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ERITREA'S ECONOMY

Ideology and Opportunity

Seth Kaplan



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EXECUTIVE SUMMARY

Eritrea is often in the news for all the wrong reasons: its high rates of migration to Europe (it has sent more refugees to Europe in recent years than any other African nation), its conflicts with neighboring Ethiopia and Djibouti, and controversy over its mandatory and indefinite national service conscription program. Human rights activists, in particular, have long singled out the country for criticism, calling it “the North Korea of Africa.” The inappropriateness of that comparison is increasingly recognized—but misunderstandings about the nature of the Eritrean regime continue to abound.

A substantive comparative analysis of Eritrea and other socialist nations will dispel many of the myths of Eritrean “exceptionalism,” in the worst sense of the word. For all its idiosyncrasies—and it is a unique country in many ways—Eritrea today looks a great deal like pre-reform China, Vietnam during the 1980s, and the pre-1989 communist countries of Eastern Europe. If Eritrea’s political and socioeconomic model resembles any existing today, it is that of Cuba, not North Korea.

Like Cuba, Eritrea is not, and does not desire to become, a democracy. The experience of the three-decade liberation struggle has led the country instead to embrace a highly egalitarian, statist model. Like any other system, this model involves trade-offs: It reduces extreme poverty and promotes national unity, but greatly limits civil liberties, international engagement, and economic growth prospects. As a result of this system of government, Eritrea shows no signs of the violent ethnic conflict that has battered other countries in the Horn of Africa (such as South Sudan, Somalia, and Ethiopia). Nor has jihadism found a foothold in the country. Nonetheless, Eritreans have suffered greatly from human rights abuses and the lack of economic opportunity. These factors are driving many young people to leave the country or to express hopelessness about the future.

Given this context, international attempts to improve the living conditions of Eritreans are more likely to succeed if they are conducted in the same way as

they are in Cuba: through engagement that starts with where the country is now, not where outside actors think it ought to be.¹ The purpose of this report, therefore, is to explore a pragmatic way forward for the Eritrean economy given the leadership’s current worldview.

At present, Eritrea’s most urgent economic priorities include boosting state revenue and increasing employment.² The latter is essential if Asmara is to continue updating its national service program. National service plays a major role in building social cohesion and throughout the period of “no peace,

no war” has effectively replaced a large chunk of the labor market (many of Eritrea’s civil servants, teachers, waiters, and construction workers, as well as soldiers, are national service conscripts). However, national service is also the font of international criticism of the country and the primary driver of migration. The Eritrean government has recognized the need to normalize the national service program by raising salaries and setting a finite term of service, but has dragged its feet on implementing these reforms³ over concerns about social stability and maintaining the country’s independence. (Reducing the term of service to eighteen months would release tens of thousands of youth into the labor market with few options for employment—a

recipe for social unrest.) Given these concerns, the sequencing of economic restructuring will be crucial but should also be conducted in a way that satisfies the population’s expectations, which have changed significantly in one generation.⁴

... [I]nternational attempts to improve the living conditions of Eritreans are more likely to succeed ... through engagement that starts with where the country is now, not where outside actors think it ought to be.

1 This report is based on a combination of desk research and a visit to the country in March 2016.

2 African Development Bank Group (AfDB), “Eritrea - Interim Country Strategy Paper (I-CSP) 2014-2016” (Abidjan, Côte d’Ivoire: AfDB, East Africa Regional Centre, September 2014); author interviews in Asmara, March 2016.

3 Senior Eritrean government officials also tend to dislike the use of the term “reform,” and prefer the phrase “evolution” or “development,” which they consider less pejorative. Author interviews in Asmara, March 2016.

4 Richard Reid, “The Politics of Silence: Interpreting Stasis in Contemporary Eritrea,” *Review of African Political Economy* 36 (2009): 210.

Eritrea can learn much from the successful reform processes undertaken by countries with similar ideologies—such as Rwanda and China—and this report will include those comparative analyses. Eritrea, in many ways, is further along in its economic evolution than Cuba is today, and bears some resemblance to China early in its reform era (late 1980s to early 1990s) as well as Hungary in the 1970s and 1980s. These countries all sought to open up in ways that promoted social cohesion, self-reliance, and national strength; all prioritized nation-building and saw economic inclusiveness as essential to the process;

and all sought local solutions and models to guide their decision-making processes and policies. In the face of myriad challenges, they all recognized the need for pragmatism and all asserted that the Western way was not the only way.⁵ To move forward, Eritrea would do well to study the strategies undertaken by those states.

5 John McKay, "The Asian 'Miracle' after the Global Financial Crisis: Some Lessons for Africa," Brenthurst Foundation Discussion Paper 2010/07, December 2010.

INTRODUCTION

Eritrea's socioeconomic model is an outgrowth of its thirty-year guerrilla-style war to achieve independence from Ethiopia, which shaped the thinking of President Isaias Afwerki and his advisers. Eritrea's independence was a victory against seemingly impossible odds, and it was achieved without any meaningful outside assistance. The birth of the Eritrean state resulted entirely from the tenacity, resilience, and keen organizational skills of the Eritrean People's Liberation Front (EPLF), which continues to run the country today as the People's Front for Democracy and Justice (PFDJ). Individual fighters, who still predominate at the two highest levels of government,⁶ were intensely loyal to the cause and driven by a strong 1960s-70s-style leftist ideology.⁷

Although officially dropped in the late 1980s, Marxism had a significant influence on the EPLF in its early years (late 1970s), when it identified itself as part of the "socialist camp" and viewed the Soviet Union as a "strategic ally."⁸ The ideology provided a focused political vision that helped mobilize and unite the country in its rebellion against the Ethiopian Derg regime while offering crucial lessons in organization; this contributed to the success of the EPLF as a movement. Social engineering—such as the emancipation of women, the provision of a basic education that instilled revolutionary ideology, the deliberate subordination of ethnic identities, and the banning of non-indigenous religious ideologies—was crucial to the EPLF's ability to win support and mobilize the full resources of the

Eritrean people, without which it could not have won the war.

Although Marxism was eventually abandoned in favor of a revolutionary leftist nationalism,⁹ some of the key values held by the PFDJ today certainly echo the Marxist ideology that spurred the EPLF movement early on (and which continues to strongly inform countries such as Cuba).¹⁰ In a 1992 book on the retreat of Marxism in Africa, Christopher Clapham speculates: "Eritrea may yet emerge as the one remaining bastion of Leninism in the region, even if the ideology is not explicitly adhered to, for reasons of external acceptability."¹¹

The birth of the Eritrean state resulted entirely from the tenacity, resilience, and keen organizational skills of the Eritrean People's Liberation Front (EPLF). . .

After independence, the EPLF was confronted with the task of building an Eritrean state from scratch with limited resources. The movement enjoyed a brief honeymoon period after the independence referendum in 1993, during which Eritrea was lionized internationally and received some significant development support from abroad. But Eritrea's development was interrupted by the 1998-2000 border war with Ethiopia over the flashpoint town of Badme, the introduction of a separate currency, and other

disagreements. That war ended when both Eritrea and Ethiopia agreed to arbitration of the dispute by an international boundary commission. However, when the commission awarded Badme and other parts of the border to Eritrea, the unwillingness of Western governments to enforce the arbitration decision caused relations with the West to deteriorate significantly. The Eritrean government's failure to enact its democratic constitution and a harsh crackdown on political dissent in 2001 further alienated Western

6 Each of the country's seventeen ministries has a minister and roughly six deputy generals. Combined, the top two levels of government (not including advisers and party officials, who may be more important at times) total roughly 119 people, all of whom are former liberation fighters, or "tegedelti." Author interviews in Asmara, March 2016.

7 Dan Connell, "Inside the EPLF The Origins of the 'People's Party' & its Role in the Liberation of Eritrea," *Eritrea Real Clear Politics's Weblog*, April 5, 2009, <https://eritrearealclearpolitics.wordpress.com/2009/04/05/inside-the-eplf-the-origins-of-the-%E2%80%98people%E2%80%99s-party%E2%80%99-its-role-in-the-liberation-of-eritrea/>; Dan Connell, "Eritrean Rebels Prepare For Life After War - and After Marxism," *Christian Science Monitor*, November 15, 1990, <http://www.csmonitor.com/1990/1115/overit.html>.

8 Connell, "Eritrean Rebels Prepare For Life After War - and After Marxism."

9 David O'Kane and Tricia Hepner, *Biopolitics, Militarism, and Development: Eritrea in the Twenty-First Century* (New York: Berghahn Books, 2009), xx.

10 The EPLF had rigid policies favoring state domination of economic and political life enshrined in its official policy documents as late as 1987. In 1990, Haile Woldensai, who was the co-chair of the EPLF's Department of National Guidance, admitted "We were carried off by the revolutionary and leftist upheavals that were the order of the day in the 1960s." Connell, "Eritrean Rebels Prepare For Life After War—and After Marxism."

11 Christopher Clapham, "The Socialist Experience in Ethiopia and its Demise," in *Marxism's Retreat from Africa*, ed. Arnold Hughes (New York: Routledge, 2015), 118.



