

ERITREA

THE LANDSCAPE FOR IMPACT INVESTING IN EAST AFRICA



WITH SUPPORT FROM



**THE
IMPACT
PROGRAMME**

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LIST OF COMMON TERMS AND ACRONYMS

AFD | Agence Française de Développement
(French Development Agency)

AfDB | African Development Bank

BIF | Burundian Franc

BIO | Belgian Investment Company for
Developing Countries

BoP | Base of the Pyramid

CEPGL | Communauté Économique
des Pays des Grand Lacs (Economic
Community of the Great Lakes Countries)

COMESA | The Common Market for
Eastern and Southern Africa

CSR | Corporate Social Responsibility

DFI | Development Finance Institution

DFID | The Department for International
Development (United Kingdom)

DRC | Democratic Republic of the Congo

EAC | East African Community

Early-stage business | Business that has
begun operations but has most likely not
began commercial manufacture and sales

EIB | European Investment Bank

ESG | Environmental, Social, and
Governance

ETB | Ethiopian Birr

FDI | Foreign Direct Investment

FMCG | Fast-Moving Consumer Goods

FMO | Nederlandse Financierings-
Maatschappij voor Ontwikkelingslanden
N.V. (Netherlands Development Finance
Company)

Focus countries | Countries under the
study where non-DFI impact investors are
most active in. Namely Ethiopia, Kenya,
Rwanda, Tanzania, and Uganda

GDP | Gross Domestic Product

GEMS | Growth Enterprise Market Segment

GIIRS | Global Impact Investing Ratings
System

GIZ | Gesellschaft für Internationale
Zusammenarbeit (German Agency for
International Cooperation)

Growth-stage business | Company has
a functioning business model and its
current focus is developing new products /
services or expanding into new markets

HDI | Human Development Index

ICC | International Criminal Court

ICT | Information and Communication
Technology

IFAD | International Fund for Agricultural
Development

IFC | International Finance Corporation

IMF | International Monetary Fund

IRIS | Impact Investing and Reporting
Standards

KES | Kenyan Shilling

LP | Limited Partner

Mature business | Profitable company with a
developed and recognizable brand

MDG | Millennium Development Goal

MFI | Microfinance Institution

MSME | Micro, Small and Medium Enterprise

NGO | Non-Governmental Organization

Non-focus countries | Countries covered in
the study but have limited non-DFI impact
investor activity. Namely Burundi, Djibouti,
Eritrea, Somalia, South Sudan, and Sudan

OFID | OPEC Fund for International
Development

OPIC | Overseas Private Investment
Corporation

PE | Private Equity

PPA | Power Purchasing Agreement

PPP | Purchasing Power Parity

PPP | Public-Private Partnership

PTA | Preferential Trade Area Bank

RDB | Rwanda Development Board

RFP | Request for Proposal

RWF | Rwandan Franc

SACCO | Savings and Credit Co-operative

SAGCOT | Southern Agricultural Corridor
of Tanzania

SDG | Sudanese Pound

SGB | Small and Growing Business

SME | Small and Medium-Sized Enterprises

SOE | State-Owned Enterprises

SOS | Somali Shilling

SSP | South Sudanese Pound

TA | Technical Assistance

TIC | Tanzania Investment Centre

TZS | Tanzanian Shilling

UGX | Ugandan Shilling

UN DESA | United Nations - Department of
Economic and Social Affairs

UNCTAD | United Nations Conference on
Trade and Development

USAID | The United States Agency for
International Development

VAT | Value-Added Tax

VC | Venture Capital

Venture-stage business | Sales have
begun but cannot sustain the company's
operations. The business model is still
being aligned with the realities on the
ground

WASH | Water, Sanitation, and Hygiene

WHO | World Health Organization

A stylized map of the African continent is shown in a dark blue color. The country of Eritrea, located in the Horn of Africa, is highlighted in a bright red color. The map is positioned in the background of the slide.

ERITREA

A CLOSED ECONOMY,
SLOWLY OPENING

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INTRODUCTION

Eritrea is one of the world's most closed economies. It has no constitution, functioning legislature, independent judiciary, elections, independent press, or non-governmental organizations. Eritrea gained independence from Ethiopia in 1993, and has since been ruled by the People's Front for Democracy and Justice (PFDJ). All power is concentrated in the hands of the government. The PFDJ established a policy of "self-reliance" that restricts foreign investment and aid from foreign organizations on the grounds that these have too many conditions and infringe on national sovereignty.

Due to Eritrea's closed economy, difficult regulatory environment, and small private sector, there has been no known impact investing in the country to date. Although there are some indicators that the economy is liberalizing and the regulatory environment is improving, Eritrea is still a challenging market for investors.

Eritrean businesses need support to grow and create wealth. The most promising investment areas for future impact investors are agriculture, aquaculture, and tourism. Given the lack of development and sophistication of the private sector, however, investors will likely need to invest in significant technical assistance for their portfolio.

FIGURE 1: MAP OF ERITREA



COUNTRY CONTEXT

Since gaining independence from Ethiopia in 1993, Eritrea has faced intense economic challenges stemming from a volatile political situation and restrictive economic policies. A former Italian and British colony, Eritrea was established by the United Nations (UN) as an autonomous entity federated within Ethiopia in 1952. A decade later the government of Ethiopia dissolved the Eritrean parliament and annexed the country, triggering a 32-year struggle for independence.

