

# Features of the Maroeconomy and Human Resource Development in Post-Independence Eritrea: An Economist's Perspective

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# Eritrea: Key Economic Facts



- Eritrea is small “state” characterized by all the consequences of smallness:
  - Limited domestic market;
  - Less diversified natural resource base;
  - Narrowly spread human capital and entrepreneurial skill; and
  - Limited technological and physical resources.
- Decades of war, neglect and inappropriate economic policies had also deprived Eritrea the necessary infusion of new investment, technology and skill development.
- The predatory and narcissistic policies or non-policies of the current “regime” have shuttered the growth and development opportunities and Eritrea is risking its existence as a “nation state” .



# Eritrea: Key Economic Indicators (from IMF and World Bank Publications, N/A= not available )

Year \ Indicator	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Real GDP Growth	-2.5	9.8	2.8	9.2	7.7	3.9	0.3	-12	8.7	-1.2	3.9	2.0	4.8
GDP per capita	139	154	165	190	183	193	184	158	170	153	133	140	207
Annual Inflation, (%) change	4.6	12	11	9.3	7.7	9.5	11	20	15	17	23	25	13
Fiscal Balance (including grants), % of GDP	-6.4	-12	-24	-20	-5	-35	-52	-41	-36	-30	N/A	N/A	N/A
Fiscal Balance (excluding grants), % of GDP	-17	-12	-30	-25	-10	-43	-58	-42	-34	-32	N/A	N/A	N/A
Current Account Balance (including transfers), % of GDP	26	20	3.5	-8	2.2	-25	-29	-17	-13	-15	N/A	N/A	N/A
Current Account Balance (excluding transfers), % of GDP	7.6	3.8	-10	-21	-6	-33	-40	-33	-30	-28	N/A	N/A	N/A
Reserves in months of imports	3.9	5.0	4.1	3.8	5.0	1.4	1.1	0.9	1.1	0.7	0.6	N/A	N/A
Public Debt (total), % of GDP	-3.7	8.6	27	39	42	77	134	177	181	202	N/A	N/A	N/A
Domestic Public Debt, % of GDP	-4.7	2.7	20	32	31	58	97	126	120	123	N/A	N/A	N/A
Dom. Debt Service,% of Revenue	-6	-16	42	163	179	299	583	876	1,130	1,080	N/A	N/A	N/A
Money Supply, % change	N/A	N/A	N/A	N/A	30.6	18.2	40.9	13	26.4	18.5	26.6	N/A	N/A

## Key Economic Indicators (Cont.)



- GDP/GNP Measurements:  
 $C+I+G+(X-M) \equiv GNP \equiv C+S+T+R_f$   
where
  - $C \equiv$  total values of consumption expenditure,
  - $I \equiv$  gross private domestic investment,
  - $G \equiv$  total government expenditures on goods and services,
  - $(X-M) \equiv$  net exports of goods and services,
  - $S \equiv$  total consumer and business savings,
  - $T \equiv$  net tax payments, and
  - $R_f \equiv$  net factor payments from abroad.
- $(X-M) \equiv (T-G) + R_f + (S-I)$

# Key Economic Indicators (Cont.)

## Sustainability and Survival

- Conditions for sustainability:

1. The present value of present and future government expenditures should not be greater than that of present and future streams of income, net of any indebtedness:

$$\sum_{i=0}^{\infty} \frac{G_{t+i}}{\prod_{j=1}^i (1+r_{t+j})} \leq \sum_{i=0}^{\infty} \frac{GDP_{t+i}}{\prod_{j=1}^i (1+r_{t+j})} - (1+r_t)D_{t-1}$$

2. Government debt should be matched by the present value of the excesses of future surpluses over deficits:

$$D_t = \sum_{i=0}^{\infty} \frac{(T - G)_{t+i}}{\prod_{j=0}^i (1+r_{t+j})}$$

- Government Budget Identity:  $G + rDD + r^*DE \equiv T + \Delta B + \Delta H$
- Public Debt:

$$D_t = DD_t + \varepsilon_t DE_t = (1+r_t)DD_{t-1} - (1-\lambda_t)(T-G) + \varepsilon_t(1+r_t^*)DE_{t-1} - \lambda_t(T-G)$$

where D is total public debt; DD is domestic debt; DE foreign debt; r is nominal interest rate on domestic debt; r\* is nominal interest rate on foreign debt; (T-G) is fiscal balance; ΔB is new bonds; ΔH is high powered money; ε<sub>t</sub> is nominal exchange rate

## Discussion of key issues that affect sustainability

- Fiscal deficits observed over the last several years are not sustainable for several reasons:
  - Government Revenue is mainly determined by tax and non-tax revenue, grants from donors and remittances from Eritrean Diaspora, which all tend to show declining trends;
  - Government Expenditures consists mainly wages and materials and services (defense and non-defense) as well as capital expenditures. Much of the labor is not paid, but it has other harmful effects;
  - Nominal interest rates affect the sustainability of fiscal deficits through their effects on debt-service. Real interest rate has been negative;
  - Nominal exchange rate determines the extent of external debt and debt-service burden and hence the sustainability of fiscal deficit. It also affects the competitiveness of the economy and the growth rate of real GDP;
  - The initial stock of domestic and foreign debt affects sustainability (Eritrea is becoming a highly indebted country). Debt service ratio is very high (see the above table)
  - Growth rate real GDP is sluggish; and
  - Inflation rate is becoming unmanageable.
- The current account deficit is not also sustainable.
  - Weak export sector
  - Donor financing is not strong
  - Diaspora (the Diaspora is getting squeezed)

