

Eritrea



Bekezela Ncube

Basic information about the country:

Eritrea gained its independence from Ethiopia on 24 May 1991 after a 30-year war of liberation. The country remains one of the poorest in the world with its infrastructure and economy left in ruins by the war. It is located in North-East Africa and is bordered to the north and west by Sudan, to the south by Ethiopia and Djibouti, and to the east by the Red Sea.

Eritrea has a command economy under the control of a single political party – the People’s Front for Democracy and Justice (PFDJ) – which is considered by some measures to be one of the most repressive regimes in sub-Saharan Africa.¹ Freedom House classifies Eritrea as “Not Free” and assigns it a rating of 7/7 for lack of political rights and 6/7 for lack of civil liberties. Most bank lending is extended to the government (some speculate that this is a form of financial repression) and the state controls the use of foreign currency very strictly, limiting its access and availability.² Eritrea has a state dominated economy that leaves little room for the private sector. A Chatham House summary report on Eritrea cited by the Financial Standards Foundation claims that, “Using a combination of easy access to...capital and unfair business practices, PFDJ firms have come to dominate all aspects of the economy.”

A large section of the economy consists of subsistence agriculture and the country is heavily dependent on foreign aid. The UNDP ranks Eritrea 151 out of 177 countries on its Human Development Index. The IMF estimates remittances from abroad at \$250mm-\$400mm annually, a substantial portion of Eritrea’s GDP of \$1.4 bn. **Table 1** shows summary statistics about the country.

Table 1: Eritrea Statistics at a Glance

	BBC	CIA World Factbook
Population	5 million (UN 2008)	5,647,168 (July, 2009 est.)
Area	117,400 sq km (45,300 sq mi)	121,320 sq km
Border Countries		Djibouti 109 km, Ethiopia 912 km, Sudan 605 km
Coastline		2,234 km
Major Languages	Tigrinya, Tigre, Arabic, English	Afar, Arabic, Tigre and Kunama, Tigrinya, other Cushitic languages
Major Religion	Islam, Christianity	Muslim, Coptic Christian, Roman Catholic, Protestant

¹ Financial Standards Foundation (2008)

² CIA World Factbook

	BBC	CIA World Factbook
Life Expectancy	56 (men) 60 (women) (UN)	Total : 61.78 male: 59.71 fem: 63.9 (2009 est.)
Main Exports - Commodities	Livestock, hides, sorghum, textiles, salt, light manufactures	Livestock, sorghum, textiles, food, small manufactures
Main Exports – Partners		Italy 34.4%, China 16.2%, Sudan 15.2%, France 9.4%, Saudi Arabia 5.2%, Australia 4.4% (2007)
Currency	1 Nakfa = 100 cents	
Exchange rates		Nakfa (ERN) per US dollar - 15.38 (2008 est.), 15.5 (2007), 15.4 (2006), 14.5 (2005), 13.788 (2004) <i>note: the official exchange rate is 15 Nakfa to the dollar</i>
GDP		\$1.479 bn (2008 est.)
GDP (PPP)		\$3.946 bn (2008 est.)
GDP per capita (PPP)		\$700 (2008 est.)
Inflation Rate		18% (2008 est.)

Eritrea does poorly on measures of its business climate. The World Bank assigns a rank of 171 out of 178 on its Ease of Doing Business Index. Other indicators of the business environment are summarized in *Table 2*.

Table 2: Business Climate of Eritrea

Index	Rank	Score
World Bank Ease of Doing Business 2008	171/178	na
World Bank Gov Indicator 2006, Regulatory Quality	2.4 Percentile	-1.87
World Bank Gov. Indicator 2006, Political Stability	20.7 Percentile	-0.87
World Bank Gov Indicators 2006, Control of Corruption	54.4 Percentile	-0.17
World Bank Gov Indicators 2006, Rule of Law	14.8 Percentile	-0.99
Transparency International Corruption Perception Index 2007	111/179	2.8/10
Bertelsmann Transformation Index 2006	113/119	2.94/10