Eritrea declared independence from Ethiopia in 1993 through a UN-sponsored referendum, in which more than 99% of the population voted for independence.¹ All power is concentrated in the hands of President Afwerki,² who has been in power since independence. His party, the PFDJ, is the sole legal political party.³

Relations between Eritrea and Ethiopia were tense in the years following independence, culminating in a border war between the two countries in 1998.⁴ After several years of mediated efforts to provide an agreeable ruling on the border dispute, a peace agreement was eventually brokered at the end of 2009. However, the two countries disagree on the implementation of the peace plan, and recently both countries remilitarized their borders.⁵ In 2008, there were clashes along the Eritrea-Djibouti border, and Eritrea was condemned by the international community for initiating hostilities.⁶ Eritrea has also been accused of supporting armed militant groups in Somalia.

The international community has condemned these conflicts. Shortly after independence in 1992, the UN imposed an arms embargo on Eritrea, and in 2009 the UN Security Council imposed new sanctions against the ruling party's elites, including an arms embargo, a travel ban, and an asset freeze.⁷ The sanctions were a result of Eritrea's support for armed insurgents in Somalia and its refusal to release Djiboutian prisoners of war captured during a 2008 invasion of Djiboutian territory.⁸

1 Crisis Group Africa, *Eritrea: The Siege State* (2010), available at <http://www.crisisgroup.org/-/media/Files/africa/horn-of-africa/ethiopia-eritrea/163%20Eritrea%20The%20Siege%20State.pdf>.

2 "World Report: Eritrea (2014)," *Human Rights Watch*, available at <http://www.hrw.org/world-report/2014/country-chapters/eritrea>.

3 Crisis Group Africa, *Eritrea: The Siege State* (2010), available at <http://www.crisisgroup.org/-/media/Files/africa/horn-of-africa/ethiopia-eritrea/163%20Eritrea%20The%20Siege%20State.pdf>.

4 US Department of State, "A Brief History of Eritrea-Part 1," *about education*, available at <http://africanhistory.about.com/od/eritrea/p/EritreaHist1.htm>.

5 Habtemicael Weldegiorgis, International Federation of Surveyors, *The Cadastral System in Eritrea: Practice, Constraints and Prospects* (2009), available at https://www.fig.net/pub/monthly_articles/september_2009/september_2009_weldegiorgis.pdf.

6 UNSC, "Security Council Committee pursuant to resolutions 751 (1992) and 1907 (2009) concerning Somalia and Eritrea," UN Site, available at <http://www.un.org/sc/committees/751/>.

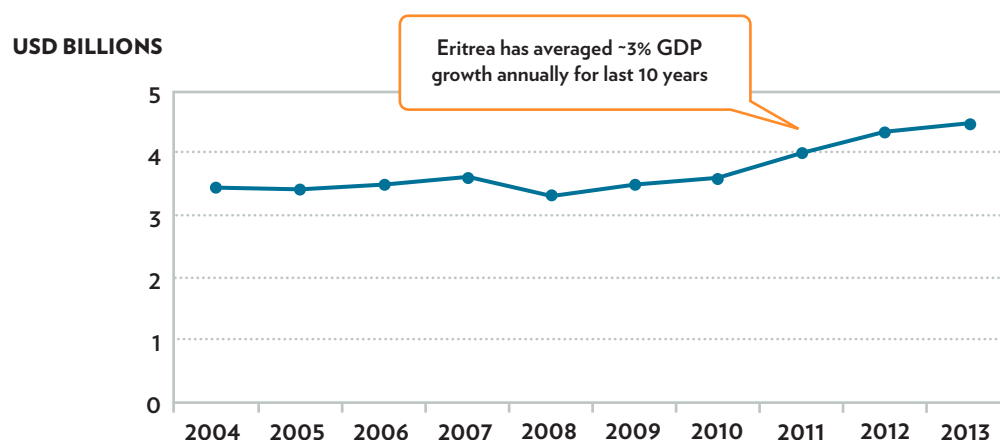
7 *Ibid.*

8 "World Report: Eritrea (2014)," *Human Rights Watch*, available at <http://www.hrw.org/world-report/2014/country-chapters/eritrea>.

Gross Domestic Product

GDP growth in Eritrea has been irregular over the past decade, averaging 3% annually (Figure 2). In 2011, Eritrea recorded an 11% GDP growth rate, making it one of the fastest growing economies in the world.⁹ This sharp increase in GDP resulted from the commencement of gold production in the country. However, Eritrea's economic growth rate fell sharply to 1.1% in 2013 following a decline in economic activity in most sectors except mining, as well as a decline in remittances into the country.¹⁰ GDP was expected to grow at 1.9% in 2014 from 2013 levels of USD 4.5 billion (PPP).¹¹

FIGURE 2: GDP (PPP), 2004–2013



Source: IMF World Bank Economic Indicators, April 2014

9 "Eritrea Overview (2012)," *The World Bank*, available at <http://www.worldbank.org/en/country/eritrea/overview#1>.