## Discussion of some outstanding issues

- **Given Eritrea's limited physical capital and natural resources base, human capital (labor force) is the engine of growth. But, the current regime not only did not promote human resource development but it also systematically undermined it, because:**
  - The incentive system (wages and salaries; promotion and position assignments; pensions and social security) is wrong;
  - The education system is in total disarray;
  - The only university of the country is totally dismantled;
  - There is no manpower planning;
  - Artificial scarcity of skilled and unskilled labor is created as a result of the regime's inappropriate policies or non-policy stance.
- **Given it's limited domestic market, "Open export-oriented and private sector-led" economic development strategy is more appropriate for Eritrea. However:**
  - The export sector is poorly developed;
  - The private sector is not promoted. Rather, the current regime deliberately destroyed it – Corrupt licensing system, Corrupt credit allocation, access to foreign exchange denial, intimidations, unrealistic procedures in license renewals, taxation, misallocation of entrepreneurs and denying access to skilled and unskilled labor, predatory and inappropriate and unsustainable market intervention in the name of price stabilization, unfair competition from public and "defacto-public" enterprises;
  - Privatization was not properly undertaken. Almost all "privatized public enterprises failed to deliver;
  - Capital flight from the informal financial sector;
  - Mass flight of entrepreneurs. some leaving branch offices in the country

## Key Issues Discussion (Cont.)

- Macroeconomic policy management has not been successful, because:
  - An institutional framework with well-functioning institutions, clear institutional mandates and coordination mechanisms is lacking in Eritrea;
  - The credibility and the integrity of the macroeconomic institutions (the Central Bank (Bank of Eritrea), the Ministry of Finance and the Ministry of Economic Development) have been compromised by their lack of independence in their policy design and implementations;
  - Lack of a well-developed financial sector that can facilitate the transmission of a policy in the intended manner (no private financial institution operates in Eritrea).
- Macroeconomic Policy regime:
  - Fiscal Policy has not been prudent
  - Monetary Policy has been dominated by deficit financing
  - Income Policy has been limited in scope
  - Exchange Rate Policy has not been efficient (almost fixed exchange rate regime, resulting in over-valued Nakfa )

# Conclusions

- The system which is currently prevailing in Eritrea is not economically *sustainable*.
- *Unless checked in time, this may compromise the survival of Eritrea as a nation state.*
- *But, why the current regime acts against sustainability and growth?*
- *Could analyzing the behavior of the individual who controls and runs the regime help shed some light? Let me borrow a term from my friend and use excerpts from Bruce Gregory's work on Narcissism and Sustainability to see if it helps.*
  
- Sustainability utilizes mutual respect and an attitude of cooperation which maximizes the appreciation of resources. It is dependent on collaborative, mutually complementary group efforts that seek to maximize benefits for the largest amount of people without exploiting each other. **Does this exist in Eritrea?**
- One of the main forces opposing efforts to achieve sustainability is narcissism, and narcissistic defenses. **Could this be our problem? Compare the following traits and decide for yourself.**
  - On the surface narcissism presents so the individual appears as confident and entitled.

## Conclusions (Cont.)

- Narcissism loves and demands attention to reinforce its grandiosity. It needs to dominate and control the "space," to be "more special" than anyone else. It also needs perfection and immediate gratification to satisfy its all powerful aspect of its grandiosity. As a result, inside the individual, the narcissism feels extremely arrogant.
- Underneath the surface narcissism is fragile.
- Disappointment and frustration threaten narcissism's grandiosity, leaving it vulnerable to feelings of shame and humiliation exacerbated by its harsh, punitive component.
- Along with the shame and humiliation come deep fears of annihilation which are fueled by the black and white, rigid thinking component: "if I am not perfect and all powerful, then I am nothing."
- The extreme fear of being found out to not be omnipotent requires the narcissism to resort to hiding its deeper nature. This act of hiding ultimately leaves the narcissistic self vulnerable to forces that have trust at their core, not fear.

## Conclusions (Cont.)

- The narcissistic defense seeks to dominate every space in which it participates – both on individual and group levels. This force of narcissism is interested in, committed to, and obsessed with power and control, and it will sacrifice people and resources indiscriminately. The narcissistic defense interferes by stonewalling, intimidating, and dominating attention in group settings.
- When the narcissistic defense is operating in an interpersonal or group setting, the grandiose part does not show its face in public. In public it presents a front of patience, congeniality, and confident reasonableness. However, beneath the surface it is supremely smug and superior. It is confident it can deceive the "fools" or their objective it is committed to blocking, while maintaining its own control and dominance over either the rules, and/or the flow of events.
- It is critical to understand that the narcissistic defense is addicted to power and control. It, the defense, and they, the people who are controlled and possessed by the defense, must have power.
- Finally, what do you decide? Hopefully this:  
***"I am the greatest; I am all powerful; the space is mine; it belongs to me; only what I want matters."*** Issaias Afeworki