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Eritrea—Recent Economic Developments

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INTERNATIONAL MONETARY FUND

ERITREA

Recent Economic Developments

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Approved by the African Department

November 22, 1994

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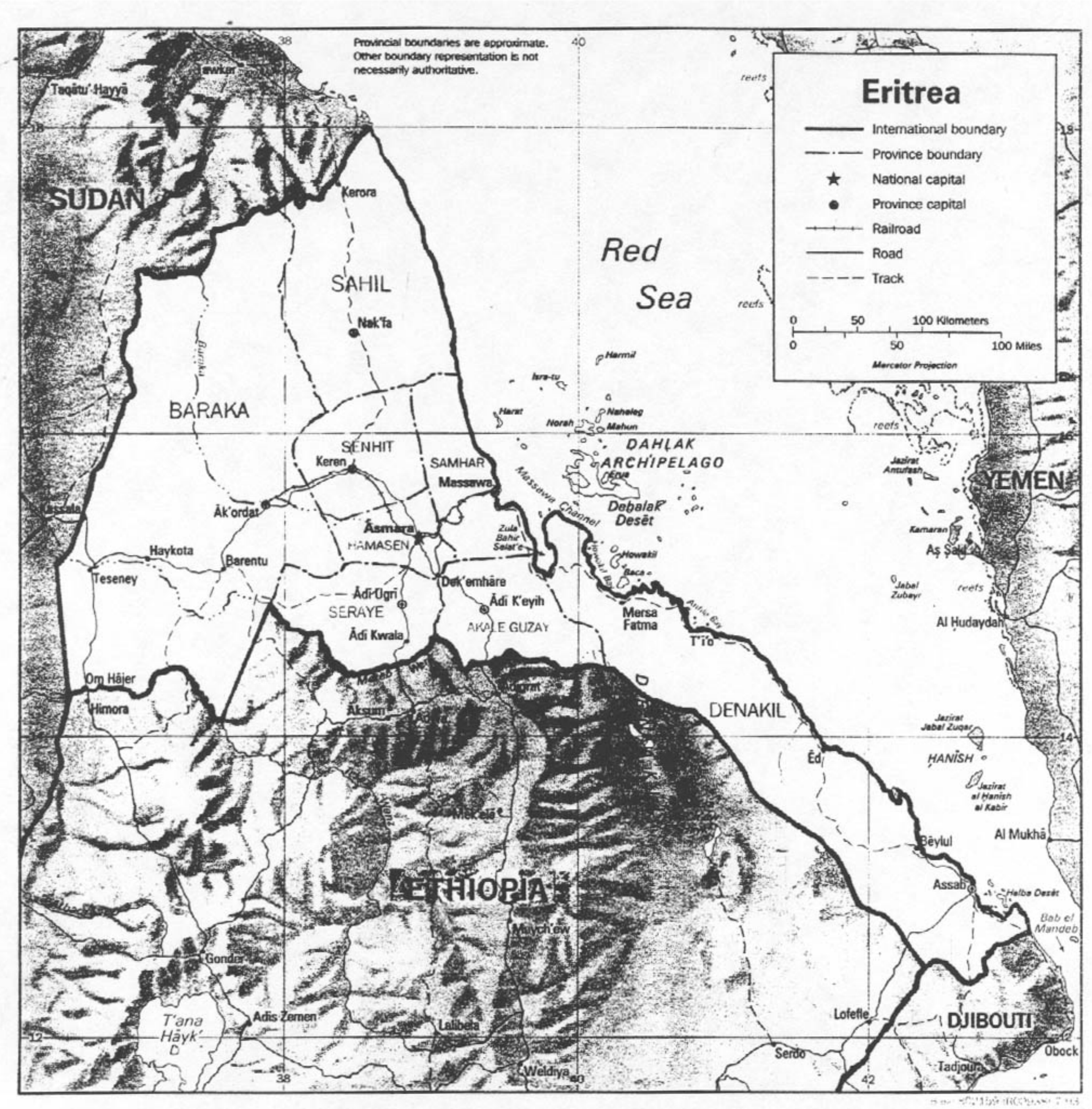
Eritrea--Basic Data

Area, population, and GDP per capita			
Area	124,320 square kilometers		
Population:			
Total	3.0-3.5 million		
Annual growth rate	3.3 percent		
GDP per capita (1993)	US$140-163		

	1992	1993	1994 1/
	(In millions of birr, unless otherwise specified)		
Gross domestic product (GDP)			
GDP at current market prices	2,010	2,537	2,791
	(In percent of nominal GDP)		
Agriculture	28.5	13.1	19.0
Industry	19.3	20.7	18.1
Distribution services	34.1	43.2	43.5
Real GDP growth rate (in percent)	...	-1.5	9.4
	(Annual percentage change)		
Prices			
Consumer prices (end-period) 2/	8.8	9.6	7.4
	(In millions of birr)		
Government finance			
Revenue	500.5	898.8	415.7
Foreign grants	121.0	455.2	167.4
Expenditure and net lending	674.6	1,507.4	715.6
Current	583.2	1,052.1	589.6
Capital	91.4	455.3	125.8
Overall balance (cash, including grants)	-53.1	-153.4	-132.5
	(In millions of birr)		
Money and credit 3/			
Domestic credit	1.0	165.0	457.4
Claims on Government (net)	-91.5	-20.9	-75.2
Net claims on the birr area	1,094.5	1,245.8	1,259.8
Broad money 4/	1,186.8	1,925.3	2,326.7
	(In millions of U.S. dollars, otherwise indicated)		
unless			
Balance of payments 5/			
Exports, f.o.b.	15.2	36.1	27.5
Imports, c.i.f.	331.3	312.2	159.2
Trade balance	-316.1	-276.1	-131.7
Services (net)	72.8	102.0	25.8
Private transfers	180.9	202.5	150.0
Current account balance	-62.4	28.4	44.1
Capital account (net)	226.6	69.9	47.5
Errors and omissions	32.6	36.9	-64.8
Overall balance (deficit -)	196.8	135.2	26.8
Current account balance, excluding grants (in percent of GDP)	-8.7	5.9	...
Gross official reserves			
In months of imports	0.3	3.8	8.8
Exchange rate (Br/US$, period average)			
Auction rate	2.8	5.2	6.1
Preferential rate	6.4	7.1	7.1

1/ January-June, except for GDP estimates.
2/ Based on incomplete data provided by the authorities; 1994 is June-on-June.
3/ End-December except for 1994, which is end-June.
4/ Deposits in the banking system, as data are unailable for currency in circulation in Eritrea.
5/ Includes both birr and non-birr transactions.


Provincial boundaries are approximate. Other boundary representation is not necessarily authoritative.
Eritrea
International boundary
Province boundary
National capital
Province capital
Railroad
Road
Track
0 50 100 Kilometers
0 50 100 Miles
Mercator Projection
Red Sea
SUDAN
ETHIOPIA
YEMEN
DJIBOUTI
SAHIL
BARAKA
SENHIT
SAMHAR
HAMASEN
SERAYE
AKALE GUZAY
DENAKIL
DAHLAK ARCHIPELAGO
HANISH
Kerora
Nak'fa
Keren
Massawa
Ak'ordat
Asmara
Haykota
Barentu
Teseney
Adi Ugri
Dek'emhare
Adi K'eyih
Adi Kwala
Om Hajer
Himora
Aksum
Mersa Fatma
T'io
Ed
Beylul
Assab
Al Mukha
Al Hudaydah
Gondar
Adis Zemen
Lalibela
Weldiya
Lofefle
Serdo
Tadjoura
Obock
Bab el Mandeb
Debalak Deset
Howakil
Mekele
Maych'ew
T'ana Hayk'
Kamaran
reefs

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I. Introduction

Eritrea gained its independence in May 1993, following a vote by an overwhelming majority in a referendum held a month earlier. Eritrea's independence was preceded by an armed struggle that lasted for over three decades and two years of de facto independence following liberation in May 1991. 1/ Damaged by war and recurrent droughts that degraded the environment, Eritrea is presently among the poorest countries in the world and is confronted with a massive need for rehabilitation and restructuring. In the short term, this challenge is further magnified by specific problems related to the integration of Eritrean refugees from neighboring countries as well as ex-combatants into the civilian economy. In sharp contrast, during the early 1940s, Eritrea was considered to be one of the more developed countries in the Eastern Africa region. A government committed to Eritrea's economic development, within the broader context of cooperation and stability in the region, and a diaspora community of successful entrepreneurs and skilled workers represent great assets for the future.

Eritrea is located in northeastern Africa, with a land area of 124,320 square kilometers. It has a coastline of roughly 1,200 kilometers on the Red Sea, and borders Sudan on the west and the northwest, Ethiopia on the south, and Djibouti on the southeast. Its four principal geographic regions include the central highlands at 1,500-2,500 meters altitude (where most larger towns, including the capital Asmara, are located), lowlands to the east and the west, the sparsely populated, hot, and dry Danakil Desert in the south, and the Dahlak Archipelago, consisting of more than 100 coral islands, in the Red Sea. Eritrea's ethnically diverse population is estimated at about 3.5 million; the largest ethnic groups are the Tigrinya of the highlands and the Tigre of the northeastern lowlands. Approximately 80 percent of Eritrea's population is rural.

Reflecting historical and political links, the structure of the Eritrean economy has been influenced by Ethiopia. The two economies are still closely integrated, and the governments have already cooperated in a number of spheres, most notably in ensuring Ethiopia's access to the Red Sea. Eritrea continues to use the Ethiopian currency, the birr, partly owing to lack of prerequisite institutional capacity for the introduction of its own currency. Over the last three years, progress has been made in establishing the country's basic legal and institutional structures, but the Government of Eritrea continues to review its economic policies and reassess its institutional structure. Also, official economic and financial statistics are either virtually nonexistent or inadequate.

The Government of Eritrea principally comprises members of the People's Front for Democracy and Justice (PFDJ)--formerly the Eritrean People's Liberation Front (EPLF). At its Third Congress in February 1994, the party

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1/ See Appendix I for an overview of the political and economic history of Eritrea.

decided to separate the affairs of the Government and the Front and to complete the preparatory steps for establishing a constitutional democracy in the medium term. The National Assembly approved a resolution in March 1994 to appoint a constitutional commission to draft the country's first constitution. 1/

The main economic policy objective of the Government--recently stated in a Macroeconomic Policy Paper--is to create a modern, technologically advanced, and internationally competitive economy within the next two decades, by way of improving agricultural productivity and establishing export-oriented industries as well as vibrant financial and tourism sectors. The Government underscored its commitment to facilitate private investment in all sectors of the economy, to pursue sound financial policies, and to phase out administrative controls, all of which are instrumental to achieving these broad objectives. It also recently approved a number of reforms, including an overhaul of the tax system, the promulgation of a new investment code, and the preparation of legislation relating to land utilization. Furthermore, the restructuring of government ministries and the civil service, and the liberalization of the exchange and trade system are under active consideration. The investment code welcomes foreign investment in all sectors of the economy. Although the Government has declared its intention to limit the role of the state in the economic and financial sphere, a well-articulated privatization program for the state enterprises is yet to be developed.

Eritrea is benefiting from an Economic Recovery and Rehabilitation Project (RRPE) financed in large part by the World Bank and other donors. The RRPE includes an Economic and Financial Management Program (EFMP) to build a basic capacity for economic management in the Government. Over a period of four years or more, the EFMP aims to enhance the institutional capacities for economic management in a number of key agencies, including the Office of the President, the Ministry of Finance and Development, the Bank of Eritrea, and the Commercial Bank of Eritrea. The Program document of the EFMP, a multi-donor technical assistance package coordinated by the UNDP, was recently finalized. Owing to various bottlenecks, however, a full-fledged implementation has not yet started. The Fund has provided technical assistance through several diagnostic missions in 1993, assistance in drafting laws governing financial institutions, and two missions with regard to fiscal management and tax administration, respectively.

1/ The National Assembly, a unicameral body, comprises 134 members, of whom 75 members represent the Central Committee of the PFDJ (formerly EPLF). The National Assembly elects from its membership the President of Eritrea.

II. Real Sector

1. Statistical background

The analysis of Eritrea's real sector is severely hampered by data deficiencies. Eritrea has no official national income accounts or price indices. Some production data regarding performance in major sectors (e.g., agriculture, industry) are compiled by relevant ministries. The Ministry of Industry and Trade compiles monthly price series for about 50 items (mostly food products). A working group organized by the Bank of Eritrea has initiated the compilation of a price index for Asmara; the report has not yet been officially issued. The National Statistics Office (NSO) at the Ministry of Finance and Development, established in May 1993, is officially in charge of collecting key macroeconomic statistics pertaining to the real sector. The NSO has not yet published any data, but plans to conduct various household and economic sector surveys in early 1995.

2. Aggregate output

Reflecting the cessation of the prolonged war in mid-1991, and favorable rains in 1992, economic activity recovered considerably, with nominal GDP reaching about Br 2 billion in 1992 (Table I). The share of the trade and transport sector in 1992 GDP is estimated at 34 percent, while agriculture and industry accounted for 29 percent and 19 percent of GDP, respectively (Table II). 1/

During 1993, despite strong growth in the industry and distribution sectors, real GDP growth was adversely affected by a substantial decline in agricultural output, owing to poor rain distribution, pest problems and drought in some regions. The growth in industry reflected increased availability of raw materials and spare parts, and construction activity related to the rebuilding of war-damaged roads, buildings, and housing. The distribution sector benefited from the growth in the industrial sector as well as a substantial increase in imports, including the receipt of food aid (Table III).

During 1994, agriculture is expected to rebound strongly, while the industry and distribution sectors are expected to maintain the strong pace of growth. The rebound in agriculture reflects various factors, including favorable rain distribution and the Government's successful efforts in controlling pest problems. The 1994 harvest is expected to equal, and possibly exceed, the high production level of 1992.

1/ The figures cited here are essentially staff estimates; aggregate GDP has been constructed by using incomplete production data by major sectors, which provide only a rough order of magnitude.

3. Sectoral developments

a. Agriculture

The agricultural sector--comprising crop production, livestock, forestry, and fishing--constitutes in a normal year about one third of GDP 1/ and absorbs the bulk of the labor force. The prolonged war and recurrent droughts led to a substantial decline in agricultural production, and environmental degradation resulted from clearing of forests for security reasons as well as excessive reliance on fuelwood consumption.

The proportion of land that is being productively utilized is relatively small. About 3.2 million hectares, equivalent to 26 percent of total land area, are estimated to be suitable for agricultural use, but only about 395,000 hectares are currently under cultivation (Table IV). Agricultural production is essentially concentrated in rain-fed staple crops produced by small-scale farmers. Irrigation is limited and is mainly concentrated in the lowlands; it is estimated that about 4,100 hectares are under perennial irrigation, and some 17,500 hectares are under seasonal irrigation. The average plot per farmer is fairly small--about 1-1.5 hectares, particularly in the densely populated highlands--but the plot size increases to some extent in the lowlands, where commercial farms have been developed. Eritrea's different altitudes allow planting of a wide variety of cereals and cash crops.

The rainy season extends from June through September, except in the eastern lowlands where the rainy season starts in October and continues through February. Barley and wheat are typically planted at higher altitudes, while teff and sorghum become important at lower altitudes. Finger millet is widespread throughout because of its drought-resistant nature, and because of the strong demand, boosted by the production of alcoholic beverages. Major oilseeds include sesame and groundnuts which are grown mainly in the lowlands and coastal plains.

In 1992, cereal production reached 3,486 quintals (Table IV); of total production, sorghum accounted for 46.4 percent, millet 20.7 percent, barley 15.0 percent, teff 4.5 percent, and maize 4.4 percent. Given the highly variable and erratic rainfall patterns, farmers normally adopt sequential planting; early-maturing crops are planted first and then later-maturing crops in case of failure. Fertilizer usage is extremely low, partly owing to low incomes and farmers' reluctance to incur a bigger loss in the event of a failure.

1/ Within the agricultural sector, it is estimated that crop production is by far the most dominant subsector (75 percent), followed by forestry (16 percent), and livestock (8 percent). Fishing, despite its potential, is currently insignificant (1 percent).

Most commercial farming activities ceased following nationalization by the Derg regime, and given the worsening security conditions. At present, there are three government-owned commercial farms. The Elaberet estate (in Senhit) covers 1,200 hectares of land, of which 300 hectares are currently under cultivation; it is by far the largest agro-industrial complex in Eritrea and includes citrus, tomato, fodder, pigs, and dairy products. The Government plans to rehabilitate the complex, and then offer it for privatization. The Alighider plantation (in Gash-Setit), before its decline during the war, used to include 5,000 hectares of cotton. At the beginning of 1993, the Government commenced a three-year program to rehabilitate the complex. A substantial part of the farm is now used for a resettlement program for ex-combatants. Ghinda farm (in Ghinda) covers about 80 hectares, and its production includes small amounts of tomato and citrus.

Since mid-1991, considerable efforts have been made to rehabilitate the agricultural sector. With a view to reducing food dependency, the Ministry of Agriculture has launched efforts to replenish depleted farm resources, including distribution of seed, tools, oxen, and other essential inputs. In addition, land concessions are granted (20-100 hectares) for a nominal fee and with leases ranging from 10 to 50 years. However, Eritrea remains heavily dependent on food aid requirements, which range from 150,000 to 300,000 tons depending on domestic production in the preceding year. In collaboration with the Ministry of Agriculture, the Eritrean Relief and Rehabilitation Agency (ERRA) has set up an early warning and food monitoring system, which begins operations in August every year with crop assessments undertaken by ERRA's ten provincial offices. Together with the Food and Agricultural Organization (FAO), the ERRA determines the amount of food aid needed for the following year.

Livestock husbandry is dominant in the western lowlands, even though Eritrea's large livestock sector is estimated to have declined by about 60 percent as a result of the prolonged war. Since 1992, it is estimated that the livestock population has increased somewhat, given the relatively favorable conditions. In the highlands, livestock is used mainly to support harvesting and plowing; the lack of oxen has impeded the cultivation of land. The sector has a large potential in terms of exports of live animals and as a key input to the leather industry.

Reflecting seasonal factors, as well as Eritrea's dependence on food aid, producer prices for staple crops have been highly volatile, adversely affecting farmers in surplus areas. A Grain Board was formally established by the Government in early 1993 to purchase cereals from surplus areas in order to stabilize producer prices and to secure a national food reserve for drought situations. Ten buying centers have been set up in the main surplus producing areas (Gash Setit, Seraye, Semhar, and in southern Sahel).

The land tenure system in Eritrea was previously composed of three categories: the diesa system, where land was collectively owned by the village community or the extended families and reallocated to heads of families every five to seven years by a system of drawing lots; the demaniale system, whereby land was owned by the state and could be leased for renewable periods of 20-50 years to individuals for commercial purposes; and the resti system, which consisted of family ownership of land. The diesa system, which prevailed almost exclusively in the highland areas, where the majority of the rural inhabitants reside, led to increased fragmentation of land and inter-village border disputes.

The Government has recently issued new land legislation focusing primarily on the rural lands in order to reform the tenure system. The new legislation provides ownership of all land exclusively to the Government but farmers are allowed a lifetime lease to currently held land. Each individual, regardless of gender and marital status, qualifies automatically for the right of lifetime use of a specific plot of land. The law requires that the Government pay compensation in the event it takes over privately held land for any purpose. While land cannot be inherited or sold by individuals, a house built on the plot could be sold or inherited. The land legislation will initially be implemented in some selected pilot areas, and a broader implementation will have to await the results of the experience in these areas. 1/

Eritrea's fishing sector has an enormous potential, owing to the country's favorable location on the Red Sea with 60,000 square kilometers of exclusive fishing zone and a remarkable diversity of fish. Currently, fishing is still insignificant, mainly because of a lack of infrastructure and the Eritreans' lack of interest in fish consumption as part of their traditional diet. In 1992 production was virtually nonexistent, under 2,000 tons, despite a potential sustainable yield of 50,000-70,000 tons. The fishing sector is being rehabilitated with increased promotion and investment efforts. The Government has already begun a project of fish stock assessment and monitoring assisted by various nongovernmental organizations (NGOs).

b. Manufacturing

The Eritrean industrial sector consists mainly of processed food, beverages, textiles, leather goods, chemical products, construction materials, and metal products (Table V). A large portion of industrial products are exported to Ethiopia, while some raw materials are imported from Ethiopia. Factories that utilize the output of other industries are few and vertical integration outside the textile industry is virtually nonexistent. Linkages between industry and agriculture are also weak. The sector is dominated by some 40 public enterprises.

1/ A lease system applies in the urban areas instead of the usufructuary approach. Regulations governing Asmara will be completed soon and will be used as an example for other urban centers. Rates at which leases will be offered are under discussion.

The industrial sector suffered considerable damage during the war and the nationalization of private industries by the Derg regime. Consequently, independent Eritrea inherited many factories with outdated or nonoperational machinery. Since 1992, factories have benefited greatly from the Government's rehabilitation efforts; machinery and raw materials have been provided to the factories, and production capacities have increased substantially. Capacity utilization in 1992 varied from 87.5 percent for paper and printing, 9 percent for tobacco and matches, about 75 percent for the metal and nonmetallic industry, 69 percent for beverages, and about 23 percent for textiles, leather, and shoes (Table V).

c. Energy

Most of the electricity generated in Eritrea is consumed in the urban centers. The rest of the country is dependent on fuelwood and biomass, with significant adverse impact on the environment. Currently, only about 10 percent of the population has access to electricity. All electric power is generated from thermal power plants; most of them are equipped with diesel engines. The nationalization of electricity-generating enterprises in 1975 adversely affected the capacity and efficiency of the power system, and destruction and poor maintenance caused most of the electricity plants to become nonoperational. Currently, the Eritrea Electric Authority (EEA), operates an Inter-Connected System among Asmara, Massawa, and surrounding areas, supplied by four power stations; there are self-contained systems for provincial towns. The scarcity of generation capacity has forced the EEA to impose restrictions on industrial consumers to use minimum electricity during the peak hours of household consumption in the afternoon and the evening. Based on the present scarcity and expected increased demand in the medium term, the EEA has recently contracted for the supply of three new medium-speed diesel units, which will be located in Asmara and are expected to be in operation by the end of 1995. The electricity tariffs were increased sharply in 1992, reflecting a government decision not to subsidize the EEA operations.