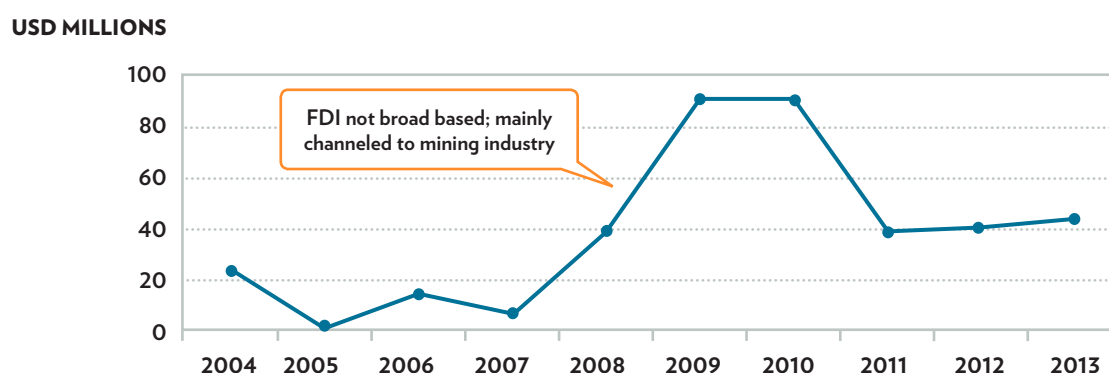
10 Magidu Nyende & Luka Okumu, UNDP, *African Economic Outlook (2014)*, available at <http://www.er.undp.org/content/dam/eritrea/docs/MDGs/AfricanEconomicOutlookEritrea2014.pdf>.

11 "Eritrea Economic Outlook," *African Development Bank Group (2014)*, available at <http://www.afdb.org/en/countries/east-africa/eritrea/eritrea-economic-outlook/>.

Foreign Direct Investment

Mineral production has also boosted foreign direct investment (FDI) inflows into the economy. Between 2011 and 2013, FDI in Eritrea grew by 13% (Figure 3), and FDI inflow is projected to increase again in 2014, with growing interest in the country's mining sector expected to be the main driver.¹² Nevertheless, Eritrea has the second lowest FDI inflows in East Africa, largely due to the country's isolation from the global community and unstable economy.

FIGURE 3: FDI FLOWS, 2004–2013



Source: UNCTAD

Historically, diaspora remittances have been an important source of capital. The government has a 2% “recovery and development tax” (or “diaspora tax”) that all Eritreans living abroad are required to pay. In the mid-2000s, these remittances were estimated to account for 20% of GDP.¹³ However, recent UN sanctions restrict the transfer of this tax due to concerns that the diaspora tax is being used in efforts to destabilize the region (e.g., to purchase arms for opposition groups).¹⁴ As a result, remittances declined to 10% of GDP in 2012 and are expected to continue to decline. Effects of the sanctions include a sharp decline in flow of hard currency to the country and a weakening of the country's overall financial position.¹⁵

12 COMESA, *Foreign Direct Investment and small and medium enterprise linkages in COMESA* (2013), available at <http://investmentpolicyhub.unctad.org/Upload/Documents/2013%20COMESA%20Investment%20Report.pdf>.

13 US Department of State, *Department of State: 2014 Investment Climate Statement* (2014), available at <http://www.state.gov/documents/organization/227167.pdf>.

14 United Nations, *Security Council, by Vote of 13 in Favour, Adopts Resolution Reinforcing Sanctions Regime against Eritrea 'Calibrated' to Halt All Activities Destabilizing Region*, (2011) available at <http://www.un.org/press/en/2011/sc10471.doc.htm>.

15 Magindu Nyende & Luka Okumu, *AFDB, African Economic Outlook: Eritrea* (2014), available at http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Erithr%C3%A9e_EN.pdf.

Inflation and Exchange Rates

Inflation is an ongoing problem in Eritrea as the country has averaged double-digit inflation over the past decade. Estimated inflation for 2013 was over 12% and is expected to remain at similar rates in upcoming years.¹⁶ The main drivers of inflation have been scarcity-induced rising food prices and ongoing defense expenditures.¹⁷

The Central Bank of Eritrea (CBE) was formed in 1994 and is the sole institution in the country providing retail and commercial banking services.¹⁸ The bank also controls the state's foreign exchange policy. For the past decade, Eritrea's currency, the Nafka, has been pegged at 15 Nafka to the USD, but given inflation, the Nafka is generally believed to be substantially overvalued.¹⁹

16 "World Economic Outlook Database," *International Monetary Fund* (2013), available at <http://www.imf.org/external/pubs/ft/weo/2013/02/weodata/index.aspx>.

17 "Eritrea Economic Outlook," *African Development Bank Group* (2014), available at <http://www.afdb.org/en/countries/east-africa/eritrea/eritrea-economic-outlook/>.

18 Bekezela Ncube, Wharton, *Eritrea*, available at <http://fic.wharton.upenn.edu/fic/africa/Eritrea%20Final.pdf>.

19 AfDB, OECD, UNDP, UNECA, *African Economic Outlook: Eritrea 2012*(2012), available at http://www.youthpolicy.org/national/Eritrea_2012_Youth_Employment_Briefing.pdf.

SUPPLY OF IMPACT CAPITAL

To date, there has been no known impact investing in Eritrea. This is predominantly due to the same factors that limit general foreign investment in the country: a closed and centrally planned economy, restrictive government policies, and few desirable investment opportunities.