Fresh vegetables for sale at a market in Keren, Eritrea. *Photo credit: David Stanley/Flickr.*

governments. Washington's strong tilt toward Ethiopia in the years since (due to its much larger size and importance to regional security) soured the Eritrean leadership's outlook toward international actors.¹² This view partly reflects the fact that Eritreans already felt betrayed by the international community after a number of events in their short history: The territory was forced by the United Nations (UN) and United States to become part of a federation with Ethiopia in the early 1950s, and when Ethiopia unilaterally abrogated the federal arrangement and annexed Eritrea in 1962, no international organization, not the UN, the United States, the Organization of African Unity, or any other, protested.¹³

In the years following independence, Eritrea has repeatedly been threatened by its larger neighbor Ethiopia, a country with which it is in a state of "no peace, no war" and that has roughly thirty times its population (similar to the United States as compared to Cuba).¹⁴ These threats may seem empty from afar but are certainly not felt as such in Asmara, where it is understood that even the slightest miscalculation could have catastrophic effects. During the 1998–2000 conflict, Ethiopia penetrated deep into Eritrean territory, occupying about a quarter of the country's land, displacing 650,000 people,¹⁵ and killing tens of thousands of soldiers and civilians.¹⁶ The psychological shock of these physical and diplomatic losses is still viscerally felt—not only by the government, but also by large segments of the population.

12 International Crisis Group (ICG), "Eritrea: The Siege State," Africa Report No. 163, September 21, 2010, 21.

13 "Eritrea and the Right to Self-Determination," *Review of African Political Economy* 25 (1982): 39–52. The article is an extract from the "Report of the Permanent Peoples' Tribunal of the International League for the Rights to Liberation of Peoples," Milan, October 3, 1980.

14 Estimates of Eritrea's population vary widely. The Eritrean government most frequently cites a population of 3.5 million, but independent sources suggest the number is less.

15 "Eritrean, Ethiopian Exchange of POWs Begins," CNN, December 23, 2000.

16 See, for instance, BBC, "Eritrea Reveals Human Cost of War," June 20, 2001, <http://news.bbc.co.uk/2/hi/africa/1398446.stm>.

ERITREA'S VISION

These experiences taught the country's leadership that its future depends on the following:

- *Strengthening self-reliance.* No outside actor has proven itself dependable, and many have shown that they are, in fact, unreliable partners. It is crucial that the country is as self-reliant as possible and dependent on no one. Eritrea's universal military service is an essential facet of this self-reliance doctrine.
- *Sacrificing the needs of the individual for the group and promoting social cohesion.* An enormous amount of sacrifice for the sake of the country was essential to achieving and maintaining independence, especially given the ongoing threat from Ethiopia. Constructing a strong nation-state depends on sharing the burden and promoting social justice. Only by leveraging everyone in close cooperation can great things be accomplished. Economic development should occur in a way that advances the state and society, not the reverse; individual enrichment and entrepreneurship should be viewed warily because they undermine social cohesion.
- *Maintaining strong leadership.* Unity is essential to overcoming great challenges, and therefore following a common position, as decided by the head of the state, is essential.
- *Encouraging resilience.* Backing down from difficulties is unacceptable; instead, efforts should be doubled to achieve one's goals.
- *Seeking local solutions.* Eritrea's problems are best solved by its leaders, who led the country to independence despite steep odds, and who know its conditions best; experiences from abroad have only limited applicability.

The PFDJ is similar to other leftist revolutionary movements that emerged victorious from war—most notably the Chinese Communist Party and the Communist Party of Vietnam, but also to some extent the Tigrayan People's Liberation Front of Ethiopia and the Rwandan Patriotic Front (both of which also had early Marxist leanings). All of these movements have evolved significantly from their ideological roots, but even as the emphasis has shifted to building up their states and developing their economies, they have preserved key elements of Marxist thought. Consequently, they have diverged somewhat from the

path promoted by Western development agencies and the international community in general. This has not been disastrous: they are all, with the exception of Cuba (see box 1), more successful economically than their peers. That success is partially rooted in the strong organizational capacity and unity brought by war, but it is also due to the maintenance of many of Marxism's core ideas.

Box 1: Cuba's Socioeconomic Model

Cuba has followed a distinctive socioeconomic model since its revolution in 1959. Adhering to the example of the Soviet Union and other communist countries, it adopted a centrally planned, highly egalitarian economic system that privileges state enterprises and limits opportunities for private business. Investment is restricted and must be approved by the government. The country has consistently been ranked as one of the world's least economically free states.¹⁷ Shortages of capital and weak growth have consistently plagued the country, making it dependent on outside financial assistance (from the Soviet Union until 1991 and from Venezuela more recently).

Meanwhile, the Cuban government has put strong emphasis on social development, investing heavily in education, health care, and poverty reduction. This has given the country a very low level of extreme poverty and relatively high level of human development. It ranked, for instance, 67 out of 188 countries on the 2014 Human Development Index, a composite statistic of life expectancy, education, and income per capita indicators.¹⁸

As in Eritrea, emigration has often been used by the government as a political safety valve (in Eritrea, the government increasingly recognizes that emigration hurts the economy and capacity of institutions). Youth that disagree with the government's policies or crave greater economic opportunity are effectively permitted to flee by boat or other means to the United States, which offers political asylum to any Cuban who reaches its territory. (Until recently, many European states have similarly offered automatic asylum to Eritreans.) Over one million Cubans have emigrated to the United States over the years.¹⁹

17 The Heritage Foundation, "Index of Economic Freedom," published annually since 1995, <http://www.heritage.org/index/>.

18 United Nations Development Programme, "Human Development Index," <http://hdr.undp.org/en/composite/HDI>.

19 This figure includes those that came before the revolution, i.e., all foreign-born Cubans in the United States. See Sylvia Rusin, Jie Zong, and Jeanne Batalova, "Cuban Immigrants in the United States," Migration Policy Institute, April 7, 2015, <http://www.migrationpolicy.org/article/cuban-immigrants-united-states>.

THE LIMITS OF IDEOLOGY

Eritrea does not recognize its kinship to any of these regimes. Revolutionary principles are so deeply embedded in how the leadership thinks²⁰—infusing everything from the national narrative to particular decisions by policy makers—that few explicitly articulate them as “core principles” in a comprehensive fashion or acknowledge their ideological roots. In contrast, details of Eritrea’s independence struggle are cited over and over again. However, understanding these core values and how they influence the Eritrean leadership’s way of thinking is essential for anyone who seeks to recognize the logic behind the choices the country has made—or to formulate a creative set of policy proposals for how it might move forward.

Of course, not every choice the Eritrean government makes is consistent. Some policies are mere reactions to difficult challenges, or the product of inexperience and the limited capacity of many institutions. Eritrea’s population is small (probably around 3.5 million people), and migration, defections, and arrests have depleted its human resources, draining talent from the senior but especially the middle and lower ranks of the administration.

Eritrea has long ignored (or arguably, due to the ongoing state of “no peace, no war” with Ethiopia, been forced to ignore) the strong relationship between economic growth and self-reliance. But ultimately, the acceleration of Eritrea’s economic development is the best form of defense. A rising gross domestic product (GDP) would allow increased investment in Eritrea’s military resources, and trade partnerships would enhance Eritrea’s diplomatic clout. Greater economic opportunity would

also help retain more of the country’s best human resources—perhaps the most critical element for securing Eritrea’s future.

Though many of the PFDJ’s economic policies have been reactive, the party has generally adhered very rigidly to its ideology when making religious decisions. Eritrea has pursued its particular socioeconomic model because its leadership has been unbendingly committed to the set of values outlined above. In consequence, the country has adhered much more to its socialist roots than its counterparts elsewhere

have—with the exception of Cuba—with both positive and negative consequences. Dynamism has, in effect, been traded for inclusive social development. Assuming that the statistics released by the government are correct, Eritrea has certainly made more progress on the Millennium Development Goals (MDGs) than most of the African countries that adhere more closely to the Western capitalist model:²¹ Eritrea has already achieved six of the eight MDGs.²² Yet, the PFDJ may be able to strike a more effective balance by adopting the practices of similar ruling parties elsewhere, such as those in China, Vietnam, and Rwanda. These governments have been more pragmatic,

and have managed to proactively use markets and market-based incentives as well as international trade and partnerships to develop their countries while still maintaining a focus on some important socialist goals.

... [T]he PFDJ may be able to strike a more effective balance by adopting the practices of similar ruling parties elsewhere, such as those in China, Vietnam, and Rwanda.

20 “The ethos of the armed struggle permeates all aspects of public life.” ICG, “Eritrea,” 9.

21 AfDB, “Africa’s Recent MDG Performance,” <http://www.afdb.org/en/topics-and-sectors/topics/millennium-development-goals-mdgs/africa%E2%80%99s-recent-mdg-performance/>.

22 AfDB, “Eritrea – Interim Country Strategy Paper (I-CSP) 2014-2016,” 8.

KEY CHALLENGES

Eritrea's prolonged national service and high levels of emigration are, to some extent, products of a larger economic malaise. Indeed, the country's financial woes have consistently hampered its broader security and development agenda. Boosting state revenue and employment opportunities are the country's two most pressing economic problems, and they are interrelated: many of the ways to resolve one would help resolve the other.

FINANCIAL DIFFICULTIES

Reliable data on Eritrea's economy are scarce, due to the government's refusal to release even the most basic statistics such as population and GDP figures. Nonetheless, there are a number of international estimates available, most notably those from the African Development Bank (AfDB). These estimates universally show the country to be in difficult financial straits. Comments made by the government's own ministers during a recent visit to the country support this conclusion.

A number of problems were obvious during the author's visit to Eritrea: government officials talked openly about the challenges of ensuring that the country had enough money to pay for essential imports; blackouts were common (possibly due to a shortage of oil imports); private businesspeople complained about the difficulties involved in getting permission to import goods, even when the goods were legal and to be purchased with foreign currency; and officials expressed concerns about the solvency of the banking system. Reports on the country repeatedly mention foreign currency shortages hampering businesses' ability to import essential machinery and equipment.²³ In response to its financial difficulties, in November 2015, the government took the dramatic and controversial step of recalling and replacing the official currency in order to direct more domestic and international trade through the banking system. This move was most likely due to a growing black market and informal economy that was draining money from the financial system and costing the government significant income in tax revenue.

