

# Eritrea as a gateway for investments in Africa: the Export Processing Zone at Massawa port.

Candidate number: 8003

Submission deadline: 15/05/2014

Number of words: 17216



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## **List of abbreviations**

BLO: Business Licencing Office

EIC: Eritrean Investment Centre

EPZ: Export Processing Zone

ILO: International Labor Office

MIGA: Multilateral Investment Guarantee Agency

UNCTAD: United Nations Conference on Trade and Development

UNCTC: United Nations centre on Transnational Corporations

UNIDO: United Nations Industrial Development Organization

PFDJ: People's Front for Democracy and Justice

RIA: Regional Integration Agreement

SCM: Subsidies and Countervalling Measures

WTO: World Trade Organization

## **1 Introduction**

The modern phenomenon of Export Processing Zone (EPZ) was born in 1958 in Ireland, around Shannon airport. Located in the South eastern part of Ireland, close to the coast, this airport was a major refuelling stop for transatlantic airlines. However, with the advent of long range jet airliners which no longer needed to refuel on the transatlantic flights, the airport faced a dramatic decline. Thus, the Irish government decided to establish an industrial estate in the vicinity of the airport to encourage foreign manufacturers to set up plants which would use the airport freight facilities for the import of components and the export of finished goods. The reasoning behind the establishment of the Shannon Free Zone was that the firms would help to replace the jobs of 1,500 people lost as a result of the airport decline.

Its success surpassed all expectations: in the first year, nearly 440 jobs were created. Ten years later, the zone employed 4,750 people, giving a new lease of life to the airport, whose staff grew from 1,250 in 1960 to 2,200 in 1975. The interesting peculiarity of this innovative approach lies in the transformation of an old age concept of free trade zone into the modern concept of industrial export processing zone. The free ports of the Roman empire, the free towns of Middle Ages and the duty free ports of the British empire (Singapore, Gibraltar and Hong Kong) were used essentially for storing duty free goods before re-exporting them. The modern EPZ on the other hand are geared for manufacturing purposes, not only for storage or trade.

This experiment attracted a good deal of international interest and the results were regarded as a considerable success by UNIDO and other international agencies which urged developing countries to imitate the Shannon project. Therefore, the first zone created

in a developing country was in India, in 1965. By 1980 more than 30 countries had established export processing zones. Ten years later the number of countries with zones had doubled and quadrupled again through 2006 to 3500. The vast majority are in developing world. Roughly 3126 are in developing or transitional countries in Africa, Asia and Latin America.

In light of this considerable success, Eritrea has also decided to establish two Export processing zones in its port cities of Massawa and Assab, in 2006. The reason behind the establishment of EPZ is the re-construction of the economy after 30 years of war with its neighbour Ethiopia. Thus, the establishment of EPZ is expected to stimulate the mobilization and the development of capital, technology, and skilled manpower that Eritrea lacks from domestic and foreign sources.

## **1.1 The rationale: reasons for the study**

Eritrea is well known for its independent thinking and hardworking people. They developed the culture of self-reliance when they were fighting to liberate their country from Ethiopian colonization, and within hours of victory, the long struggle for rehabilitation and reconstruction was launched.

The private sector was envisaged as the lead economic actor in the new Eritrea. The macro-economic policy framework was meant to promote private enterprise, stimulate private investment and achieve economic recovery and growth to enhance the standard and quality of life of the Eritrean people.

Thus, the implementation of the free zone in Massawa's port means attracting foreign investments that will be the major catalyst for economic growth and the integration for a developing country as Eritrea in the global economy. Since it occupies a strategic

maritime location that straddles one of the world's busiest sea lanes, the researcher believes that Eritrea has a potential to become a hub of regional trade.

Hence, since many people have not even heard about Eritrea, the researcher wants to conduct this study in order to demonstrate the importance of Eritrea for the African's and global economy in general. Furthermore, through this study, the researcher is willing to increase the understanding about the phenomenon of the "export processing zones" and find out if they can be a valid development tool.

## **1.2 Research questions**

The key question that will be addressed in this study is: "Can Eritrea be a gateway for investments in Africa?" In line with this, other questions that will be given answer to are:

- What are the main characteristics and goals of an EPLZ?
- What are the costs and benefits of an EPLZ to host countries?
- How can the national economic environment of host countries influence the performance of an EPLZ?
- What are the arguments for and against EPLZ?
- How can human rights be protected in these zones?
- What effects do multilateral and regional trade agreements have on EPLZ?
- What kind of relations does Eritrea have with the rest of the world?
- How can Eritrea be of fundamental importance for the global economy?
- Can EPLZ be a valid strategy for the post-war economic recovery's project of Eritrea?

### **1.3 Research objectives**

The main objective of this study is to understand if the EPLZ can integrate Eritrea into the global supply chain. In regard to this, it would therefore require to:

- Describe the history of Eritrea and analyze the effects that had the foreign colonization on the Eritrean economy;
- Describe the main characteristics and goals of an EPLZ;
- Explore the role and impact of an eplz for the economic development of developing countries.
- Explore the crucial factors for a successful EPLZ;
- Examine the pros and cos of an EPLZ..



## 2 Methodology

### 2.1 Introduction

The present chapter will discuss the overall research strategy which enables the drawing of correct inferences to answer the various research questions that are asked by the researcher. It starts with an overview of research paradigms as fundamental beliefs that affect the ways to conduct social research, including the choice of a particular research methodology. The chapter then details the elements of case study design, including the justification to choose case study approach. The sections that follow present an overview of the required data.