Broader Investing Landscape

Eritrea is an incredibly challenging environment for investors, in large part due to its self-reliance policy (see text box). Eritrea stopped requesting financial aid from the United States in 2005 and in 2006 blocked aid from third-party NGOs funded by western nations.²⁰ The government, however, appears to be softening its stance on this in recent years.²¹ In 2013, the government of Eritrea and the UN agreed on a four-year USD 188 million cooperation framework for capacity building, food security, environmental improvements, and social services. Under the framework, the UN will provide USD 50 million in grant funding and attempt to raise the remaining money from donor countries.²² Other recent evidence of efforts to drive development include:

- The Global Health Fund provided a government grant to improve basic services.
- The International Fund for Agricultural Development (IFAD) supported the national agriculture project through a USD 17.8 million grant to the national government.
- The Abu Dhabi Fund for Development (ADFD) extended an AED 183.6 million concessionary loan to the government to help meet its budgetary deficit.
- The African Development Bank (AfDB) Group loaned USD 19.2 million to the government to improve equitable access to vocational education and training.

Recent trends in the general investment sector show signs of the economy beginning to liberalize, which may enable impact investors to move into the country. These trends include increasing privatization of state-owned enterprises, gradual opening to foreign investors, and a softening of the government's self-reliance policy, as well as an increase in private investment, particularly in the mining sector.

ERITREA'S SELF-RELIANCE POLICY

Beginning with independence, the government of Eritrea established a policy of strict self-reliance, turning away foreign aid and expelling the UN from the country. The government has said that it is best qualified to look after the interests of its citizens. The government has also accused the UN and the West of failing to resolve the border dispute with Ethiopia.

20 Mawuna Remarque Koutonin, "We Don't Want Aid. Please Keep it for Your Local Poor!," *Eritrea-Ministry of Information*, (April 18, 2014), available at <http://www.shabait.com/categoryblog/16773-we-dont-want-aid-please-keep-it-for-your-local-poor>.

21 Edmund Sanders, "Eritrea Aspires To Be Self-Reliant, Rejecting Foreign Aid," *Los Angeles Times* (Oct. 2, 2007), available at <http://www.latimes.com/world/la-fg-eritrea2oct02-story.html#page=1>.

22 "World Report: Eritrea (2014)," *Human Rights Watch*, available at <http://www.hrw.org/world-report/2014/country-chapters/eritrea>.

Since 2013, the government has begun privatizing state-owned firms in a plan to encourage private sector participation in the country. In total, 13 large- and medium-sized enterprises were identified for privatization including the Eritrean Telecommunication Company, Asmara Breweries, and the National Insurance Corporation of Eritrea.²³ South Africa Breweries is currently in negotiations to acquire Asmara Breweries,²⁴ while the government has already sold part of its stake in the telecommunications business to domestic investors.²⁵

To attract foreign investors, the Eritrean government has developed free trade zones in the port cities of Massawa and Assab. Investors operating in these zones are exempt from paying taxes on profits or dividends. Eritrea also provides relief from duties and taxes on imports that receive value-added processing prior to export.²⁶ The zones allow 100% foreign ownership and repatriation of profits. However, very few foreign companies operate in the zones, which are marred by corruption and alleged smuggling of consumer goods across the border to Sudan.²⁷ Most companies that have expressed interest have been Chinese firms.²⁸

Eritrea is also investing in infrastructure and expanding its road network, particularly to mines and free trade zones.²⁹ The government is strongly encouraging companies and individuals to invest in infrastructure projects, particularly in building residential housing, roads, airports, ports, and hospitals.³⁰

Despite the liberalizing of the economy, accessing capital remains difficult. The central bank controls all retail and commercial activities in the country. The bank holds 90% of the country's deposits and 80% of private sector claims.³¹ Collateral requirements can reach 100% of the loan value, which severely limits borrowers. The CBE prefers lending to large state-owned and private manufacturing firms, which are considered low risk, and controls interest rates to meet the country's development objectives.³²

23 "Eritrea to Re-start Aggressive Privatization Program," *Tefsanews* (Dec. 27, 2013), available at <http://www.tesfanews.net/eritrea-to-re-start-aggressive-privatization-program/>.

24 "More Foreign Companies are Seeking Business with Eritrea," *Madote* (Nov. 23, 2013), available at <http://www.madote.com/2013/11/more-foreign-companies-are-seeking.html>.

25 "Eritrea Offers Stake in EriTel to Domestic Buyers Only," *Telecompaper* (Jan 7, 2013), available at <http://www.telecompaper.com/news/eritrea-offers-stake-in-eritel-to-domestic-buyers-only--917220>.

26 Eritrea Investment Center, *Investment Policies and Opportunities of the State of Eritrea* (2003), available at http://www.eritreaembassy-japan.org/data/Investment_Policy_and_Opportunities_of_the_state_of_Eritrea.pdf.

27 "2012 Investment Climate Statement: Eritrea," *US Department of State*, available at <http://www.state.gov/e/eb/rls/othr/ics/2012/191144.htm>.

28 "2014 Investment Climate Statement: Eritrea," *US Department of State*, available at <http://www.state.gov/documents/organization/227167.pdf>.

29 Magindu Nyende & Luka Okumu, UNDP, *African Economic Outlook: Eritrea* (2014), available at <http://www.er.undp.org/content/dam/eritrea/docs/MDGs/AfricanEconomicOutlookEritrea2014.pdf>.