Banking System³

The modern financial system of Eritrea began under Italian colonial rule with some private Italian banks opening in the 1920s. The financial system did not develop much further under British military rule that began in 1941, and when federation with Ethiopia was instituted in 1952, the State Bank of Ethiopia opened branches in the country⁴. Until the country's independence from Ethiopia, the financial system of Eritrea was therefore a derivative of the banks and financial institutions of Ethiopia. For example, although the country obtained independence in 1991, it was only in 1997 that a new currency – the *Nakfa* – was created, to replace the Ethiopian *birr*. During that 7-year period, the Ethiopian central bank – the National Bank of Ethiopia – conducted all monetary policy for the common currency area, and thus realized all benefits of seigniorage over the *birr*. Thus, an independent currency was formed to protect Eritrea's national interest.

³ Rena (2007a)

⁴ Citation Unknown, *Chapter 3: Eritrean Financial Institutions*

Although Eritrean law allows the licensing of private financial institutions, including the establishment of foreign banks, no local or foreign private financial institution (except for foreign exchange bureaus) has been allowed to work in Eritrea besides the 4 main institutions described below.

Bank of Eritrea:

The Bank of Eritrea is the country's apex bank and its principal objective is to manage money and credit in the economy. Prior to independence the bank was a branch of the National Bank of Ethiopia and performed the following functions:

- Exchange control
- Local transfer services
- Supply of *birr* notes to branches of the Commercial Bank of Ethiopia
- Clearing house for checks drawn on the Ethiopian banks and
- Redemption of deteriorated notes

Since independence, the Bank of Eritrea has assumed all functions of a central bank including:

- The regulation and supervision of financial institutions
- The issuance of bank notes and coins
- Advisor, banker, and fiscal agent to the Government of Eritrea
- Determination of the exchange rate system for the *Nakfa*
- Acceptance of deposits from and provision of advances to depository institutions
- Influence of the supply of money and credit in the economy
- Regulation of rates of interest and foreign exchange

Commercial Bank of Eritrea (CBE):

The largest commercial bank in the country, the CBE was established in 1994 and is the sole institution in the country that provides full retail and commercial banking services. The bank is government-owned. With *Nakfa* 13.6bn in deposits in 2004 (up from *Nakfa* 365mm in 1991) and ~*Nakfa* 3.5bn in loans (from ~86mm in 1991), the bank holds about 90% of the country's deposits and 80% of private sector claims. The excess of deposits over loans prevents the bank from being able to pay depositors and limits profitability, and the bank shows return on assets and return on equity of 0.6% and 2.1% respectively. Branches are few and limited in geographic breadth, leaving many in the population underserved. The CBE is charged with:

- promotion of savings and provision of credit
- promotion of exports, foreign exchange and trade
- stimulation of agricultural production and rural development
- financing the working capital requirements of the industrial sector

Table 3 shows the composition of CBE loan portfolio from 1996 through 2004. The interest rates on loans and deposits are fixed by the Bank of Eritrea (see note 4). Collateral requirements are as high as 100% of loan value, severely limiting borrowing power. The CBE typically lends to large state-owned and private manufacturing firms which are considered relatively low-risk borrowers. Entrepreneurs, small-scale farmers, and people in the informal

sector are considered high-risk and seldom receive loans from the CBE. (To attempt to remedy this, the government has supported the development of microfinance institutions.)

Table 3: CBE Loan Portfolio (millions of Nakfa)*

Sector	1996	1997	1998	1999	2000	2001	2002	% of 2002 Total
Total	1,444	1,475	1,675	1,827	1,454	1,639	1,923	100%
Domestic Trade & Services	719	589	783	984	687	880	987	51%
Manufacturing	202	332	358	325	290	364	410	21%
Export & Import	220	244	276	229	247	170	231	12%
Agriculture	103	120	137	171	144	157	225	12%
Building & Construction	90	104	44	62	47	39	35	2%
Personal Loans	110	85	77	56	40	28	34	2%

Source: Reproduced from *Chapter 3: Eritrean Financial Institutions* (citation unknown) which gives sources as CBE records on loans and deposits (2003) and notes that *1996 and 1997 are given in millions of *birr*

Housing and Commerce Bank of Eritrea (HCBE):

Also established in 1994, the HCBE has 9 functional branches and provides housing loans to customers who qualify under the banks credit standards. The bank provides loans for residential and commercial construction, and also for the repair and maintenance of existing buildings. The HCBE also builds and re-sells housing complexes and provides loans to state enterprises.