### 2.2 Research paradigms: positivism, interpretivism, critical post-modernism and pragmatism

Research paradigms address the philosophical dimensions of social sciences. A research paradigm is a set of fundamental assumptions and beliefs as to how the world is perceived which then serves as a thinking framework which influences how one undertake a social study from the way of framing and understanding social phenomena. Although the philosophical backgrounds usually remain implicit in most research, they affect the practice of research.

These paradigms or systems of thinking, guide a study by defining its nature along the dimensions of *ontology*, *epistemology* and *methodology*. **Ontology** is the view of how one perceives a reality: it specifies the nature of the knowledge, . On the other hand, **epistemology** specifies the development of that knowledge. In addition to these two fundamental philosophies, a basic belief that affect the way to investigate reality is

**methodology** that refers to a model for undertaking a research process in the context of particular paradigm. The methodology defines the practical way in which the researcher goes about doing the research.

Following this suggestion, the main theoretical paradigms that discussed in the literature are: *positivist, interpretivist/constructivist, postmodern critical theory* and *pragmatism*.

**Positivism** is the world of science and testing hypothesis that is why it is sometimes referred as a “scientific method”. According to the positivist ontology, there is a single social reality that is external and objective against which researchers can compare their claims and ascertain truth. Epistemologically, this paradigm advocates the use of a scientific approach by developing numeric measures to generate acceptable knowledge. On the other hand, positivist methodology is value neutral in which the researcher as an external observer, describe and explain relationships in order to formulate laws, thus creating a basis for prediction and generalization. It commences with the test of theory in the form of hypotheses and involves statistical tests in their research process. Therefore real events can be observed empirically and explained with logical analysis. For this reason, positivist approaches rely heavily on experimental and manipulative methods.

On the contrary, the **interpretivist/constructivist** paradigm developed as a critique of positivism in the social sciences, it asserts that human beings construct their own social realities in relation to one another. By positing a reality that cannot be separate from our knowledge of it (no separation of subject and object), the interpretivist paradigm posits that researchers' values are inherent in all phases of the research process. Ontologically, the reality is subjective: many social realities exist due to various human experiences, including people's knowledge, views and interpretations. Regarding the epistemology, events in interpretivism are understood through the mental processes of interpretation that is influenced by interaction with social contexts. Furthermore the interpretivist methodology as opposed to the positivist methodology, is directed at understanding and interpreting phenomenon where the researchers' values are inherent in all phases of the research process.

The **critical post-modernism** is a combination of two paradigms: critical theory and post-modernism. The former, developed by the Frankfurt school in Germany, it asserts that social reality is historically constituted and has been shaped by cultural, political, economic, ethnic and gender values. On the other hand, the latter emerged in part through the work of French intellectuals and believes that social reality is created by discourses (such as media, academic disciplines, religions...) which thereby are used to understand such reality. Thus, critical post-modernism politicizes social problems by situating them in historical and cultural contexts, and by deconstructing (analysing) discourses such as languages, policies and practices. Therefore like the interpretivist paradigm, social reality is understood by multiple interpretations.

**Pragmatism** is not committed to any one system of philosophy or reality (such as ontology and epistemology). In fact since the emphasis is on what works best to address the research problem at hand, instead of questioning ontology and epistemology as the first step, pragmatist users start off with the research question to determine their research framework.

### **2.3 Paradigm adopted in this study: critical post-modernism**

Following the above discussions, the philosophical assumption underlying this study come from critical post-modernism as it gives the researcher greater scope to address issues of influence and impact. Furthermore, critical post-modernism enable social phenomena to be critically examined from a cultural, historical and political stance, thus allowing the researcher to understand and analyse the phenomenon from various perspectives. Through the use of this approach the researcher analyses extant discourses and deconstructs them in order to break open discursive closures and facilitate new discourses. In doing so it is important to understand current discourses which means that history and context of discourses should be considered.

In practice, critical methodologies are often similar to interpretive ones in using in research methods, however the difference to interpretive research is that empirical "data" is used for the purpose of changing reality and not only describing it.

## 2.4 Research methodology: quantitative and qualitative approaches

Each of the paradigms discussed above has definite research methods which can be used in carrying out a study. **Research methodology** is the philosophical basis for method. On the other hand, **research method** is a technique or processes the researcher use to conduct his/her enquiry, which moves from the underlying assumptions to research design and data collection.

Although there are other distinctions in the research modes, research methods can be placed into two basic categories: *qualitative* and *quantitative*. At one level, qualitative and quantitative refer to distinctions about the nature of knowledge: how one understands the world and the ultimate purpose of the research. On another level of discourse, the terms refer to research methods, that is, the way in which data are collected and analysed, and the type of generalizations and representations derived from the data.

In regard to the nature of knowledge, **quantitative** research method was originally developed in the natural sciences to study natural phenomena and it is based on a positivist approach: there is an objective view of the reality which can be measured by an instrument in order to establish relationships between measured variables. On the contrary, **qualitative** research method which was developed in the social sciences to enable researchers to study social and cultural phenomena, is associated with the interpretivist paradigm: social reality is subjective and therefore the purpose of the research consists in understanding phenomena through the meanings that people assign to them.