30 *Ibid.*

31 Bekezela Ncube, Wharton, *Eritrea*, available at <http://fic.wharton.upenn.edu/fic/africa/Eritrea%20Final.pdf>.

32 AfDB, OECD, UNDP, UNECA, *African Economic Outlook: Eritrea 2012* (2012), available at http://www.youthpolicy.org/national/Eritrea_2012_Youth_Employment_Briefing.pdf.

Impact Capital Disbursed

Despite the government relaxing its self-reliance policy and an increase in general investment activity, to date there are no documented examples of impact funds investing in Eritrea. There is approximately USD 840 million in committed impact capital from regional investors who consider the entire region, but based on historical deal flow it seems unlikely that much of this capital will flow to Eritrea.

To date, all DFI³³ capital disbursed has been to government agencies and programs (as outlined in the ‘Broader investing landscape’ section above) rather than to private sector players. Please see the Introduction and Methodology chapter for more detail on the definition of impact investing used throughout this report.

³³ Due to the unique nature and large size of development finance institutions (DFIs), the authors of this report analyzed their activity separately from those of other types of impact investors (“non-DFI”), and present this separate analysis when appropriate. See the Introduction and Methodology section of this report for more details.

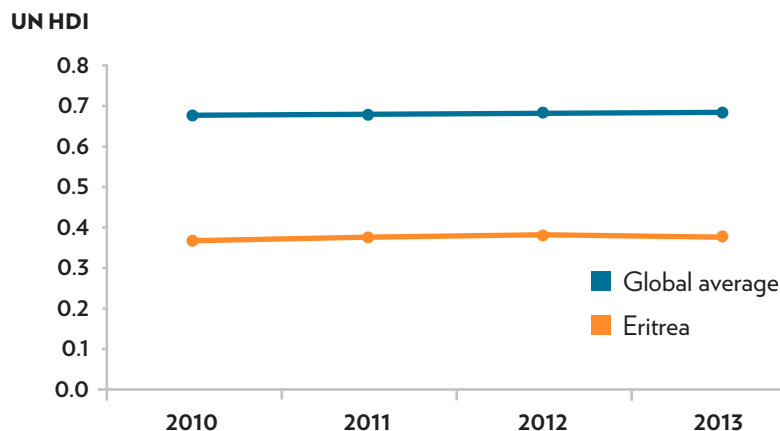
DEMAND AND NEED FOR IMPACT INVESTING CAPITAL

Given the poverty levels in the country, many Eritrean businesses implicitly have a social impact by targeting base of pyramid (BoP) consumers, addressing a social need and/or having an impact within the communities in which they operate. Such businesses may be of interest to impact investors.

Development Context

Eritrea is one of the least developed countries in the world, ranked 181st out of 187 countries on the UN's Human Development Index. It struggles to provide important social services for its population, which is reflected in the country's HDI score. Although data is only available since 2010, Eritrea's aggregate HDI score in that time has been no higher than 0.38 (Figure 4), lower than the regional average of 0.43 and far behind the global average of 0.68. It is estimated that more than 53% of Eritreans live under the poverty line, earning less than USD 1.25 per day (Figure 5), while 37% of the rural population lives in extreme poverty.³⁴

FIGURE 4: UN HDI SCORES, 2010-2013

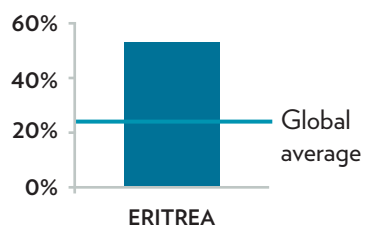


Source: United Nations Human Development Report 2014

34 WHO, *Health Action in Crises: Eritrea* (2008), available at http://www.who.int/hac/crises/eri/eritrea_oct08.pdf.

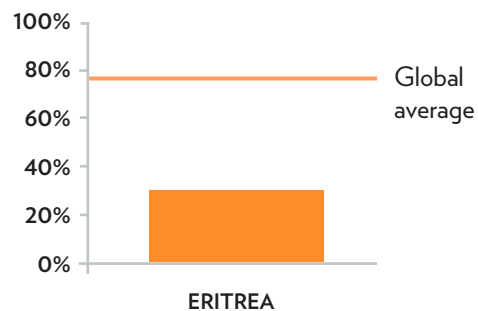
Eritrea has invested in education since independence and, as a result, literacy rates compare favorably with other East African countries. Gross enrollment in secondary school was 32% in 2010 (Figure 6) compared to 36% in Ethiopia and 28% in Uganda.³⁵