Deposits increased from *Nakfa* 30mm in 1994 to 3bn in 2003 (~50% CAGR), in the period from 1994 to 1998 loans grew commensurately from 105mm to a peak of 801mm in 1998. The border conflict with Ethiopia significantly slowed loan growth and 1999 saw a 33% drop in loans outstanding. Loan growth has revived since then. **Table 4** shows the distribution of HCBE loans for 2 years

Table 4: Sectoral distributions of HCBE loans (millions of Nakfa)

Sector	2001	2002	% of 2002 Total
Total	727	789	100%
Mortgages	683	713	90%
Domestic Trade & Services	16.3	36.5	5%
Building & Construction	14.8	21.7	3%
Export & Import	9.02	14.46	2%
Manufacturing	2.9	3.0	0.4%
Agriculture	0.66	0.19	0.02%

Source: Reproduced from *Chapter 3: Eritrean Financial Institutions* (citation unknown) which gives the source as HCBE' brochure (2002)

Table 5 shows the deposit composition of both the CBE and the HCBE

Table 5: CBE and HCBE Deposits (millions of Nakfa)

Deposits	1994		1995		1996		1997		1998		1999		1999 % of Total	
	CBE	HCB	CBE	HCB	CBE	HCB	CBE	HCB	CBE	HCB	CBE	HCB	CBE	HCB
Total	3223	49	4064	255	4712	484	5271	879	6333	1227	7193	1606	100%	100%
Savings	1318	30	1668	186	1827	325	2121	495	2529	696	2871	872	40%	54%
Claims on Private Sector	329	19	651	38	952	86	1219	262	1722	351	1753	418	24%	26%
Demand	1258	0	1296	0	1671	6	1598	18	1809	72	2277	131	32%	8%
Foreign	0	0	0	0	0	0	147	43	142	76	132	98	2%	6%
Fixed	318	0	449	31	261	68	186	62	131	32	161	88	2%	5%

Source: Reproduced from *Chapter 3: Eritrean Financial Institutions* (citation unknown) which gives the source as IMF staff country reports No. 00/55, April 2000

Eritrean Development and Investment Bank:

Though established in 1996, the government-owned EDIB began banking operations in 1998 in order to stimulate the country's economic development through mobilization and financing of development-oriented projects in the agricultural, industrial, mining, tourism, construction sectors, among others. The bank offers financing primarily through term lending. **Table 6** shows the distribution of EDIB loans for 2 years

Table 6: Sectoral distributions of HCBE loans (millions of Nakfa)

Sector	2001	2002	% of 2002 Total
Total	30.94	29.31	100%
Manufacturing	6.24	13.65	47%
Agriculture	10.03	5.80	20%
Services	6.71	4.04	13.8%
Mining & Construction	7.96	5.82	19.86%

Source: Reproduced from *Chapter 3: Eritrean Financial Institutions* (citation unknown) which gives source as EDIB brochure (2003)

Insurance companies and other financial institutions⁵:

The National Insurance Corporation of Eritrea (NICE) was established in 1992 by government proclamation as an autonomous public enterprise to provide insurance services to individuals and companies. It is a monopoly in the country and its capital rose from *Nakfa* 5mm at inception to ~*Nakfa* 52mm in 2004. NICE has offices in the principal cities of Asmara, Massawa, and Assab and operates under the supervision of the Bank of Eritrea.

NICE underwrites both life and non-life insurance including Motor, Fire, Accident, Livestock, Engineering, Marine, and Aviation, with a significant proportion of gross premiums (48%) from motor insurance. Gross profits grew from *Nakfa* 4mm in 1991 to 60mm in 2004. In that time, net profits rose from ~*Nakfa* 2.6mm to ~39mm. **Table 7** summarizes the breakdown of the gross premiums of NICE from 1992 through 2004.