Given these distinctions and definitions of a qualitative study, qualitative research is most appropriate for this study because allows the researcher to become more familiar with the

phenomenon of interest, to achieve a deep understanding of how people think about a topic and to describe in great detail the perspectives of the research participants. The goal of qualitative research is to discover patterns which emerge after close observation, careful documentation, and thoughtful analysis of the research topic. Furthermore the researcher choose to select a qualitative study because of the nature of the research question: while quantitative research can tell you when, where, and how often things happen, qualitative research looks at the “why” and “how”.

## 2.5 Research design: an exploratory/descriptive case study

**Research design** refers to the structure of an enquiry to integrate the different components of the study in a coherent and logical way thereby, ensuring the researcher will effectively address the research problem. There are three basic types of research design depending on the purpose of the study: *exploratory*, *descriptive*, and *causal*. **Exploratory** research is often considered a preliminary stage of the research process and its goal is to gain a greater understanding of a phenomenon and to discover ideas and insights. **Descriptive** research is designated to describe characteristics of a phenomenon and the real-life context in which it occurred. On the other hand, **causal** research is used to establish cause-and-effect relationships between variables (experiments are commonly used in this type of design).

The research design for this study is an exploratory/descriptive case study since they are both considered non-experimental or observational research. The combination of these two designs will help the researcher to straighten its inquiry: if the exploratory approach will be used to discover the important variables in a given situation, a descriptive research will be used to provide an accurate and valid representation of those variables. In other words, where exploratory research discovers something of interest and gives directions, descriptive research encapsulates it.

**Case study** is an approach to research that facilitates exploration of a phenomenon within its context using a variety of data sources. This ensures that the issue is not explored through one lens, but rather a variety of lenses which allows for multiple facets of the phenomenon to be revealed and understood. According to Yin (2003) a case study is “an empirical inquiry that investigates a contemporary phenomenon within its real-life context, especially when the boundaries between phenomenon and context are not clearly defined”.

This approach has the potential to deal with simple through complex situations. It enables the researcher to answer “how” and “why” type questions, while taking into consideration how a phenomenon is influenced by the context within which it is situated. Therefore this approach is suitable for the researcher who is willing to cover contextual conditions because she believes they are relevant to the phenomenon under study.

## **2.6 Data sources**

The researcher will use secondary data sources to base and confirm her study and findings. Secondary data sources are data which already exist and they are used to interpret and analyse primary sources. These sources will include previous research reports, government reports, online interviews and journal content. Also, existing findings on journals and existing knowledge on books will be used. The interpretation will be conducted which can account as qualitative in nature since it uses observation as the data collection method and aims to get a better understanding through first hand experience and truthful reporting. As the topic of this thesis is related to international investment law, law sources such as treaty collection and the Eritrean Investment code will be used in this research.

### **3 Economic history of Eritrea**

#### **3.1 The foreign trade of the ancient port of Adulis and the Kingdom of Aksum**

Aksum was a powerful and wealthy ancient kingdom situated in what is now Eritrea and and Tigray (a province in North Ethiopia). The Aksumite state bordered one of the ancient world's great arteries of commerce, the Red Sea, and through its port of Adulis, the kingdom participated actively in contemporary events and became a major naval and trading power from the 1st to the 7th centuries AD.

The port of Adulis, located in the modern eritrean port of Massawa, was once used to be a centre of the world trade and the most important port city in Africa. Before the rise of the Aksumite kingdom, Adulis was known as part of the Land of Punt (the Land of Gods) an area that attracted the trading ships of the Egyptian Pharaohs for millennia. From this land ancient Egyptians were used to acquire amongst other precious goods, Frankincense and Myrrh, which when combined with Onycha, styrax benzoine, (an operculom shell found only along Eritrea's coastline) were used to create the sacred incense used in Egyptian (and Hebrew) temples. Myrrh oil was used to anoint the bodies of the Pharaohs, a requirement for their souls to pass into the afterlife. Other valuable trade goods imported from Punt were gold, salt (still harvested in Massawa and used as currency in ancient times), ivory and ebony (ebony wood is found in Eritrea's western lowlands where even today a herd of elephants still roam today).

These relations began to relax and lately the Eritrean coastal zone became a trading post for South Arabian merchants who used the natural anchorage of this region for the purpose

of trading with African coasts. By the 2<sup>nd</sup> millennium BC the region saw a massive influx of migrants from the opposite side of the Red sea. According to some scholars, these people who mostly belonged to a tribe called Habashat (incense gatherers) originally from the southeastern Yemenite kingdom of Hadramaut, faced with population pressure, and the failure of their irrigation system, crossed the intervening sea, and after inhabiting the hot and damp Eritrean islands of Dahlak, they penetrated into the interior and preferred to settle on the Eritrean and Tigray plateau which resembles in their moderate climate and the fertility of their soil their original homeland. The Habashat soon assumed a predominance over all the other tribes and thus founding the kingdom of Aksum.

The South Arabian settlement had a significant impact on Aksum civilization: they imposed their culture and their written language (Ge'ez) on the local people. They also introduced the means of cultivating hills by means of terracing hillsides, building with sheer stone unconnected by plaster, building oval temples and palaces, and other means of civilisation and progress. Thus, a new South Arabian kingdom arose which did not sever relations with their old homeland, but it remained interested in it, sending its goods to it, interfering in its affairs, sending campaigns against it and occupying it at certain times.