Eritrea has few exports and thus consistently runs a large trade deficit. Given the little foreign investment it receives, the government must depend on remittances and debt to purchase imports (see chart 2). Remittances, in particular, have long been a major

source of cash for Eritrea, peaking at as much as one-third of GDP in the early 2000s before declining to one-sixth of GDP in 2008 and less more recently.²⁴

Eritrea's foreign reserves covered less than one month of imports almost continuously from the time of the 1998 border war until 2007. Although reserves have since climbed from \$58 million in 2008 to over \$200 million in 2014,²⁵ due in part to the opening of the Bisha mine,²⁶ reserves have rarely, if ever, climbed above the amount required for three months of imports, the internationally recommended minimum (they generally hover at a number between two and three months now).²⁷ Such a low level of foreign reserves leaves the country susceptible to any crisis that might affect its finances. Since 2007, however, imports have almost doubled, a sign that the economy is at least in better, if not good, health when compared with the decade after the war ended.

The success of the Bisha mine, a joint venture between the Eritrean government and Canada's Nevsun Resources Ltd., has significantly improved Eritrea's financial situation, but has not been sufficient by itself to end the country's financial problems. Following the start of the mine's production in 2011, exports rose dramatically to \$261 million, up from only \$23 million in 2010.²⁸ By 2014, exports had climbed to about \$500 million (see chart 1).²⁹ Before this spike, Eritrea had one of the lowest ratios of exports to GDP in the world—a measure of the country's integration with the international economy—an astonishing statistic given the small size of the country (smaller economies typically have larger ratios).³⁰ With the steep decline

23 AfDB, "Eritrea - Interim Country Strategy Paper (I-CSP) 2014-2016," 2 and 5.

24 Library of Congress, Federal Research Division, Country Profile: Eritrea, September 2005; AfDB, "Eritrea - Interim Country Strategy Paper (I-CSP) 2014-2016," 3.

25 EIU, "Country Report," 2016, p. 6; EIU, "Country Report: Eritrea," April 29, 2013, 5.

26 The AfDB Data Portal says the current account is roughly balanced. See AfDB Data Portal. But the EIU says the country still has a large deficit. See EIU, "Country Report," 2016, 6.

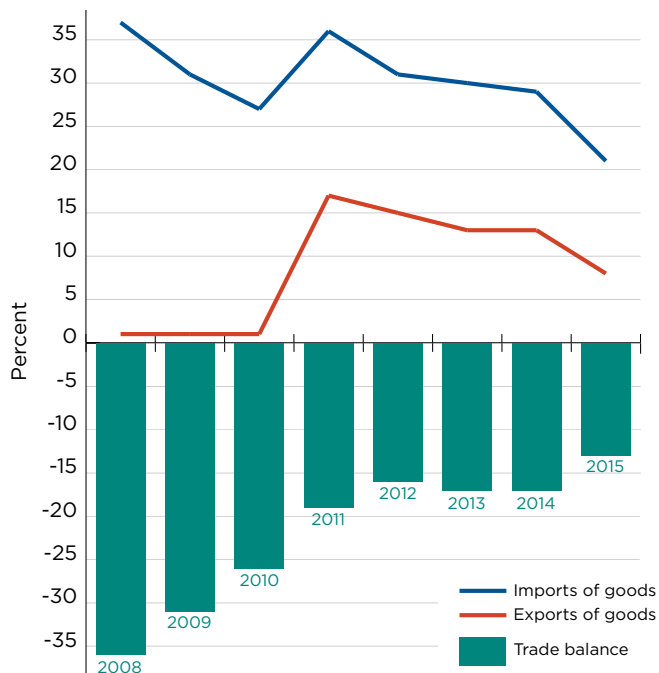
27 "Import Cover," *The Economist*, August 12, 2010, <http://www.economist.com/node/16793524>.

28 AfDB Data Portal, <http://dataportal.afdb.org/>. The report "Eritrea - Interim Country Strategy Paper (I-CSP) 2014-2016" offers different numbers, but the same trend; see page 4.

29 The Economist Intelligence Unit estimates \$493.6 million whereas the AfDB estimates \$599 million. Nevsun, whose only asset in 2014 was the Bisha mine, had revenue of \$555 million for the year, but not all of this may have been included in the export figures. EIU, "Country Report: Eritrea," February 11, 2016, 6; AfDB Data Portal; <http://www.nevsun.com/news/2015/february26/>.

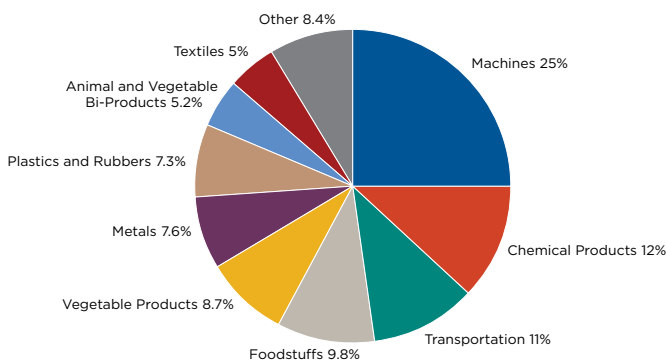
30 AfDB, "Eritrea—Interim Country Strategy Paper (I-CSP) 2014-2016," 4, footnote 7.

Figure 1. Eritrea's Exports, Imports, and Trade Balance



Source: Economist Intelligence Unit (EIU), "Country Report," 2016, 6; EIU, "Country Report: Eritrea," 2013, 5.

Figure 2. Eritrea's 2014 Imports (Excluding Oil)



This data source is not capturing the country's oil and gas imports, possibly because they are not purchased or reported through regular international trade channels. The country, for instance, mainly depended on Libyan gifts of oil before 2011. Alexander Simoes, "Eritrea," Observatory of Economic Complexity.

in mineral prices after 2013, export earnings are now probably declining.³¹ The price of copper, which made up 94 percent of total Eritrean exports in 2014, has fallen by more than half since 2013.³²

Eritrea's total external public debt climbed consistently throughout the 2000s, reaching over \$1 billion in

2009–2011 before dropping as revenue from the Bisha mine kicked in (see chart 3). The external debt-to-GDP ratio hovered around 60 percent from 2002 until 2008, near the upward limit of what would be considered a safe level (40 percent is recommended for developing countries),³³ limiting the government's flexibility and surely making it somewhat uncomfortable given its strong emphasis on self-reliance. The ratio has since fallen sharply and is now around 20 percent.³⁴ Servicing the debt required a dangerously high level of 44 percent of exports in 2003, and still accounted for one-third of exports as late as 2010. With the opening of the Bisha mine, debt servicing fell to only 7 percent of exports in 2014.³⁵

Internal debt, however, still remains a major problem. The government is estimated to have "a highly unsustainable public debt burden, estimated at 108 percent of GDP in 2015," making it "among the most heavily indebted countries in the world" (see chart 4).³⁶ This figure, which combines international and domestic debt, has declined from earlier peaks but still signifies the country's weak financial position. Such debt is a significant drag on the economy, as government borrowing limits the availability of credit to private business.

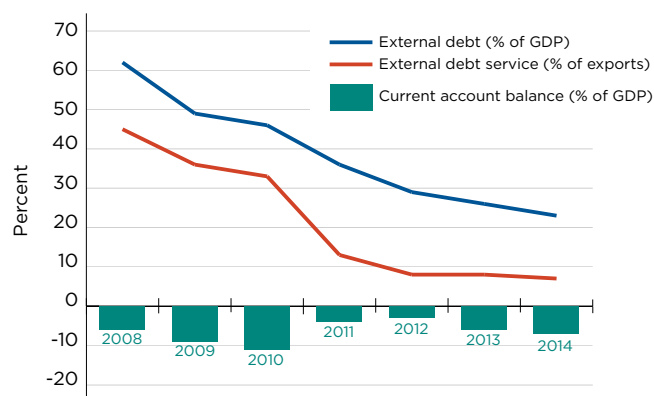
High government deficits, partially the result of significant defense spending, contribute to these high debt figures. According to the Economist Intelligence Unit, fiscal deficits averaged a whopping 16 percent of GDP between 2005 and 2015. There has been a modest decline in deficits since Bisha opened and brought an increase in revenue, but the figure remains around 12 percent (see chart 5).³⁷

Consistent deficits have produced consistently high inflation; when the government prints money to pay its bills, it increases the money supply faster than it should. Inflation has been in double digits since at least the early 2000s, peaking at about 20 percent

31 The EIU estimated in early 2016 that Eritrea's exports dropped by 16 percent to \$413 million in 2015. EIU, "Country Report," 2016," 6.
 32 See Alexander Simoes, "Eritrea," Observatory of Economic Complexity, <http://atlas.media.mit.edu/en/profile/country/eri/>.

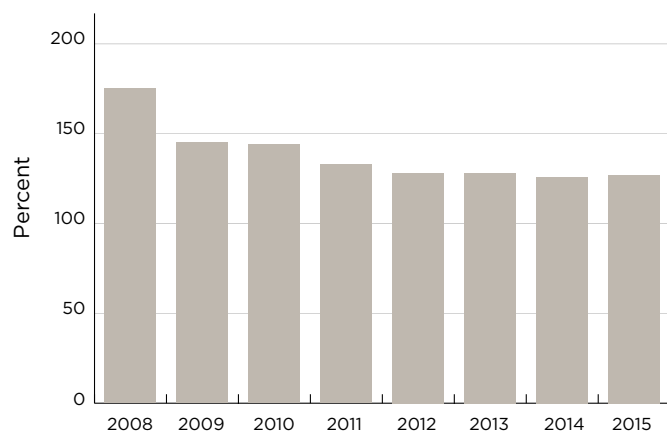
33 AfDB, "Eritrea - Interim Country Strategy Paper (I-CSP) 2014-2016," 4, footnote 6.
 34 These figures are derived from a combination of the AfDB Data Portal and the two EIU reports.
 35 AfDB Data Portal, accessed May 15, 2016.
 36 EIU, "Country Report," 2016, 12. The International Monetary Fund shows an even worse situation in its October 2014 World Economic Outlook (WEO) database. See *Global Finance*, "Eritrea GDP and Economic Data," <https://www.gfmag.com/global-data/country-data/eritrea-gdp-country-report>. Public debt differs from gross debt, which appears in chart 4. The two numbers come from different sources, which may also be making estimates based on different information.
 37 EIU, "Country Report," 2016, 12. The IMF's WEO shows similar numbers. See *Global Finance*, "Eritrea GDP and Economic Data."