Table 7: Annual Gross Premiums by Insurance Class (Nakfa)

⁵ Rena (2007b)

	Motor	Fire & Accident	Marine & Aviation	Life	Total
2004	72,138	30,158	47,059	2,433	151,788
'04 % of Total	48%	20%	31%	2%	100%
2003	66,589	27,921	27,700	2,021	124,231
2002	64,272	26,331	18,700	1,840	111,143
2001	51,543	21,351	15,238	2,212	90,344
2000	44,950	16,820	12,463	2,268	76,501
1999	42,500	17,593	12,033	2,413	74,539
1998	38,475	15,584	14,253	2,483	70,795
1997	35,687	18,245	14,021	2,136	70,089
1996	35,106	16,989	14,117	1,488	67,604
1995	26,988	10,706	12,921	367	50,982
1994	14,233	7,955	9,647	282	32,117
1993	12,565	5,153	8,252	100	26,070
1992	7,717	5,992	3,706	35	17,450

In 2004, the corporation was privatized in one of the government's largest privatization efforts. The Eritrean Ministry of Finance and the Martyrs' Trust Fund are the biggest shareholders with ownership interest of 64 and 30 per cent respectively and appoint half of the Board of Directors. To protect against catastrophe, NICE has the following measures in place:

- Reinsurance agreements with overseas reinsurers
- 10% of profits are allocated to a "technical reserve" to cover catastrophic claims
- A further 10% of profits are committed to a "general reserve"

Challenges that have hindered the development of Eritrea's insurance industry include:

- Lack of qualified and experienced manpower. Education about the industry is low
- Lack of adequate legislation to safeguard the interests of the insuring public
- Lack of adequate supervision of operations by the Bank of Eritrea

- Lack of public awareness, particularly among the rural inhabitants who comprise 75% of the country. This includes a lack of education among the public about the benefits of an intangible good such as the “peace of mind” benefit of insurance coverage
- Irrelevance of insurance. While family and social structures in Eritrea often negate the benefits of insurance, policies are often designed for the needs of urban dwellers and insurance benefits prove useless for the rural population
- The conflict with Ethiopia, which retarded post-independence economic growth, destroyed infrastructure, and displaced about one third of the population

Central bank and its role in the economy⁶:

As discussed, above, the central bank is the Bank of Eritrea. In order to achieve price stability the bank has the authority to use three monetary instruments: open market operations, the discount rate, and required reserves.

The open market operation is not used in Eritrea, because both money and capital markets are non-existent. At present, the bank also does not have a discount program, leaving required reserves as the only tool currently used by the bank. Currently the bank requires that commercial banks set aside 20 per cent of their deposits as reserves.

Government Bond Market:

- Bank of Eritrea

Stock Market:

No stock exchange exists in Eritrea, although NICE has in the past attempted to establish an over-the-counter market for trading of its shares.

Other Types of Finance/Financial Market:

a) Microfinance

Eritrea began a Saving and Microcredit Program (SCMP) in 1996 in an attempt to reach the rural population. Under the SCMP, First Tier borrowers are offered loans at 16% annual simple interest and Second Tier can reduce this to 14%. 91% of borrowers are in the former category. The repayment rate has been about 80% in past years and the % of women borrowers has risen from about 30% of Tier 1 borrowers in 1996 (14% of Tier 2) to 40% in 2006 (35%).⁷ Other

⁶ Citation unknown, *Chapter 3: Eritrean Financial Institutions*

⁷ Rena (2007c)

players in the microfinance sector include NGOs such as ACORD, which, together with the SCMP serves 22,500 clients⁸

The Rural Enterprise Investment Partnership (REIP) is a government program to enhance the economic recovery of Eritrea by restoring the agricultural capacity of the country and enhance agricultural exports. REIP charges 8% interest, and unlike, CBE judges credit-worthiness by loan performance and not by the level of collateral. The money is donated by USAID, stored in the Commercial Bank of Eritrea, and disbursed by REIP.

⁸ Graeub-Kraehenbuehl

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