Lately, the flow of Arab migrations stopped temporarily when the Greek Ptolemies in Egypt intervened in the Red Sea who acquired political and military influence on both sides of the Red Sea. Their objective was to subjugate the Red sea and its coasts to acquire incense, musk and other valuable products. Therefore they sent several reconnaissance missions to study the conditions of the sea, the coast and the peoples, with the aim of putting their findings to use in furthering their practical objectives in the Red Sea and the Indian Ocean.

Ptolemy II ordered an increase in the trade with the coasts of Africa and those of the Arabian Peninsula and India, and an increase in the number of categories imported from the hot regions. Then he founded several colonies along the coasts of the Red Sea to protect Egyptian ships and trade such as Adulis as one of the important historic stations. In particular, Adulis became a base to support the hunting of elephants and a marketplace to



export them: from this port the Ptolomies procured their own war elephants used in the battle against Syria.

Consequently, the interests of the Arab caravans in the south of the Arabian Peninsula and Hijaz began to be affected by the interference of the Ptolomies in the affairs of the sea, by their placing Greeks in several places on the coast to protect their ships. Thus, Arab merchants were forced to abandon the sea to their mighty rivals and settle for sending their trade on the land routes to Syria.

This led to the flourishing of Adulis, which became early in the first century A.D. the greatest commercial port on the Red Sea and a particularly cosmopolitan city. It included people from Aksum's widespread trading partners, such as Egypt, Arabia, Greece, Rome, Persia, India, and even Byzantium. In the babble of tongues heard in Aksum, Greek stood out as the international language of the time, much as English does in the world today.

The first mention of Adulis was in a Greco-Egyptian trade manual, written around 100 AD, the *Periplus of Erythraean sea*". It describes as a "legally limited port where big ships from the Arabian Peninsula and from every direction in the Indian Ocean brought it daggers, spears, glass, olive oil and wine and sailed from it laden with ivory, Rhinoceros horns and turtle skins".

In the first century B.C., the Romans put an end to the Ptolomies, rule in Egypt and displaced them in authority. The Romans, who were the mightiest empire in that age, also inherited the Greeks in the Red Sea, and set their sights on its coasts and on the Indian Ocean.

They kept sending ships to India across the Red Sea. and they made commercial treaties with the kingdom of Aksum. The kingdom of Aksum had a tremendous impact on the ancient Roman empire. Roman ships came to Adulis weekly to trade with the Aksumites and many Roman merchants lived in Adulis as well as in the capital city, Aksum. One of the chief commodities that linked the two powers was gold: the Aksumites had access to it from inland gold mines and the Romans needed it to support their monetary system of their growing empire.

In this line, in order to participate in the highly influenced Roman-Greco trade of the Red sea, the Aksumite kingdom began to produce coins. This explains why King Endubis used Roman weighting standards to issue his coins and the first Aksumite coins used had writing in Greek. Consequently, Aksum became the first African civilization, and according to Many, became one of the great powers of his time along with Rome, Persia and China.

Thereafter, under king Ezana, Aksum converted to Christianity and became the first State ever to use the image of the cross on its coins. The entry of the Christianity in the kingdom strengthened the cultural ties between Axum and Rome at the expense of the bonds that had linked it to South Arabia.

Therefore it happened that when the Jewish king of Himyar (who was an ally of the Persians, the mightily rivals of Romans) began to persecute Christians and lately ordered the killing of one or more caravans of Romans traders who were passing through his kingdom to Adulis and Aksum across the Red Sea, the two Christian empires waged a campaign against the Jewish king. Adulis served as a staging area for Aksum invasion of the Humyarite king, which then culminated in his defeat and murder. Even though apparently the real motive for this great expedition was only seemingly religious; in actual fact it was the struggle between the two mightiest empires, the Roman and the Persian, for the routes of international commerce in the Red Sea. Infact,, once the Jews assumed power in the land of Himyar, they started avenging themselves on the Roman Christians passing with their goods through the land of Yemen and Bab el Mendeb to Adulis and Egypt, which provoked the anger of the Romans and aroused their fear over their commercial interests, especially since the Persians supported the Himyarites.

The historic role of Adulis was finished when the Persians managed to spread their influence over Yemen again after the Hemyarites regained sovereignty and expelled the Aksumites. This enabled the Persians to spread their control over Adulis and the Daklak Archipelago, thus impeding the traffic of Roman trade and reducing the number of ships that called on Adulis until it became a deserted city. It ended in ruins after it was overrun

by the pastoral Beja tribes, which came from eastern Sudan after the Islamic conquest of Egypt in the eighth century.

The culmination of Islamic dominance in the region occurred in 1557 when an Ottoman invasion took the port city of Massawa and adjacent cities, and declared the province of Habesh. The Ottoman state maintained control over much of the northern coastal areas for nearly three hundred years, and left their possession to their Egyptians heirs in 1865.

### **3.2 Italian colonization:**

#### **Eritrea as the industrial centre for Italian East Africa**

The present day Eritrea was once used to be the firstborn colony of Italy which named it using the the latin name for the Red (*Erythraea*) sea. Italian colonialism in Eritrea lasted fifty years from 1890 to 1941 during which Eritrea has been highly modernized and urbanized.