Figure 3. International Financial Position



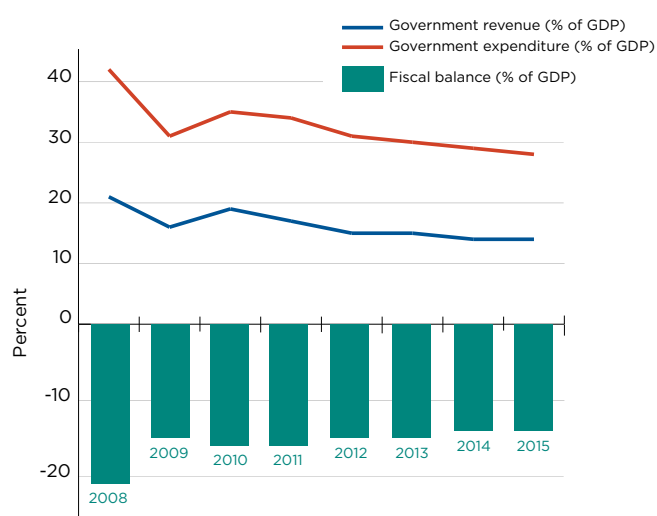
Source: World Economic Outlook Database, <http://www.imf.org/external/pubs/ft/weo/2016/01/weodata/index.aspx>.

Figure 4. Eritrea's Gross Debt



Source: World Economic Outlook Database, <http://www.imf.org/external/pubs/ft/weo/2016/01/weodata/index.aspx>.

Figure 5. Eritrea's Public Finance



Source: World Economic Outlook Database, <http://www.imf.org/external/pubs/ft/weo/2016/01/weodata/index.aspx>.

in 2008–2011 before dropping to around 12 percent in 2014.³⁸

These dynamics made the nakfa (Eritrea's currency), which has been pegged to the US dollar since 2005, heavily overvalued.³⁹ This overvaluation creates large incentives for traders to operate illicitly—the black market exchange rate was more than three times the official rate in 2015—which, in turn, feeds foreign currency shortages. The government's attempt to address the nakfa's overvaluation by introducing a new legal tender in November 2015 reduced the value of the notes in circulation by as much as three-fifths⁴⁰—an undoubtedly large blow to the private sector. Demand for goods and services has significantly declined in the months since the new tender was introduced. Businesspeople—whether they drive a taxi, manage a retail store, run a restaurant, or own a hotel—bitterly complain about the currency change.

Such reform is not only painful to the public, but is unsustainable if it does not address the main underlying cause of the problem: Eritrea's fiscal deficit requires it to print money to pay its bills.

ISOLATION AND THE SANCTIONS REGIME

More foreign direct investment (FDI) and international partnerships could alleviate many of these problems by increasing exports (at least in the case of FDI) and revenue. But whereas per capita official development assistance has fluctuated in a range between very low and modestly below average for Africa, per capita foreign direct investment in Eritrea has consistently been very far below average for the continent.⁴¹ The latter, for instance, has been under \$10 per capita since 2011—less than one-fifth the average for Africa as a whole.⁴²

Eritrea's lack of interaction with the international economy—whether through investment, trade, or cooperative arrangements with institutions such as the African Development Bank, the European Union (EU), and China—severely limits the country's ability to learn and develop. Foreign investment, in particular, could

38 AfDB, "Eritrea - Interim Country Strategy Paper (I-CSP) 2014-2016." The 2014 number comes from EIU, "Country Report," 2016," 6.

39 The black market exchange rate was in the mid-fifties (stretching as high as sixty) before the reform and has been in the low twenties (reaching as low as eighteen) since. The official exchange rate is about 15.7 nakfa to one US dollar.

40 Author interviews in Asmara, March 2016.

41 Only Burundi, the Central African Republic, and Malawi did worse in 2014. AfDB, "Eritrea - Interim Country Strategy Paper (I-CSP) 2014-2016," 5.

42 AfDB, *African Statistical Yearbook 2016* (Abidjan: AfDB, 2016), 67.

be used to bring new technology and expertise into the country, especially with regard to financial services, manufacturing, and world markets. The mining sector is a promising example of what is possible (see box 4).

International sanctions, which were imposed in 2009, play a major role in deterring international investment in Eritrea. Economic conditions were difficult in the years following the 1998–2000 war with Ethiopia and the subsequent closure of the border. However, it is important to note that investment rates in Eritrea were consistently above 20 percent until 2005, when the UN first threatened to sanction the country.⁴³ At that point, Eritrea's relations with the outside world began to deteriorate rapidly and youth started leaving in large numbers. Since 2008, the private investment rate has been between 2 and 3 percent of GDP, an extraordinarily low figure.⁴⁴ FDI per capita is among the lowest in Africa, with only Burundi, the Central African Republic, and Malawi doing worse in 2014.⁴⁵ Given numerous alternatives, few companies will invest in a country designated as a high political risk, unless they have personal ties (the diaspora, for example) or the desire to exploit an asset not found elsewhere (mining companies, for example). Indeed, there are occasional spikes in FDI driven by new investment in the mining sector, but little outside interest in the rest of the economy. Sanctions thus have significantly weakened Eritrea's economy, diminishing the quality of life for its citizens in the process.

NATIONAL SERVICE AND POLITICAL RISK

Of course, national service also plays a role in these low investment figures by creating a risk that any foreign investor will be sued for using forced labor. Although there are an ample number of workers in the free labor market (Eritreans who have either completed and been released from national service or have returned from overseas), companies that choose to invest in Eritrea must be continuously on guard for the problems that national service causes. Potential employees must be checked and double-checked to ensure that they have genuinely finished their national service commitment. Some specialist positions may be hard to fill because

the government does not want to release conscripts with valuable skills. The Eritrean government may also require investors to use state-owned contractors for building projects that are staffed by national service conscripts.

Indeed, it is impossible to invest in Eritrea without gaining—however indirectly—some benefit from national service. For example, infrastructure such as roads have probably been built or at least repaired at some point by a state-owned firm that uses national service workers. Basic supplies—including possibly food and gasoline—may have been produced or imported with some involvement of national service workers. Employees may have learned in school from teachers who were on national service. And the government offices that license or regulate business may contain workers still doing their national service. (The hotel waiter who pours the investor's morning coffee, and the customs official who stamps his passport on arrival, may also be national service conscripts.) As such, foreign investors face an almost impossible task if they wish to involve themselves with Eritrea in a way that completely avoids the entanglements the program brings from almost every direction. National service thus creates a litigation and public relations risk that is not present in any other developing country. As such, it is a severe drag on Eritrea's economic development.

POOR LIVELIHOODS AND EMIGRATION

Eritrea has suffered from significant emigration in recent years; tens of thousands have left the country and sought residence in Europe and elsewhere. This has devastated the country's human resources, weakened the capacity of its institutions (likely including the military),⁴⁶ and limited its geostrategic and economic options. It has also had a debilitating effect on Eritrea's image abroad and the morale of the people at home.

The rules related to national service—the very low salaries and the indefinite length of service—certainly play a role here, but they are part of a larger, and potentially insoluble, dynamic. Eritrea's leadership feels threatened by Ethiopia and knows from experience that the only way to defend the country is to ensure that all hands are available at all times. But while young Eritreans remain as committed to the country as the generation that won its independence, they have not had the same experiences or endured the same hardship. Exposed to a much broader set of influences, especially from abroad, they are not willing

43 The UN first threatened sanctions over the 2000 peace plan with Ethiopia in late 2005; in August 2007, the United States first threatened sanctions over the provision of arms and supplies to armed groups in Somalia.

44 AfDB Data Portal, accessed May 17, 2016; AfDB, "Eritrea – Interim Country Strategy Paper (I-CSP) 2014-2016," Annex II. The country has had one of the lowest overall investment rates in the world, consistently below 10 percent of GDP (the only countries in Africa with comparable rates to Eritrea are Swaziland and Guinea-Bissau). See IMF, World Economic Outlook Database, January 2016, <https://www.imf.org/external/pubs/ft/weo/2016/01/weodata/index.aspx/>.

45 AfDB, *African Statistical Yearbook 2016*, 67.

46 ICG, "Eritrea," 10.



A small store in the old city of Massawa, Eritrea. Photo credit: David Stanley/Flickr.

to demonstrate their commitment in the same way as their parents. The system of prolonged national service is therefore unsustainable.

The contradiction between government plans and the population's expectations is exacerbated by the country's financial woes. Salaries for national service have been so low, in part, because the government has had little money to pay people (a problem it says it can now rectify—salaries appear to be steadily rising to competitive levels).⁴⁷ Resources have been significantly constrained, and most available funds have been directed toward the country's defense.

The psychological shock of the 1998–2000 war with Ethiopia lingers, and though the informal rules related to national service have become much more relaxed in recent years (with people finding many more ways to avoid it),⁴⁸ the Eritrean leadership is reluctant to bend the formal rules too far for fear of the consequences. However, the massive emigration of so many people, including some of the country's best educated,⁴⁹ suggests that some serious adjustment needs to be considered. Eritrea needs to retain its leaders, managers, and technicians to build the country, and

this need will become increasingly urgent in the future when the current generation of leaders starts to retire.