The petroleum refinery at Assab produces petroleum products on behalf of both Eritrea and Ethiopia under mutual agreement. As the Assab refinery was the only refinery in Ethiopia, and considering the essential nature of its products, a production and distribution sharing arrangement was reached by the two governments (Chapter V). In 1993 Eritrea purchased a total of 169,871 metric tons (MT) of petroleum products from Ethiopia, which represented 26.5 percent of the production, and about 90 percent of the then allocated quota (Table VI).

Ex refinery and retail prices of petroleum products are reviewed and set twice a year by a committee established by the Government (Table VII). In contrast to frequent changes in ex refinery prices, the retail price was revised only once in October 1992, along with the devaluation of the birr. The margin between the ex refinery price and retail price has been set wide enough to absorb increased costs of the refinery as well as to avoid volatility in retail prices. Petroleum product distribution is managed by private companies (Shell, Mobil, Total, and Agip) through their own network of independent retailers.

d. Mining

Exploration for base metals (ore containing a mix of metals) started at the end of the 1960s, and mining by a Japanese company at Debarwa started in 1973. These activities stopped in 1974, because of the political situation, after one shipment of 2,000 tons had taken place. In addition to the Debarwa mine (with an estimated reserve of 1.6 million tons), there are three other explored mines for base metals of different grades, with considerable probable reserves.

e. Construction

In 1993, the Government, with support from the RRPE, began to rehabilitate public enterprises, giving priority to the construction sector, notably the rehabilitation of the cement, metalworks, and limestone factories. In the process, the corrugated iron sheet factory, which had been idle for about 25 years, and the limestone factory, which had been closed for about 18 years, were rehabilitated. Construction activities have also focused on rebuilding government offices, commercial, and residential buildings, as well as reconstructing roads and other infrastructure.

f. Transportation

Eritrea's transport sector is at a very early stage of development. The country has very low road density, and roads that constitute the main network were constructed during 1934-38. It is estimated that only 1,000 kilometers of the road network are in reasonable condition. There is an adequate commercial trucking capacity, which comprises privately owned fleets and the fleet of the government-owned Freight Transport Corporation. Operations of all airports are handled by the Civil Aviation Authority; the Asmara International Airport operates on a 24-hour basis, although substantial investment in communication and navigation is necessary in order to meet the International Civil Aviation Organization standards. A large share of the activities at the ports are related to food aid, of which some 25 percent is channeled to Ethiopia; the tariffs (i.e., charges and fees) vary with respect to the specific service concerned. A storage charge is applied 15 days after the ship leaves the port except for consignments to Ethiopia, which are charged after 30 days. Rates on handling fees are uniform. All tariffs are stated in dollar terms but Ethiopia pays all charges and fees in birr.

4. Prices, wages, and employment

a. Prices

As noted above, there are no price indices in Eritrea. Price developments, measured by a crude index for Asmara indicate that end-period annual inflation rates in 1992 and 1993 were at 8.8 percent and 9.6 percent, respectively. 1/ Price developments during the first half of 1994 have shown some volatility, with an annual inflation rate of 7.4 percent at end-June 1994. The effect of last year's poor harvest is reflected in the large price increase in the cereal component of the price index (Table VIII).

With a view to establishing a market economy, the Eritrean Government has abolished most of the price interventions and controls over the past three years. Prices of beverages (soft drinks and alcoholic drinks), flour, bread, pasta, fuel, mineral water, pharmaceuticals, detergents, and cement were controlled until August 1994. Since then, prices have been decontrolled except for flour, bread, petroleum products, and pharmaceuticals. The controls on prices of flour and bread are expected to be eliminated in the near future.

b. Employment

The Ministry of Labor routinely compiles summary statistics with respect to developments in the urban labor market (Table IX). Despite statistical problems, the figures provide an indication of the urban labor market situation in Eritrea. The public sector dominates formal urban employment, with the civil service and public enterprises accounting for a large share of employment. Employment in the private sector has begun to show signs of recovery, especially in the urban informal services sector, such as shops, hotels, restaurants and bars. Nevertheless, the number of registered unemployed increased by some 58 percent in the nine months after September 1993 to about 66,200, while the increase of reported vacancies during the same period was only 39 percent, implying a worsening of the employment situation. In the rural areas, work on family farms constitutes the major source of employment, with commercial agriculture recently showing a slight recover from the devastation of the war.

Considerable overemployment in many public enterprises existed at the time of liberation. However, since May 1991, public enterprises have tried to retain staff and to increase productivity through rehabilitation efforts and the introduction of more shifts, and through the transfer of staff from less productive to more productive factories. Retrenchment has taken place only on a voluntary basis with no provision of any special incentives.

c. Wages

The relative wage structure (Table X) indicates that starting salaries for low-skill occupations are higher in the public sector while those for high-skill occupations are relatively uniform across public and private employment. The Government increased the minimum wage in the civil service from Br 50 to Br 70 soon after liberation. Subsequently, in October 1992,

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1/ The index was constructed based on commodity price data for Asmara compiled by the Ministry of Trade and Industry.

civil service wages were increased across the board, including a further rise in the minimum wage from Br 70 to Br 140. A general review of the salary structure is under way in the context of the planned restructuring of the Central Government. A committee established by the Government has studied this issue and has submitted a proposal to the Government.

5. Private sector investment

In August 1994, Eritrea issued a new investment code, which replaced the code that was issued in 1991. The new code eliminates special tax holidays, 1/ provides a lower tax rate for investment income, and grants 100 percent foreign exchange retention to exporters. In addition, new investment registration procedures will be streamlined and the Eritrean Investment Center (EIC) is obligated to respond to the applicants within ten days. The EIC will promote investment and provide information about investment opportunities; organize advisory and training services for local investors; assist foreign investors in acquiring the necessary legality for their investment; keep registers of certifications and technology transfer agreements; and advise the Government on investment policy matters. The EIC will have a Managing Director appointed by the President and will be funded through fees and charges, proceeds from sale of publications, and government assistance. Since January 1992, the EIC has approved some 210 investment projects in the areas of manufacturing, fishing, and hotels. Despite the strong interest from investors, the Government is fully aware of, and intends to address, investment constraints such as power shortages, poor infrastructure and communication, and skill shortages. Land legislation has also added uncertainty to investors. 2/

The objectives of the newly issued investment code are to encourage investments that develop and utilize the country's natural resources, to expand exports and encourage competitive import-substituting businesses, to create and expand employment opportunities, to encourage the introduction of new technology in order to enhance production efficiency and thereby optimize resource exploitation, to encourage regional growth and development, and to encourage small- and medium-scale enterprises. Basically, all economic sectors are open to all investors, although foreign investors cannot participate in domestic retail and wholesale trade or import activities, unless Eritrea has a bilateral agreement of reciprocity with the country of the investor. 3/

1/ The Government nevertheless maintains that special fiscal incentives could be granted to attract foreign investors in those areas that are deemed crucial.

2/ Under the proposed land lease system, investors can access urban land for leases on a case-by-case basis by going through sequentially the Investment Office and the Land Commission at the President's Office.

3/ This precondition can be waived by the Government.

The fiscal incentives for new investment include the following: all sales taxes will be rebated on materials and inputs that have been used for export production, exports have been exempted from export duties and sales taxes, and the highest income tax rates have been reduced sharply, to 35-38 percent (Appendix II). Furthermore, corporate profit set aside for reinvestment purposes are subject to a 20 percent income tax and there are no taxes on declared dividends, while any loss incurred during the first two years of operation can be carried forward for three consecutive years.

Investors, in accordance with the regulations of the Bank of Eritrea (BE), may open and operate foreign exchange accounts in Eritrea, and use the foreign exchange for procurement necessary for the operations of their investments. The BE will grant foreign exchange to all investors, with priority to exporters, subject to its rules and regulations. Investors can retain up to 100 percent of their export earnings in foreign currency in Eritrea in accordance with BE regulations.

At the prevailing exchange rate, foreign investors can remit net profits and dividends accrued from investment capital, and debt-servicing payments for a foreign loan incurred pursuant to this new investment proclamation. Also, the following payments will be unrestricted: fees or royalties in respect of technology transfer agreements, proceeds received from liquidation of investment, and payments received from the sale or transfer of shares. Expatriates employed from abroad in accordance with this proclamation and the labor laws may remit savings from their salaries under the foreign exchange regulations of the BE.

III. Public Finance

1. Background

Eritrea's fiscal system is still evolving. Since liberation in May 1991, the Eritrean Government has tried to integrate the system operated by the Ethiopian Government and that of the EPLF. Prior to May 1991, Eritrea was divided into two Ethiopian Provinces, Eritrea and Assab, and the Provincial Administrations used a fiscal framework of a centrally planned economy that was generally characterized by cumbersome administrative methods. Moreover, given the political situation, the Ethiopian Provincial Governments could not count on much support from the Eritrean population, and their reach was largely restricted to the formal sector of major towns.

The EPLF operated its own fiscal system in liberated areas, which relied substantially on voluntary contributions from both within and outside Eritrea. In addition, the EPLF derived revenue from EPLF-owned commercial enterprises such as the Red Sea Trading Corporation and the Nacfa Corporation, while receiving external support through the Eritrean Relief and Rehabilitation Agency (ERRA). For example, the EPLF's customs duty administration was simpler than Ethiopia's, and its maximum rate (60 percent) was lower than Ethiopia's maximum tariff rate of 230 percent.

Since liberation in May 1991, the Government has undertaken a number of fiscal reforms with the objective of establishing a unified fiscal system that is consistent with the Government's declared policy of creating a free-market economy. The tax system has been reformed gradually, and the tax administration has been strengthened. 1/ Moreover, beginning in 1992, the Eritrean Government adopted the calendar year as its fiscal year.

Eritrea's public sector comprises the Central Government, local governments, and a number of parastatal agencies and public enterprises. The Central Government consists of the President's Office: 16 ministries; and several agencies and commissions, including the Office of the Auditor General, the ERRA, the Commission for Eritrean Refugee Affairs (CERA), the Land Commission, the Constitutional Commission, and the Investment Center. The local government sector consists of the ten Provincial Administrations and major municipalities.

2. Overall fiscal developments

Fiscal performance in Eritrea since 1992 has been strongly influenced by the legacies of the past, the economic structure of the country, and the process of economic recovery and rehabilitation. The Government's fiscal policy stance was generally prudent in 1992, but fiscal pressures increased during 1993 and the first six months of 1994. The overall budget deficit (including grants and on a cash basis) was limited to Br 53 million, or 2.6 percent of GDP in 1992; however, the deficit rose to Br 153 million, or 6.0 percent of GDP in 1993, and surpassed Br 133 million in the first six months of 1994 (Table XI). In 1993, revenue rose sharply, by about 80 percent compared with the previous year; during that year, tax revenue amounted to 20.4 percent of GDP, while nontax revenue, largely derived from port fees and charges, was particularly significant at 15.1 percent of GDP. However, expenditures rose by more than 120 percent to 59.4 percent of GDP. During the first six months of 1994, available data for revenue and current expenditure indicate that spending continued to grow at a faster pace than revenue.

The fiscal deficit during 1992-93 was largely financed by a drawdown of government deposits with the domestic banking system. In the first six months of 1994, a further drawdown of deposits was the major source of financing for the budget deficit, even though external financing, provided through a World Bank loan under the RRPE, increased to about Br 37 million.

3. Revenue and grants

a. Tax revenue

Tax revenue performance was generally favorable during the period under review, starting at about 15 percent of GDP in 1992, and increasing to about

1/ See Appendix II on recent changes in the tax system.

20 percent of GDP in 1993 (Table XII); in the first half of 1994, the rising trend accelerated and surpassed the comparable period in 1993. Tax revenue performance in 1992 was understandably modest and reflected the war's after-effects on economic activity and the inadequate revenue administration in the fledgling Government. The substantial rise in tax revenue during 1993 and the first half of 1994 are attributable to the strong recovery in the nonagricultural sectors, improvements in tax administration, and substantial obligatory and voluntary contributions of the population to the country's rehabilitation efforts. 1/

Revenue from direct taxes was relatively low in 1992, largely because of low receipts from the business profit tax. 2/ Revenue from the personal income tax and other direct taxes was also low, while revenue from the rehabilitation tax was already significant. In 1993, direct tax revenue increased sharply, reflecting a surge in business profit tax receipts stemming from a strong recovery in the nonagricultural sectors. Revenue from the personal income tax also rose sharply, thanks to an increase in employment, the favorable developments in the nonagricultural sectors, and the October 1992 civil service salary adjustment. Other direct tax collections, including the agricultural income tax and land use fee, and the tax on dividends also rose strongly (albeit from a very low base), mainly because of improved tax collection. Revenue from the rental income tax remained low because this tax did not become effective before July 1993.

The positive trend of tax revenue continued during the first six months of 1994. Receipts from the personal income tax were already higher than for the whole of 1993, reflecting mainly a further increase in employment in the private sector. Receipts from the business profit tax also showed a favorable outcome, with revenue almost reaching the level of the full year 1993. While no data were available for revenue from the rehabilitation tax during the first half of 1994, revenue from other direct taxes was much lower compared with their levels during the same period in the preceding year.

Revenue from domestic indirect taxes was already substantial in 1992 and rose considerably in 1993, thanks to the strong recovery of the industrial and service sectors; however, revenue growth decelerated during the first six months of 1994. However, the share of domestic indirect taxes in total government revenue declined from 22 percent in 1992 to about 16 percent in 1993 and the first half of 1994.

Import duties and taxes were the most important source of tax revenue in 1992 and 1993. However, revenue from import duties and taxes in the

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1/ See Appendix III for a summary of Eritrea's tax system.

2/ The assessment of the business profit tax for incorporated enterprises is carried out on the basis of profits in the preceding fiscal year, and since most of these enterprises were still in a rehabilitation phase during 1991, tax receipts were low during 1992.

first six months of 1994 was unchanged from the level of the comparable period in 1993. Export tax revenue was very low in 1992 but more than tripled in 1993, and showed a favorable result in the period January-June 1994, clearly reflecting the increase in exports, which was particularly pronounced during the first half of 1994. However, the export tax has so far contributed only marginally to tax revenue, mainly because of the limited tax base.

b. Nontax revenue

During the period 1992-June 1994, nontax receipts contributed heavily to government revenue; in 1992 and 1993, nontax revenue amounted to 38 percent and 43 percent of total revenue, respectively, before declining to 29 percent in the first half of 1994 (Table XII). The most important nontax revenue items are fees and charges from Eritrea's two major ports, Assab and Massawa, through which the country's exports and imports, as well as a significant share of Ethiopia's international trade, are shipped. 1/ Receipts from port fees and charges were already high in 1992, and increased by 63 percent in 1993. During the first six months of 1994, port receipts were relatively low compared with the level of 1993, but this may not adequately reflect actual developments because of a time lag in reporting. 2/

Other significant nontax receipts since 1992 included voluntary contributions to the country's rehabilitation and recovery process, nonport fees and charges, pension contributions, and proceeds from sales of goods, services, and government property. The strong increase in revenue from these sources in 1993 largely reflects a substantial transfer of funds from other government units to the Ministry of Finance and Development's Budget Office. In 1992, a number of ministries and other spending units had retained revenue from fees and charges; in 1993, such receipts were transferred to the Budget Office.

c. External grants and loans

Incomplete data have made it difficult to obtain a clear picture of external grant assistance to Eritrea, apart from food aid. However, the Ministry of Finance and Development has recently begun to collect data on external grant financing on a systematic basis for fiscal year 1993, and to establish a permanent system of reporting for all central government ministries and institutions. Based on available official data, in 1992 Eritrea received food aid of Br 121 million (US$43 million). In 1993, total external grant assistance was recorded at Br 455 million

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1/ More than 90 percent of shipments through Assab and about 30-40 percent of goods channeled through Massawa are destined for or originate from Ethiopia.

2/ A delay in reporting occurred in 1993, when most port revenue was received by the Government during the second half of the year.

(US$88 million); Br 91 million accounted for food aid, and Br 365 million was for capital budget support (Table XII). A large share of the capital support (Br 110 million or US$22 million) was through the RRPE. 1/ In the first half of 1994, total external grant disbursements amounted to Br 167 million (US$27 million); RRPE disbursements accounted for Br 55 million, and food aid was Br 111 million. 2/

Counterpart funds, which could be expected to become a major source of financing for the government budget in the years to come, have so far not played a role as a financing source for government operations. Until mid-1994, a total of Br 10 million was generated and deposited to government accounts. In 1994, the Government and donors negotiated an agreement pertaining to the generation, management, and use of counterpart funds. Based on this agreement, private enterprises have to pay counterpart funds to the Government for donor-financed imports when the foreign exchange allocated by the Bank of Eritrea is utilized; public sector agencies and commercial enterprises pay the counterpart funds after imports have arrived in the country. The RRPE-Management Unit has been given the responsibility for monitoring the generation of counterpart funds and for reporting periodically to donors. The agreement also stipulates that counterpart funds will be used for general budget support, i.e., there is no earmarking of funds within the budget.

4. Public expenditures

a. Recurrent expenditures

Recurrent expenditures increased from about 29 percent of GDP in 1992 to about 42 percent of GDP in 1993; during the first half of 1994, recurrent outlays were more than twice the level of the same period in 1993 (Table XIII). A number of factors are responsible for the sharp rise in recurrent expenditures in 1993 and the first half of 1994, including an increase in the number of civil servants and civil service wage payments, higher outlays for demobilization, and rising expenditures in the context of rehabilitation activities and strengthening of government institutions.

Regarding developments in recurrent expenditures by economic classification, available data preclude a detailed analysis for the following reasons. First, there is generally no adequate distinction

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1/ Donors pledged a total of US$114 million to the RRPE; in addition to a World Bank/IDA credit of US$25 million, other major donor contributions to the RRPE come from Italy, the European Union (EU), Sweden, Germany, Denmark, the Netherlands, and the UNDP.

2/ Food aid data are available from the Eritrean Relief and Rehabilitation Agency (ERRA) and the World Food Program (WFP), which both appear to have a relatively good overview of food aid shipments coming into the country. However, external trade data would indicate that food aid and other grant-financed recurrent expenditures may be higher.

between recurrent and capital expenditures. According to the authorities, a substantial part of outlays recorded as recurrent during 1992 and 1993 may have been misclassified capital expenditure owing to lack of expertise in line ministries and the Budget Office. Second, until the beginning of 1994, outlays for wages, salaries, and allowances on the one hand, and materials on the other, were not classified consistently. For example, during 1993 some personnel-related general costs and demobilization outlays were included in material expenditures, which to some extent explains the sharp increase for material outlays in 1993, and the comparatively low level of material outlays in the first half of 1994. Such classification problems also could result in understating the government wage bill for 1993.

Data deficiencies aside, outlays for wages, salaries, and allowances rose markedly during 1993 and the first half of 1994. The increase in the wage bill is partly explained by the October 1992 wage adjustment for the 16,100 civil servants and about 5,000 contractual staff working for the Government. The minimum monthly wage was doubled from Br 70 to Br 140; percentage increases were substantially lower for higher salary grades. Following these adjustments, the compression in the civil service wage scale became more accentuated; the compression ratio of the lowest and highest professional salary groups fell from 4 to 3.1.

Expenditure outlays for ex-combatants have also been a significant element in the recurrent budget since 1992. A large number of ex-combatants have been working for the Government in exchange for free housing, food rations, and pocket money equivalent to US$10 a month; most of these ex-combatants have been involved in rehabilitation activities. Precise data on outlays for ex-combatants are not available, but total recurrent expenditures of the Ministry of Defense for 1993 and the first half of 1994 indicate that these costs have been very substantial.

Regarding the ex-combatants working in the civil service, the Government decided to include about 6,000 in the permanent establishment and has begun to pay regular monthly salaries of Br 450 plus Br 10 for each year of service for the EPLF. 1/ The Government is committed to pay all of these 6,000 ex-combatants their full salaries retroactive to January 1, 1994, once the process of civil service restructuring is finalized. As the total number of civil servants (excluding the ex-combatants) has remained unchanged, the increase in the 1994 wage bill is largely explained by the above changes.

More significantly, the Government has incurred considerable expenditures since 1993 through the demobilization of ex-combatants. During

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1/ In many government institutions, important and high-level posts after liberation have been filled with ex-combatants, and ex-combatants constitute a varying but often significant fraction of employment. For example, about half of the staff of the Ministry of Health and about one fourth of the staff of the Ministry of Education are reportedly ex-combatants.

1993, the Government demobilized about 25,000 ex-combatants, following the last-in-first-out principle. Each of these ex-combatants received a lump sum of Br 2,500-5,000, which resulted in total costs of about Br 100 million. 1/ In 1994, the demobilization efforts have continued and it is envisaged that an additional 17,000 ex-combatants will be demobilized during the year. The Government is committed to pay each of these long-serving ex-combatants a lump sum of Br 10,000 when they are demobilized. Also, US$30 for each month of service for the EPLF will be paid sometime in the future. For 1994, the Government has budgeted about Br 140 million to finance this year's demobilization exercise, but actual costs are very likely to be higher, if contingencies such as transport as well as costs for targeted safety net measures are considered.