Following the opening of the Suez canal in 1869, the Red sea became a scene of rivalry among the various european powers of that time which began to scramble over the territory along the African coast, as they needed way-stations for their shipping. In this scramble for Africa, there was a conflict between two main powerful countries: France and Britain, which the latter in order to block the former, supported Egypt and later Italy to have possessions over this strategically area.

Therefore this led Italy in 1882 to buy the bay of Assab (Eritrea's second largest port) through its steamship company Rubattino, which purchased it from the local sultan, and used it as a coalition station. Three years later, after occupying Massawa, (which later became the temporary capital of the overseas possessions) Italy gradually occupied the highlands and lowlands by driving out the Egyptians and Abyssinians. By the 1<sup>st</sup> of

January 1890, the various Italian possessions on the coast of the Red Sea were united by royal decree into one province under the title of “Colony of Eritrea”.

Thus, after bringing Eritrea fully under its control, Italy quickly moved to assess its economic potential and suitability for settlement. In fact, the primary objectives of the Italian colonialists were to exploit the raw materials of the colony and make it a market to sell surplus of Italian production. Further, in order to absorb the excess of labour, Italy also planned to provide land for the Italian surplus of population, mainly from southern Italy who were demanding land reform. Therefore the Italians decided to reserve the Eritrean highlands for Italian settlement because of the pleasant climate and moved the capital of the colony to Asmara in 1897.

As a result, one-fifth of the total arable land was confiscated, but ultimately this programme failed. This because there was an opposition by the indigenous people to expropriation of their property and to the intention of the Italians to involve the Eritrean farmers in increasing agricultural productivity for the benefit of the colonial's power market. Thus, land was given on a concessionary basis to Italian investors, and the colonial authorities encouraged the Eritreans to produce cash crops for Italy by distributing plants and by providing other assistance.

However, it was during the fascism in 1922 that Eritrea has been subject to an intense modernization project, originally commissioned by the governor Jacopo Gasparini who sought to transform it into the industrial center for the commerce of products and raw materials. Thus, thousands of bridges and roads were built and the Eritrean railway (launched in 1887) was extended. This railway network connected mineral-rich areas with the highlands (Asmara), reserved for Italian resettlement, and with the most fertile areas of the colony's western lowlands near the Sudan border (Biscia). The railway linked all of these economically strategic places with the Red Sea Port of Massawa, paving the way for raw materials to be shipped to the colonial country. As a result, Massawa became the largest and safest port on the east coast of Africa, and the largest deep-water port on the Red Sea.

Further, with the establishment of a transportation network, the colonial power also started to set up new factories concentrated in the areas of construction, mechanics, textiles, electricity and food processing. However, the Italians never developed industrial enterprises in Eritrea that might compete with Italian industries. They greatly benefited from their trade with the colony by adopting a protectionist policy imposing an *advalorem* tax at the rate of eight percent or more on foreign products entering Eritrea while exempting its own goods coming into the colony. Italy also applied a quota system and used price discrimination in its trade with the colony. Under this system goods imported from Italy to Eritrea were sold at higher prices than goods from other countries. Conversely, Eritrean goods were sold at much lower prices to Italy than to other places.

Additionally, the colonial power used Eritrea as a staging post to launch its 1935–1936 campaign to conquer and colonize Ethiopia. The military mobilization for the occupation of Ethiopia led Italy to invest heavily in its colony. For instance, it was in this period that the Italians built the Asmara-Massawa cableway, a great engineering work which won the approval of technicians and admiration of the world. This cableway was used to move food, supplies and war materials for the Italian Imperial army when conquering Ethiopia.

The preparations for the war also led to urban development and social change in Eritrea: new cities emerged on the plateau and linked by all-weather and seasonal roads. The capital of Asmara grew from a relatively minor city into Africa's most sophisticated and urbanized city of the time with the world's most remarkable concentrations of Modernist architecture. As a result, peasants and nomads from all over the territory became urban dwellers, office clerks and wage earners in industries and construction.

However, despite these improvements, the colonial educational policy was discriminatory. In order to generate low paid officers for the colonial administration, education was provided to only a small percentage of Eritreans and limited to four years of elementary school.

Notwithstanding this, Italian colonialism did create an Eritrean identity from people of nine distinct ethnic groups and religious backgrounds.

### **3.3 Ethiopian colonization: the federation and annexation period**

Following the World war II Eritrea became part of Ethiopia, when both countries were liberated from Italian occupation. Under the Ethiopian rule, Eritrea has experienced a period of oppression and deterioration of its economy, which started off a bitter 30-year war of independence with Ethiopia.

When the British forces defeated Italian forces during the World War II, they established a protectorate over Eritrea in 1941, until the Allied forces could determine its fate. During this period, the British exploited the labor forces and industrial potential of Eritrea in order to supply the Allied forces. After the end of the war, they decided to remove the Eritrean industries to Kenya as war compensation and dismantled parts of the Eritrean Railway system. This led to economic crises and unemployment, thus sowing the seeds of the formation of political parties with agendas for the country's future.

In the absence of agreement amongst the Allies (Britain, France, Soviet Union and United States), regarding Eritrea's future, the matter was referred to a UN Commission of five countries: Norway, Burma, Guatemala, Pakistan and South Africa to propose a solution. Meanwhile, since Ethiopia was landlocked and looked longingly to Eritrea's two seaports, the Ethiopian emperor Haile Sellassie was working hard on the diplomatic front to acquire Eritrea. Therefore given Ethiopia close ties with the United States (and with the West in general) the latter backed Eritrea's federation with Ethiopia and a UN resolution 390 A(V) was passed in that effect in 1952.

