2010 Investment Climate Statement - Eritrea
2010 Investment Climate Statement
Bureau of Economic, Energy and Business Affairs
March 2010

Openness to Foreign Investment

Eritrea remains a strict command economy, with government activities crowding out most private investment. Investors in Eritrea face significant risks, including: lack of transparency in the regulatory process, severe limits on the possession and exchange of foreign currency, lack of objective dispute settlement mechanisms, difficulty in obtaining licenses, large-scale use of conscripted labor, and expropriation of private assets. The Government of the State of Eritrea (GSE) uses the judicial system as a coercive tool to promote its own interests, making the courts a biased arbiter in legal disputes. These risks discourage domestic private investment not conducted under the GSE's auspices.

The exception to this trend appears to be the mining sector. Fourteen small and mid-size mining and exploration companies have signed license agreements with the GSE, many of them have already set up offices and begun exploring. Representatives from the mining companies claim companies receives preferential treatment, including blanket travel permits, personal security details in the field, liberal import and export agreements, and easy access to government officials.

The World Bank's 2010 "Doing Business" ranking of 181 countries rates Eritrea in the bottom 10 in the following categories: overall ease of doing business (175), starting a business (181), obtaining credit (177), dealing with construction permits (183), and closing a business (183). Eritrea was also near the bottom for registering property (171) and trading across borders (164). Eritrea was ranked in the upper half in only two of a possible eleven categories: employing workers (86) and enforcing contracts (48).

The Heritage Foundation's 2009 Index of Economic Freedom labeled the Eritrean economy as "repressed," ranking it 175 out of 179 countries, with an overall score of 38.5. The index also ranks Eritrea 45th out of 46 countries in the region. Eritrea scored far below the world average in the following categories: business freedom (18.3; world avg 64.3), government size (9.9; world avg 65.0), investment freedom (10.0; world avg 48.8), financial freedom (20; world avg 49.1), property rights (10.0; world avg 44.0), and freedom from corruption (28.0, world avg 40.3). Eritrea did score above the world average, however, for labor freedom (73.9; world avg 61.3) and fiscal freedom (86.4; world avg 74.9).

The Transparency International's 2009 Corruption Index ranked Eritrea 126 out of 180 countries for corruption perception, "the degree of corruption as seen by businesspeople and country analysts."

The Millennium Challenge Corporation's 2009 scorecard ranked Eritrea unfavorably in the following categories: government effectiveness (24%), rule of law (29%), fiscal policy (1%), regulatory quality (7%), business start up (28%), and natural resource management (13%). Eritrea scored high marks in the following categories: control of corruption (72%), trade policy (54%), and land rights and access (86%).

The GSE enacted a number of commercial laws purporting to allow for private enterprise, but these laws are not consistently implemented. The Foreign Financed Special Investments (FFSI) Proclamation issued in April 2007 established a framework for investments greater than $20 million. The proclamation's stated objectives are to achieve self-sustaining growth, facilitate the rapid expansion of exports, expand employment, and promote and protect foreign investment. The Eritrean Investment Proclamation issued in 1994 establishes a more general framework for investment. This proclamation's stated objectives are to encourage investment, expand exports, expand employment, and encourage the use of new technology. It also provides tax incentives for investors, as well as a framework for dispute resolution.

Proclamation 114 issued in August 2001 gives the Ministry of Trade and Industry the authority to negotiate the sale of public enterprises, but details of the process are unspecified. In practice, investors require approval from the Ministry regulating the specific project before investing, but there may also be other unpublished approval requirements. The Office of the President must approve all large-scale projects. The GSE has selectively and narrowly courted foreign investors to explore under-utilized resources, primarily in mineral extraction, but also in energy, fisheries, and tourism. Despite the investment proclamation's assurance against expropriation, the GSE has nationalized many foreign-owned businesses and other assets.