In 1993, material outlays more than doubled from their 1992 level; although classification problems exist, this expansion nevertheless reflects a substantial increase in rehabilitation activities. Grants and contributions have so far been of minor importance; in 1993, the largest grant was provided to the Grain Board (Br 11 million) as start-up capital and to finance grain purchases. 2/ Given Eritrea's favorable position in terms of domestic and external debt, interest payments have so far been negligible.

Public enterprises have not received any (explicit) operating subsidies from the budget since May 1991, following the Government's policy of mandating hard-budget constraints. However, an implicit subsidy may have recently evolved through delayed payments of counterpart funds, and public enterprises benefited from the freezing of debt service on credits that had been taken up prior to May 1991. Also, cross-subsidization among industrial-sector public enterprises was reportedly undertaken in 1992 and 1993; however, this has been officially discontinued since the beginning of 1994.

A proper analysis of recurrent expenditure trends in functional terms is difficult, because of substantial classification problems. For example, costs for maintaining and demobilizing ex-combatants, is included in the defense portfolio, which results in extremely high percentage shares for defense. Accordingly, based on available data, defense-related expenditure since 1992 has been very high, partly reflecting the burden of maintaining a large number of ex-combatants. No breakdown is available as to the share of nonmilitary and military recurrent outlays, classified under the portfolio of the Ministry of Defence, which were about about 13 percent of GDP in

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1/ Including some contingencies for transport, and food rations, but excluding costs involved in rehabilitation and retraining programs.

2/ In principle, the category grants and contributions consists of (i) grants to individuals (e.g., scholarships), (ii) block grants to domestic institutions for various purposes, and (iii) contributions to domestic (e.g., churches) and international organizations (e.g., United Nations).

1992, and 21 percent of GDP in 1993 (Table XIV). During the first six months of 1994, recurrent defense expenditures were substantially higher than the level of the comparable period in 1993.

Recurrent expenditure for economic services has been comparatively low since 1992, with the possible exception of outlays for agriculture, transport, and communication. Recurrent expenditures for social services, in particular health and education, were also very modest. Outlays for health and education were 2.3 percent and 2.5 percent of GDP in 1992 and 1993, respectively. Although available data for the first half of 1994 would indicate a rising trend in recurrent outlays for health and education, underfunding, especially with regard to materials (e.g., drugs, school books) may already prevail, considering the pace at which the Government has increased the number of health facilities and schools. 1/ At the same time, efforts to achieve adequate staffing and material supply for these additional facilities will likely result in further substantial pressure on the recurrent expenditure.

b. Capital expenditures

The analysis of capital expenditure trends is constrained by data classification problems and by inadequate data on donor-financed capital expenditure. Taking into account capital expenditure financed by the Treasury from own resources, capital outlays amounted to about Br 90 million in both 1992 and 1993 and about Br 34 million in the first half of 1994 (Table XV). However, total capital expenditure was significant in 1993, as external financing of capital outlays amounted to Br 365 million. Regarding the sectoral distribution, capital expenditures in 1993 were particularly high in agriculture and natural resources (about 54 percent of total capital expenditure) (Table XV). Capital outlays in 1993 for roads, transport, construction, and communication accounted for about 13 percent of total capital expenditure. Capital outlays for social development were relatively low in 1993, which would appear somewhat inconsistent with the large increase in the number of health and education facilities that have been constructed. However, this can be explained by the fact that many of these facilities have been established or rehabilitated by ex-combatants, and with substantial contributions from local communities, either in cash or in kind.

5. Government decentralization

In 1992, the Eritrean Government initiated a process of decentralization. The local government sector in Eritrea now consists of ten Provinces (including Asmara) and three municipalities, Asmara, Assab,

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1/ According to official data, in 1991, Eritrea only had 8 hospitals, 4 health centers, and 45 health stations; by mid-1994, there were 17 hospitals, 32 health centers, and 120 health stations under the administration of the Government. During the same period, the number of schools almost tripled, to about 600.

and Massawa. 1/ Provincial Administrations and Municipalities now enjoy a considerable degree of autonomy in political terms, but they still largely depend on the Central Government in terms of institutional capacity, fiscal management, and financing. For example, Provinces and Municipalities cannot freely introduce or change existing local taxes; all tax policy initiatives must be authorized by the Ministry of Local Government.

In principle, the three major municipalities should be financially independent from the Central Government; however, so far this has only been achieved in the case of Asmara. The provinces have only few revenue instruments and a limited tax base, consequently they have to rely strongly on Central Government transfers for financing. About 62 percent of the 1993 total expenditure of Provincial Governments was financed from central government grants channeled through the Ministry of Local Government; own revenue accounted for about 11 percent and voluntary community contributions represented 27 percent.

The Asmara Municipality has a fairly well-established administration and its tax base is supported by the large mumber of public and private enterprises located in the city. Since 1992, both the revenue and expenditure of the Municipality have increased sharply. The Municipality's major revenue instruments include a surtax on business profits and local sales taxes. In contrast, Massawa, which was damaged heavily during the war, has a very limited tax base and lacks institutional capacity; this year, about 50 percent of the Municipality's total budget is expected to be financed through central government transfers.

6. Civil service reform and safety net measures

The Government plans to undertake a major civil service restructuring which, over the medium term, would involve a reform of the civil service pay structure, organizational reform, and a reduction in the number of civil servants. The authorities intend to establish a small and efficient government administration that is free of corruption. In this context, the Government plans to establish an autonomous revenue authority, comprising both the Inland Revenue Administration and the Customs Administration.

Since May 1991, the Government has initiated a number of important safety net measures for a variety of target groups, including demobilized ex-combatants, refugees, and those who were adversely affected by the war. One of the safety net measures for ex-combatants is a resettlement program on the Alighider state farm in the western lowlands. In 1993, about 5,000 hectares were allocated under lease arrangements to some

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1/ The other provinces are Akele-Guzai, Barka, Dankalia, Gash-Setit, Hamasien, Seraye, Semhar, Senhit, and Sahel; in addition to the three major municipalities, each province has a varying number of minor municipalities. Lower levels of local government comprise 35 subprovinces (sub-aurajas), 184 districts (waredas) and about 2,400 villages.

1,500 ex-combatants, who have begun to produce cotton, plus some other crops (e.g., sesame, sorghum) on irrigated plots. These farmers are provided extensive services and other support by the Government. Other safety net measures for ex-combatants are providing vocational training, including programs for teachers and nurses; and credits and other support necessary to establish small-scale enterprises. The Government has given ERRA the mandate to coordinate all activities with regard to the demobilization of ex-combatants.

The Government also initiated a program for the return and the resettlement of refugees in Eritrea. 1/ In collaboration with the UN High Commission for Refugees (UNHCR) and other donors, the Government has initiated a Program for Refugee Reintegration and Rehabilitation of Resettlement Areas in Eritrea (PROFERI). After lengthy and protracted negotiations between the Eritrean and Sudanese Governments and UNHCR, agreements have recently been signed; PROFERI is coordinated and implemented by the Commission for Eritrean Refugee Affairs (CERA), and a number of other donors have pledged to support this program. A pilot project to resettle 4,500 families (15,000-20,000 people) is already under way. In general, resettlement programs for the refugees would involve activities such as food-for-work programs, agricultural projects, constructing low-cost houses and rehabilitating infrastructure, and vocational training programs.

Other safety net measures focus on the large number of people adversely affected by the liberation war. According to official information these include about 100,000 orphans and widows as well as about 44,000 disabled civilians. A large number of food-for-work projects and other public works programs have been initiated since liberation, mainly targeted to those who have to rely on food aid, either temporarily or permanently; these measures have made an important contribution to the infrastructure and environmental rehabilitation, for example, through road reconstruction, and terracing and reforestation schemes.

The Government has also initiated a National Service Program. In July 1994, the first 10,000 men from the capital, Asmara, were conscripted and began a six-month military training and service program, which will be followed by a year of national service (e.g., reconstruction, reforestation). The Government intends to expand this program on a nationwide basis, by taking in a further 20,000 young men and women, starting in January 1995.

7. Public enterprises

The Government owns 43 industrial public enterprises, most of which are located in Asmara: 3 large-scale agricultural farms, 11 hotels; and a number of other enterprises in the services sectors. This excludes a few

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1/ According to official sources, about 70,000 refugees have already returned spontaneously to Eritrea, while about 430,000 remain in camps in the Sudan.

enterprises that had been nationalized under the Ethiopian Derg regime but were returned to their previous owners in May 1991.

The Government has so far focused on rehabilitating of the industrial public enterprises, because most factories had outdated machinery, lacked adequate maintenance, and operated at low capacity levels. In this rehabilitation process, enterprises in the construction sector (e.g., Massawa Cement Mill), as well as some selected others (e.g., Massawa Salt Works) have received the highest priority. Available information indicates that this policy has been successful in terms of substantially improving capacity utilization rates, productivity, and profitability.

Since 1991, the Eritrean Government has begun to give more and more autonomy to public enterprises. At present all public enterprises in the industrial sector are fully autonomous in terms of management, wage and employment policies, price setting, and marketing; capital investment is the only area where the Government still has a direct influence. Moreover, the Eritrean Government is principally committed to the privatization of public enterprises in the productive sectors in a gradual and phased approach. Asset valuation has been completed for the large majority of the 43 public enterprises in the industrial sector, and the authorities have identified certain criteria that will be used in determining the privatization process. It is intended to sell small enterprises first; those with a "strategic role" or a monopoly position will be sold later.

Regarding the hotels, which are all owned by the Eritrean Tourism Service (ETS) Corporation, a tender was published in late 1993 for the sale or "lease under management contract" of eight hotels in Asmara; the tender was explicitly directed at both domestic and foreign investors. 1/ According to official information, until mid-1994, a number of bids were received, but the bids were reportedly too low to be accepted by the Government; and some bidders were not considered sufficiently qualified. However, very recently, the Nyala Hotel was sold to foreign investors, and the Ambassador Hotel was returned to its previous owner. The Government has also indicated its intention to complete the divestiture of all hotels before the end of 1994. Early privatization plans for the two major state farms (Elaberet and Alighider) have so far not been successful. The Government has declared its intention to undertake a major rehabilitation of both farms, and then to offer them to private investors. Large parts of the third farm (located in Ghinda) have been given to farmers for cultivation.

1/ Including the Nyala, Selam, Ambasoira, Hamasien Hotels in Asmara, the Dhalak and Red Sea Hotels in Massawa, the Keren Hotel in Keren, and the Zerai Deres Hotel in Assab.

IV. Monetary Sector

1. Institutional structure

The financial system in Eritrea consists of a few government-owned institutions, including the Bank of Eritrea, the Commercial Bank of Eritrea, two specialized banks--the Agricultural and Industrial Development Bank and the Housing and Savings Bank--and the National Insurance Corporation. The system is currently operating under a temporary Proclamation (No. 32/1993), and comprehensive legislation governing the functions and the authority of the central bank--the Bank of Eritrea Act--has recently been submitted for government approval.

The Bank of Eritrea (BE), formerly a branch of the National Bank of Ethiopia (NBE), holds the formal status of a central bank, although its current policymaking capacity and operations are limited both by severe shortages in skilled personnel and Eritrea's continued reliance on the Ethiopian birr as its sole legal tender. Despite its legal authority, the BE is not yet in a position to effectively exercise supervision over the financial system and there are no statutory reserve requirements in place, even though the Commercial Bank of Eritrea (CBER) customarily maintains a fraction of its deposits with the BE. 1/ The Central Bank has recently introduced a rediscount window, although the facility is not yet operational, partly owing to the extremely liquid position of the CBER.

However, in addition to the new legislation on the central bank, the BE has taken a number of steps to enhance its capacity as a policy making authority and to assume a pivotal role in Eritrea's financial system. In the personnel area, a redeployment and reevaluation program for the existing staff as well as a new recruitment policy targeting employment of both domestic and foreign staff (including foreign consultants) are under way, along with an overall reorganization and restructuring of the BE. An advisor to the Governor of the BE has been provided by Germany and two more consultants (in the areas of monetary analysis and supervision) have been requested from the same German agency. Furthermore, a decision was taken in late 1993 to have all central government accounts transferred from the CBER. This followed an earlier decision to separate the central and local government deposit accounts at the CBER as of September 1, 1993; prior to that date it was not possible to distinguish central and local government balances that were not separated in the CBER accounts. Also, the BE has taken steps to strengthen its role as the manager of the country's foreign exchange reserves; however, this process has been delayed owing to technical difficulties in separating the accounts of the Government and the EPLF.

The Commercial Bank of Eritrea dominates the financial system, and acts in part as an agent for the BE. There are 11 branches across the country, and 2 more are planned to open soon. The operations of the CBER are

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1/ These balances are not renumerated.

constrained by various bottlenecks, one of which is a major lack of skilled personnel. In May 1991, about one third of the total staff, all senior personnel from Ethiopia, left Eritrea, leading to a shortage of skilled and experienced personnel at the CBER. A number of staff members have recently been trained by Citibank, and it is expected that additional training will follow with assistance from Germany. Recruitment of staff from the Eritrean diaspora has been limited, owing to lower salary levels, housing shortages, and lack of adequate schools. Moreover, although the lending activities of the CBER are still limited, its capital base needs to be increased and financial accounts brought up to prudential ratios commensurate with international standards.

The CBER holds about 80 percent of the total assets of the banking system, and generally operates with a short-term loan portfolio, consisting mostly of overdrafts. Although the share of private sector loans has been growing recently, most of the CBER loan and overdraft facilities are to public enterprises. Lending to the Central Government as well as to the local governments from the CBER sources has been negligible. 1/ Since end-1993 the CBER has been dealing only with the local governments. Although the CBER has thus far broadly managed to break even, without substantial revival in lending activity or development of investment instruments, its liquid position will continue to pose a major threat to its financial viability.

Of the two specialized banks, the Housing and Savings Bank (HSB) has resumed operations in mobilizing retail savings as well as providing loans, in the area of building and construction; the Agricultural and Industrial Development Bank (AIDB) is not operational at present because of its poor financial position, and it is awaiting restructuring. The National Insurance Corporation of Eritrea (NICE) is the only insurance company in Eritrea, and it has been expanding, with gross turnover increasing from Br 17.4 million in 1992 to Br 26 million in 1993. The NICE insures virtually everything (including life), although its operations are concentrated mostly in motor vehicles (45 percent), marine and other transport (20 percent), and fire (15 percent).

2. Financial relations with Ethiopia

a. Macroeconomic setting

Eritrea continues to use Ethiopia's currency, the birr, as the sole legal tender, and thus participates in a de facto currency union with Ethiopia. No specific time frame has yet been announced regarding the introduction of Eritrea's own currency, although the Government's intentions in that direction have been expressed in a recent policy paper. A friend-

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1/ In the balance sheets, the loans classified as central government loans during most of 1993 mainly comprise those given to the (EPLF-owned) Finance Commission.

ship and cooperation agreement was signed in late 1993, and subsequently the Eritrean and Ethiopian authorities have met a number of times to discuss coordination issues in the birr area. However, the currency union still functions in the absence of a comprehensive agreement that explicitly deals with specific issues related to the coordination and harmonization of economic policies. Furthermore, there are no mutually agreed rules or a designated monetary authority to conduct monetary policy, and Eritrea does not receive any seigniorage revenue from Ethiopia. The National Bank of Ethiopia continues to determine the overall orientation of financial policies in the birr area: consultations with the Bank of Eritrea are limited, although steps to exchange monetary data were initiated recently.

Excessive liquidity in Eritrea's banking system accumulated largely during 1992 and continued, although at a much slower pace, through June 1994. Besides undermining the financial viability of the CBER, the excess liquidity could prove inimical to financial stability in the birr area in the absence of explicit policy coordination, most notably as a potential source of excessive credit expansion. While the rudimentary financial structures in the birr area, particularly in Eritrea, preclude a market-oriented allocation of these excessive funds through a union-wide money market, a strong possibility remains for destabilizing intra-union monetary flows as the two partners continue to seek differential responses to various policy objectives without adequate consultation.

b. Financial accounts

The formal financial transactions between Eritrea and Ethiopia are conducted through a clearing account and a correspondent account. Besides the balances of these two accounts, which record the claims between the two countries channeled through the banking system, the Eritrean banking system holds a considerable amount of vault cash, which is also considered a claim against the National Bank of Ethiopia.

The inter-branch clearing account involves various claims pertaining to pre-liberation deposits and loans, and reflects developments in the clearing of these claims since liberation. Negotiations have already taken place, but there are unresolved issues regarding the loans supplied by the Commercial Bank of Ethiopia to enterprises in Eritrea prior to May 1991, which are unlikely to be recovered. The total outstanding loans still under negotiation amount to Br 53 million. The clearing account also reflects Eritrea's claims on Ethiopia to cover pre-May 1991 bank deposit liabilities. Ethiopia agreed to compensate Eritrea for the shortfall between the cash in the vaults, about Br 60 million at the time of liberation, and the deposit liabilities. Between August 1991 and end-1992, the CBER received cash transfers amounting to Br 375 million to partially cover its deposit liabilities. In addition, the clearing account carries a fixed amount of about Br 40 million maintained in the commercial bank (Asmara branch) by the Tigray Province prior to liberation, which has become Eritrea's liability to Ethiopia.

The correspondent account was opened on May 1993 (at the time of official independence) to record all transactions remaining outside the clearing account. Although the details of transactions channeled through this account are not recorded, a major component represents fees associated with services of the Assab port, since most trade transactions between Eritrea and Ethiopia are estimated to be cash based. Starting with a negative balance in mid-1993 (about Br 60 million in June 1993), the balance in this account steadily improved thereafter and amounted to a surplus of about Br 60 million as of June 1994.

In addition to these two accounts, the vault cash, by far the largest item in the balance sheets, reflects developments in the reserve cash position of both the BE and the CBER. Since the National Bank of Ethiopia is the sole issuer of the birr, these constitute, in principle, Eritrea's claims on Ethiopia. The movements in this account capture a component of the balance of payments transactions between Eritrea and Ethiopia. However, since currency in circulation in Eritrea is not known, the changes in this account could also reflect changes in cash in circulation in Eritrea as much as cash transfers from or to Ethiopia.

3. Monetary developments

No official data are published by the BE or any other statistical unit on the financial performance of the banking system in Eritrea. The Central Bank is in the initial stages of organizing consolidated balance sheet information in a monetary survey format (in line with the recommendations of recent Fund missions); the CBER reports regularly to the BE according to a standard format; the level of detail in these accounts, however, is inadequate, particularly with regard to the economic sector of the customers and to the types of financial instrument. 1/

a. Developments in 1992-93

During 1992, a large birr accumulation took place in Eritrea's banking system, as evidenced by high growth rates of several monetary indicators, most notably in terms of cash in the vaults of the banking system, which grew by about 138 percent (Table XVI). Net birr claims--which comprise the vault cash, the clearing account, and the correspondent accounts--almost doubled from Br 568 million in December 1991 to Br 1,094 million in December 1992. Broad money expanded by 140 percent, from Br 494 million in December 1991 to Br 1,187 million in December 1992, mainly reflecting this liquidity buildup in the banking system; the changes in net domestic assets and net foreign assets in percent of (beginning-of-period) money stock were 28 percent, and 5 percent, respectively. Net domestic assets increased by

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1/ The exact demarcation in the balance sheets of the CBER of the central government, local government, and other government entities remains unclear. Monetary analysis is hampered by lack of data on currency in circulation in Eritrea.

about Br 140 million, owing to a combination of factors, including an increase in credits to public enterprises as well as a decline in the Government's net deposits with the banking system. 1/ Credit to the private sector declined slightly from Br 29.8 million in December 1991 to Br 20.1 million in December 1992. The net foreign assets of the banking system, which comprised only small amounts of foreign currency holdings in the vaults during 1992, increased from Br 3.1 million in December 1992 to Br 27.7 million in December 1993.

The liquidity buildup continued in 1993, albeit at a slower rate, as net birr claims expanded by 15.3 percent (of beginning period broad money), to Br 1,276 million, in 1993. Broad money grew by 62.2 percent, to Br 1,925 million, in December 1993. The growth in broad money during 1993 was mostly driven by an increase of Br 526 million in Eritrea's net foreign assets. This development may partially have reflected the transfer of government-held foreign exchange reserves to the banking system. Also, a significant balance of payments surplus was generated during the year. Net domestic credit rose by 13.8 percent of beginning-period money stock in 1993. The Central Government's net position with the banking system was drawn down by about Br 71 million during 1993. Credit to the private sector increased about threefold during 1993, albeit from a very low base, to Br 65.5 million, and credit to public enterprises expanded by about 72 percent.

b. Developments during January-June 1994

The expansion in broad money (20.8 percent) continued during the first half of 1994, reaching Br 2,327 million in June 1994, even though net claims on the birr area declined (by about 1 percent), from Br 1,275 million in December 1993 to Br 1,260 million in June 1994. The decline in vault cash was more pronounced at 7 percent during the same period, but was partially offset by a rise in the correspondent account claims against Ethiopia. The growth in broad money was attributable to continued expansion in credit to the private sector and the public enterprises, as well as a further buildup in net foreign assets, which rose by Br 180 million in the first half of 1994. The net central government position with the banking system improved, as deposits were about Br 75 million higher than the borrowing from the Bank of Eritrea.

4. Liquidity buildup

As noted above, the liquidity buildup in Eritrea's banking system took place mainly during 1992, although it continued during 1993 and the first half of 1994. The increase may be attributed to various factors, including:

1/ An assessment of the Central Government's net position with the banking system is complicated by the inclusion of overdrafts to the Finance Commission, an EPLF-owned organization, as claims on the Government in the monetary accounts.