That decision which was made without considering the willing of independence of most part of the Eritrean people, envisaged that Eritrea was an autonomous territory federated with Ethiopia. According to the Resolution, the jurisdiction of the federal government covered matters such as foreign affairs, defence, currency and finance, foreign and interstate commerce, interstate communications, and ports. Jurisdiction of the Eritrean government included power to maintain the internal police, to levy taxes to meet the expenses of domestic functions and services, and to adopt its own budget.

But since Ethiopia's ultimate objective was to abolish the autonomous status of Eritrea and make it as one of its provinces, Ethiopia began to weaken Eritrea's economy as part of the annexation process. First, in order to paralyze Eritrean's government of its economic power, Ethiopia acquired the revenues from customs of the Eritrean's government necessary for its budget. Second, enterprises were asked to relocate to Addis Abeba, the capital of Ethiopia, and their foreign owners were advised to make the move or have their property confiscated. Furthermore, foreign investments in Eritrea were discouraged. As a result, these policies left thousands of people unemployed and forced others to emigrate.

As a consequence of Ethiopia's intervention on the autonomous rules, a militant opposition to the federation emerged in 1958 with the founding of the Eritrean Liberation Movement (ELM). Since when Eritreans tried to protest to the UN they couldn't gain access to the assembly, the ELM staged a protest demonstration in Asmara. Afterwards, these acts were used as a pretext by Haile Selassie to unilaterally dissolve the federation and illegally annex Eritrea in 1962.

Once Eritrea fell under the complete control of Ethiopia, Haile Selassie started to accelerate the realization of his main objective: exploit Eritrea's developed economic resources and gain access to the Red Sea. Therefore, during the early years after annexation, the main policy of Addis Abeba government was to force those enterprises which remained in Eritrea to sell their shares to members of the Ethiopian Royal family and the business were converted into joint ventures.

Moreover, the Ethiopian government was also quick to use the strategic location of of the Red sea. With Soviet Union assistance, Ethiopia built a petroleum refinery at Assab port and also gave licences to foreign companies for petroleum exploration in the Red sea. This allowed the econommc development of the central parts of Ethiopia but also the emigration of thousands of skilled Eritrean workers to Ethiopia as many economic activities were shifted there.

Meanwhile, the activities of the Eritrean oppositiion to the Ethiopian government were intensified and became the emperor's main preoccupation. By the late 1970's, a new Eritrean armed group was created: the Eritrean People's liberation (EPLF) and Iseyas Afewerki emerged as its leader. When Mengistu Haile Mariam overthrowned the emperor

and presided a Marxist military junta (called 'Dergue') in 1974, he stepped up with his campaign against Eritreans. Under his regime all foreign and locally owned enterprises were nationalized without compensation.

Therefore, with the help of Soviet Union, Korea, Cuba and other countries in the Eastern Block, the Dergue sustained a very bitter war over Eritrea between 1978 and 1991. The war left Eritrea in complete ruins. In terms of infrastructure, all basic services such as electricity, water, and transportation were virtually disrupted for much of the war years. Industrial sectors were wiped out and the ports were destroyed. Ethiopian forces bombed Massawa extensively during the last days of the war, killing many civilians, destroying most of the buildings and depopulating the area. However at end of the 1980s the collapse of the Soviet Union and the East Bloc caused the political and military destabilization of the Mengistu regime. Also, the Soviet Union cut back and then eliminated military aid to Ethiopia.

Thus, in May 1991, the EPLF captured the last Ethiopian outposts in Eritrea. Asmara, was occupied on May 24 1991 and together with the Tigrean People's Liberation Front (TPLF) which had also been fighting against the Dergue, took over the Ethiopian government. The EPLF created a provisional government for Eritrea, until a referendum was carried out to determine the choice of the Eritrean people. In the referendum held on 23-25 April 1993 the great majority of the registered voters (98,5%) voted for independence.

Finally, on 24 May 1993 Eritrea became Africa's 52nd independent State with Isayas Afewerki as its president.



## **4 The role of Export Processing Zones**

### **4.1 What is an export processing zones?: The problem of definitions.**

In a context of structural changes of global economic development, the export processing zones have become a truly widespread phenomenon for several decades. As a policy tools and strategic measures, EPZs have a great impact on the economy and structural reforms of developing countries. The fundamental concept of these zones is that is covered by a policy framework designed by a government that is distinct from what applies elsewhere and that aims to promote certain policy objective. Although the general concept is basically the same, different countries have adopted different terms for their EPZs and different definitions have been used by analysts to describe this phenomenon.

Concerning the terminology, the diversity in names reflects the evolving nature and distinct purpose of each zone, and while the stated objective of the government is reflected in its terminology, the actual operation of the zone can be quite different. Thus, the most commonly terms used are: "special economic zones" in China, "industrial free zones" and "export free zones" in Ireland, "duty free export processing zones" and "free export zones" in the Republic of Korea, "Maquiladoras" in Mexico, "export processing zones" in the Philippines, "investment promotion zones" in Sri Lanka, "foreign trade zone" in India and "free zones" in the United Arab Emirates.