Box 2: Israel's Military Service

There are alternatives that Eritrea could explore to achieve national security and military readiness without hemorrhaging large numbers of youth. For instance, Israel has created a system whereby every man and woman (with some exemptions) must join the military for two to three years and then be available annually for reserve duty until they are forty-five. Middle-aged men can still be found fighting wars, as was the case in the last conflict in Gaza. This system has contributed to Israel's economy while engendering none of the resentment found in Eritrea; to the contrary, it has boosted morale, social cohesion, and loyalty to the state.

National service could be an excellent way for Eritrea to develop were it transformed into a more flexible institution that builds skills immediately applicable for earning a living, something the Israeli military service does, albeit indirectly. Some students gain useful skills now (such as those working on technical jobs), but most do not. Turning national service into a useful work training program would require paying more competitive rates and ensuring jobs provide practical skills, such as those typically found in technical and vocational schools.

⁴⁷ Interviews with Western diplomatic staff, September 2016.

⁴⁸ Author interviews in Asmara, March 2016.

⁴⁹ Author interviews in Asmara, March 2016.

Eritrea's low income level is an important driver of emigration (as is the ease with which many emigrants gain legal status).⁵⁰ In 2015, nominal per capita income was only \$695 (\$1,297 at purchasing power parity, which takes into account how much the money can buy locally),⁵¹ one of the lowest figures in the world.⁵² For those employed in national service, the figures are much lower, as these jobs pay only a nominal amount. Inequalities between urban and rural areas exacerbate these difficulties; as many as four-fifths of the population depend on agriculture for their livelihoods,⁵³ and this income is both more erratic and lower than what an urban worker could earn.

The lack of opportunity is partly the product of a weak educational system. Eritrea has one of the lowest scores on the Human Development Index, ranking 186 out of 188 countries worldwide in 2014, far behind the averages for Africa as well as the low development group of countries. Of the countries assessed, only the Central African Republic and Niger did worse.⁵⁴ Over four-fifths of students finish high school without employable work skills, and this produces legions of people unemployable for any job requiring specialized knowledge.

As such, “the greater part of Eritrea’s public and private sectors are faced with insufficient human capital, which is seriously constraining the country’s economic and social transformation.”⁵⁵ As a partial result, over half the men, and even more of the youth, are unemployed or underemployed in seasonal agricultural work.⁵⁶ These conditions spur many to emigrate, as even jobs in food service, janitorial work, or transportation abroad are more lucrative.

The government has recognized the scale of the problem and is trying to improve the sector. It has reorganized Sawa, the fifteen-month secondary school and military training camp that all youth attend, to include more practical training. It has directed a significant part of its AfDB funding toward higher education and technical vocational education and training.⁵⁷ It has further increased the number of students in post-secondary studies (about a quarter go now), and it has sought to upgrade the quality of teaching in higher education by sending many instructors overseas for training and importing a large number (roughly one-third) from places such as

India, which has a large supply of inexpensive, reasonably qualified teachers.⁵⁸ The country, however, has historically invested relatively little in the education sector. Its expenditure on education as a percentage of GDP was only 2.1 percent in 2012—the same as in 2006, the last time statistics were available—and one of the lowest figures in the world.⁵⁹

POOR BUSINESS ENVIRONMENT

Eritrea’s lack of employment opportunities and weak financial position are directly related to the poor business environment. Indeed, like Cuba, Eritrea has managed its economy with little concern for how incentives influence behavior. It has adopted policies that dissuade the population from taking initiatives to build up their wealth (forcing many to look overseas for opportunity); discouraged investment and competition in most sectors of the economy; and deterred institutions from learning and modernizing through dynamic interaction with international markets and organizations.⁶⁰ Overall, the country ranks last out of 189 countries on the World Bank’s *Doing Business* indicators, scoring especially low on issues

[Eritrea’s] expenditure on education as a percentage of GDP was only 2.1 percent in 2012 . . . and one of the lowest figures in the world.

50 AfDB, “Eritrea – Interim Country Strategy Paper (I-CSP) 2014-2016,” 9.

51 *Global Finance*, “Eritrea GDP and Economic Data.”

52 The IMF ranked the country 168th out of 186 in 2015 for nominal GDP and 177th out of 185 for GDP per capita based on purchasing power parity numbers. See IMF, “World Economic Outlook Database,” <https://www.imf.org/external/pubs/ft/weo/2016/01/weodata/index.aspx/>.

53 National Statistics Office and Fafo Institute for Applied International Studies, “Eritrea: Population Household Survey 2010,” August 2013, 2; AfDB, “Eritrea – Interim Country Strategy Paper (I-CSP) 2014-2016,” 15.

54 United Nations Development Programme, “Human Development Index,” <http://hdr.undp.org/en/composite/HDI>.

55 AfDB, “Eritrea—Interim Country Strategy Paper (I-CSP) 2014-2016,” 12.

56 AfDB, “Eritrea—Interim Country Strategy Paper (I-CSP) 2014-2016,” 9.

57 AfDB, “Eritrea—Interim Country Strategy Paper (I-CSP) 2014-2016,” 1 and 13.

58 Author interviews in Asmara, March 2016. The teachers sent to Western countries did not return, claiming asylum. So the government now sends them to places like China instead.

59 See United Nations Development Programme, “Expenditure on education, Public (% of GDP) %,” <http://hdr.undp.org/en/content/expenditure-education-public-gdp>.

60 As the Economist Intelligence Unit concludes, “Onerous regulations, high levels of bureaucracy and woefully inadequate infrastructure will continue to deter investment and, beyond former state-owned companies, private-sector activity is expected to remain limited. . . The absence of a vibrant private sector will, in turn, prevent the emergence of an organised labour market and local supply chains.” See EIU, “Country Report,” 2016, 11.

related to regulation (e.g., starting a business, dealing with construction permits, and resolving insolvency), international trade, and access to credit.⁶¹

The anti-business sentiments of many top government officials do not help matters. These attitudes are a direct product of the leftist ideology that is still pervasive among the country's leadership, which has abandoned Marxism, but still retains some of its ideas. As such,

the private sector (outside the agricultural sector) plays a limited role and is mostly concentrated in the services and trade sub-sectors.... [It] is small, under-developed, and continues to be constrained by lack of skilled labour and limited infrastructure, particularly in energy and roads. Private sector development has also been hampered by a weak legal and judicial framework, especially in terms of law enforcement.⁶²

Eritrea has singularly failed to take advantage of the country's unique geostrategic location and long coastline to advance the economy, allowing neighboring Djibouti to monopolize all the opportunity produced by one of the world's most important international trade routes (almost one-third of all shipping in the world passes by the two countries' shores).⁶³ Furthermore, Eritrea has one of lowest tourist arrival figures of any non-island in the world, despite its immense tourism potential and location.⁶⁴

Infrastructure is also a problem. The country has major deficiencies in energy supply, roads, telecommunications, and ports.⁶⁵ Eritrea ranked forty-seven out of fifty-three countries across the continent in the 2013 Africa Infrastructure Development Index "due to poor road networks, water and sanitation, energy, and ICT [information and communications technology] deficiencies."⁶⁶ It ranked 156 out of 160

countries in the 2014 Logistics Performance Index, which measures, among other things, perceptions of the quality and efficiency of a country's trade- and transport-related infrastructure and logistics services. Only Congo-Brazzaville, Afghanistan, the Democratic Republic of the Congo, and Somalia fared worse.⁶⁷ It had the lowest per capita numbers of mobile phone subscribers and Internet users in Africa in 2014.⁶⁸ As a result, these shortcomings sharply increase the cost of doing business for companies, which decreases productivity and incentives for investment.

Weak institutions exacerbate the challenges. Although top officials sometimes show great vitality and knowledge, the lack of capable middle managers (and the risk-adverse atmosphere generated by the Eritrean political context) enervates most institutions in the country. This dynamic is exacerbated by the emigration of many educated young people who should be filling up middle management positions in key organizations.

Though international assessments of governance can be problematic (in theory and method), they do highlight general trends, especially when they focus on performance rather than on perceptions or values. The most well-known assessment, the World Bank's Worldwide Governance Indicators, gives Eritrea extremely low scores for "Government Effectiveness," "Regulatory Quality," and "Rule of Law" (all rank in the bottom fifth percentile).⁶⁹ The country performs similarly poorly on an African Development Bank index of "Public Sector Management and Institutions," where it beat out only Somalia.⁷⁰

Such rankings may, of course, be distorted due to poor international perceptions of, or a lack of access to, the country. (For example, although donors and investors universally acknowledge that Eritrea has very little corruption, it is nevertheless ranked by Transparency International as one of the most corrupt in the world).⁷¹ They may also reflect more on policy choices or

61 See World Bank Group, "Ease of Doing Business in Eritrea," <http://www.doingbusiness.org/data/exploreeconomies/eritrea/>.

62 AfDB, "Eritrea - Interim Country Strategy Paper (I-CSP) 2014-2016," 3 and 7.

63 Katrina Manson, "Jostling for Djibouti," *Financial Times*, April 1, 2016, <http://www.ft.com/intl/cms/s/2/8c33eefc-f6c1-11e5-803c-d27c7117d132.html>.

64 In 2011, the latest year for which data are available, 107,000 tourists visited Eritrea. The only non-island countries with fewer tourists are Moldova, Sierra Leone, Djibouti, the Central African Republic, Bhutan, Chad, Niger, and the Gambia. About a dozen countries do not report their numbers. See The World Bank, "International tourism, number of arrivals," http://data.worldbank.org/indicator/ST.INT.ARVL?order=wbapi_data_value_2011+wbapi_data_value+wbapi_data_value-first&sort=asc.

