' relations with its neighbours are ambivalent. Relations with Sudan, especially with southern Sudan have been improving. A seminar at Asmara in June 2006 is a testimony towards building the relationship again after two years. The Eritrean President Isaias visited Yemen and arrived at several bilateral agreements with that country in early 2006. The president of Yemen Abdualla Saleh visited Eritrea in mid 2006. Relations with Djibouti have improved and several cooperation agreements were signed in the recent past. Relations with Libya remain positive. Eritrea is member of the Common Market for East and South Africa (COMESA), and benefits from the Regional Indicative Programme. Eritrea has not joined the COMESA Free Trade

Due to the emerging border conflict with Ethiopia, there was a near collapse of exports between 1997 and 1998. The exports suffered another setback after trade relations broke with Sudan. However, imports rose during this time by 14 per cent on account of food aid. This has led to a shrinking economy and a collapse in foreign reserves. In 2004, it is estimated that the purchasing power parity stood at 4.154 billion dollars and the GDP grew at the rate of 2.5 per cent. The reserves of foreign exchange and gold stood at 30.87 million dollars, exports stood at 64.44 million dollars and current account balance at 144.9 million dollars. (World Bank, 2005; Rena, 2005^b).

Conclusion

Until the outbreak of hostilities with Ethiopia in May 1998, Eritrea had been making a steady progress in reviving its economy that was devastated after 30 years struggle for independence. After independence, Eritrea laid down policy foundations for a liberal market economy. By reducing protectionism and controls, the Government tried to build an economy led by the private sector. The country also established good relations with its neighbours in a bid to promote trade. All these measures helped Eritrea improve its economy. Eritrea is in a state of transition from post conflict reconstruction towards sustainable long-term development. The Government has focused its efforts towards reducing poverty. Eritrea is striving hard to achieve the objectives of self-reliance and food security. It values trade more than aid. Although, the Government has been making efforts in different domains of development, the economy is moving at a slow pace. The border dispute has become a stalemate. The border conflict with Ethiopia not only interrupted the progress but also caused serious disruptions. The aftermath of the war also resulted in labour shortages due to mobilisation of conscripted soldiers. The war also led to high military spending, a halt in bilateral trade, scarcity of hard currency, rising inflation, decline in private investment (both domestic and foreign), fall in the growth rate of real GDP, increase in domestic and external public debt, and unfavourable overall fiscal balance.

Though Eritrea and Ethiopia signed a comprehensive peace agreement, the process of border demarcation had not begun till the end of December 2006. The Ethiopian Government rejected parts of the Eritrea Ethiopia Border Commission (EEBC) ruling

saying these were wrong and unjust. Ethiopia has said that the stalled peace deal with Eritrea will not move ahead until Eritrea agrees to pave way for talks. On its part, the Eritrean Government says the decision is legal, formal and binding, and there is no need for discussion and negotiations. According to Eritrea, a prompt implementation of the EEBC ruling is the only mechanism to resolve the crisis. Yet, no steps have been taken even after four and half years of the Border Commission ruling. The escalating tensions have become major impediments for the development of the Eritrean economy. Nevertheless, Eritrea should exploit its unique geographic inheritance and geo-strategic location, since it is situated at the crossroads of Europe, Middle East, the Persian Gulf, and Asia. The committed and hardworking Eritreans are now struggling towards achieving economic independence.

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