**FIGURE 5: POPULATION BELOW USD 1.25/DAY
(LATEST AVAILABLE DATA POINT)**



Source: World Health Organization

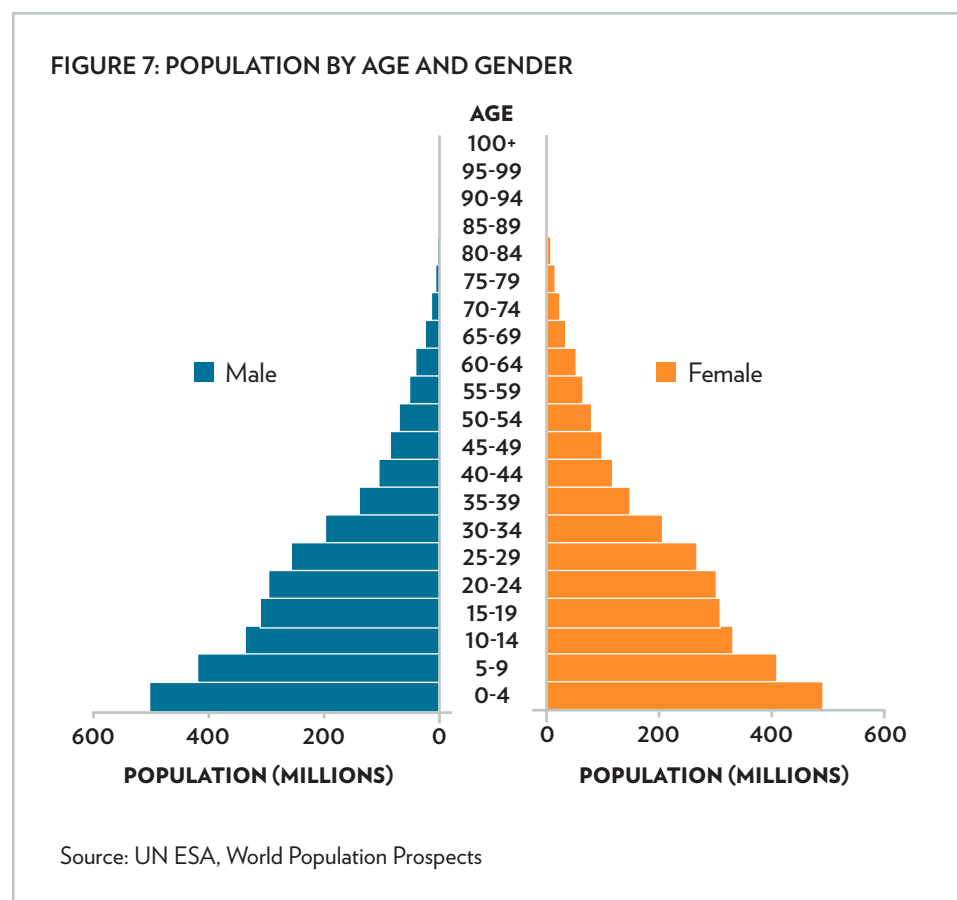
**FIGURE 6: SECONDARY SCHOOL
GROSS ENROLLMENT**



Source: UN Human Development Report 2014

³⁵ UNESCO, *Education For All Global Monitoring Report, Regional Fact Sheet, Education in Eastern Africa* (2013), available at <http://unesdoc.unesco.org/images/0021/002193/219351e.pdf>.

Like the rest of East Africa, Eritrea has a disproportionately young population (Figure 7). Half of its youth are unemployed³⁶ and skills are not being developed to match the demands of the labor market. In addition, the absence of data on youth and labor limits the government's ability to make informed policy decisions.



Eritrea's mandatory military conscription policy has exacerbated the shortage of young talent. Due to the long-standing conflict with Ethiopia, as well as recent border skirmishes with Djibouti, all Eritrean men and unmarried women under the age of 50 must complete compulsory military service, and are enlisted for indefinite periods. Hundreds of thousands of Eritrea's most productive workers are employed by the army, with an estimated one in 20 Eritreans living in army barracks.³⁷ As a result, a significant share of the most productive section of Eritrea's population is committed to compulsory military service, greatly limiting the labor force and weakening the private sector.³⁸

There has been a mass exodus of Eritreans fleeing forced conscription and other human rights violations in the country, further decreasing available labor. Human Rights Watch characterizes human rights conditions in Eritrea as "dismal," citing

36 AfDB, OECD, UNDP, UNECA, *African Economic Outlook: Eritrea 2012*, available at http://www.youthpolicy.org/national/Eritrea_2012_Youth_Employment_Briefing.pdf.

37 "National Service in Eritrea, Miserable and Useless," *The Economist*, (Mar. 10, 2014), available at <http://www.economist.com/blogs/baobab/2014/03/national-service-eritrea>.

38 Sally Healy, Chatham House et. al, *Eritrea's Economic Survival* (2007), available at <https://www.chathamhouse.org/sites/files/chathamhouse/public/Research/Africa/200407eritrea.pdf>.

indefinite military service, extreme restrictions on freedoms of expression and religion, torture, and arbitrary detention as some of the worst offences.³⁹ Since independence, an estimated 6% of the Eritrean population has fled the country and thousands more flee every month—a continuous “brain drain.”⁴⁰ Among those citizens not in the army or not fleeing the country, there is a dearth of readily apparent entrepreneurs. More than 75% of the population lives in rural villages and there are few support programs or policies that enable citizens to successfully launch a business.⁴¹

Entrepreneurs

Ranked last out of 189 countries in the World Bank’s *Ease of Doing Business* report, Eritrea is not an easy country in which to start or run an enterprise.⁴² Private sector development has been severely limited by lack of capital, restrictive government policies, and a shortage of talent. As a result, the private sector, including the capital market, is underdeveloped and small.