65 AfDB, "Eritrea - Interim Country Strategy Paper (I-CSP) 2014-2016," 2.

66 AfDB, "Eritrea—Interim Country Strategy Paper (I-CSP) 2014-2016," 8.

67 See The World Bank, International LPI Global Ranking, "Global Rankings 2016," <http://lpi.worldbank.org/international/global> and The World Bank, International Scorecard, "Country Score Card: Eritrea 2014," <http://lpi.worldbank.org/international/scorecard/radar/254/C/ERI/2014/R/SSA/2014/I/LIC/2014>.

68 AfDB, *African Statistical Yearbook 2016*, 72.

69 The World Bank, "Worldwide Governance Indicators," <http://databank.worldbank.org/data/reports.aspx?source=Worldwide-Governance-Indicators>.

70 AfDB, "2013-Country Governance Rating (CGR)," <http://www.afdb.org/en/documents/document/2013-country-governance-rating-cgr-47378/>.

71 Eritrea ranked 154 out of 167 countries on the Corruption Perceptions Index 2015. See Transparency International, "Corruption Perceptions Index 2015," <https://www.transparency.org/cpi2015/#results-table>.



The railway station in Asmara, Eritrea. Many of the trains still run on steam power. *Photo credit: David Stanley/Flickr.*

attitudes expressed during implementation than actual capacity to govern. For example, the mining industry and donors who have worked with the government generally have positive stories to tell.⁷² Despite their limitations, these indices do show that the country needs to substantially upgrade its state capacity in many areas.

While the Bisha mine has achieved its aims in Eritrea and its managers have few complaints about the country's infrastructure, institutions, and logistics,⁷³ the

mine functions as an island separate from the rest of the economy. It is more an atypical example of what may be possible for high priority projects.

Eritrea is promoting its mining sector actively and with remarkable competence. Mines do not, however, produce many jobs, and thus can contribute to raising incomes for only a sliver of the population (unless the government were to funnel all its increased revenues into job-creating sectors like agriculture and infrastructure, rather than defense).⁷⁴ The creation of backward linkages to and services for this industry could also expand the number of jobs (see below), but it will not be easy.

⁷² Author interviews in Asmara, March 2016.

⁷³ Author interviews in Bisha, March 2016. Bisha managers were generally complementary about the business conditions, especially the logistics.

⁷⁴ EIU, "Country Report," 2013, 13.

THE NEED FOR INCREMENTAL CHANGE

Eritrea's challenges seem daunting but are actually quite comparable to those faced at one time by Vietnam and China. These countries are good models for the Eritrean government to examine, because they are both somewhat similar ideologically to the PFDJ and came to the conclusion during the 1980s that a course correction was not only necessary, but could be conducted without abandoning the core principles that had underpinned the regimes. Both permitted free market enterprises to take a larger and more decisive role in shaping the economy, but retained a pivotal central role for the state. As a result, both states were able to create models better suited to local conditions than those promoted by Western institutions, yielding what Vietnam calls the "socialist-oriented market economy" and what China calls the "socialist market economy" or "socialism with Chinese characteristics." Importantly, both countries also sought incremental rather than wholesale reforms. This permitted learning by trial and error and enabled the government to focus on increasing the efficiency of existing institutions rather than the construction of new ones.

China, for instance, eschewed the "big bang" approach to reform that is typically advocated by Western development actors, under which all prices and markets are freed simultaneously. Instead, it focused on dealing with the "big issues," such as incentives, worker mobility, price flexibility, competition, and openness.⁷⁵ This unleashed the potential of Chinese workers in ways that the Communist Party considered politically feasible. Enormous economic advances were made despite, and perhaps because, institutional reforms were put off. This directly contradicts the normative Western development perspective, but in the Chinese case, it worked. Institutional weaknesses, government malfeasance, a lack of democracy, and even gross distortions to some markets mattered much less than Western models predicted because initiative was rewarded at every level. Fundamentally, this is what the PFDJ needs to accomplish: it needs to better leverage incentives to produce investment

and competition in order to expand the economy and increase employment.

Eritrea is already moving slowly away from what has been, in effect, a command economy.⁷⁶ The trajectory of this change is likely to look a lot more like the process underway in Cuba, which is going through its own period of piecemeal reform from a command to fully market-based economy, than that of countries operating under the auspices of the International Monetary Fund. And the end result is likely to be closer to what currently exists in Vietnam than in Western capitalist countries.

Eritrea's economic changes have paralleled its political reengagement with the international community after many years of separation. On the political front, the country has reactivated its membership in a number of international organizations, such as the AfDB and the African Union. It has opened its doors to more visitors than in previous years, including many from the media. It has made tentative steps to address some of the complaints of Western human rights actors in order to create better relations with Europe and the United States. And it has concluded an important development agreement with the European Union.

On the economic front, the government has privatized a number of state-owned enterprises,⁷⁷ held several investment conferences, and discussed improving the business climate (though change here is hard to discern). However, government authorities still seem averse to private business and foreign investment outside of the mining sector.

Given the PFDJ's strong policy preferences, only ideas that creatively fit within the current socioeconomic model have a chance of improving the country's economy and employment situation. Arguing that the PFDJ should completely abandon its approach and adopt a Western model wholesale therefore does not make sense and may even be counterproductive. Instead, pragmatic policies that leverage the country's strengths and fit comfortably within the leadership's ideological framework ought to be pursued.

⁷⁵ Loren Brandt and Thomas Rawski, "China's Great Economic Transformation," in *China's Great Economic Transformation*, eds. Brandt and Rawski (Cambridge: Cambridge University Press, 2008), 20.

⁷⁶ EIU, "Country Report," 2016, 11.

⁷⁷ *Ibid.*

ONE WAY FORWARD

As the mining sector and key international partnerships (with the EU, United Nations Development Programme, and AfDB, for instance) show, Eritrea has the capacity to manage a small number of high profile initiatives well when it so desires. The cohesiveness and competence of its top leaders surpass those of many countries in Africa. If this senior-level competence could be applied more pragmatically to developing the economy, Eritrea could certainly grow its economy much faster.

It could, for instance, develop a number of state- or ruling party-owned investment companies that would play a prominent role in developing the economy, as is the case in Rwanda, China, and Vietnam. These companies would aim to both maximize profit and achieve certain strategic social or economic goals for the country (e.g., develop certain industries), and be completely managed by the private sector (for all hiring, promotions, technology imports, and so on).⁷⁸ Such an approach would necessitate giving competitive markets a key and improved role in the economy, on the understanding that markets drive progress, but leave control over the “commanding heights of the economy” in the hands of the state. (Rwanda offers an interesting model along these lines from which Eritrea could learn. See box 3).

78 David Booth and Frederick Golooba-Mutebi, “Developmental Patrimonialism? The Case of Rwanda,” *African Affairs* 111 (July 2012): 379–403.

Box 3: Learning from Rwanda⁷⁹

Rwanda and Eritrea have much in common: both are led by a cohesive rebel organization that won control through war and then converted itself into a political party to run the country. Both have charismatic leaders. Moreover, both President Isaias Afwerki and President Paul Kagame are ambivalent about foreign aid and question the utility of Western development paradigms, while being highly committed to nation-building, national development, and self-reliance. Both leaders are rather austere, have a strong sense of public duty, and fervently stamp out corruption. Both have fallen out with former close political allies, who now have either “disappeared” or been forced into exile. Both countries are intolerant of any opposition to the government and have stirred controversy abroad with some of their actions abroad.

79 This case study is based on Booth and Golooba-Mutebi, “Developmental Patrimonialism? The Case of Rwanda.”

The country does some of this today with its myriad party- and government-owned businesses (such as the Red Sea Trading Corporation), but these operate less on private sector lines than they should; are faced with less competition; target a much smaller market; receive more favorable treatment from government regulators; and seem to be organized in a less strategic fashion than comparable entities in other countries. As such, they have not been nearly as effective in helping the country develop.

Eritrea’s private sector, which today is limited to mostly small-scale businesses (in areas such as retail, agriculture, restaurants, and hotels), should be given more room to grow. This will require greater transparency, consistency, and efficiency in the application of rules and laws. The state should see a flourishing private sector as a crucial ally in the country’s development, and should take steps to encourage its growth with less ambivalence and inconsistency. The more Eritreans can be incentivized (rather than ordered) to develop their country, the more likely progress will become a population-wide endeavor that can catalyze people inside and outside the country to work together to build it up. This type of formula worked very well during the war years but has not been repeated since.

The similarities also extend to the economic sphere. Both countries use highly centralized decision-making models; give state- or party-led companies leading roles; and aim to use the rents these generate for long-term national development rather than short-term (corrupt) personal gain. As such, they differ substantially from the typical African and Middle Eastern modal pattern, under which rent seeking is widespread and uncontrolled.⁸⁰

Perhaps because it is unimpeded by border conflicts and the threat of war, Rwanda has performed much better in a wide range of development areas. As such, it can offer a few important lessons for Eritrea.