(i) a shift of cash--which was already in Eritrea--into the banking system as confidence in the financial system improved; (ii) unrecorded (across-the-border) movements of currency, mainly in the form of deposits of Eritreans living in Ethiopia beforehand or through illicit trade; (iii) cash deliveries by Ethiopia to meet the deposit liabilities in Eritrea's banking system at the time of liberation; and (iv) balance of payments surpluses vis-à-vis Ethiopia, besides the recorded transactions other net cash transfers may have taken place (e.g., remittances by Eritreans living in Ethiopia).

While it is virtually impossible to determine the relative significance of each of these components, the slowdown after 1992 in the rate at which the banking system has been accumulating birr claims indicates that a decline in cash in circulation in Eritrea might have played the major role. Accumulation of cash in Eritrea outside the banking system prior to liberation can be explained by the ongoing economic activity in EPLF-held territory despite the lack of banking institutions, the large Ethiopian army stationed in Eritrea, and the distrust toward the banking system because of security reasons. 1/ Thereafter, the increase in the stock of birr claims is explained largely by the recorded overall balance of payments surpluses.

Although vault cash declined during the first half of 1994, there are reasons to believe that this resulted from an expansion in domestic credit rather than a loss of birr to Ethiopia. Eritrea recorded a surplus in its current account position with Ethiopia during the first half of 1994. Also, the broad money stock (excluding the currency in circulation) increased during the period, indicating a recycling of money balances within Eritrea.

5. Sectoral composition of loans

Despite considerable economic recovery, loan demand was not very strong in 1992-93; however, during the first half of 1994 there was a significant expansion in domestic credit (Table XX). The relatively low demand in the first two years could reflect high collateral requirements by the CBER (coupled with limitations on the types of assets that were acceptable as collateral), and lack of clarity over land issues, which inhibited the construction industry, and other constraints on investments. Loan demand by public enterprises has also largely been limited to overdrafts. Despite the obvious administrative costs, the CBER has recently started providing small loans to the agricultural sector.

As of June 1994, the CBER held Br 532 million in credit, of which 23 percent was lent to the private sector; over 70 percent of the total loan portfolio was in overdrafts, while the remainder was in term loans. Loans to the domestic trade and services sector accounted for 60 percent of total

1/ The lack of confidence was such that even small amounts of withdrawals from the banks "necessitated" a security escort.

loans, followed by manufacturing (9 percent), building and construction (8 percent), external trade (6 percent), and agriculture (6 percent).

6. Interest rates

Interest rates are partly administered owing to the extremely rudimentary nature of the financial sector and the lack of competition. In a recently issued directive (No. 5/1994), the Bank of Eritrea lowered interest rates, effective September 1, 1994, with a view to "promoting investment and growth" in the country. Although interest rates on both loans and deposits were reduced 2-3 percentage points on average, a number of other measures were undertaken to increase efficiency in the allocation of financial resources. These included the elimination of differential interest rates between public and private sectors and an explicit commitment to maintain positive real interest rates in order to promote domestic savings. However, the preferential structure of lending rates across economic sectors was maintained (Table XXI). Currently, loans to small-scale agriculture and construction have the lowest rates (7.5 percent and 7 percent, respectively), followed by exports and commercial agriculture (8 percent). The term structure of interest rates on both loans and deposits is flat, although the rate concerned is negotiable between the bank (currently the CBER) and the customer.

As stipulated in the directives, interest rates on saving deposits were reduced from 8 percent to an annual rate of 6 percent. Before September 1, 1994, the interest rate for deposits exceeding Br 100,000 was reduced (to as low as 4 percent), but under the current system a flat 6 percent is applicable to the entire deposit base. The directives also introduced a discount rate for the BE, at 5.5 percent, although its use will be limited in the short run, given the excess liquidity at the CBER as well as the rudimentary nature of the financial system. Under the current system, interest rates in Eritrea remain considerably lower than those prevailing in Ethiopia. Savings deposits in Ethiopia are paid an annual rate of 10 percent while interest rates on loans effective September 1, 1994, are at a uniform rate of 14 percent (for short-term loans). The respective rates on medium- and long-term loans are 14.5 and 15 percent.

V. External Sector

1. Balance of payments data

The balance of payments data are at best incomplete and the compilation process has major deficiencies. Nonetheless, the available data give broad indications of external developments, particularly current account transactions, since 1992. 1/ Major data sources include foreign exchange records at the Bank of Eritrea, comprising merchandise trade, invisible transactions, and certain transfers, as well as trade data compiled by the Customs Office. The Bank keeps records on: (i) commissions on franco valuta imports, i.e., imports that do not require foreign exchange from official sources; 2/ (ii) imports for which foreign exchange is provided from official sources, as well as aid-related imports; and (iii) certain invisible transactions. Data on aid-related imports and invisible transactions are partial. Customs data for 1994 include, for the first time, aid imports.

Customs data began to be compiled at all customs posts as of the beginning of 1994, and are believed to have improved considerably compared with 1992-93; these improvements in statistical methodology as well as coverage make a meaningful comparative assessment difficult. Efforts to reconcile merchandise trade data from the two different sources, i.e., the BE and the Customs Head Office, are under way. 3/

Data on capital account transactions, in particular, external grants, remain significantly deficient. Although a unit at the President's Office is reported to be in charge of compiling data on disbursements of external financing, and only partial information is available at the Ministry of Finance and Development. Data on RRPE-related grants (and loans) and food aid imports are available, but other external aid data are inadequate. The problems associated with data on the capital account are further aggravated by the existence of quasi-official foreign exchange accounts outside the banking system with various government-related entities. Following a decision taken in early 1994, a committee has now been assigned the task of separating the accounts of the Government from those of the PFDJ.

A breakdown of Eritrea's balance of payments transactions into birr and nonbirr (convertible currency) components allows a more meaningful analytical assessment. Although data on major transactions with Ethiopia are now available, both the quality and the coverage of the data need to improve. Merchandise trade data in birr transactions draw exclusively on

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1/ Pre-1992 data are virtually non-existent, reflecting the full integration between Eritrean and Ethiopian economies as well as the severe impact of war on data collection.

2/ The commissions amount to 2 percent of the estimated value of imports (inclusive of 1 percent insurance and freight charge). In order for franco valuta imports to be released, the importer submits a form to customs indicating that the commission has been paid.

3/ In addition to collection and recording problems in both institutions, reasons behind the discrepancies include: (i) the possibility that the BE data are based on clearance through a limited number of customs stations and therefore are not as comprehensive; (ii) valuation issues (customs records valued at the auction rate, as opposed to the BE records valued at the preferential rate); and (iii) timing issues.

customs records, except the data for petroleum transactions, which are obtained from Petroleum Corporation of Eritrea (PCE), and port fees and charges (obtained from the Eritrean Port Authority).

2. Balance of payments, 1992-June 1994

a. Overall developments

Based on available data, Eritrea posted large trade deficits in both birr and nonbirr transactions during 1992-93 and the first half of 1994 (Table XXII). However, the current account balance (excluding official grants) was in surplus vis-à-vis Ethiopia, and appeared to have improved significantly against other countries. This outcome was mainly attributable to considerable service receipts in the case of birr transactions, and to large private transfers, mainly from nonresident Eritreans abroad in the nonbirr accounts. In addition, substantial official transfers received during the period led to a significant surplus in Eritrea's overall balance of payments position. As changes in both birr and nonbirr claims of the banking system did not fully capture these developments, errors and omissions account for a significant and volatile component of the balance of payments.

b. Balance of payments with Ethiopia

Eritrea's considerable trade deficit with Ethiopia is mainly attributable to imports of large volumes of petroleum products. During 1992-93 and the first half of 1994, this was more than offset by service receipts associated with Ethiopia's use of Massawa and Assab ports as well as refinery fees, resulting in a current account surplus. Petroleum transactions are governed by an intergovernmental agreement between Eritrea and Ethiopia. According to this agreement, the Ethiopian Petroleum Corporation (EPC) purchases crude oil and ships it to the Assab refinery; the refinery produces products and delivers the whole amount to the EPC; Eritrea then purchases petroleum products through the Petroleum Corporation of Eritrea for domestic consumption under a quota system agreed by both governments. Regarding the transactions behind this arrangement, the EPC pays foreign exchange for purchasing the crude oil, and for the payment of spare parts for the refinery. However, a refinery processing fee--which covers labor costs, maintenance fees, and the replacement or purchase of chemicals--is paid in birr. For the purchase of products the Petroleum Corporation of Eritrea pays in local currency. 1/

Merchandise trade with Ethiopia excluding petroleum products appears to have recorded a small deficit in 1992, and has since been in surplus. The trade account improvement reflected the recovery in Eritrea's manufacturing sector, and the resulting increase in the production of exportable goods (to

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1/ At present, Eritrea's import needs for petroleum products are fully met through this arrangement.

Ethiopia) as well as import substitutes. Further evidence of this outcome is shown by the decline in Eritrea's non-oil imports from Ethiopia, by about 40 percent in 1993, with no significant reversal during the first half of 1994. Lack of a comprehensive trade agreement between Eritrea and Ethiopia and the ongoing restrictions on Eritrea regarding the purchases of Ethiopia's exportable goods as well as goods that are in short supply in Ethiopia (such as textiles, tea, cigarettes, and construction materials) 1/ are estimated to contribute considerably to Eritrea's non-oil trade surplus vis-à-vis Ethiopia.

In the services account, a substantial part of service receipts is related to Eritrea's involvement in the transshipment of Ethiopia's foreign trade. Fees associated with Ethiopia's use of the Assab refinery account for the remainder. Apart from a transfer comprising cash deliveries from Ethiopia to Eritrea at the beginning of 1992 in order to compensate for a shortfall in the liquidity of Eritrea's banking system, virtually no other capital account transactions have been recorded during the period.

The errors and omissions component of the balance of payments with Ethiopia is affected by various factors, including, most notably, unrecorded across-the-border trade transactions as well as movements in private capital flows. In addition, as currency in circulation in Eritrea is largely unknown, any changes in this item affect the birr holdings of the banking system, and thereby contribute to the errors and omissions balance. An important component of unrecorded trade transactions is reportedly re-exports to Ethiopia.

c. Balance of payments with other countries

Since 1992 Eritrea has recorded large trade deficits in convertible currencies, reflecting extreme dependence on imports of raw materials, manufactured goods, and capital goods as well as extremely low level of exports (to countries other than Ethiopia). Eritrea's dependency on aid, particularly food aid, also has contributed to this outcome. In contrast to the trade deficit, the current account balance (excluding official transfers) has improved from a deficit of US$96 million in 1992 (13.4 percent of GDP) to a deficit of US$6.3 million in 1993 (1.3 percent of GDP), and registered a surplus of US$29.3 million during the first half of 1994. Considerable amounts of official grants led to surpluses in the overall balance of payment during the entire period, as reflected in the foreign asset buildup in the banking system.

During 1992-93, Eritrea's exports in convertible currencies increased significantly, to US$11.1 million in 1993, albeit from an extremely low

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1/ Ethiopia requires that payments be made in convertible currencies for the purchase of these commodities.

base. 1/ During the first half of 1994, total exports at US$14.5 million had already surpassed the level of 1993. Imports were almost unchanged at around US$270 during 1992-93 and amounted to US$140 million during the first half of 1994. During 1993 and the first half of 1994, about half of Eritrea's imports were through the franco valuta channel, while aid-related imports, comprising food aid and RRPE-related grants, accounted for 26 percent and 29 percent of total imports, respectively. 2/ Imports that are financed by the foreign exchange provided from official sources accounted for 22 percent of total imports in 1993; during the first half of 1994 the "official exchange" imports represented about 21 percent of total imports.

Net service receipts, while negligible during 1992 at US$7.6 million, increased considerably to US$50.5 million in 1993, reflecting an increase in travel receipts largely related to the return of Eritreans from abroad to participate in the referendum for Independence. During the first half of 1994, net service receipts amounted to US$4.9 million.

Private transfers, mostly remittances from Eritreans living abroad, are an important component of Eritrea's balance of payments. Private transfers comprise a component that is presumed to finance all private franco valuta imports and another component that represents net receipts of transfers by the banks and by unofficial foreign exchange dealers. Total private remittances were US$174 million in 1992, US$202 million during 1993, and US$150 million in the first half of 1994. Official grants declined significantly, from US$168 million in 1992 to US$70 million in 1993, partly reflecting large grant disbursements immediately following the de facto independence and relatively high food imports following the poor 1991 harvest. During the first half of 1994, official grants, consisting mostly of food aid and RRPE-related disbursements, reached US$41.5 million. 3/

As would be expected from the data deficiencies discussed above, Eritrea's balance of payments includes a large and volatile errors and omissions component. Although large overall surpluses in both current and capital accounts were recorded, the net foreign exchange reserve position was almost unchanged in the banking system in 1992. However, in 1993, reserve accumulation significantly exceeded the recorded balance of payments surplus. During the first half of 1994, the reserve buildup continued, albeit at a rate less than the overall balance of payments surplus. Apart

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1/ This low base may be attributed in part to the high penalty involved in surrendering exports to the official channels prior to the devaluation of the birr on October 1, 1992; for that reason, total exports in 1992 might have been larger than the officially recorded amount.

2/ Aid-related imports were much higher in 1992 in percent of total (60 percent).

3/ As noted above, data on official grants are particularly deficient and should be interpreted with caution.

from the statistical problems, surrender of foreign exchange to the banking system by other government-related entities could explain this discrepancy.

3. Direction and composition of trade

Ethiopia continues to be Eritrea's main trading partner, although Ethiopia's significance as a trading partner has since 1993 been more pronounced in terms of exports (60 percent) than imports (7 percent) (Table XXIII). 1/ Eritrea's main exports to Ethiopia comprise textiles, shoes, household goods (e.g., plastic ware, candles, and matches), salt, and beverages. 2/ Eritrea mainly imports some consumer items and petroleum products from Ethiopia, mostly on a quota basis.

Eritrea's exports to countries other than Ethiopia have increased recently, particularly during the first half of 1994, thus contributing to a decline in Ethiopia's share in Eritrea's total exports (Table XXIV). These exports included sesame seed exports to Egypt (3,000 tons), hides and skins to Italy (100,000 tons), and livestock to Saudi Arabia (10,000 goats and sheep). Fish exports continue to be negligible, partly owing to low levels of domestic production. However, it is estimated that exports through unofficial channels to neighboring countries such as Ethiopia, Sudan, and Yemen could be significant.

Eritrea's imports are predominantly from the Gulf countries (Saudi Arabia, United Arab Emirates) and Europe (Italy, Germany). 3/ Imports of machinery and transport goods, and manufacturing products account, respectively, for about 40 and 30 percent of Eritrea's total imports (excluding petroleum products). This distribution reflects Eritrea's level of development as a small country with an underdeveloped industrial sector and the resulting dependence on imports of capital goods, manufactures, and consumer durable goods (Table XXV).

4. Exchange rate arrangements and payments system 4/

Eritrea's present exchange and trade system is based, de jure, on the old Ethiopian system. Comprehensive foreign exchange regulations are currently under preparation; however, the de facto orientation of the system is discretionary and, compared with Ethiopia, considerably more liberal. Alongside the Bank of Eritrea and a number of (official) foreign exchange dealers authorized by the Bank of Eritrea (including the Commercial Bank of

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1/ Based on customs data, which exclude petroleum products and include aid imports only for 1994.

2/ A precise breakdown indicating the relative significance of these items is not available, and some re-exports may well be included in the data.

3/ It is not possible to detect from the customs data whether the records reflect the actual or the transit origin.

4/ See Appendix IV for details on Eritrea's exchange and trade system.

Eritrea), a number of officially tolerated unlicensed dealers engage in foreign exchange operations.

Eritrea uses three different exchange rates. In addition to the official exchange rate of the birr, Eritrea uses the auction rate as determined in the fortnightly foreign exchange auctions held in Addis Ababa, as well as a more depreciated preferential rate. The official rate, at Br 5.95 to the U.S. dollar as of end-October 1994, applies only to petroleum transactions with Ethiopia. The auction rate is adopted on each Monday following the fortnightly (Saturday) auction in Addis Ababa, and mainly applies to grants and official assistance as well as various service receipts from the Assab port, transportation, and tourism. The auction rate stood at Br 6.2 per U.S. dollar as of end October 1994. The preferential rate, which approximates the parallel market rate, thus far appears to have served an equilibrating function in Eritrea's foreign exchange market, as evidenced in the comfortable foreign exchange reserve position; virtually all exports, imports that cannot be met through the official channels, as well as purchases of foreign exchange by unofficial dealers are effected at the preferential rate.

Although information on the activities of unofficial dealers is limited, these dealers are a combination of private- or EPLF-owned entities involved in foreign exchange trading, and are awaiting licensing by the Bank of Eritrea following the introduction of new foreign exchange regulations. Reportedly, the Red Sea Trading Corporation (RSTC) and the Finance Commission are among the major dealers. The CBER has not been dealing directly with the nonresident Eritreans at the preferential rate; however, foreign exchange accounts were introduced in late 1993 for nonresident Eritreans who wish to transfer money from abroad.

In relation to the U.S. dollar, the preferential rate was about Br 6 from May 1991 through August 1992, when it was raised to Br 7.2 in the wake of pressures prior to the Ethiopian devaluation. At the time, the black market was expanding and the rate therein was about Br 7.5-8; significant amounts of foreign exchange coming from the remittances were being lost to the unofficial market. Eritrea started implementing the auction rate in August 1993. Before that, alongside the preferential rate, Eritrea used a rate of Br 2.07 until October 1992, and then Br 5 until August 1993. Since then, the official rate has applied only to refinery-related transactions, and all other transactions are effected either at the auction rate or the preferential rate.

5. External debt and international reserves

Eritrea began its existence as an independent state without any external public debt. The Transitional Government of Ethiopia has assumed all external liabilities of Ethiopia (i.e., including Eritrea up until May 24, 1991). Eritrea became the owner of all Ethiopian physical assets located in its territory and does not intend to seek reparations for war damage from Ethiopia. Since independence, Eritrea has received an IDA credit of US$25 million under the RRPE, which has been channeled through Ethiopia. The legal process for transferring the obligations arising from the portion representing disbursements of the IDA credit to Eritrea has been initiated, following Eritrea's membership in the World Bank on July 6, 1994. As of end-September 1994, US$11.8 million had been disbursed by IDA. 1/ As to other external loans, three loan agreements with China, Kuwait, and the European Investment Bank have either been signed recently or are being negotiated.

Although the net foreign asset position in the monetary accounts is broadly indicative of the size of Eritrea's foreign exchange reserves, the exact foreign reserve position is unknown, owing to a number of accounts that remain outside the banking system. Until independence, foreign exchange was held by the EPLF in various accounts abroad. Before June 1993, the reserves of the banking system comprised only small amounts of foreign currency holdings. Thereafter, a considerable accumulation in foreign exchange reserves took place which, as noted above, is attributed to various factors, including a government decision to transfer foreign exchange reserves to the banking system and modest balance of payments surpluses generated since 1992.

1/ The foreign exchange is allocated through a committee, chaired by the Bank of Eritrea; private importers are asked to pay the full amount in advance to the Treasury when they open a letter of credit; public enterprises are required to pay the counterpart funds upon receipt of the goods.

Eritrea - Overview of Political and Economic History

Until Independence, Eritrea was ruled by a succession of ancient independent kingdoms and invading colonizers; the most recent were Ottoman Turks, Egyptians, and Italians. Italy's interest in Eritrea began in 1869 with the leasing of Assab harbor from the Egyptian Government and a local sultanate by the Italian Florio Rubattino Shipping Company for use as a coaling station. In 1882, the holdings of the Rubattino Shipping Company at Assab were transferred to the Italian Government, and the area was declared an Italian colony. In 1885, the Italians captured Massawa and progressively expanded their colonial holdings at Massawa westward and northward. On January 1, 1890, a decree of the King of Italy created the colony of Eritrea, named from the Mare Erythraem (Red Sea) of the Roman geographers.

Eritrea was under Italian administration from 1890 to 1941. The early period of Italian colonization of Eritrea, from 1890 to the early 1930s, was aimed primarily at promoting settlement and developing raw materials. Consequently, there was relatively limited development of infrastructure and commerce. Local agriculture was encouraged to support the needs of the Italian settlers and to develop primary commodities for export to Italy (e.g., coffee, cotton, sisal, and tropical fruits). Controlled irrigation from the Gash River was begun in 1915; distribution of this water was the subject of an agreement with the Sudan in 1925. Irrigated cotton cultivation eventually covered 7,000 acres of land.

In the 1930s, in preparation for the planned invasion of Ethiopia, Mussolini's regime intensified infrastructural development in Eritrea. A large network of all-weather roads and highways was created, airports were built at Asmara and Gura, and Massawa port was expanded and improved. In addition, numerous military installations, workshops, warehouses, offices, and private facilities were set up. Tens of thousands of Italian workers were also brought to Eritrea.

Industrial development accelerated during this period, especially in construction-related industries like cement, bricks, and tile-making. A large number of manufacturing plants for light consumer goods (e.g., food, beverages, furniture) were also established. At the end of the 1930s, there were numerous construction organizations and companies producing a wide variety of light industrial goods, as well as hundreds of transport and trading companies. Exhaustive exploration was also carried out for minerals, but no deposits of great significance were discovered.

Exports to Italy were diversified, including coffee, cotton, cement, salt, and hides and skins, and rose substantially during the 1930s. However, owing to high food imports 1/ and the enormous war-related

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1/ The food imports reflected unfavorable topography and weather, as well as a policy of supplying subsidized agricultural goods from Italy.

import, requirements for the war, Eritrea continued to show an adverse trade balance, with exports averaging about 50 percent of imports. In addition, an overvalued exchange rate and the existence of trade restrictions (except for Italy) further contributed to the adverse trade balance.