Conversion and Transfer Policies

Proclamation 115 issued in August 2001 allows for unrestricted investment and repatriation of foreign currency. In addition, Legal Notice 44 issued in July 2000 states that the Bank of Eritrea is responsible for all foreign exchange, and no other entity can transfer funds into or out of Eritrea. The Bank of Eritrea has maintained an artificial Nakfa/dollar exchange rate at 5:1, but the black market exchange rate may be as high as 40:1. The GSE has extremely low foreign currency reserves and requires using a government-owned monopoly for all foreign exchange. Foreign business owners are unable to convert locally generated profits to hard currency. For example, the GSE notified Lufthansa in July 2001 that it would no longer be allowed to convert profits from nakfa to euros.

Expropriation and Compensation

The GSE has shown a pattern over many years of expropriating businesses without notice, explanation, compensation, or recourse. For example, in October 2008 the GSE abruptly terminated the Intercontinental Hotel Corporation's management contract for a government-owned hotel in Asmara. The hotel later reopened as a GSE-operated establishment. Legal provisions for such expropriations, other than eminent domain for public purposes, do not exist, and the GSE liberally interprets the idea of public purpose.

Dispute Settlement

Eritrea does not have neutral dispute mechanisms, although there are several unimplemented laws on the books regarding dispute settlement. Article 15 of Investment Proclamation No. 59/1994 provides a framework for investment dispute settlement and pledges the GSE to enter into bilateral and multilateral protection treaties. Foreign investors also have the option to resolve disputes through mechanisms specifically stipulated in investment agreements with the GSE, or through mechanisms created by multilateral treaties such as International Center for Settlement of Investment Disputes (ICSID). Eritrea has neither ratified nor signed the ISCID Convention, and there are no known cases in which the GSE accepted international arbitration for business disputes.

Performance Requirements and Incentives

Although laws and regulations provide for investment incentives, in reality the GSE provides them only rarely and on an ad hoc basis. The Customs Proclamation of 2000 Part X, provides for relief from duties and taxes for imports receiving value-added processing prior to export, but due to the lack of businesses operating in Eritrea, the Embassy is unaware of any businesses receiving such relief. The GSE restricts travel within Eritrea, requiring explicit written permission for foreigners with a minimum ten-day advance notice. The GSE frequently denies foreigners permission to travel, often by not replying to the application, and explanations are rarely given. Eritrea also has an opaque visa regime, and foreigners of many nationalities have reported difficulties obtaining entrance visas, including lengthy and unexplained delays. Eritrea is not a member of the WTO.

Right to Private Ownership and Establishment

The FFSI specifically limits foreign investment in financial services, domestic wholesale trade, domestic retail trade, and commission agencies, but permits investment in other sectors. The FFSI makes allowances for the remittance of net profits and has guarantees against nationalization or confiscation, except for public purposes and with due process of law. Investors should be aware, however, that most medium-to-large businesses in Eritrea are controlled by either the GSE or the ruling party, the People's Front for Democracy and Justice (PFDJ). In 2005 the GSE suspended all private construction activity, leaving only those owned by the GSE or PFDJ in operation.

Protection of Property Rights

Eritrea's civil law protects private property, but the GSE has a history of expropriating houses, businesses, and other private property without notice, explanation, or compensation. Trademarks, patents, and copyrights are available through a procedure involving a public advertisement in the local press, but Eritrea is not a party to any international conventions on intellectual property rights.

Transparency of the Regulatory System

Eritrea has not convened a parliament for over a decade, and all laws are issued by proclamation from the executive branch. The GSE also does not operate a clearly organized regulatory system; what procedures are in place appear to be of haphazard creation and irregularly enforced. The GSE often does not announce new regulations prior to implementation, and they are often unequal in application and subject to sudden change. In addition, the GSE neither publishes accounts of its decision making process nor offers a public comment period for proposed laws or regulations. Local business owners report extensive difficulties with obtaining import and export licenses, customs clearances, telephone and mobile phone lines, land leases, and work permits. The central and regional governments often do not coordinate policies and procedures, adding to the opacity of conducting business outside of Asmara. The International Monetary Fund (IMF) reported investor confidence is undermined by the state's growing role in commercial activities and the lack of a transparent regulatory environment.