Rwanda’s government has not hesitated to opportunistically take advantage of foreign aid. This foreign funding has helped the Rwandan government focus even more than the Eritrean regime has on building up its legitimacy through economic and

80 Booth and Golooba-Mutebi, “Developmental Patrimonialism?,” 384–87.

social development and the delivery of public services. In particular, while Eritrea has compelled its citizens into national service for nominal pay, Rwanda has placed a very strong emphasis on building a competitive civil service and has sought creative ways to achieve this goal (such as recruiting from overseas). Eritrea's national service has actively hamstrung the government's efforts to administer the country by forcing many capable people to leave and discouraging the diaspora from returning, either to work for the government or to open businesses of their own.⁸¹

Rwanda has used a series of investment or holding companies to lead its development efforts. Crystal Ventures Ltd (formerly known as Tri-Star Investments),⁸² which is fully owned by the ruling party (the Rwandan Patriotic Front), has played a key role. It wholly or mainly owns eleven businesses, including entities in metals trading, road construction, housing estates, building materials, fruit processing, mobile telephony, and printing, as well as furniture imports and security services; most are the largest in their sector in the country. It also has a minority stake in a

number of joint ventures. Its taxes amounted to about 9 percent of all direct taxes paid in fiscal year 2009–2010. The army also created an investment company, Horizon Group. Lastly, the government worked with a group of thirty-one wealthy domestic and diaspora entrepreneurs, four medium-sized companies, and six institutional investors to form an investment consortium, the Rwanda Investment Group, to invest in large projects that could not be funded otherwise given the country's weak capital markets.

In all these cases, the companies use their “financial clout to fund investments with high expected social benefits and/or positive economic externalities, including those associated with venture capitalism.”⁸³ They are all run on private sector lines and aim to build productive enterprises that can be profitable. They thus have dual goals, one purely financial and one socioeconomic. Rwanda also takes a “robustly internationalist approach to filling skills gaps...with business efficiency and the meeting of strategic social objectives taking precedence over commitments to local hiring and capacity development.”⁸⁴

81 Booth and Golooba-Mutebi, “Developmental Patrimonialism?,” 392.

82 See Crystal Ventures, “About Us,” <http://www.crystalventuresltd.com/>.

83 Booth and Golooba-Mutebi, “Developmental Patrimonialism? The Case of Rwanda,” 398–402.

84 Booth and Golooba-Mutebi, “Developmental Patrimonialism?,” 398–402.

STRATEGIC OPPORTUNITIES

Eritrea has a number of sectors that are ripe for development. Some, such as the mining and agricultural sectors, have received ample attention from the government. Others, such as tourism, transshipping, and manufacturing, seem neglected despite rhetoric to the contrary.

- Agriculture:** The government has long prioritized farming, seeing it as crucial to food security, poverty reduction, and national self-reliance. Yet yields are quite low, forcing the country to depend on imports to fill gaps despite the relatively small population. Unpredictable water supplies (including frequent droughts) and energy supplies are persistent problems. Although there are ongoing attempts to improve soil and water conservation, technological inputs, and the availability of solar, wind, and thermal energy,⁸⁵ perhaps more must be done to link effort to reward (which would boost productivity and output) or to ensure that peasant farmers have the resources, knowledge, and incentives to maximize output. Improvements to extension services, better infrastructure, investments in agricultural research, and large-scale education and training programs could all pay dividends. International partnerships, especially with countries in Africa or the Middle East that face similar challenges (e.g., Israel), could help here. The country has the potential to be a base for cash crops dedicated to export markets (such as cotton, which it once exported), especially given its close proximity to Europe.
- Mining:** This sector has become far and away the most important to the country. The state has set attractive terms and established a sophisticated regulatory framework (in areas such as labor and the environment) copied from best practices abroad, and multinationals are investing.⁸⁶ There are strong strategies in place to develop human resources for the sector. The government's work on logistics has been praised. Investors appear to have few if any complaints about the Eritrea National Mining Corporation, the local joint venture partner.⁸⁷ The main limitations of the sector are the lack of jobs it creates; the difficulties in developing backward linkages or peripheral businesses (in sharp contrast to manufacturing); and the sector's

isolation from the rest of the economy, limiting its ability to impact the country's overall business climate and international competitiveness. Given the country's ample natural resources—including copper, tin, gold, potash, and rock salt—there is strong potential for expansion. There is also the possibility of oil offshore.⁸⁸ The value of these natural resources must, of course, be weighed against the risk that the Eritrean government will force the investor to subcontract with a state-owned enterprise that employs national service workers, thus exposing the mine to the threat of lawsuits overseas (see box 4).

Box 4: The Bisha Mine

The Bisha mine showcases the country's significant mineral deposits and the government's ability to plan and implement key projects when prioritized.

The Bisha Mining Share Company (BMSC), a joint venture between Eritrea's National Mining Corporation and Canada's Nevsun Resources Ltd., manages the mine, which is about 150 kilometers west of Asmara. Commercial production started in February 2011. The mine was originally a low-cost, high-grade gold producer (2011–2012), before transitioning into mainly a high-grade copper concentrate producer (2013–2016), and subsequently a high-grade zinc producer (2016 onwards). The state of Eritrea owns 40 percent of the mine. The exploration license includes a satellite deposit and several other areas that have yet to be explored.⁸⁹ Its area was significantly expanded in mid-2016 to include “two highly prospective land packages.”⁹⁰

The mine achieves world-class performance, partly due to transparent and consistent government support and fulfilled commitments. The country's mining regulations are highly sophisticated and the terms offered highly attractive. Its social, environmental, labor, and cultural protection regulatory regimes reflect best practices. Logistics have been handled efficiently, and there are no difficulties getting output to export markets. According to executives at the

85 AfDB, “Eritrea—Interim Country Strategy Paper (I-CSP) 2014–2016,” 12.

86 Author interviews in Washington with Nevsun, October 2015.

87 Author interviews in Bisha, March 2016.

88 “Oil and Gas Exploration in the Red Sea Still Goes Ahead” Red Sea Oil & Gas 2015 Summit, 23rd–24th February, Dubai,” PRWeb, March 14, 2015, <http://www.prweb.com/releases/2015/03/prweb12583439.htm>.

89 Public records; AfDB, “Eritrea – Interim Country Strategy Paper (I-CSP) 2014–2016, Annex VIII.

90 “Nevsun Increases Bisha's Exploration License Area Nearly Twenty-Fold,” Nevsun Press Release, July 26, 2016, <http://www.nevsun.com/news/2016/july26/>.

company, the government's performance has easily surpassed that of more developed countries, such as Brazil. There is no apparent corruption at any level. The turnaround time at the port is only twenty-four hours. Customs can be handled right outside the mine in Bisha.

Nevsun's main complaints concern how long it takes to transport supplies to the mine (due to its relative isolation) and the challenge of hiring well-trained employees.⁹¹ It must also be unhappy with the risk it faces from working in the country: the company, which denies any wrong-doing, is being sued over its alleged use of forced labor due to the fact that it had to use a state-owned contractor to do some of the construction work when building the mine.⁹²

Eritrea is now using the mine to develop its broader capacities in the sector. Schools are offering specialized degrees. Trainees are staying on site. Positions at the mine are being localized. Backward linkages that would jumpstart related businesses are being explored. And as other mines open, some employees can expect to be transferred to take up more responsible jobs.⁹³

All of this shows a high degree of sophistication and capacity not typically associated with Eritrea. It demonstrates what would be possible if such partnerships were applied to the economy more broadly.

- **Transshipment and logistics:** Eritrea sits astride one of the world's most important international shipping routes, and yet it has allowed neighboring Djibouti to monopolize all the gains of this industry. Whereas the latter has attracted hundreds of millions in investment—and built eight ports to handle containers, livestock, oil, phosphates, and more—Eritrea's coastal cities remain astonishingly quiet, a pale reflection of how they were a few generations ago. In addition, Djibouti has exploited its location to attract the militaries of the United States, China, Japan, and several European countries, creating a steady source of income as well as a robust security blanket, which keeps the ruling party in power.⁹⁴ Though Eritrea is unlikely

to become a transit hub while its border with Ethiopia remains closed, and though Djibouti's ascendancy can hardly be challenged at this point, Eritrea could still profit by investing more in the development of the Assab and Massawa ports. These could serve as hubs for transit trade to Sudan and South Sudan, and possibly Yemen. Partnering with a major international ports operator—such as Hutchison Port Holdings, PSA International, DP World, or COSCO—in the way it currently partners with mining companies would be a logical way forward.

- **Manufacturing:** Eritrea has a prime location to develop a special economic zone geared for exports to the Middle East and Europe. Given the cost of labor and ports, the country could potentially be a dynamic hub that creates tens of thousands, if not more, jobs, soaking up surplus labor and providing an attractive alternative to migration. The government has long talked about the Massawa Free Trade Zone (FTZ) fulfilling this vision, but implementation has been slow. Some sort of public-private joint venture or the hiring of an overseas private company could significantly accelerate this effort.
- **Tourism:** Eritrea's beautiful coastline and historical sites hold enormous potential for promoting niche tourism (e.g., serving up to five hundred people at a time), especially given the country's stability and proximity to Europe and the Middle East. The government, however, has never seemed excited about the sector, possibly because it sees the arrival of large numbers of foreigners as somehow threatening its self-reliance. Although there is a certain logic to this, such an approach stands in sharp contrast to what similar countries have done in recent years: China, Vietnam, and Rwanda actively seek out tourists because of the money they bring and jobs they create. Eritrea's approach is more akin to that of communist countries of an earlier era. If the country focused solely on high-end customers to combine short tours of Asmara with longer stays at coastal resorts, it could take better advantage of its natural assets without significantly disrupting the status quo. As in the other sectors above, a partnership with an international hospitality company—possibly a regional one sensitive to the government's concerns—might offer a way forward.

91 Author interviews at Bisha, March 2016.

92 Peter Koven, "There are Many Good Reasons for Takeover Interest in Nevsun — and One Really Big Downside," *Financial Post*, November 20, 2014, <http://business.financialpost.com/news/mining/nevsun-takeover-talk>.

93 Author interviews in Asmara and Bisha, March 2016.

94 Manson, "Jostling for Djibouti,"; Robert Wright, "Djibouti Shows Depth of Port Ambitions," *Financial Times*, February 22, 2009,

<http://www.ft.com/intl/cms/s/0/4c296e0a-00fa-11de-8f6e-000077b07658.html#axzz49Ou3sPcD>.