The Italian colonial administration relied massively on grants in aid from the Italian Government for current and capital expenditures. Subsidies were provided to inefficient parastatal monopolies dominating commercial and industrial activity. There was generous provision of social services to the European population. In contrast, services provided to the local population were of a markedly inferior nature, owing to discriminatory practices that excluded the local population from participating in the provision of social services.

After Italy entered World War II, Eritrea was occupied by British forces under a United Nations mandate. At the end of Italian rule in 1941, Asmara was one of the leading cities in the region. It had a population of over 100,000, and had functional utilities (water, sewerage, electricity) and other social amenities. Massawa, with a population of 10,000, had grown to a fully equipped port and naval base. Villages sprang up along the railway and roadways as administrative centers, with electricity and water services, and hospitals or dispensaries. About 20 percent of the Eritrean population was urbanized.

British administration of Eritrea lasted from 1941 to 1952. The most prominent factor shaping the British administration of Eritrea was a desire to spend as little as possible. The British administration increased taxes on the Eritrean population, and attempted to economize on all expenditures; new capital works projects were eliminated and economic infrastructure was not adequately maintained. A large number of staff from the former bloated colonial administration were dismissed. Under the British, the local population benefited from the expanded access to social and other services. In addition, the British abolished racial discrimination and promoted freedom of speech and the formation of political organizations.

During the years of World War II, there was favorable economic development in Eritrea, owing principally to the substantial British and American military expenditures on ports, air bases, munitions plants, and storage depots. Also, demand for Eritrea-produced consumer goods picked up and the more liberal economic policies implemented by the British reduced distortions and barriers to trade and production. In addition, this growth was facilitated by the large stocks of industrial inputs, skilled workers, and the well-developed physical infrastructure left behind by the Italians.

As the war had made it difficult to import foodstuffs, the British sought to make the territory self-sufficient in food production. Ten thousand acres were given out in concession to Italian farmers, cotton plantations on the Sudanese border were converted to grain production, and lands adjacent to rivers in the Coastal Plain were irrigated and developed as grain-producing areas. Extension services to farmers were expanded.

Grain production rose from under 30,000 tons a year in the period 1939-1941 to an average of 60,000 tons in 1942-43.

The industrial sector grew strongly during the war years, both to supply the domestic market as well as the export market. Industrial enterprises that had stopped operating during the war were restarted under local Italian managers, producing a large number of consumer and light industrial goods, including soap, matches, beer, hand tools, brushes, paper, and glue. During 1943, new factories began to produce buttons, pottery, glassware, boots, and shoes. The existing cement works at Massawa were re-equipped by the end of 1943. An industry that declined during the war was the Red Sea fishing industry, which suffered from war damage to fishing fleets and competing uses for sea craft.

In the monetary and financial sector, a branch of Barclays Bank opened in June 1941 in Asmara, and was made responsible for exchange transactions and control. Italian banks were closed at the outset of the British occupation, but were allowed to reopen subsequently. 1/ The British introduced tighter credit mechanisms and set higher interest rates in order to reduce the growth of the money supply and control inflation. With respect to the exchange rate, until 1940, the Italian lira was trading against the pound sterling at fixed rates under 90 lira to a pound even though transactions in Europe and in parts of Africa showed a considerable depreciation of the lira. In March 1941, the British authorities fixed the rate for the lira at 480 lira to a pound.

With the end of the war came a decline in allied military expenditures and a resumption of industrial exports in Europe. The Eritrean economy went into a severe recession, heightened by the fragility of the British military administration and the uncertainty of Eritrea's political future. One by one, local industries had to close down or reduce production just to cater to domestic needs. In addition, a large number of infrastructural and industrial facilities were either sold or destroyed, including extensive demolition undertaken around Assab, reducing the port's capacity by three-fourths.

The Eritrean economy continued to deteriorate after 1952, when Eritrea was turned over to a new Eritrean-Ethiopian federation, in accordance with a UN General Assembly resolution reached in 1950. Starting with the federal period (1952-1962), the economic base of Eritrea steadily deteriorated; industries were closed down or dismantled, while certain industries, including the match factory, became Ethiopian government monopolies. The Federal Government abrogated an agreement between Fiat and the Eritrean Government to establish a factory in Decamere and a project involving hydro-electric power generation, cotton plantations, and a textile factory in the

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1/ Banca d'Italia (the Italian Central Bank) and three other Italian banks were active in Eritrea. Under Italian rule, the Banca d'Italia had acted as the banker for the administration, and offered overdraft facilities.

western lowlands near Sudan was canceled. Many Eritreans seeking employment moved to Ethiopia. The level of government expenditure in Eritrea was substantially reduced, except for developing Assab.

A guerrilla group under the name of the Eritrean Liberation Front (ELF) started an armed struggle for independence in 1961, shortly after the formal annexation of Eritrea by Ethiopia. However, internal political and ethnic differences in the ELF emerged in the 1970s, leading to serious frictions and conflict. The Eritrean People's Liberation Front (EPLF) split off and, by 1977, emerged as the dominant military and political party in Eritrea. In 1977, the EPLF was able to take control of nine tenths of Eritrean territory, partly because Ethiopia became involved in a border dispute with Somalia. However, in 1978, with support from the Soviet Union and Cuba, Ethiopia managed to regain much of the lost territory in Eritrea, and drove the EPLF back to the northern parts of Eritrea.

In 1988, the EPLF forces seized an Ethiopian arsenal and were able to relaunch the offensive in alliance with the Tigrean People's Liberation Front, the anti-Mengistu resistance movement within Ethiopia. When support from the Soviet Union and its allies was reduced and finally ceased toward the end of the 1980s, the Tigrean People's Liberation Front and the EPLF jointly ousted the Mengistu regime. The EPLF captured the last remaining Ethiopian positions and took control of Asmara on May 24, 1991. A Provisional Government of Eritrea (PGE) was installed by the EPLF. In April 1993, a referendum on self-determination was held with more than 99 percent of the votes in favor of independence, which was officially proclaimed on May 24, 1993.

At its third national congress in February 1994, the EPLF transformed itself into the People's Front for Democracy and Justice (PFDJ), which at present is the ruling and effectively the only political party. At this congress, the party also decided to hold multiparty elections in 1997. The authorities have indicated their intention to draft and ratify a democratic constitution, which will guarantee basic civil rights and political pluralism. A law on political parties will also be prepared.

A National Assembly, composed of the PFDJ Central Committee plus three representatives from each of Eritrea's ten regions and 30 appointed members, act as Eritrea's legislative body. The executive body is constituted by a cabinet of 16 ministers chaired by the President. The judiciary, comprising the Supreme Court, 10 provincial courts and 29 district courts, operates independently from the executive and legislative bodies.

Recent Changes in the Tax System

Eritrea inherited a very complex tax system from Ethiopia, with a narrow base, a complex schedular income tax system with a large number of different marginal rates and income brackets, many different customs duties and sales taxes, and cumbersome assessment methods that led to substantial delays in tax collection. Since May 1991, the authorities have implemented a number of changes in tax policy and administration to reform the tax system.

In February 1993, the Government introduced a new customs duty classification system and sales tax rate structure. The new maximum customs duty was set at 50 percent and the dispersion of customs duty rates was narrowed, while the number of sales taxes was reduced. In July 1993, a new tax on rental income was introduced, with a large number of brackets (25) and a maximum marginal tax rate of 48 percent. In November 1993, the Government lowered the maximum marginal tax rates on profits for incorporated business to 40 percent, and on income from commercial farming to 20 percent.

In August 1994, the Government adopted a Macroeconomic Policy Paper, in which a number of objectives and principles for tax policy and administration reform were laid out. The tax reforms were to be undertaken with a view to improving the efficiency of resource allocation, promoting an equitable distribution of income and wealth, enhancing external competitiveness, fostering savings and private investment, promoting competition in the domestic markets, and ensuring that revenue yields grow at least in line with GDP. Also, the Government aimed to rely more on revenue from direct taxes, while reducing dependence on indirect taxes. Regarding the system of direct taxes, the Government has declared its intention to (i) cover all types and sources of income; (ii) lower tax rates, reduce the number of brackets, and achieve "moderately progressive" tax rates; (iii) set the exemption level at a minimum national income level; and (iv) introduce a property tax. On indirect taxes, the Government were to introduce excise taxes on selected commodities and to avoid extreme regressivity in setting sales tax rates.

Recent tax policy reforms

In October 1994, the Government introduced tax reforms based on the principles laid out in the policy paper, including the simplification and rationalization of income taxes. 1/ For personal income taxes, the number

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1/ Proclamation No. 62/1994, introduced effective October 5, 1994, new schedules for the personal income tax, the business profit tax for incorporated and unincorporated enterprises, and the tax on dividends; Proclamation No. 63/1994 covered the agricultural land-use fee, the agricultural income tax, and the cattle tax; Proclamation No. 64/1994 revised the sales tax and introduced an excise tax; Proclamation No. 65/1994 changed stamp duties; and Legal Notice 18/1994 introduced changes in customs tariffs.

of brackets was reduced from 16 to 8, thresholds were raised, and the maximum marginal tax rate was lowered from 85 percent to 38 percent (on monthly income above Br 8,000). In contrast to the previous system, the exemption for the lowest income bracket was replaced by a 2 percent tax on personal income up to Br 200 a month.

The number of brackets of the profit tax for incorporated business was reduced from eight to four, while the maximum marginal tax rate was reduced from 40 percent to 35 percent (for income above Br 750,000). However, the highest tax rate for reinvested profits is only 20 percent. In contrast to the previous legislation, a 2 percent tax is now applied to the lowest income bracket of incorporated business, which was exempt from this tax. Regarding the profit tax for unincorporated business, the number of brackets was reduced from 23 to 8, while the maximum marginal rate was cut from 51 percent to 38 percent. The lowest income bracket is no longer exempted from this tax, but a rate of 2 percent is applied.

The number of brackets of the income tax on commercial farming was reduced from 21 to 5, while the maximum marginal rate of 20 percent was unchanged. However, the thresholds were changed, with a somewhat lower threshold for the highest bracket than before (Br 35,000 as compared with Br 42,400 annual income). A new agricultural income tax geared toward smallholders (Br 5 for each quarter of a hectare of commercially farmed area) and a new cattle tax with four specific rates were introduced.

Other changes in direct taxes were the elimination of the tax on dividends (previously a flat 25 percent was applied) and the introduction of a new tax on income from lottery and other games, royalties, and some services. Moreover, as Proclamation No. 62/1994 explicitly states that all previous tax proclamations, laws, legal notices, directives, etc., are replaced, it implies that the rehabilitation tax is no longer effective. 1/ However, it is not evident whether previously existing presumptive methods of taxation for certain groups of self-employed individuals and unincorporated enterprises have been discontinued. 2/

Regarding the sales tax, the following major changes were introduced: (i) the specific sales tax rates for alcoholic drinks and some other products were abolished; (ii) the dispersion in the number of sales tax rates was reduced, and the maximum sales tax rate of 24 percent was reduced to 12 percent; (iii) a new sales tax rate of 5 percent for certain services

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1/ A 2 percent rehabilitation tax (called "Mehwey Gibri" in Tigrinya) was previously levied on taxable income of individuals and public enterprises, and monthly on gross sales of private incorporated enterprises.

2/ Prior to October 5, 1994, presumptive taxation methods were used for some hard-to-tax groups, including operators of flour mills and transporters. For example, owners of flour mills were obliged to pay a fixed amount of BR 1,650 a year; owners of taxis, minibuses, and large buses had to pay fixed amounts of Br 2,400 a year for each vehicle, and truck owners had to pay amounts ranging from Br 8,500-9,100 per annum.

in addition to the previously existing 10 percent rate was introduced; and all goods now carry the same sales tax rate, regardless of whether they are domestically produced or imported. 1/ The sales tax paid on raw materials used for production will be refunded. Exemptions from the sales tax include cereals, live animals, a variety of capital goods, transport vehicles, kerosene, and medical equipment (Schedule E). Most raw materials and intermediate goods are still subject to a 3 percent sales tax rate (Schedule A), most consumer goods continue to carry a sales tax rate of 5 percent (Schedule B), while all other goods not explicitly mentioned under schedules A, B, and E are now subject to a sales tax of 12 percent.

Effective October 5, 1994, the Eritrean Government introduced excise taxes for both domestic production and imports, ranging from 10 percent (mineral water) to 100 percent (alcoholic beverages, cosmetics, perfumes). 2/ Finally, about 15 different stamp duties--some ad valorem, and other specific rates--will be levied on a wide range of transactions.

The new customs tariff regulation

Under the new customs tariff regulations the following changes were made: (i) the maximum customs duty was raised from 50 percent to 200 percent (for beverages with high alcoholic contents, and tobacco products), 3/ (ii) previously zero-rated goods (e.g., capital goods, raw materials, fertilizer) now mostly carry a 2 or 3 percent customs duty; (iii) the large number of specific rates was substantially reduced; (iv) the exemption for all relief and aid imports was eliminated; (v) the import of used clothes, ivory, drugs, and asbestos is now forbidden.

Through Legal Notice 18/1994, the export tax of 3 percent was abolished, while exports (and re-exports) are exempt from sales taxation. This notice also states that sales tax paid on imported goods that are used for export production will be refunded.

New investment tax regulations

1/ It should be noted that the sales tax on imports is calculated on the basis of the c.i.f. price plus customs duty and (if applicable) the excise tax; the sales tax on domestically produced goods is calculated on the basis of the wholesale price and (if applicable) the excise tax.

2/ An exception to the uniform treatment of domestically produced and imported goods appears to be salt, which is not included in the list of goods that shall be liable to excise tax in Proclamation No. 64/1994, but which carries a 3 percent excise tax when imported, according to Legal Notice 18/1994.

3/ In addition, a number of other products are now subject to duties higher than the previous maximum rate, including video recorders (160 percent); compact disc recorders, electrical household appliances (100 percent); soft drinks, beer, perfumes and cosmetics (90 percent); mineral water, video cameras, jewels, and some other miscellaneous manufactured articles (80 percent).

According to the recently adopted Investment Code (Proclamation No. 59/1994, issued in August 1994), the Government does not intend to provide any major tax incentives for investors; the marginal income tax rates for new investors are the same as in the recently proclaimed tax legislation. In addition to the new income tax legislation, the Investment Code states that any loss incurred during the first two years of operations by an investor may be carried forward for three consecutive years. Under exceptional circumstances, the Inland Revenue Administration may extend the carry-over period for one additional year.

Tax administration

Since 1991, the Eritrean Government has made strong efforts to streamline and strengthen tax administration. The Inland Revenue Administration (IRA) and Customs Administration (CA) have undergone substantial restructuring, including the introduction of a new organizational structure and enhanced staffing, mostly through EPLF volunteers. In addition, internal control procedures have been strengthened and material support to both agencies has improved. During 1993, both the IRA and CA have also benefited from IMF technical assistance.

Despite this progress, a number of important problems remain. First, tax assessment and collection methods are still very cumbersome and outdated. Second, the IRA and CA need substantial additional material support from the Government, as well as more training for their staff, in order to become more effective. Consequently, despite past institutional strengthening and improvements in tax compliance and collection efforts, the authorities acknowledge that the revenue potential is far from being fully tapped, owing to administrative weaknesses that still exist. Most importantly, the rental income tax has so far not produced any noteworthy revenue, while presumptive taxation of the hard-to-tax unincorporated enterprises is not well developed.

The Government is planning to establish an autonomous revenue authority, comprising both the IRA and CA. Already, the heads of both agencies report directly to the Minister of Finance and Development. According to the authorities, the intention of this reform is to make the revenue administrations more independent from the Government. In addition, the change will enable the revenue authority to set employment and wage policies outside the civil service and to operate more efficiently.

Eritrea: Summary of the Tax System as of October 1994

Tax	Nature of Tax	Deductions and Exemptions	Rates
1. Tax on income and profits			
1.1 Income tax on employment. (Proclamation No. 62/1994; October 5, 1994)	Tax withheld monthly by employers on salaries, allowances, pension contributions, and other benefits and personal emoluments (cash and in kind).	Exemptions: Income from employment of unskilled workers, employed on a daily and irregular basis; income of business representatives residing in the country less than 183 days.	No. / Taxable income (Birr/month) / Tax rate on additional income (in percent) 1 / up to 200 / 2 2 / 201 - 500 / 7 3 / 501 - 1,200 / 12 4 / 1,201 - 2,000 / 17 5 / 2,001 - 3,500 / 24 6 / 3,501 - 5,500 / 29 7 / 5,501 - 8,000 / 34 8 / over 8,000 / 38
1.2 Income taxes on agriculture			
1.2.1 Income tax on commercial farming (Proclamation No. 62/1994; October 5, 1994)	Annual tax levied on taxable income of commercial farms, payable within 4 months after the end of the fiscal year. Assessment based on returns filed.	None.	No. / Taxable income (Br/year) / Tax rate on additional income (in percent) 1 / up to 1,000 / 2 2 / 1,001 - 1,0000 / 5 3 / 10,001 - 20,000 / 10 4 / 20,001 - 35,000 / 15 5 / above 35,000 / 20
1.2.2 Income tax and rural land use fee for smallholders (Proclamation No. 63/1994; October 5, 1994)	General annual land use fee for every farmer, and an additional annual fee levied on smallholder commercial farming, and specific rates for livestock.	None.	General annual land use fee of Br 18 per farmer, and Br 5 for every quarter of a hectare that is commercially used. Specific tax rates for each head of animal: Camel: Br 4.0 Horned cattle, horse, mule: Br 2.0 Donkey: Br 1.0 Sheep or goat: Br 0.5

Eritrea: Summary of the Tax System as of October 1994 (continued)

Tax	Nature of Tax	Deductions and Exemptions	Rate: No.	Taxable income (Br/year)	Tax rate on additional income (in percent)
1.3 Income tax on profits					
1.3.1 Income tax on profits of incorporated business (Proclamation No. 62/1994; October 5, 1994)	Annual tax levied on taxable income, payable within 4 months after the end of the fiscal year. Assessment based on returns filed.	Exemptions: Dividends, and interest income from bank accounts. Profits derived from mining activities to be taxed as per mining legislation. For new investments, losses incurred during the first 2 years may be carried forward for 3 consecutive years (or further in exceptionally critical circumstances).	1	up to 100,000	25
			2	100,001 - 400,000	28
			3	400,001 - 750,000	30
			4	above 750,000	35
			Reinvested profit will be taxed only at 20 percent.		
1.3.2 Income tax on profits of unincorporated business (Proclamation No. 62/1994; October 5, 1994)	Annual tax levied on taxable income, payable within 4 months after the end of the fiscal year. Assessment based on self-declared income, except for certain sectors where presumptive tax rates are applied.	Exemptions: Dividends, interest income from bank accounts, and income from self-employed persons residing in rural areas in certain sectors (e.g., blacksmiths, pottery).	1	up to 2,000	2
			2	2,001 - 5,000	7
			3	5,001 - 18,000	15
			4	18,001 - 35,000	20
			5	35,001 - 60,000	25
			6	60,001 - 100,000	30
			7	100,001 - 150,000	35
			8	over 150,000	38

	Tax	Nature of Tax	Deductions and Exemptions	Rate	
1.4	Income tax on lottery and other games, royalties, and services from abroad (Proclamation No. 62/1994; October 5, 1994)	Levied on taxable income. To be paid within 1 month after income was received. Assessment based on returns filed.	None.	Income from lottery (above Br 500), and from bingo (above Br 400)	10 percent
				Royalty and income from services from abroad	10 percent
1.5	Rental income tax (Proclamation No. 64/1994; October 5, 1994)	Annual tax levied on all income received in cash and in kind from the rental of movable and immovable property. Assessment based on returns filed. Tax payments are required within one month after the end of the fiscal year.	None. Local property tax payments, and one fourth of gross income received for the rent of buildings, furniture and equipment (as allowance for repairs, maintenance and depreciation) are deductible.	See schedule below.	