Access to capital is a major constraint plaguing Eritrea’s private sector. The Eritrean financial services industry is significantly underdeveloped and uncompetitive. The state has a majority stake in the country’s five financial institutions—Central Bank of Eritrea, the Commercial Bank of Eritrea, the Housing and Commerce Bank of Eritrea, the Eritrean Development and Investment Bank, and the National Insurance Corporation of Eritrea—which limits private sector participation.⁴³ The lack of competition means that businesses struggle with low access to credit. Credit supply to the private sector has grown slowly, between 1% and 4% annually over 2009 to 2011.⁴⁴ Eritrea’s banking sector has stringent collateral requirements and high interest rates, which are administered by the government and typically prohibitively high—often exceeding 30% per annum.⁴⁵

Currently the Central Bank of Eritrea (CBE) deploys only 29% of the funds collected from its depositors.⁴⁶ The CBE lends mainly to large state-owned and private-owned manufacturing businesses, which results in a lack of finance for small firms and restricts growth of these companies. Collateral requirements are a significant hindrance as the CBE requires that businesses provide up to 100% of the loan value

39 World Report: Eritrea (2014), *Human Rights Watch*, available at <http://www.hrw.org/world-report/2014/country-chapters/eritrea>.

40 *Ibid.*

41 Ravinder Rena, “Eritrea: Rural Enterprises to Catalyze Economy (Opinion),” *Norwegian Counsel for Africa* (June 15, 2007), available at <http://www.afrika.no/Detailed/14379.html>.

42 Economy Rankings,” *Ease of Doing Business Index* (2014), available at <http://data.worldbank.org/indicator/IC.BUS.EASE.XQ>.

43 Magindu Nyende & Luka Okumu, AFDB, *African Economic Outlook: Eritrea* (2014), available at http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Erithr%C3%A9e_EN.pdf.

44 *Ibid.*

45 *Ibid.*

46 Henk von Eije, Michael Fishazion and Clemens Lutz, *Journal of Eritrean Studies, Accessing Bank Credit in Eritrea: Bottlenecks for Small Firms and for the Commercial Bank of Eritrea*, available at http://arts.eldoc.ub.rug.nl/FILES/publications/general/other/2002/eije.h.von_costs/accessing.pdf.

in collateral, which is impossible for many small firms. The bank also often asks to see financial statements and feasibility studies.

Without capital to support small businesses, the Eritrean economy relies heavily on remittances from the diaspora for its survival. Studies show migrants send home an average of USD 300-400 per year. Remittances form nearly a third of the value of GDP (USD 1.2 billion)⁴⁷ and are proportionately the highest in the world.⁴⁸

Businesses in Eritrea also face many infrastructure challenges, such as high fuel prices and inconsistent provision of electricity and water.⁴⁹ Eritrea's electricity generation capacity per capita is 61 kWh, which is far below the country's energy needs. In comparison, per capita electricity generation capacity is 4,301 kWh in South Africa, 694 kWh in Zimbabwe and 129 kWh in Kenya.⁵⁰ Recent developments in the mining sector and free-trade zones have further increased pressure on the grid.

47 Berhane Tewolde, *Journal of Middle Eastern Geopolitics, Remittances As a Tool For Economic Development and Reconstruction in Eritrea*, available at <http://ojs.uniroma1.it/index.php/JMEG/article/viewFile/3123/3107>.

48 Sally Healy, Chatham House et. al, *Eritrea's Economic Survival* (2007), available at <https://www.chathamhouse.org/sites/files/chathamhouse/public/Research/Africa/200407eritrea.pdf>.

49 US Department of State, *Department of State: 2014 Investment Climate Statement* (2014), available at <http://www.state.gov/documents/organization/227167.pdf>.

50 Eritrean Embassy-Japan, *Investment Opportunities in the Energy Sector of Eritrea*, available at <http://www.eritreanembassy-japan.org/data/Investment%20Opportunities%20in%20the%20Energy%20Sector%20of%20Eritrea.pdf>.

ENABLING IMPACT INVESTING: THE ECOSYSTEM

In response to the regulatory, legal, and infrastructure challenges facing both businesses and investors, the government of Eritrea has begun to work on reform to improve the business environment. With the softening of its self-reliance policy, more NGOs and DFIs are being allowed back into the country and have started to improve the investment ecosystem in Eritrea.

Regulatory Environment

Eritrea lacks an organized regulatory system. The country does not have a sitting parliament and laws governing the country are issued by proclamation from the executive arm of government.⁵¹ The country's regulatory framework is opaque and inconsistently enforced, but the following are particularly relevant to potential investors:

- **Repatriation of profits and dividends:** The Foreign Financed Special Investment (FFSI) policy makes allowances for the remittance of net profit, dividends accrued from investments, debt service payments, savings from expatriate salaries, and proceeds from the sale or transfer of shares. However, the government's strict control of foreign currency makes repatriation of profits difficult and discourages investors.⁵²
- **Foreign exchange controls:** The government controls all foreign exchange in the country. Only state-owned entities are authorized to manage foreign exchange activities.⁵³ The black market is pervasive, where the Eritrean Nakfa trades for less than a third of its nominal value.⁵⁴
- **Leasehold structure for foreign land ownership:** All land in Eritrea is owned by the state but the government issues lifetime usufruct rights. Nevertheless, the government also has a history of withdrawing usufruct rights on land without notice or compensation, including housing and commercial property, which is a considerable risk for both investors and entrepreneurs interested in developing businesses in the country.⁵⁵ Despite state ownership, traditional land tenure systems persist in rural areas, where communities allocate land.