As regard to the definitions, they all refer to a "geographic or fenced-in areas" and "free trade conditions" to attract "export oriented manufacturers". Internationally used definitions of EPZs are:

- ILO (International Labor office)/UNCTC (United Nations centre on Transnational Corporations): An EPZ could be defined here as a clearly delineated industrial estate which constitutes a free trade enclave in the customs and trade regime of a country, and where foreign manufacturing firms producing mainly for export benefit from a certain number of fiscal and financial incentives (ILO/UNCTC, 1988: 4).
- WORLD BANK: An EPZ is an industrial estate usually a fenced-in area of 10 to 300 hectares that specializes in manufacturing for export. It offers firms free trade conditions and a liberal regulatory environment (World Bank 1992: 7).
- UNCTAD (United Nations Conference on Trade development): Export processing zones are industrial estates which form enclaves within the national customs territory and are usually situated near an international port and/or airport. The entire production of such zones is normally exported. Imports of raw materials, intermediate products, equipment and machinery required for export production are not subject to customs duty (UNCTAD, 1985: 10).

However the above mentioned definitions are inadequate when dealing with borderline cases. According to these definitions EPZs is a small area within the territory of a country that are aimed at export, as indicates the name. But does all its output have to be exported for the zone to be qualified as a true EPZs? And would the entire territory of a country be considered an EPZs?

An increasing number of EPZs are now selling some part of their production on the local market, but it is generally accepted that even if these sells are considerable, the zone is considered an EPZs. For instance, this is the case of Manaus free zone in Brazil which as its most of its products are sold in Brazil, it seems to be more appropriate to qualify it as an import processing zone. Further, there are other countries or areas such as Hong Kong, Macau and Singapore which have no tariffs or other trade restrictions, and therefore their entire territory might be qualified as an EPZs. However, it is now widely recognized that EPZs in such countries/ areas are essentially the specially designed industrial parks situated

in a well defined area, rather than the whole territory with its older and well established industries activities<sup>1</sup>.

For this case study, the more appropriate definition of an EPZ is the one used by the UNCTAD, especially as the the EPZ in Massawa is situated near both a port and international airport.

#### **4.2 Why set up an Export processing zone?: characteristics and goals.**

Generally speaking, the establishment of an EPZs is considered as a policy objective directed at enhancing a country's productive capacity in manufactured goods, especially for the world market. However EPZs are characterized by specific goals each of which may assume more importance depending on the needs of the host country. In addition, features of EPZs in turn exhibit the reasons behind the setting up of an EPZ and show the various incentives that the government decide to provide to the zone.

In general, EPZs have three primary goals:

- provide foreign exchange earnings by promoting non-traditional exports;
- provide jobs to alleviate unemployment or under-employment and generate income in the host country;
- attract foreign direct investments (FDI), technology transfer, knowledge spillover, demonstration effects and backward linkages.

Moreover, some EPZs have some additional goals such as the promotion of regional development and experimentation of new industrialization strategies.

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<sup>1</sup> A joint publication by the UNCTC and the ILO, Economic and social effects of multinational enterprises in export processing zones (1988), p.4

As regard to the characteristics, EPZs share several common features on the basis of the incentives they offer to the firms:

- They allow duty free imports of raw and intermediate inputs and capital goods necessary for the production of exports;
- They provide flexible regulations: firms established within an EPZ may have access to a streamlined customs process with less bureaucracy and red tape, allowing "one-stop shopping" for permits investment applications. Additionally, labor laws are often more flexible than for most firms in the domestic market;
- Firms in EPZs are given generous long-term tax holidays and concessions;
- Communication services and infra-structure are more advanced than in other parts of the country. Also, utility and rental subsidies are common;

Furthermore, EPZs can be distinguished in publicly and privately owned or managed. Initially, the older EPZs were typically established and run by the host government, however over the 10-15 years a growing number of EPZs have been owned or managed by private entities because they are believed to achieve higher results.

Finally, EPZs can be also classified into high-end and low-end depending on the quality of the management, facilities and services provided by the zone to the firms.

### **4.3 Business environment: government involvement and industrial policy.**

In the context of EPZs, a friendly business environment is necessary in order to attract foreign investors. Thus, to this end the host's government should proceed in the implementation of a transparent and consistent institutional framework. However, there has been much debate on the extent of the government interventions, and consequently on

actual efficiency and role that the industrial policy implemented by the latter may have on the development of the host country.

According to Chang (1994) industrial policy is considered to be a set of governmental actions supporting the generation of production and technological capacity in industries considered strategic for national development. In this regard, there are two main ways through States intervene in support of industrial development:

- As **regulator/facilitator**: by setting tariffs and production levels for certain activities or by creating fiscal incentives or subsidies to support industrial sectors. In this case, State merely sets conducive rules of the game so as to encourage economic development in a certain direction. This is considered to be as a "horizontal" intervention.
- As **entrepreneur**: in this case State participates directly in economic activity, by establishing State-owned enterprises. These can be wholly owned by the State or joint ventures between States and multinational corporations. This is regarded to be a "vertical" intervention.

Therefore, concerning EPZs, host's government can opt a hands-on or hands-off approach. At the extreme case, the hands on approach would consist in the total control of the establishment and management of the EPZs (eg. Taiwanese, South Korean and Malaysian EPZs are publicly owned and run).