- **Infrastructure:** Certain infrastructure projects could be significantly advanced via a joint venture. The most obvious target is the cellular phone network (currently run by EriTel, the Eritrean Telecommunication Services Corporation), which remains by far the worst in Africa, despite the large number of international actors that might welcome a chance to enter the market. A joint venture offering attractive terms to a foreign partner could draw such international actors in, and a competitive bidding process would maximize returns to the state. Energy and the ports (as mentioned above) could be similarly developed through a public-private partnership of this kind.
- **Seafood:** The country's location and shoreline hold potential for the development of a seafood industry fueling exports to Europe, the Middle East, or beyond. In addition, higher value-added products (e.g., canned goods) could eventually be developed in the FTZ. By utilizing the Massawa international airport and new cold storage equipment from China, opportunities for developing this industry abound.
- **Trade with Ethiopia:** Reestablishing trade relations with Ethiopia would be a great boon for the country. Inarguably, there is nothing that would benefit the Eritrean people more than the resumption of the thriving cross-border trade

with Ethiopia; two-thirds of Eritrea's exports went to Ethiopia before ties were cut in 1998.⁹⁵ The common culture and language shared by the elites of both countries would give Eritrea some advantage in competing with alternative routes. However, reopening the border would require the United States and Britain, among other countries, to honor their commitments to enforce the ruling of the border commission—a matter that is beyond Eritrea's control.

While the economic policies that might advance these sectors are relatively straightforward, the political and institutional prerequisites are complex. Creative ownership structures—giving the leadership more control over outcomes and returns—could increase incentives for the government to prioritize new areas.⁹⁶ The greater openness demonstrated in recent years augurs well for some change, but it will come slowly.

In whatever way Eritrea's government proceeds, experimentation and incrementalism seem to be its preference. This approach fits well with the strategies adopted by other successful economies, particularly China.

⁹⁵ Author interviews in Asmara, March 2016.

⁹⁶ Governments tend to support only the sectors in which they have a stake. See Ministry of Foreign Affairs of Denmark, "Elites, Production and Poverty. A comparative study," <http://drp.dfcentre.com/project/elites-production-and-poverty-comparative-study>.

PRACTICAL ADVICE FOR INTERNATIONAL ACTORS

The international community has strong opinions about the direction Eritrea should take on a variety of issues, from human rights to governance to international affairs to economic policy. While some of this is well-intentioned, much of it is based on a very limited understanding of—and empathy for—Eritrea's historical experience. Although some of the Eritrean government's choices deserve criticism, any attempt to assist the country needs to start with where it is now, not where foreigners think it ought to be.

Eritrea has shown, especially in recent years, a willingness to work with countries and organizations that treat it with respect and not as a target of “help.” It has, however, consistently refused to develop a dependency on foreign aid or assistance that made it the junior partner.⁹⁷ In 2011, for example, Eritrea pulled out of a long-term development agreement with the UN on the grounds that “aid only postpones the basic solutions to crucial development problems by tentatively ameliorating their manifestations without tackling their root causes. The structural, political, economic, etc. damage that it inflicts upon recipient countries is also enormous.”⁹⁸ Eritrea refused to work with the AfDB until it changed the country's designation from a fragile state to a transition state.⁹⁹ On the other hand, the government seems to find it easy to work with China, with which it shares some characteristics and values, and whose officials understand—from their own experiences with the

Eritrea has shown, especially in recent years, a willingness to work with countries and organizations that treat it with respect and not as a target of “help.”

West—the intensity of Eritrea's desire to be treated as an equal partner despite great differences in economic conditions and political ideology. Finding a method of cooperation that reflects Eritrea's values is not only possible, but is also more likely to succeed, given the starting conditions, than an approach seeking to make it something it is not.

Despite international human rights and media rhetoric to the contrary, Eritrea is neither uniformly evil¹⁰⁰ nor incompetent. In fact, Eritrea is far more

like its neighbors than either the international community or government cares to recognize. The government's concept of the state's role does not seem all that different from that of Ethiopia, Saudi Arabia, Sudan, and Egypt. And Eritrea's record on human rights is certainly not substantially worse than that of Ethiopia, Sudan, Egypt, Saudi Arabia, Djibouti, Yemen, or Somalia—the other countries on the Horn of Africa and Red Sea—even though it has been singled out as the bad actor far more than any other country in this region. International actors

must first and foremost rebalance their rhetoric on Eritrea, if they hope to project any influence on the country.

As discussed above, the government has capably managed a number of large, joint projects with organizations such as Nevsun, the UN, the AfDB, and the EU. Practical assistance to strengthen Eritrea's policy-making capacity, legal frameworks, education, vocational training, the energy sector, and infrastructure should all be welcome.

⁹⁷ See, for instance, Edmund Sanders, “Eritrea aspires to be self-reliant, rejecting foreign aid,” *Los Angeles Times*, October 2, 2007, <http://www.latimes.com/world/la-fg-eritrea2oct02-story.html>.

⁹⁸ George Russell, “Eritrea to U.N.: Take This Aid and Shove It,” *Fox News*, March 30, 2011, <http://www.foxnews.com/world/2011/03/30/eritrea-aid-shove.html>.

⁹⁹ Author interviews in Abidjan at the AfDB, November 2015.

¹⁰⁰ See, for instance, Adam Taylor, “The Brutal Dictatorship the World Keeps Ignoring,” *Washington Post*, June 12, 2015, <https://www.washingtonpost.com/news/worldviews/wp/2015/06/12/the-brutal-dictatorship-the-world-keeps-ignoring/>.

PRAGMATISM AND SELF-RELIANCE

Eritrea's complex situation calls for, above all else, pragmatism. The international community needs to be more realistic—indeed, more agnostic—when engaging Eritrea. Their policies toward the country should resemble those applied to Cuba, not to North Korea. The success of countries such as those in East Asia and Rwanda show that every country has unique assets and challenges, and building incrementally on what already works is far more likely to succeed than trying to import a particular model from overseas.

As Justin Yifu Lin, the first person from a developing country to serve as the World Bank's chief economist, writes:

Theories and models taught in universities generally assume a 'first-best world,' but in the real world—especially in developing countries—there are distortions, bumps, and barriers that leave many countries far removed from the first-best situation...

So it is important for us to be pragmatic, to understand the opportunities at hand, and make small, but welfare-improving, changes. Small changes can lead to large changes in the future.¹⁰¹

But this will also require more flexible thinking from Eritrea's leaders. Eritrea can and should pursue economic growth on its own terms, but it should be more like China and Rwanda, and less like Cuba. Eritrea has great economic potential. But the PFDJ

needs to more flexibly interpret its ideological emphasis on self-reliance. Specifically, the party needs to find a way to exploit foreign partnerships as a vehicle for empowerment, rather than as a threat to self-sufficiency. If Eritrea can find a way to embrace international investors and foreign assistance while maintaining its commitment to self-reliance and to its core, egalitarian values, it could become a symbol of African renaissance, as some hoped would be the case in the 1990s.

International actors should support this vision. After all, "Create self-reliance!" should be the rallying cry for aid agencies everywhere. The best way to achieve this goal is to recognize that domestic actors must play the leading role, and that the primary role of outside actors should be to build on what capacity already works and facilitate an organic, domestically driven process of state building and policy making.¹⁰² Local communities are bound to make mistakes, but the job of outside actors should be to help local people learn from those mistakes.¹⁰³ In this way, refocusing the involvement of foreign actors would allow for a more collaborative aid system to replace the current externally driven process (see table 1) in Eritrea and elsewhere.

¹⁰² Seth D. Kaplan, *Betrayed: Promoting Inclusive Development in Fragile States* (New York: Palgrave MacMillan, 2013), 219–20.

¹⁰³ As a report published in 2011 by three distinguished development academics concluded, "In general, aid is most likely to be effective if it's essentially organic, in the sense of (a) supporting existing domestic initiatives and pressures for change, and (b) in ways that are consistent with the initial state of the polity." Shantayanan Devarajan, Stuti Khemani, and Michael Walton, "Civil Society, Public Action, and Accountability in Africa," HKS Faculty Research Working Paper Series RWP11-036, John F. Kennedy School of Government, Harvard University, 2011, 32.

¹⁰¹ Justin Yifu Lin, "Let's Be Pragmatic: My Final Post as World Bank Chief Economist," World Bank Let's Talk Development Blog, May 31, 2012, <http://blogs.worldbank.org/developmenttalk/let-s-be-pragmatic-my-final-post-as-world-bank-chief-economist>.

Table 1. Comparison of Two Aid Paradigms

Externally Driven Aid Delivery System	Collaborative Aid System
Local people seen as beneficiaries and aid recipients	Local people seen as colleagues and drivers of their own development
Focus on identifying needs	Focus on supporting/reinforcing capacities and identifying local priorities
Pre-planned/pre-determined programs	Context-relevant programs developed jointly by recipient communities and aid providers
Provider-driven decision-making	Collaborative decision-making
Focus on spending on a pre-determined schedule	Fit money and timing to strategy and realities on the ground
Staff evaluated and rewarded for managing projects on time and on budget	Staff evaluated and rewarded for quality of relationships and results that recipients say make lasting positive changes in their lives
Monitoring and evaluation by providers on project spending and delivery of planned assistance	Monitoring, evaluation, and follow-up by providers and recipients on the results and long-term effects of assistance
Focus on growth	Planned draw down and mutually agreed exit/end of assistance strategy

Source: This is a modestly revised version of a table in Mary Anderson, Dayna Brown, and Isabella Jean, *Time to Listen: Hearing People on the Receiving End of International Aid* (Cambridge, MA: CDA Collaborative Learning Projects, 2012), 138.

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