51 US Department of State, *Department of State: 2014 Investment Climate Statement* (2014), available at <http://www.state.gov/documents/organization/227167.pdf>.

52 *Ibid.*

53 *Ibid.*

54 *Ibid.*

55 *Ibid.*

- **Local ownership requirements:** The FFSI proclamation restricts foreign investment in certain sectors of the Eritrean economy, including financial services, domestic wholesale trade, domestic retail trade, and commission agencies. However, foreign investment in other sectors is permitted.⁵⁶
- **Government enterprises:** Almost all medium and large enterprises in Eritrea are controlled by the government.

Ecosystem Players

With a small formal private sector and no impact investing activity, there are very few ecosystem players operating in Eritrea at this time.

⁵⁶ US Department of State, *Department of State: 2014 Investment Climate Statement* (2014), available at <http://www.state.gov/documents/organization/227167.pdf>.

CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Challenges

As evidenced by the lack of impact investing in Eritrea, investors face a number of challenges in investing in the country:

- **Weak legal system:** Eritrea's inconsistent legal system makes it difficult for investors to enact and enforce legal contracts.
- **Challenging regulatory system and corruption:** Regulation and government policy-making are highly opaque. The government often does not announce new or amended regulations prior to implementing them, and they may be subject to abrupt change.⁵⁷ Sudden changes in regulation and uneven implementation of laws have led to uncertainty and rising corruption in the country. In Transparency International's 2013 Corruption Index, Eritrea ranked 160th out of 177 countries.⁵⁸
- **Expropriation risk:** In theory, the law guarantees against confiscation of investment without just cause or compensation but the risk of expropriation is high regardless. The government has nationalized private businesses in the past without notice or compensation. For example, in 2008 the government terminated the Intercontinental Hotel's management contract for a government-owned hotel in Asmara and later reopened the hotel as a government-operated establishment.⁵⁹
- **Profit repatriation risk:** There is generally a hard currency shortage in Eritrea. Some airlines, for instance, report deposits of hundreds of millions of unconvertible Nakfa held in local banks. These conditions prompted Lufthansa to cease operations to Eritrea in 2013, while its competitors are now charging fares directly in hard currency.⁶⁰
- **Lack of investment options:** As a result of Eritrea's restrictive regulations and policies, there is minimal private sector participation in the country and consequently there are very few desirable businesses for impact investors to consider for investment.

57 US Department of State, *Department of State: 2014 Investment Climate Statement* (2014), available at <http://www.state.gov/documents/organization/227167.pdf>.

58 "Corruption Perceptions Index," *Transparency International* (2013), available at <http://www.transparency.org/cpi2013/results>.

59 "2013 Investment Climate Statement: Eritrea," *US Department of State*, available at <http://www.state.gov/e/eb/rls/othr/ics/2013/204637.htm>.

60 Ravinder Rena, "Eritrea: Rural Enterprises to Catalyze Economy (Opinion)," *Norwegian Counsel for Africa* (June 15, 2007), available at <http://www.afrika.no/Detailed/14379.html>.

Opportunities

Despite challenges, there are opportunities in Eritrea. The most promising sectors of the Eritrean economy include agriculture, aquaculture, tourism, and mining. As impact investors do not typically operate in extractive industries, the following sectors present the greatest opportunities for impact capital:

- **Agriculture:** Eritrea possesses abundant arable land, and 80% of the population is engaged in agricultural activities. However, frequent drought, famine, and poor climatic conditions and unsophisticated production practices have hampered agricultural growth in the past. Nevertheless, with investments in training, irrigation, and equipment, the country has considerable potential to generate growth in agricultural production, agro-processing, and livestock production.⁶¹ Eritrea's ecological environment is ideal for growing a wide range of crops, and the economy could benefit from developing high-value horticultural ventures.
- **Aquaculture:** Fisheries and fish processing also show high potential, with the export of fish and fishmeal becoming an increasingly significant part of the Eritrean economy. Eritrea's coast is abutted by over 52,000 square kilometers of prime fishing waters, rich in a wide variety of fish species.⁶²
- **Tourism:** Given Eritrea's coastal location, there is high potential for tourism which has not been realized to date. The government has started encouraging both foreign investors and the returning diaspora to invest in the sector with some encouraging results, as a Qatari firm has begun construction on a multimillion-dollar resort complex on Dahlak Kabir Island in Eritrea.

61 Magindu Nyende & Luka Okumu, AFDB, *African Economic Outlook: Eritrea* (2014), available at http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Erithr%C3%A9e_EN.pdf.

62 Eritrea Investment Center, *Investment Policies and Opportunities of the State of Eritrea* (2003), available at http://www.eritreambassy-japan.org/data/Investment_Policy_and_Opportunities_of_the_state_of_Eritrea.pdf.



ABOUT THE GLOBAL IMPACT INVESTING NETWORK

The Global Impact Investing Network (GIIN®) is a nonprofit organization dedicated to increasing the scale and effectiveness of impact investing. The GIIN builds critical infrastructure and supports activities, education, and research that help accelerate the development of a coherent impact investing industry. For more information, see www.thegiin.org.

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