Efficient Capital Markets and Portfolio Investment

Eritrea has neither a stock exchange nor a stock market, and the state owns all financial institutions. Although the IMF states that the banks have a high proportion of non-performing loans, the banks may be profitable due to income from foreign currency transactions. The GSE's complete control of foreign exchange makes repatriation of profits difficult or impossible.

Political Violence

The threat from domestic insurrection, civil disturbances, and political violence is low, although there are reports of opposition movements operating in remote areas. Eritrea's borders with Ethiopia and Djibouti are tense due to unresolved border issues. The GSE uses the unsettled border dispute with Ethiopia to justify drafting large numbers of Eritreans into national and military service for unlimited terms of service, as well as extensive restrictions on country's economic and political freedoms.

Corruption

Eritrea has historically been known as a country with low corruption, but there are indications that corruption does exist. Civil court cases are often directly influenced by the Office of the President, or by former fighters obtaining decisions in their favor (fighters, soldiers from the struggle for independence, have high social standing and considerable influence within the GSE). High ranking military officials have also been known to confiscate houses and other property. The GSE controls all foreign exchange, making it virtually the only legal source of imports and creating illicit profit opportunities for smugglers (who are often high-ranking Eritrean military officers). Eritrea is not known to be a party to any international anti-corruption agreements.

Bilateral Investment Agreements

Eritrea's only known bilateral investment agreement is with Italy, although it is possible that unpublished investment agreements also exist with Qatar, the U.A.E, Iran, and/or China.

OPIC and Other Investment Insurance Programs

OPIC programs do not currently operate in Eritrea. Due to the poor state of bilateral relations and the lack of bilateral trade, the GSE has little interest in such an arrangement.

Labor

Eritrea has a large supply of semi-skilled laborers due to high levels of unemployment. Technical experts, highly skilled professionals, and managers are in short supply. Many of the highest skilled workers have left Eritrea due to deteriorating economic conditions. Eritrea is not a signatory of the ILO, although purporting to uphold many of its provisions. As much as one-third of Eritrea's workforce is conscripted into national service, in which there is no defined term of service. The GSE forces national service employees to work indefinitely in specific jobs with no job mobility, in which they are paid well below the national minimum wage.

Foreign Trade Zones and Free Trade Zones

The GSE constructed a free trade zone in Eritrea's port city of Massawa in 2001, and promised to issue the first licenses in 2006, but no companies are known to operate in the zone. The GSE continues to promise the imminent issuance of more licenses, but it has yet to follow through. Proclamation 115 issued in August 2001 declares that in the zone there will be: 1) no taxes on income, profits, or dividends; 2) no customs duties on imports; 3) no currency convertibility restrictions; 4) no minimum investment; 5) 100 percent foreign ownership; and 6) 100 percent repatriation on profits and capital. There is at least one foreign company that shows readiness to invest in the free zone. The free zone authorities claim that at least 14 other companies, local and foreign, will follow suit.

Foreign Direct Investment Statistics

Data on foreign direct investment (FDI) is not available from the Bank of Eritrea. Although the Investment Proclamation of 1994 governs all foreign investment, it contains no specific definition of FDI. The UN Conference on Trade and Development (UNCTD) 2008 FDI report states Eritrea had $3 million in FDI inward flows and $380 million in FDI stock (accumulated inflows) in 2007, the most recent year for which data is available. No data is available on outflows. FDI in the mining sector increased substantially in 2009, as Nevsun's Bisha mining project prepares for ore extraction, beginning in 2010. It is unlikely, however, the GSE will see profits until 2012, since the initial profits will be used to recoup Nevsun's investment costs.

FOUND IN U.S. DEPARTMENT OF STATE DIPLOMACY IN ACTION