No.	Taxable income (Br/year)	Tax rate on additional income (in percent)
1	up to 120	Br 1
2	121 - 380	1.5
3	301 - 480	3.0
4	481 - 660	4.5
5	661 - 840	6.0
6	841 - 1,020	8.0
7	1,021 - 1,200	10.0
8	1,201 - 1,600	12.0
9	1,601 - 2,000	14.0
10	2,001 - 2,400	16.0
11	2,401 - 2,800	18.0
12	2,801 - 3,600	20.0
13	3,601 - 4,400	22.0
14	4,401 - 5,200	24.0
15	5,201 - 6,000	26.0
16	6,001 - 8,000	28.0
17	8,001 - 10,000	30.0
18	10,001 - 12,000	32.0
19	12,001 - 16,000	34.0
20	16,001 - 20,000	36.0
21	20,001 - 24,000	38.0
22	24,001 - 30,000	40.0
23	30,001 - 36,000	42.0
24	36,001 - 42,000	44.0
25	above 42,000	48.0

Eritrea: Summary of the Tax System as of October 1994 (continued)

Tax	Nature of Tax	Deductions and Exemptions	Rate
2. Taxes on goods and services			
2.1 Sales tax on domestic goods (Proclamation No. 64/1994; October 5, 1994)	Single-staged tax levied at factory or wholesale level on all manufactured goods, and collected monthly. Sales tax paid on raw materials used for local production will be refunded. Assessment based on self-declaration.	All exports, and the following products for domestic sale are exempted: basic foodstuffs (e.g., cereals, vegetables, njera, rice, bread); live animals; capital goods for agriculture, industry, and construction; some construction materials (e.g., bricks); fire-fighting equipment; public transport vehicles; vehicles used for road maintenance, lifting and loading equipment; kerosene and aviation fuel; medical equipment; medical, scientific, and technical instruments; fish nets; beehives and incubators; silver and gold when imported by the Bank of Eritrea; traveler's checks, revenue stamps, and bands.	Agricultural products, raw materials, most intermediate goods 3 percent Most consumer goods, drugs, some intermediate goods 5 percent All other products 12 percent
2.2 Sales tax on domestic services (Proclamation No. 64/1994; October 5, 1994)	Assessment based on self-declaration. Collected monthly.	None.	Subject to 10 percent sales tax: Telecommunications; laundry; legal services, and public affairs services; photography, photocopying, and other reproduction; auditing and accountancy; lodging; consultancy; agents and brokers; cinema; tourism; rent of goods and movable property; garages. Subject to 5 percent sales tax: Contractors; hair dressing and beauty salon; tailoring; repairs and maintenance excluding garages; washing and greasing; billiard and bowling; education and training.
2.3 Excise tax on domestic goods (Proclamation No. 64/1994; October 5, 1994)	Levied at factory or wholesale level on all manufactured goods, and payable within one month from the date of production. Assessment based on self-declaration.	None.	Mineral water, textiles, carpets 10 percent Glass beads and ornaments 30 percent Tobacco products, beverages with high alcoholic contents 50 percent Four-wheel drive vehicles 90 percent Beer, perfumes, cosmetics 100 percent

Eritrea: Summary of the Tax System as of October 1994 (continued)

Tax	Nature of Tax	Deductions and Exemptions	Rate	
3. Taxes on international trade				
3.1 Customs duties (Legal Notice 18/1994; (October 5, 1994)	Customs tariff regulations follow the Standard International Trade Classification (SITC) system.	Exemptions: Imports of diplomatic and consular missions, personal effects, and trade samples not used as merchandise.	12 different ad valorem rates, including:	
			Agricultural products and essential foods (e.g, cereals, oil seeds, hides and skins), most capital goods, raw materials (e.g., fertilizer) pharmaceuticals, pesticides, agricultural and construction machinery	2 percent
			Other basic consumer items (e.g., sugar, coffee), some capital goods and raw materials	3 percent
			Fish and fish products, manufactured consumer items, and intermediate goods	5-50 percent
			Mineral water, video cameras, marble, jewels, and some other manufactured items	80 percent
			Soft drinks, beer, perfumes, and cosmetics	90 percent
			CD recorders, electrical household appliances	100 percent
			Video recorders	160 percent
			Beverages with high alcoholic contents, and tobacco products	200 percent
			Specific rates for grease (Br 0.15/kg) and small family cars (10 percent of CC).	
			Imports prohibited are: old or used clothing, asbestos and construction materials made of asbestos, ivory, second grade alcohol, and narcotics.	

Eritrea: Summary of the Tax System as of October 1994 (concluded)

	Tax	Nature of Tax	Deductions and Exemptions	Rate
3.2	Sales tax on imports (Proclamation No. 64/1994 and Legal Notice 18.1994; October 5, 1994)	The sales tax applies to all imported commodities, and is computed based on the c.i.f. price plus customs duty and, if applicable, excise tax.	Same exemptions as for customs duties, and as for sales tax on domestically produced goods. Re-exports are also exempted. Sales tax paid on imports that are used for export production is refunded.	Same as for domestic sales tax.
3.3	Excise tax on imports	Paid by the importer when goods are cleared from customs.	Same as for domestically produced goods.	Same as for domestically produced goods, except for imported salt (3 percent).
3.4	Export tax	Abolished on October 5, 1994.		
4.	Other taxes			
4.1	Stamp duties (Proclamation No 65/1994; October 5, 1994)	Duties are levied on a range of legal documents and instruments including contracts, agreements, bill of exchange, etc.	None.	15 different ad valorem and specific rates.

Source: Data provided by the Eritrean authorities.

Eritrea: The Exchange and Trade System

1. Exchange arrangement

The provisional legal tender of Eritrea is the Ethiopian birr, which is issued by the National Bank of Ethiopia and is pegged to the U.S. dollar at an official exchange rate of Br 5.95 per US$1 as of end-October 1994]. The official rate applies only to transactions between Eritrea and Ethiopia associated with refinery services. The Bank of Eritrea applies the marginal auction rate (determined in the fortnightly foreign exchange auctions conducted by the National Bank of Ethiopia) to aid funded imports and most service transactions. The marginal rate established in the auction of October 29, 1994 was Br 6.2 per US$1 and was in effect in Eritrea for the two-week period starting October 31, 1994. A more depreciated preferential rate (Br 7.20 per US$1) applies to foreign exchange remittances by Eritreans abroad, export proceeds, and most import payments. The Bank of Eritrea undertakes transactions with authorized dealers, which in turn carry out transactions with the public on its behalf. In addition, a limited number of unofficial (but sanctioned) dealers buy and sell foreign exchange at the preferential rate. Exchange rates for currencies other than the U.S. dollar 1/ are communicated daily by the Bank of Eritrea to authorized dealers, on the basis of same-day early morning quotations in the London market for these currencies against the U.S. dollar. For all but bank note transactions, the Bank of Eritrea prescribes a commission in its favor of 0.5 percent for purchases and 1.5 percent for sales of foreign exchange. In addition, authorized dealers are permitted, but not obliged, to levy service charges for their own account of up to 0.25 percent buying and 0.75 percent selling and, for currencies other than the U.S. dollar, to include the margin charges applied by the correspondents abroad.

There are no taxes or subsidies on purchases or sales of foreign exchange. There is no forward market in foreign exchange. As of end-October 1994, the exchange rate of the birr in the parallel foreign exchange market stood at Br 7.2-7.4 per US$1. There is indication that the volume of transactions is low, although information on the parallel market is limited.

2. Administration of control

The Bank of Eritrea, during the transitional period, is working to ensure that all foreign exchange settlements are carried out through authorized dealers, which it licenses in accordance with Monetary and Banking Proclamation No. 32/1993. Under this proclamation, the Bank of Eritrea may from time to time issue regulations, directives and instructions on foreign exchange matters. Comprehensive foreign exchange regulations as

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1/ At present, pound sterling, deutsche mark, French franc, Swiss franc, Dutch guilder, Belgian franc, Japanese yen, Canadian dollar and Italian lira. The Bank of Eritrea intends to quote rates for the Danish krone, the Swedish krona, and the Norwegian krone in the near future.

well as a new Central Bank Act have been prepared and submitted for the Government's approval.

The Exchange Control Department of the Bank of Eritrea issues permits only for those imports that require foreign exchange from the banking system. The Ministry of Trade and Industry issues licenses for importers, exporters, and commercial agents, and has authority to regulate foreign trade and investment. The Investment Center, established under the Investment Proclamation No. 59/1994, vets and licenses technology transfer agreements as well as investment projects (including joint ventures) that wish to take advantage of the tax, foreign exchange, and other concessions of the Investment Proclamation. The Asmara Chamber of Commerce issues certificates of origin for exports.

3. Prescription of currency

Payments may be made and received in the currencies quoted by the Bank of Eritrea or any other convertible currency it deems acceptable. All transactions with Ethiopia, except for those related to the imports of spare parts for the refinery (see Section 4 below), are settled in birr.

4. Trade and payments with Ethiopia

Under an agreement of friendship and cooperation, signed by both Presidents in September 1993, Eritrea and Ethiopia undertook to cooperate closely and develop common policies in a wide range of areas, including matters pertaining to their exchange and trade systems. A joint ministerial commission is entrusted with the responsibility of ensuring the implementation of the provisions of the agreement, notably its Article 9, which calls for mutual consultation on the use of the birr and the exploration of the possibilities of adopting a common currency by both countries. A communique was issued in May 1994 to further underscore the need for harmonization and coordination but no detailed agreement has yet been concluded.

An agreement that governs trade between Eritrea and Ethiopia has not yet been concluded. Both governments are committed to encourage bilateral trade on a free-market basis, to exempt such trade from customs duties, and to harmonize their customs tariffs, as well as the rules and formalities of trade between both countries, in an effort to facilitate the exchange, storage, and transshipment of goods and transfer of payments. Payments are generally made in birr, although the Government of Ethiopia has required payment in foreign currency for Eritrea's purchases of Ethiopia's export products as well as goods that are in short supply in Ethiopia. Under an intergovernmental agreement with Ethiopia, Eritrea pays Ethiopia in birr for its domestic requirements of petroleum products. The refinery in Assab, in turn, is reimbursed in birr for the refining costs of the derivative products consumed by Ethiopia, except that the part corresponding to depreciation of equipment is paid for in foreign exchange.

As stipulated under an intergovernmental transit and port services agreement as well as a customs arrangement (amended annually), the port of Assab is a free port for Ethiopia, with its own Ethiopian customs branch office, and goods transshipped to or from Ethiopia remain exempt from Eritrean customs duties and related charges. Procedures for the clearing of goods and the exchange of documentation are to be harmonized, and port and shipping charges are paid in birr.

5. Nonresident accounts

With the approval of the Bank of Eritrea, nonresidents may open accounts in U.S. dollars or birr with the Commercial Bank of Eritrea. These accounts may be credited only with foreign exchange, apart from exceptional cases that are subject to approval by the Bank of Eritrea. The Bank of Eritrea has authorized the maintenance of interest-bearing accounts in U.S. dollars for Eritreans residing abroad as of November 1993. Members of the diplomatic community, welfare organizations, nongovernmental organizations and their personnel may maintain nonresident accounts in birr. Joint ventures and other business firms which invest their capital wholly or partly in foreign exchange may also maintain nonresident accounts in birr.

Residents may not maintain foreign currency accounts, with the exception of investors (who, in accordance with the regulations of the Bank of Eritrea, may maintain foreign currency accounts in Eritrea), exporters (who may credit up to 100 percent of their export proceeds to U.S. dollar accounts in Eritrea), and individuals earning foreign exchange in the exercise of their trade. Nonbank residents may not open accounts abroad, except where specifically authorized by the Bank of Eritrea.

6. Imports and import payments

All importers must possess a valid trade license issued by the Ministry of Trade and Industry, which must be renewed each year at a cost of Br 200. 1/ Import payments made through the banking system require permits that are issued by the Bank of Eritrea upon presentation of pro forma invoices showing full details as to type, quantity, unit price, and freight cost (where applicable). A commission of 2 percent is collected on imports that do not require official foreign exchange and are not aid funded. The Bank of Eritrea ensures full collection of franco valuta commissions by requesting the display of a payment document to the Customs Office at the time of the import declaration. Imports of cars and other motor vehicles require prior permission from the Ministry of Transport to ensure their suitability for existing infrastructure and other similar considerations. There are no priority and negative lists for imports, except that a public enterprise producing tobacco and matches holds monopoly over the import of these products. Most imports requiring official foreign

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1/ The annual license fee for commercial agents of foreign companies is Br 500.

exchange are effected under letter of credit or on a cash-against-documents basis. Suppliers' credits must be registered by the Bank of Eritrea.

7. Payments for invisibles

Payments for invisibles may be made to all countries with a foreign exchange permit issued free of charge by the Bank of Eritrea. Travel allowances for business trips are US$50 a person a day for up to 20 days and no more than two trips a year. In bona fide cases, these limits may be exceeded with the approval of the Bank of Eritrea. Also, exporters may freely use their retention accounts for this purpose. For personal travel, the allowance is US$100 a person (adult or minor) for up to two trips a year. Medical expenses of up to US$2,000 for treatment abroad are allowed upon the recommendation of the Medical Board of the Ministry of Health. This limit may be exceeded in exceptional circumstances. Residents may remit premia on life insurance policies that were taken out before May 1991.

Upon the approval of the new foreign exchange regulations, foreign investors may freely remit net profits and dividends accrued from investment capital, payments associated with the servicing of private foreign loans, and fees and royalties in respect of any technology transfer agreements. Foreign employees may remit up to 40 percent of their net earnings each month, and up to 60 percent of their cumulative earnings upon completion of their term of service in Eritrea.

8. Exports and export proceeds

Exporters must be licensed by the Ministry of Trade and Industry. The annual license fee is Br 300 for producers and Br 500 for commercial agents of foreign companies. All exports require documentation by the Bank of Eritrea, which examines the sales contract as to type of product, quantity, and unit price. Certain commodities may require clearance from specific government bodies (e.g., the Eritrean Institute of Standards). In particular, livestock and cereals require the permission of the Ministry of Agriculture, and marine products require the permission of the Ministry of Marine Resources. Exports of hides and skins have been suspended since mid-1993 in an attempt to improve supply to domestic tanneries and processors.

Exports may be made under letter of credit, or on an advance payments basis; in some cases, exports can be permitted on a consignment basis. Export proceeds must be repatriated to an authorized bank within 90 days of passing through Eritrean customs; where justified, this deadline can be extended by another 90 days. Exporters may retain up to 100 percent of sales proceeds.

9. Proceeds from invisibles

Except for temporary visitors to Eritrea, all foreign exchange receipts from current invisibles by residents must be surrendered to authorized dealers. However, residents earning foreign exchange in the exercise of their trade, such as consultants and engineers working temporarily abroad for foreign companies, may on request be permitted by the Bank of Eritrea to hold foreign exchange in Eritrea, in interest-bearing U.S. dollar accounts provided for nonresident Eritreans, or in accounts abroad. Travelers do not declare their foreign exchange holdings at the point of entry into Eritrea and are not allowed to reconvert balances into foreign currency.

10. Capital

Foreign exchange proceeds representing capital inflows must be surrendered, except for funds deposited in authorized nonresident accounts. Capital inflows must be registered with the Bank of Eritrea in order to ensure the smooth transfer of profits, dividends and interest, amortization of principal, and the proceeds of the sale of shares to residents or from the liquidation of investments.

Direct foreign investment (including joint ventures) in Eritrea is governed by the provisions of the Investment Proclamation No. 59/1994 (which repealed Proclamation No. 18/1991). Foreign direct investment is permitted in all sectors, except that domestic retail and wholesale trade, import and commission agencies are open to foreign investors only when Eritrea has a bilateral agreement of reciprocity with the country of the investor; the latter condition may be waived by the Government. Approved investments and their subsequent expansion enjoy exemption from customs duties and sales tax for capital goods and spare parts associated with the investment. There are no exemptions from income tax. Under the foreign exchange regulations submitted to the Government, foreign investors may freely remit proceeds received from liquidation of investment and/or expansion, and payments received from the sale or transfer of shares. Petroleum contractors and subcontractors may freely transfer abroad funds accruing from petroleum operations and pay subcontractors and expatriate staff abroad.

Foreign borrowing by residents in Eritrea has to be registered with the Bank of Eritrea. Authorized banks are permitted to purchase and hold foreign bank notes up to the equivalent of US$500,000. Amounts exceeding this limit must be surrendered to the Bank of Eritrea or deposited in correspondent accounts abroad. With the approval of the Bank of Eritrea, authorized banks may borrow abroad or overdraw their correspondent accounts abroad. They may acquire foreign securities under similar conditions.

11. Gold

Residents may own gold jewelry without restriction. Beyond this, ownership or possession of gold or other precious metals or ores requires the authorization of the Ministry of Energy, Mines and Water Resources.

Table I. Eritrea: Sectoral Composition of Gross Domestic Product, 1992–93

(In millions of birr)

	1992 Est.	1993 Est.	1994 Est.
Agriculture	503.7	287.0	499.4
Agriculture and livestock	418.7	204.1	414.4
Forestry and fishing	85.0	82.9	85.0
Industry	340.0	451.2	476.8
Mining and quarrying	0.8	1.0	1.1
Manufacturing	152.7	206.4	220.5
Handicrafts and small industry	70.5	95.2	101.8
Electricity and water	23.4	31.6	33.7
Building and construction	92.6	117.0	119.7
Distribution services	601.4	943.0	1,143.5
Trade, wholesale, and retail	368.9	589.6	790.1
Transport and communications	232.5	353.4	353.4
Other services	319.3	501.7	508.5
Financial services	34.2	37.6	46.2
Dwellings and domestic services	47.7	54.0	54.6
Public administration and defense	154.2	304.6	283.0
Social services	43.8	65.0	82.9
Domestic and other	39.3	40.5	41.7
GDP at current factor cost	1,764.3	2,182.8	2,628.1
Indirect taxes less subsidies	245.3	354.1	162.9
GDP at market prices	2,009.6	2,536.9	2,791.0
GDP at constant factor cost	1,764.3	1,737.1	1,900.5

Source: Staff estimates based on information provided by the authorities.

Table II. Eritrea: Sectoral Composition of Gross Domestic Product, 1992–94

(In percent of GDP)

	1992 Est.	1993 Est.	1994 Est.
Agriculture	28.5	13.1	19.0
Agriculture and livestock	23.7	9.4	15.8
Forestry and fishing	4.8	3.7	3.2
Industry	19.3	20.7	18.1
Mining and quarrying	--	--	--
Manufacturing	8.7	9.5	8.4
Handicrafts and small industry	4.0	4.4	3.9
Electricity and water	1.3	1.4	1.3
Building and construction	5.3	5.4	4.6
Distribution services	34.1	43.2	43.5
Trade, wholesale, and retail	20.9	27.0	30.1
Transport and communications	13.2	16.2	13.4
Other services	18.1	23.0	19.3
Financial services	1.9	1.7	1.8
Dwellings and domestic services	2.7	2.5	2.1
Public administration and defense	8.7	14.0	10.8
Social services	2.5	3.0	3.2
Domestic and other	2.2	1.9	1.6
GDP at current factor cost	100.0	100.0	100.0

Source: Staff estimates based on information provided by the authorities.

Table III. Eritrea: Growth Rates of Sectoral GDP, 1992–94

(Annual percentage change)

	1992 Est.	1993 Est.	1994 Est.
Agriculture	50.2	–43.0	74.0
Agriculture and livestock	...	–51.2	103.0
Forestry and fishing	...	–2.5	2.5
Industry	55.9	32.7	5.7
Mining and quarrying	100.0	26.3	2.4
Manufacturing	44.1	35.2	6.8
Handicrafts and small industry	44.1	35.2	6.8
Electricity and water	44.1	35.2	6.8
Building and construction	100.0	26.3	2.4
Distribution services	94.9	56.8	21.3
Trade, wholesale, and retail	50.6	59.8	34.0
Transport and communications	243.3	52.0	--
Other services	28.1	57.1	1.3
Financial services	–6.0	10.0	23.0
Dwellings and domestic services	50.0	13.1	1.2
Public administration and defense	53.0	97.5	–7.1
Social services	4.0	48.4	27.4
Domestic and other	3.0	3.0	3.0
GDP at current factor cost	58.8	23.7	20.4
Indirect taxes less subsidies	126.6	44.4	–54.0
GDP at market prices	64.8	26.2	10.0
GDP at constant factor cost	...	–1.5	9.4

Source: Staff estimates based on information provided by the authorities.

Table IV. Eritrea: Structure of the Agricultural Sector, 1992–1994

	1992	1993	1994 Est.
		(In thousands of quintals)	
Staple crops			
Sorghum	1,617.5	322.6	1,617.5
Taff	157.6	66.7	157.6
Millet	720.9	186.3	720.9
Barley	523.7	104.5	523.7
Wheat	104.6	67.1	104.6
Peas	71.1	18.6	71.1
Sesame	87.5	97.0	87.5
Maize	153.2	71.4	153.2
Others 1/	49.7	46.4	49.7
Total	3,485.8	980.5	3,485.8
		(In thousands)	
Livestock			
Cows	864	949	...
Goats	4,153	4,152	...
Poultry	2,500	2,500	...
		(In thousands of hectares)	
Area	12,189.0	12,189.0	...
Cultivated	375.0	394.6	...
Percent of total	3.1	3.2	...

Sources: Ministry of Agriculture; and staff estimates.

1/ Includes mainly horsebeans, groundnuts, and lentils.

Table V. Eritrea: Indicators of Economic Activity of the Industrial Sector, 1992–June 1994

Type of Industry	Number of enter-prises	Number of employees June 1994	Production capacity	1992	1993	1994 1/	Average 2/	Capacity utilization 1992
				(In thousands of birr)				
Food industries	6	990	88.8	48.5	48.4	28.8	18.8	54.7
Beverage industries	3	841	79.4	55.1	65.5	32.8	23.0	69.4
Tobacco and matchs	2	389	21.0	2.0	3.6	2.8	1.3	9.3
Textile industries	5	3,752	54.7	13.2	16.5	16.2	6.9	24.1
Leather and shoes	5	1,550	75.1	17.2	28.2	16.5	9.3	23.0
Nonmetallic industries	4	711	19.7	14.4	24.0	14.2	7.9	73.2
Paper and printing	3	349	10.4	9.1	17.7	6.5	5.0	87.5
Chemical industries	5	880	58.5	37.4	51.1	31.0	17.9	63.9
Metal industries	10	1,002	23.1	17.6	34.0	14.8	10.0	76.2
TOTAL	43	10,464	430.7	214.6	289.1	163.7	100.0	49.8

Source: Department of Trade.

1/ January–June.
2/ Average for 1992–94, in percent of total.

Table VI. Eritrea: Assab Refinery Production and Purchase by Eritrea, 1992–June 1994

(Quantity in metric tons; value in millions of birr; ratio in percent)

	1992				1993				1994 (January–June)			
	Production	Purchase	Value	Purchase/ Production	Production	Purchase	Value	Purchase/ Production	Production	Purchase	Value	Purchase/ Production
Liquedified petroleum gas	4,760	353	0.9	7.4	4,976	583	2.4	11.7	3,097	292	1.2	9.4
Regular gasoline	88,000	6,355	5.1	7.2	81,429	10,533	12.1	12.9	46,324	5,210	5.6	11.2
Premium gasoline	262,991	13,080	6	18	252,840	23,782	14	22	154,894	13,623	8	24
Jet fuel	38,682	4,744	3.2	12.3	22,767	4,923	4.4	21.6	20,802	2,206	2.3	10.6
Kerosene	15,130	7,976	6.0	52.7	30,395	12,551	12.9	41.3	18,990	6,497	6.7	34.2
Automobile diesel	180,681	67,685	51.0	37.5	222,238	101,999	97.1	45.9	112,472	50,144	48.6	44.6
Other	22,553	4,884	3	41	25,916	15,500	9	124	17,755	8,882	5	117
Total	612,797	105,077	74.9	17.1	640,561	169,871	152	26.5	374,334	86,854	76.7	23.2

Source: Petroleum Corporation of Eritrea.

Table VII. Eritrea: Ex Refinery and Retail Prices of Petroleum Products, 1992–June 1994

	Unit	Ex refinery prices				Retail prices (as of 6/30/94)				
		Prior to 1/4/92	Up to 2/11/92	Up to 6/2/92	As of 6/30/94	Asmara	Massawa	Assab	Keren	Nacfa
Liquefied petroleum gas	birr/ton	520.00	635.00	131.31	131.31	...	...	...	...	...
Regular gasoline	cents/liter	88.50	143.00	194.60	194.60	248.50	244.50	244.50	252.50	266.50
Premium gasoline	cents/liter	38.50	46.50	75.50	75.50	89.50	85.00	85.00	93.39	108.19
Jet fuel	cents/liter	56.17	56.17	123.50	123.50	178.50	...	134.00	...	...
Kerosene	cents/liter	47.75	63.00	114.00	114.00	134.00	130.00	130.00	138.00	152.00
Automobile diesel	cents/liter	52.75	62.00	114.30	114.00	145.00	141.00	117.00	149.00	163.00
Asphalt	birr/ton	500.00	500.00	500.00	1,270.00	...	...	...	...	...

Source: Petroleum Corporation of Eritrea.

Table VIII. Eritrea: Asmara Price Index, December 1991–June 1994 1/

	(Weights)	1991 Dec.	1992 March	1992 June	1992 Sept.	1992 Dec.	1993 March	1993 June	1993 Sept.	1993 Dec.	1994 March	1994 June
Cereals	0.25	100	109.1	119.2	112.9	103.4	102.3	106.7	98.7	99.6	109.9	144.0
Vegetables, pasta, etc.	0.15	100	97.3	96.9	106.2	109.4	122.3	124.5	123.8	139.1	100.7	114.4
Beef, fish, dairy	0.10	100	100.7	97.9	96.2	101.7	104.4	105.7	102.9	99.7	97.5	104.4
Miscellaneous household items	0.15	100	113.5	109.3	93.2	97.3	95.8	105.3	89.9	125.6	90.3	122.9
Beverages	0.15	100	110.3	100.0	98.0	99.2	108.1	107.7	105.0	108.9	105.1	114.0
Clothing	0.10	100	107.2	101.0	90.0	124.8	152.6	110.5	129.9	132.5	69.2	61.9
Livestock (other) 2/	0.10	100	112.6	126.0	164.2	144.5	128.2	145.1	146.6	151.2	159.4	164.7
Average index	1	100	107.5	108.2	107.9	108.8	113.0	113.4	110.4	119.3	104.5	121.8
Inflation												
Asmara												
Quarterly		...	7.5	0.7	−0.3	0.9	3.8	0.3	−2.6	8.0	−12.4	16.5
12 months change		...	...	...	...	8.8	5.2	4.8	2.4	9.6	−7.5	7.4
Annual average		...	...	...	...	...	...	...	...	4.6	3.0	3.6

Sources: Ministry of Industry and Trade; and staff estimates.

1/ Index has been constructed using estimated weights. Indices for subgroups have been constructed by using simple arithmetic averages; data provided by the Department of Trade.
2/ As a proxy for durables.

Table IX. Eritrea: Summary of Developments in the Labor Market, September 1993 – June 1994

	September 1993			December 1993			June 1994		
	Male	Female	Total	Male	Female	Total	Male	Female	Total
Registered job	25,846	16,137	41,983	37,609	21,731	59,340	42,533	23,664	66,197
Number of job–seekers placed	5,114	1,226	6,340	5,887	1,492	7,379	7,008	1,634	8,642
Reported vacancies	...	...	7,598	...	...	8,575	...	...	10,598
Eritreans permitted to work abroad	416	320	736	452	359	811	474	516	990
Eritreans returning from abroad	...	...	120,000	...	...	...	...	...	...
Graduates of technical and high schools	11,992	9,476	21,468	11,992	9,476	21,468	...	...	25,344
Estimated job–seekers among graduates	...	...	10,750	...	...	10,750	...	...	...
Employment in civil service	11,677	5,829	17,506	...	...	...	...	...	...
Asmara	5,077	3,549	8,626	...	...	...	...	...	...
Provinces	6,600	2,280	8,880	...	...	...	...	...	...
Employment in private and public establishments 1/	16,440	8,181	24,621	17,015	8,343	25,358	17,848	8,429	26,277
Government–owned establishments	5,678	5,253	10,931	5,876	5,357	11,233	6,164	5,413	11,577

Source: Ministry of Labor.

1/ Large establishments only.

Table X. Eritrea: Structure of Wages, June 1994

(Base salary per month, in birr)

Level 1/		Civil service		Production		Service	
		Lower	Upper	Lower	Upper	Lower	Uppe
I – IV	Messenger, postman, driver, typist	140	290	156	480	50	358
V – VII	Clerk, storekeeper, inspector	339	498	296	887	225	568
VII – X	Teacher, statistician, nurse	572	735	483	1,029	568	778
X – XII	Senior supervisor, production manager, section head	735	956	637	1,249	778	1,128
XII – XIV	Department Head, university graduates with master's degree	956	1,239	919	1,418	943	1,558
XIV – XV	Specialists in all fileds, senior experts, and managers	1,239	1,418	1,200	1,418	1,339	2,095

Sources: Ministry of Labor; World Bank Country Economic Memorandum of Eritrea.

1/ Draws on an ad hoc grouping based on civil service salary scale.

Table XI. Eritrea: Summary of Government Finance, 1992–94

	1992	1993	1992	1993
	Preliminary Actual		January–June	
	(In millions of birr)			
Total revenue	500.5	898.8	264.4	415.7
Tax revenue	309.3	516.3	224.8	295.1
Direct taxes	63.8	172.4	51.8	127.1
Indirect domestic taxes	109.2	143.6	78.8	68.6
Import duties and taxes	131.6	185.8	90.2	90.0
Export tax	4.7	14.5	4.0	9.4
Nontax revenue	191.2	382.5	39.6	120.6
Port fees and charges	152.0	244.5	...	93.0
Contributions and other	39.2	138.0	39.6	27.6
Total expenditure	674.6	1,507.4	...	715.6
Current expenditure	583.2	1,052.1	236.8	589.8
Wages, salaries, and allowances	136.9	233.4	...	235.2
Materials	319.0	714.6	...	119.5
Grants and contributions	6.1	12.4	...	122.5
Interest and charges	--	0.9	...	...
Pension contributions	0.2	0.2	0.1	0.2
Food aid	121.0	90.6	...	112.4
Capital expenditure 1/	91.4	455.3	...	125.8
Central treasury	...	89.4	...	34.1
External grants	...	364.6	...	55.0
External loans	--	1.3	--	36.7
Overall balance (cash, excluding grants)	−174.1	−608.6	...	−299.9
Grants	121.0	455.2	...	167.4
External grants (capital and current)	121.0	455.2	...	167.4
Counterpart funds from external grant	...	...	...	...
Overall balance (cash, including grants)	−53.1	−153.4	...	−132.5
Financing	53.1	153.4	...	132.5
External	--	1.3	...	36.7
Gross borrowing	--	1.3	...	36.7
Capital budget	--	1.3	...	36.7
Other	--	--	...	--
Amortization	--	--	...	--
Domestic	53.1	152.1	...	95.8
Banking system	53.1	152.1	...	95.8
Other and residual	--	--	...	--
	(In percent of GDP)			
Total revenue	24.9	35.4	...	...
Tax revenue	15.4	20.4	...	...
Nontax revenue	9.5	15.1	...	...
Expenditure	33.6	59.4	...	...
Current expenditure	29.0	41.5	...	...
Capital expenditure	4.5	17.9	...	...
Overall balance (cash, excluding grants)	−8.7	−24.0	...	...
Grants	...	17.9	...	...
Overall balance (cash, including grants)	−2.6	−6.0	...	...
Financing	2.6	6.0	...	...
External	...	0.1	...	...
Domestic	2.6	6.0	...	...
Banking system	2.6	6.0	...	...
Memorandum item:				
GDP at current market prices	2,009.6	2,536.9	...	...

Sources: Ministry of Finance and Development; staff estimates.

1/ In 1992, excluding all external grants; in 1994, only Relief and Rehabilitation Project (RRPE).

Table XII. Eritrea: Central Government Revenues and Grants, 1992–94

Fiscal year = calendar year	1992	1993	1993	1994
	Preliminary Actual		January – June	
	(In millions of birr)			
Tax revenue	309.3	516.3	224.8	295.1
Direct taxes	63.8	172.4	51.8	127.1
Personal income	16.8	37.0	17.6	40.8
Business profits	27.1	95.1	31.6	85.6
Rehabilitation tax	19.0	34.0	...	...
Other 1/	0.9	6.3	2.6	0.7
Domestic indirect taxes	109.2	143.6	78.8	68.6
Sales tax on domestic goods and services 2/	109.2	143.6	78.8	68.6
Import duties and taxes	131.6	185.8	90.2	90.0
Customs duties	51.1	75.8	38.5	34.5
Sales and other taxes on imports	78.6	107.3	51.7	51.6
Other 3/	1.9	2.7	...	3.9
Export tax	4.7	14.5	4.0	9.4
Nontax revenue	191.2	382.5	39.6	120.6
Port fees and charges	152.0	244.5	...	93.0
Contributions 4/	––	7.0	...	...
Other 5/	39.2	131.0	39.6	27.6
Total revenue	500.5	898.8	264.4	415.7
External grants	121.0	455.2	...	167.4
Grants in kind/earmarked	121.0	455.2	...	167.4
Current external assistance (food aid)	121.0	90.6	...	112.4
Capital assistance (external grants)	...	364.6	...	55.0
Of which: RRPE	(––)	(109.5)	(...)	(55.0)
Total revenue and grants	621.5	1,354.0	264.4	583.1
	(In percent of total revenue)			
Direct taxes	12.7	19.2	19.6	30.6
Domestic indirect taxes	21.8	16.0	29.8	16.5
Import duties and taxes	26.3	20.7	34.1	21.7
Export tax	0.9	1.6	1.5	2.3
Nontax revenue	38.2	42.6	15.0	29.0

Sources: Ministry of Finance and Development; staff estimates.

1/ Agricultural income tax and land use fee; taxes on dividends and rental income.
2/ Including stamp duties.
3/ Including stamp duties, license fees, and penalty payments and "unspecified revenues."
4/ Including voluntary contributions for rehabilitation purposes.
5/ Other fees and charges; sales of goods, services, and government property.

Table XIII. Eritrea: Central Government Current Expenditures by Economic Classification, 1992–94

Fiscal year = calendar year	1992	1993	1993	1994
	Preliminary Actual		January – June	
	(In millions of birr)			
Total current expenditures	583.2	1,052.1	236.8	589.8
Total wages and operating expenditures	455.9	948.0	...	354.7
Wages, salaries, and allowances	136.9	233.4	...	235.2
Materials	319.0	714.6	...	119.5
Grants and contributions	6.1	12.4	...	122.5
Pension payments	0.2	0.2	0.1	0.2
Interest and charges	--	0.9	...	...
Domestic debt	--	0.9	...	...
External debt	--	--	--	--
Food aid	121.0	90.6	...	112.4
	(In percent of GDP)			
Total current expenditure	29.0	42.0	...	...
Total wages and operating expenditures	22.7	37.4	...	...
Wages, salaries, and allowances	6.8	9.2	...	...
Materials	15.9	28.2	...	...
Grants and contributions	0.3	0.5	...	...
Pension payments	...	...	...	...
Interest and charges	...	...	...	...
Food aid	6.0	3.6	...	...
	(In percent of total)			
Wages, salaries, and allowances	23.5	22.2	...	39.9
Materials	54.7	67.9	...	20.3
Grants and contributions	1.0	1.2	...	20.8
Pension payments	--	--	...	--
Interest and charges	--	0.1	...	--
Food aid	20.7	8.6	...	19.1
	(Annual changes in percent)			
Total wages and operating expenditures	...	64.7	...	...
Wages, salaries, and allowances	...	35.1	...	...
Materials	...	77.5	...	...
Grants and contributions	...	61.0	...	...
Pension payments	...	...	...	...
Interest and charges	...	...	...	...
Food aid	...	–40.6	...	...
Total current expenditure	...	80.4	...	...

Sources: Ministry of Finance and Development; staff estimates.

Table XIV. Eritrea: Central Government Current Expenditures by Functional Classification, 1992–94

Fiscal year = calendar year	1992	1993	1993	1994
	Preliminary Actual		January – June	
	(In millions of birr)			
General services	329.0	649.8	153.0	326.6
Internal affairs	22.5	33.9	15.9	10.1
Regional administration	11.6	21.8	12.5	10.5
Foreign affairs	17.3	25.0	2.5	26.8
Ministry of Finance and Development	9.0	16.3	8.1	11.7
Defense 1/	252.3	539.2	110.1	257.7
Other 2/	16.3	13.6	3.9	9.8
Economic services	63.2	103.3	19.2	90.5
Agriculture and natural resources 3/	21.8	17.1	6.5	7.7
Trade, industry, and tourism	2.9	6.3	2.1	1.8
Mining and energy	2.3	2.5	0.2	1.5
Roads, transport, and communications	30.2	52.7	--	50.5
Construction and urban development	6.0	24.4	10.4	28.3
Other 4/	--	0.3	--	0.7
Social services	63.7	94.5	44.6	53.2
Education and training	34.7	46.3	23.2	27.1
Health	11.0	18.2	7.3	11.1
Labor and social welfare	7.0	11.9	6.0	9.4
Relief and rehabiliation (ERRA)	1.7	4.9	2.3	1.5
Other 5/	9.3	13.2	5.8	4.1
Safety net measures	...	99.0	...	...
Demobilization of ex–combatants	...	99.0	...	...
Pension payments	0.2	0.2	0.1	0.2
Interest and charges	...	0.9	...	...
Domestic debt	...	0.9	...	...
External debt	--	--	--	--
Food aid	121.0	90.6	...	112.4
Miscellaneous	6.1	13.8	19.9	6.9
Total current expenditure (incl. external assistance) 6/	583.2	1,052.1	236.8	589.8
Total current expenditure (excl. external assistance)	462.2	961.5	236.8	477.4
	(In percent of GDP)			
General services	16.4	25.6	...	...
of which defense	12.6	21.3	...	...
Economic services	3.1	4.1	...	...
Social services	3.2	3.7	...	...
of which education and health	2.3	2.5	...	...
Other	0.3	0.6	...	...
	(Annual changes in percent)			
General services	...	97.5	...	...
Economic services	...	63.4	...	...
Social services	...	48.4	...	...
Other	...	136.5	...	...
Total current expenditure	...	80.4	...	...

Sources: Ministry of Finance and Development; staff estimates.

1/ Including some demobilization costs.
2/ Including President's Office, Ministry of Justice, Auditor General, and CERA.
3/ Including Ministry of Marine Resources.
4/ Including Standards Office and Land Commission.
5/ Including Ministry of Information and Culture.
6/ Excluding externally financed expenditures other than food aid.

Table XV. Eritrea: Central Government Capital Expenditures, 1992–1994

Fiscal year = calendar year	1992 Preliminary	1993 Actual	1993 January – June	1994 January – June
	(In millions of birr)			
General services	7.8	41.7	...	...
Economic development	71.5	372.5	...	...
Agriculture and natural resources 1/	28.8	244.3	...	...
Mining and energy	...	9.9	...	...
Trade, industry, and tourism	5.0	58.1	...	...
Transport, construction, communications	37.7	60.2	...	...
Social development	12.1	41.1	...	...
Education	...	19.3	...	...
Health	0.2	18.1	...	...
Social affairs	11.9	3.6	...	...
Other 3/	...	0.1	...	...
Total capital expenditure	91.4	455.3	...	125.8
Financing by source	91.4	455.3	...	125.8
Central Treasury	91.4	89.4	...	34.1
External grants	...	364.6	...	55.0
Of which: RRPE	(– –)	(109.5)	(...)	(55.0)
External loans	– –	1.3	...	36.7
	(In percent of GDP)			
General services	0.4	1.6	...	...
Economic development	3.6	14.7	...	...
Of which: agriculture and natural resources	(1.4)	(9.6)	(...)	(...)
Social development	0.6	1.6	...	...
Of which: education and health	(– –)	(1.5)	(...)	(...)
	(In percent of total)			
General services	8.5	9.2	...	...
Economic development	78.2	81.8	...	...
Of which: agriculture and natural resources	(31.5)	(53.7)	(...)	(...)
Social development	13.2	9.0	...	...
Of which: education and health	(0.2)	(8.2)	(...)	(...)
	(Annual changes in percent)			
General services	...	434.6	...	...
Economic development	...	421.0	...	...
Social development	...	239.7	...	...
Total capital expenditure	...	398.1	...	...

Sources: Ministry of Finance and Development; staff estimates.

1/ Including Ministry of Marine Resources.
2/ Including Standards Office and Land Commission, and financial agencies.
3/ Including Ministry of Information and Culture.

Table XVI. Provisional Monetary Survey, December 1991–June 1994 1/

	1991 Dec.	1992 June	1992 Dec.	1992 June	1992 Dec.	1994 June
	(In millions of birr)					
Net foreign assets 2/	3.1	78.0	27.7	316.4	553.5	733.0
Foreign assets	3.1	79.7	29.8	322.5	575.7	762.0
Foreign liabilities	0.1	1.6	2.1	6.0	22.3	29.0
Net claims on the birr area	568.2	848.2	1,094.5	1,206.9	1,275.8	1,259.8
Birr assets	599.2	908.4	1,214.7	1,325.7	1,450.3	1,458.8
Cash in vault	486.5	801.1	1,160.1	1,300.0	1,301.7	1,209.6
Correspondent account	--	--	--	0.0	97.9	198.4
Clearing account	112.7	107.3	54.6	25.6	50.7	50.8
Birr liabilities	31.0	60.2	120.2	118.7	174.5	199.1
Correspondent account	--	--	--	58.6	114.3	138.9
Clearing account	31.0	60.2	120.2	60.2	60.2	60.2
Domestic Credit	–90.4	–225.7	1.0	33.1	165.0	457.4
Claims on Central Government (net) 3/	–162.5	–245.9	–91.5	–104.8	–20.9	–75.2
Credit to Central Government	--	--	213.6	201.8	82.9	140.0
Deposits of Central Government	162.5	245.9	305.1	306.6	103.8	215.2
Claims on local government	--	--	2.3	--	--	--
Claims on public enterprises	42.3	7.2	70.1	109.3	120.4	405.2
Claims on private sector	29.8	12.9	20.1	28.7	65.5	127.4
Broad money 4/	494.5	771.8	1,186.9	1,534.3	1,925.3	2,326.7
Money 4/	203.0	292.1	517.3	637.6	866.8	1,122.7
Quasi–money	291.5	479.7	669.5	896.6	1,058.5	1,203.9
Other items (net)	–13.5	–71.2	–63.6	22.2	69.0	123.5
	(Annual percentage change) 5/					
Broad money	...	...	140.0	98.8	62.2	51.6
Net foreign assets	...	...	5.0	30.9	44.3	27.2
Net claims on the birr area	...	...	106.4	46.5	15.3	3.4
Credit to private sector and public enterprises	...	...	3.7	15.3	8.1	25.7

Source: Based on data provided by the Eritrean authorities; staff estimates.

1/ The net presentation is based on items that appear on the balance sheets of the BE and CBER.
2/ Net external assets position of BE and CBER.
3/ Includes borrowing by Finance Commission.
4/ Excludes currency outside banks in Eritrea.
5/ Annual change as percent of beginning–of–period money stock.

Table XVII. Eritrea: Detailed Accounts of the Bank of Eritrea, December 1991 – June 1994

(In millions of birr)

	1991	1992		1992		1994
	Dec.	June	Dec.	June	Dec.	June
Net foreign assets	--	--	--	0.3	73.0	353.7
Claims on foreign commercial banks	--	--	--	--	69.1	331.0
Foreign exchange	--	--	--	0.3	3.9	22.7
Gold	--	--	--	0.2	3.7	12.8
Foreign currency	--	--	--	0.1	0.2	9.9
Net claims on the birr area	226.9	203.2	234.0	153.8	326.3	305.2
Birr in vault	245.2	221.5	252.3	172.0	344.6	323.4
Liabilities to CBE Addis	18.3	18.3	18.3	18.3	18.3	18.3
Domestic credit	–95.8	–88.7	–72.0	–58.4	–103.8	–75.2
Claims on Central Government (net)	–95.8	–88.7	–72.0	–58.4	–103.8	–75.2
Credit to Central Government	--	--	--	--	--	140.0
Central Government deposits	95.8	88.7	72.0	58.4	103.8	215.2
Claims on commercial banks	--	--	--	--	--	--
Claims on other banks	--	--	--	--	--	--
Other items (net)	5.9	–2.4	9.5	–19.1	–18.2	–31.3
Unclassified assets	6.2	0.2	11.7	2.7	16.0	16.6
Uncleared effects	...	...	11.6	0.2	9.7	1.2
Debtors	...	...	--	--	3.7	12.7
Fixed assets	...	...	--	2.6	2.6	2.7
Unclasified liabilities	0.3	0.4	--	11.0	23.1	15.1
Creditors	...	...	--	1.0	1.1	1.5
Other accounts	...	...	--	9.9	21.9	13.6
Capital account	--	2.2	2.2	10.9	11.1	32.9
General reserve fund	--	--	2.0	8.0	8.0	8.0
Capital reserves	--	--	--	2.5	2.5	2.7
Provisions	--	--	0.2	0.4	0.4	22.1
Reserve money	137.0	112.1	171.5	76.6	277.4	552.3
Deposits of commercial banks	137.0	112.1	171.5	76.6	277.4	552.3

Source: Bank of Eritrea; staff estimates.

Table XVIII. Detailed Accounts of the Commercial Bank of Eritrea, December 1991 – June 1994 1/

(In millions of birr)

	1991	1992		1993		1994
	Dec.	June	Dec.	June	Dec.	June
Reserves	137.0	112.1	171.5	76.6	278.0	552.3
Deposits with the BE	137.0	112.1	171.5	76.6	278.0	552.3
Net foreign assets	3.1	78.0	27.7	316.2	480.4	379.3
Assets	3.1	79.7	29.8	322.2	502.7	408.3
Gold	--	--	--	--	--	--
Foreign currency	1.6	2.0	1.8	1.7	6.9	22.7
Claims on foreign banks	1.5	77.7	28.0	320.5	495.7	385.6
Nonresident birr accounts	0.1	1.6	2.1	6.0	22.3	29.0
Net claims on the birr area	341.4	645.0	860.4	1,053.1	949.5	954.6
Claims on the birr area	354.0	686.9	962.4	1,153.6	1,105.7	1,135.4
Cash in vault	241.3	579.6	907.8	1,128.0	957.1	886.2
Correspondent account	--	--	--	0.0	97.9	198.4
Claims on CBE Addis	112.7	107.3	54.6	25.6	50.7	50.8
Liabilities to birr area	12.7	41.9	102.0	100.5	156.2	180.8
Correspondent account	--	--	--	58.6	114.3	138.9
CBE Addis	12.7	41.9	102.0	41.9	41.9	41.9
Claims on Central Government (net)	–66.7	–157.2	–19.5	–46.5	82.9	--
Credit to the Central Government	--	--	213.6	201.8	82.9	--
Loans and advances	--	--	--	0.7	--	--
Overdrafts	--	--	213.6	201.1	82.9	--
Central Government deposist	66.7	157.2	233.1	248.3	--	--
Claims on local government	--	--	2.3	--	--	--
Loans and advances	--	--	2.3	--	--	--
Overdrafts	--	--	--	--	--	--
Claims on nonfinancial public enterprises	42.3	7.2	70.1	109.3	120.4	405.2
Loans and advances	5.0	0.8	59.9	56.9	49.3	75.9
Overdrafts	37.2	6.5	10.3	52.4	71.1	329.3
Claims on the private sector	29.8	12.9	20.1	28.7	65.5	127.4
Loans and advances	29.5	12.4	16.0	18.8	34.9	72.9
Overdrafts	0.3	0.5	4.1	9.9	30.6	54.5
Other items (net)	7.6	73.6	54.2	–3.1	–51.4	–92.2
Demand deposits	203.0	292.1	517.3	637.6	866.8	1,122.7
Local government	--	--	--	--	74.1	141.1
Nonfinancial public enterprises	52.6	132.9	307.2	382.5	540.7	668.8
Private sector	69.2	117.6	152.2	194.7	192.8	239.1
Other	81.3	41.6	57.9	60.5	59.2	73.8
Savings deposits	280.9	471.0	660.7	801.0	936.2	1,086.9
Private sector	280.7	470.9	660.2	799.8	935.7	1,086.6
Other	0.1	0.1	0.5	1.1	0.5	0.3
Fixed deposits	10.6	8.7	8.8	95.7	122.3	117.1
Private Sector	3.6	3.9	4.1	3.8	3.9	16.5
Nonfinancial public enterprises	--	--	--	--	--	--
Other	7.0	4.0	4.0	4.0	4.0	19.0
Margin held accounts	--	0.8	0.8	87.8	114.3	81.5

Sources: Bank of Eritrea; Commercial Bank of Eritrea; staff estimates.

Table XIX. Eritrea: Distribution of Net Foreign Assets and Claims on the Birr Area, December 1991–June 1994

(In millions of birr)

	1991	1992		1993		1994
	December	June	Dec.	June	Dec.	June
Net foreign assets	3.1	78.0	27.7	316.4	553.5	733.0
BE	--	--	--	0.3	73.0	353.7
CBER	3.1	78.0	27.7	316.2	480.4	379.3
Assets						
BE	--	--	--	0.3	73.0	353.7
CBER 1/	3.1	79.7	29.8	322.2	502.7	408.3
Liabilities						
BE	--	--	--	--	--	0.0
CBER	0.1	1.6	2.1	6.0	22.3	29.0
Change 2/	...	...	24.7	238.4	525.7	179.6
BE	...	...	0.0	0.3	73.0	280.6
CBER	...	...	24.7	238.1	452.7	−101.1
Birr claims (net)	568.2	848.2	1,094.5	1,206.9	1,275.8	1,259.8
BE	226.9	203.2	234.0	153.8	326.3	305.2
CBER	341.4	645.0	860.4	1,053.1	949.5	954.6
Assets						
BE	245.2	221.5	252.3	172.0	344.6	323.4
CBER	354.0	686.9	962.4	1,153.6	1,105.7	1,135.4
Liabilities						
BE	18.3	18.3	18.3	18.3	18.3	18.3
CBER	12.7	41.9	102.0	100.5	156.2	180.8
Change 2/	...	...	526.2	358.7	181.4	−16.1
BE	...	...	7.2	−49.4	92.2	−21.1
CBER	...	...	519.0	408.2	89.1	5.1

Source: Tables XVII and XVIII.

1/ Correspondent account (net).
2/ Annual change except for June 1994, which is six months through June.

Table XX. Eritrea: Sectoral Distribution of Commercial Bank Loans, 1991 – June 1994

(In millions of birr)

	1993			1994			
	June	Dec.		March		June	
		Total	Of which: Private 2/	Total	Of which: Private	Total	Of which: Private
Agriculture	5.5	21.3	1.3	25.0	2.9	31.7	3.5
Term loans	--	0.3	0.0	1.4	1.6	4.4	1.8
Overdrafts	5.5	21.0	1.3	23.6	1.3	27.3	1.7
Manufacturing	28.0	32.5	4.3	41.6	7.2	48.4	21.7
Term loans	7.0	3.4	2.7	3.9	3.6	5.0	12.1
Overdrafts	21.0	29.1	1.6	37.7	3.6	43.4	9.6
Domestic trade and services	241.0	120.2	42.9	460.2	59.4	317.1	68.1
Term loans	67.7	67.2	26.4	77.3	36.0	71.2	34.2
Overdrafts	173.3	53.0	16.5	383.0	23.5	245.9	34.0
Export	2.0	3.1	0.6	1.0	4.2	4.1	7.0
Term loans	--	0.6	0.6	0.6	4.2	4.1	7.0
Overdrafts	2.0	2.5	--	0.5	--		--
Import	21.1	27.5	13.2	28.0	14.6	29.6	18.2
Term loans	1.0	1.8	4.7	2.5	7.3	2.4	7.6
Overdrafts	20.2	25.7	8.5	25.5	7.3	27.2	10.6
Building and construction	41.7	51.3	1.6	53.1	54.7	40.7	2.5
Term loans	0.5	0.9	1.6	0.9	2.5	0.8	2.2
Overdrafts	41.2	50.5	--	52.1	52.1	39.9	0.4
Other	52.3	65.0	0.2	56.8	0.2	60.9	0.2
Of which:							
Loans under opinion differences	(51.6)	(52.1)	(--)	(52.1)	(--)	(52.8)	(--)
Total 2/	391.5	320.9	64.1	665.6	143.3	532.5	121.2
Term loans	128.4	139.2	36.2	143.3	55.6	148.8	65.0
Overdrafts	263.2	181.7	27.9	522.4	87.7	383.7	56.2

Source: Commercial Bank of Eritrea.

1/ Data available since December 1993.

2/ Figures include borrowing by Finance Commission and may not correspond exactly to those reported in Table XVIII, owing to classification issues.

Table XXI. Eritrea: Structure of Interest Rates

(In percent per annum)

	December 1992 – August 1994		As of September 1, 1994
	Government–owned enterprises	Individuals and private organizations	
Savings deposits	...	8	6
Loans			
Agriculture	9	10	...
Commercial	...	...	8
Small–scale	...	...	7.5
Industry, mining, power, and water resources	11	12	8.5
Domestic trade	11	12.5	9
Transport and Communications	11	11	8.5
Export trade	10	10	8
Import trade	11	12	9
Hotels and tourism	10	12.5	9
Housing			
Construction	8.5	9.5	7
Purchases	10	12	8

Source: Bank of Eritrea; Commercial Bank of Eritrea.

Table XXII. Eritrea: Balance of Payments, 1992–June 1994

(In millions of U.S. dollars)

	1992 (Prel.)			1993 (Prel.)			1994 Jan.–June (Prel.)		
	Birr	Nonbirr	Total	Birr	Nonbirr	Total	Birr	Non–birr	Total
Trade balance	–38.5	–277.6	–316.1	–16.8	–259.3	–276.1	–6.0	–125.6	–131.7
Exports, f.o.b. 1/	14.3	1.0	15.2	25.0	11.1	36.1	13.0	14.5	27.5
Imports, c.i.f.	52.8	278.5	331.3	41.8	270.4	312.2	19.1	140.1	159.2
Franco valuta (private) 1/ 2/	6.9	95.4	102.3	––	140.7	140.7	––	68.1	68.1
Aid–related imports	––	167.7	167.7	––	69.7	69.7	––	41.5	41.5
Of which: food	(––)	(43.2)	(43.2)	(––)	(17.3)	(17.3)	(––)	(18.5)	(18.5)
RRPE	(––)	(––)	(––)	(––)	(21.2)	(21.2)	(––)	(15.1)	(15.1)
Petroleum products	23.8	––	23.8	29.1	––	29.1	12.6	––	12.6
Other 3/	22.1	15.5	37.6	12.7	60.0	72.6	6.5	30.4	36.9
Services (net)	65.2	7.6	72.8	51.5	50.5	102.0	20.9	4.9	25.8
Receipts	65.2	7.6	72.8	51.5	51.5	102.9	20.9	14.0	35.0
Oil refining	6.1	4.3	10.4	5.2	2.9	8.1	4.4	1.4	5.9
Port services	59.1	3.2	62.4	46.3	2.8	49.1	16.5	1.0	17.5
Other	––	––	––	––	45.7	45.7	––	11.6	11.6
Payments	––	––	––	––	0.9	0.9	––	9.2	9.2
Private transfers (net) 1/	6.9	174.0	180.9	––	202.5	202.5	––	150.0	150.0
Receipts	6.9	175.1	182.0	––	202.6	202.6	––	150.5	150.5
Counterpart franco valuta	6.9	95.4	102.3	––	140.7	140.7	––	68.1	68.1
Other 4/	––	79.7	79.7	––	61.9	61.9	––	82.3	82.3
Payments	––	1.1	1.1	––	0.1	0.1	––	0.4	0.4
Current account (excluding official transfers)	33.6	–96.0	–62.4	34.7	–6.3	28.4	14.9	29.3	44.1
Capital account (including official transfers)	58.9	167.7	226.6	––	70.0	69.9	––	47.5	47.5
Official transfers (net)	––	167.7	167.7	––	69.7	69.7	––	41.5	41.5
Of which: food	(––)	(43.2)	(43.2)	(––)	(17.3)	(17.3)	(––)	(18.5)	(18.5)
RRPE	(––)	(––)	(––)	(––)	(20.9)	(20.9)	(––)	(9.0)	(9.0)
Official long–term capital	––	––	––	––	0.2	0.2	––	6.0	6.0
Disbursements (RRPE)	––	––	––	––	0.2	0.2	––	6.0	6.0
Private capital 5/	58.9	––	58.9	––	––	––	––	––	––
Quasi–financial institutions 6/	...	...	...	...	...	...	...	...	...
Errors and omissions	95.4	–62.8	32.6	0.1	36.8	36.9	–17.5	–47.3	–64.8
Overall balance	187.9	8.8	196.8	34.7	100.5	135.2	–2.6	29.5	26.8
Net foreign assets and claims on the birr area (– increase)	–187.9	–8.8	–196.8	–34.7	–100.5	–135.2	2.6	–29.5	–26.8
Bank of Eritrea	–2.6	––	–2.6	–17.6	–14.0	–31.6	3.5	–46.1	–42.6
Commercial Bank of Eritrea	–185.4	–8.8	–194.2	–17.0	–86.6	–103.6	–0.8	16.6	15.8
Memorandum items :									
Reserves (in months of imports)	...	...	0.3	...	...	3.8	...	...	8.8
Exchange rate (average)									
Auction rate	...	...	2.8	...	...	5.2	...	...	6.1
Preferential rate	...	...	6.4	...	...	7.1	...	...	7.1

Sources: Bank of Eritrea; Customs Office; Ministry of Finance and Development; and staff estimates.

1/ Converted to dollars at the preferential rate.

2/ Imports that do not require official foreign exchange from the banking system (on official lines of credit) and charged 2 percent commission.

3/ Imports funded through the banking system; converted to dollars at the preferential rate.

4/ Includes transfers collected by unofficial foreign exchange dealers, mainly Red Sea Trading Corporation and Investment Unit; converted to dollars at the preferential rate.

5/ Comprise cash deliveries to CBER by Ethiopia to compensate for deposit liabilities.

6/ Foreign exchange retained by unofficial foreign exchange dealers.

Table XXIII. Eritrea: Commodity Composition of Foreign Trade, 1992 – 1994 1/

(In millions of birr)

	Exports				Imports			
	1992	1993	1994		1992	1993	1994	
			Q1	Q2			Q1	Q2
Food and live animals	1.5	27.8	10.8	44.6	99.1	166.4	95.7	84.8
Of which: Ethiopia	(1.3)	(5.0)	(1.2)	(0.9)	(48.6)	(50.1)	(13.6)	(10.4)
in percent	(86.4)	(17.9)	(11.0)	(1.9)	(49.1)	(30.1)	(14.3)	(12.3)
Beverages and tobacco	4.0	8.7	1.1	1.9	13.8	35.9	15.1	8.9
Of which: Ethiopia	(2.8)	(7.6)	(0.9)	(1.4)	(1.6)	(0.6)	(0.2)	(0.6)
in percent	(70.4)	(87.5)	(85.8)	(73.3)	(11.4)	(1.6)	(1.1)	(6.3)
Crude Materials	35.7	76.6	27.2	36.6	3.6	31.3	13.5	14.1
Of which: Ethiopia	(31.0)	(66.2)	(23.4)	(15.2)	(0.1)	(0.4)	(1.3)	(1.1)
in percent	(86.8)	(86.4)	(86.2)	(41.6)	(3.2)	(1.3)	(9.4)	(7.7)
Mineral fuels, lubricants and related materials	--	--	--	--	4.6	6.8	2.5	2.5
Of which: Ethiopia	(--)	(--)	(--)	(--)	(0.1)	(0.2)	(0.2)	(0.2)
in percent	(100.0)	(100.0)	(100.0)	(--)	(1.4)	(2.6)	(8.7)	(7.7)
Animal and vegetable oils, fats and waxes	--	0.1	--	--	1.9	10.7	7.1	7.2
Of which: Ethiopia	(--)	(--)	(--)	(--)	(0.1)	(0.1)	(--)	(--)
in percent	(100.0)	(30)	(--)	(--)	(6.0)	(0.5)	(--)	(0.2)
Chemicals and related products	0.3	6.2	1.6	1.2	32.2	56.4	15.6	40.4
Of which: Ethiopia	(0.3)	(0.3)	(1.2)	(1.2)	(0.8)	(1.2)	(0.5)	(0.2)
in percent	(100.0)	(48.8)	(76.4)	(98.6)	(2.4)	(2.1)	(3.2)	(0.6)
Manufactured goods	2.4	52.9	18.1	14.9	107.1	222.2	78.5	72.2
Of which: Ethiopia	(2.4)	(17.4)	(6.8)	(7.2)	(6.8)	(7.5)	(4.5)	(3.7)
in percent	(99.4)	(32.9)	(37.4)	(48.3)	(6.4)	(3.4)	(5.7)	(5.2)
Machinery and transport equipment	1.2	3.5	0.6	3.0	55.0	381.9	155.9	181.0
Of which: Ethiopia	(1.2)	(3.0)	(0.5)	(2.0)	(2.2)	(3.8)	(0.9)	(0.8)
in percent	(100.0)	(84.7)	(93.0)	(66.3)	(4.0)	(1.0)	(0.6)	(0.4)
Miscellaneous								
Manufactured articles	1.0	33.5	8.9	11.8	49.9	111.2	26.2	28.8
Of which: Ethiopia	(1.0)	(28.3)	(6.0)	(11.6)	(1.6)	(2.5)	(0.5)	(0.7)
in percent	(99.8)	(84.3)	(67.4)	(98.0)	(3.2)	(2.2)	(1.9)	(2.4)
Total	46.1	209.2	68.1	114.1	367.1	1,022.8	410.1	439.9
Of which: Ethiopia	(40.0)	(130.5)	(40.0)	(39.4)	(61.9)	(66.2)	(21.7)	(17.8)
in percent	(86.7)	(62.3)	(58.7)	(34.6)	(16.8)	(6.5)	(5.3)	(4.0)

Source: Customs Office; staff estimates.

1/ Excludes petroleum imports; aid imports are included only in 1994.

Table XXIV. Eritrea: Direction of Exports, 1992 – June 1994 1/

	1992	1993	1994 Jan.–March	1994 April–June
		(In millions of birr)		
Belgium	--	--	--	--
Djibouti	--	--	--	--
Egypt	--	--	--	11.4
Ethiopia	40.0	130.5	40.0	39.4
Germany	0.1	1.4	--	0.2
Italy	3.4	5.4	3.6	1.8
Netherlands	0.1	0.2	--	--
Saudi Arabia	0.1	3.6	5.8	41.0
Sudan	--	46.5	13.6	9.8
Sweden	1.2	0.6	--	--
Switzerland	--	--	--	--
United Arab Emirates	0.3	0.1	--	--
United Kingdom	0.3	--	--	1.8
United States	--	--	--	--
Yemen	0.2	0.0	1.5	1.1
Other	0.3	1.7	0.1	5.7
Total	46.1	190.0	64.5	112.2
		(In percent)		
Belgium	--	--	--	--
Djibouti	--	--	--	--
Egypt	--	--	--	10.2
Ethiopia	86.7	68.7	62.0	35.1
Germany	0.3	0.7	--	0.2
Italy	7.5	2.9	5.6	1.6
Netherlands	0.3	0.1	0.0	--
Saudi Arabia	0.3	1.9	8.9	36.6
Sudan	--	24.5	21.1	8.7
Sweden	2.5	0.3	--	--
Switzerland	0.0	--	--	--
United Arab Emirates	0.6	0.1	--	--
United Kingdom	0.6	--	--	1.6
United States	--	--	--	--
Yemen	0.5	--	2.3	0.9
Other	0.6	0.9	0.1	5.1
Total	100.0	100.0	100.0	100.0

Source: Customs Office; staff estimates.

1/ Figures differ from Table XXIII owing to incomplete information of on direction of exports.

Table XXV. Eritrea: Source of Imports, 1992 – June 1994 1/

	Exports			
	1992	1993	1994	
			Jan.–March	April–June
	(In millions of birr)			
Belgium	0.5	14.3	2.0	13.4
Djibouti	13.0	11.3	1.4	5.2
Egypt	1.6	1.6	0.1	4.7
Ethiopia	61.9	66.3	21.7	17.8
Germany	7.0	79.3	24.2	38.0
Italy	27.8	136.8	46.5	100.1
Netherlands	6.7	22.0	6.0	45.5
Saudi Arabia	136.1	282.5	75.7	71.0
Sudan	2.1	53.4	7.3	22.9
Sweden	2.1	25.9	2.1	3.1
Switzerland	1.5	9.2	0.9	2.1
United Arab Emirates	35.8	96.6	20.0	16.0
United Kingdom	4.7	29.7	5.2	38.2
United States	1.3	11.4	0.9	7.6
Yemen	7.1	12.5	3.1	3.5
Other	57.8	46.9	33.0	32.9
Total	367.1	899.7	250.1	421.9
	(In percent)			
Belgium	0.1	1.6	0.8	3.2
Djibouti	3.6	1.3	0.6	1.2
Egypt	0.4	0.2	0.0	1.1
Ethiopia	16.8	7.4	8.7	4.2
Germany	1.9	8.8	9.7	9.0
Italy	7.6	15.2	18.6	23.7
Netherlands	1.8	2.4	2.4	10.8
Saudi Arabia	37.1	31.4	30.3	16.8
Sudan	0.6	5.9	2.9	5.4
Sweden	0.6	2.9	0.8	0.7
Switzerland	0.4	1.0	0.4	0.5
United Arab Emirates	9.8	10.7	8.0	3.8
United Kingdom	1.3	3.3	2.1	9.1
United States	0.3	1.3	0.4	1.8
Yemen	1.9	1.4	1.2	0.8
Other	15.7	5.2	13.2	7.8
Total	100.0	100.0	100.0	100.0

Source: Customs Office; staff estimates.

1/ Figures differ from Table XXIII owing to incomplete data on origin of imports.