Proponents of public zones emphasize the leadership role the government provides in terms of the social and economic goals of an EPZ: job creation, attracting FDI, technology transfer, promoting industrial growth and diversification<sup>2</sup>.

In contrast, opponents to the hands-on approach, argue that frequent shortages of transparency and capacity among the policymakers in low-income countries hinder the success of an EPZ. They point to the necessity for competitiveness and efficiency in a global economy, which can only come from for-profit entities which are considered to be

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<sup>2</sup> Madani, A review of the Role and Impact of Export Processing Zones (1999), p.66

more flexible and innovative to adapt to changing market conditions. Thus, based on a neoclassical approach, they believe that industrial policy distorts market mechanism and hence provides less than optimal allocation of the factors of production in contrast to the optimal allocation achieved by free-market mechanisms.

This view has been also endorsed by the World Bank, which has strongly suggested that government should let markets work unless it is demonstrably better to step in, for instance to correct market failures. In this line, the number of private-run zones have significantly increased in recent years, and their success demonstrated the fact that the hands-off governmental approach works.

However, the current debate on promoting industrial development is seeking a certain balance between the public sector and private agents, given the fact that there is consensus that even in modern capitalism, development depends on an interaction of market and non-market mechanisms. In this line, industrial policy is not just a last resort to be used "reluctantly" but a legitimate normal tool of development policy (neo-structural approach).

Thus, in accordance with this approach, the governments' role should be as a facilitator:

- provide the necessary legal framework analysing the nature of the incentives offered and their costs to the country;
- provide the initially bureaucratic effort such as launching a feasibility study, encouraging domestic private sector involvement and marketing the zone abroad.
- ensure adequate infrastructure, by improving roads, ports and airports near the zone location and by securing a steady supply of electricity and water.

Once the initial legal, bureaucratic and physical framework has taken shape, the government shall provide (and shoulder the cost of) the ongoing services such as customs, regulatory and supervisory duties, leaving the running of the business to a private corporation or managerial group.

As we seen, regardless of whether zones are public or private, industrial policy plays an important role in promoting development.

#### **4.4 The effects of an EPZs for host countries : costs and benefits.**

In assessing the effectiveness and impact of an EPZ in the host economy, a cost-benefits analysis should be used to make choices among the economic goals of the EPZ. Because of its supposed capacity to reveal economic price and gains, cost-benefit analysis is a much appreciated tool in economic studies. Thus, such analysis can provide policy makers with an efficient and objective evaluation of programs.

The principle behind the cost-benefit analysis lies on the value of a particular program: the analyst simply operates the difference between the benefits that have resulted from its implementation and its cost. If the result of such computation is negative, the program has cost more than what it has brought.

Further, the benefits and costs of an EPZ are quantified within the framework of an "enclave model". Under such a model, the EPZ is not a "normal" component of its national economy: a country establishing a zone hosts a foreign enclave. Warr (1989) bases his analysis on the necessity to reveal the evolution of the economic welfare of citizens of the host country induced by the existence of a zone. According to him, the flows between this enclave and the world are external to the national economy and the latter is solely concerned with welfare gains or losses in the flows taking place between it and the zone.

Therefore, a cost-benefit analysis will be limited solely to the flow of goods and services and the financial flows between the host economy and the EPZ. Thus, the relationships relevant for the welfare of citizens consist in:

- EPZ firm is provided by the domestic economy of capital, infrastructure, workers, public utilities and some local input.
- In return, the host economy will receive wages, electricity tariffs, taxes, profits channelled to domestic shareholders and payment for local inputs. Also, EPZ employees receive skills. Further, domestic borrowing by EPZ firms, would enhance banking activities within the host economy.

As can be seen from this approach, the “enclave” nature of the EPZ does not promote forward linkages (because sales of the EPZ output to the domestic market are minimal) but instead generate backward linkages between the EPZ and the domestic economy. Backward linkages are generated when EPZ firms raise demand for output in the rest of the economy, and through technological spill-overs which come as skills attained in EPZ-based production are passed on to the rest of the economy. For this reason, these are considered to be the direct channel through which a country can achieve its economic development objective.

To this end, the expected benefits in establishing an EPZ for the host country are:

- Increased foreign exchange earning and gross Export;
- Creation of job and income;
- Average wage in EPZ higher than average wage outside the zone;
- Good source of Labor training and learning by doing and management and supervisory training;
- Catalyst effect;
- Provides efficient industrial structure in countries that may not possess one;

While expected costs are:

- capital infrastructure cost of establishment of an EPZ;



- administrative expenditure for zone operation.

### **Foreign Exchange Earnings potential**

There are static (increased capital and capital goods) and dynamic benefits (technology diffusion, export promotion) from FDI. Whilst the static benefits of FDI are not to be neglected, it is the dynamic benefits from FDI which are most important and has raised the interest of many developing countries on FDI.

Foreign exchange earnings are one of the main benefits expected from an EPZ. It is argued that EPZ provide foreign exchange earnings that allow low income economies to slacken the foreign exchange constraints regarding their import needs for the rest of the economy.

### **Attract foreign direct investment**

The major benefits that countries derive from FDI in EPZ's can best be viewed as of two types. The first are short-term benefits, such as employment, and foreign exchange earnings and exports, which are the most formal as well as easily quantifiable and therefore the most often studied. The second type is the long-run benefits from EPZ operations, which lead to various indirect and informal externalities primarily through the development of linkages with the domestic economy (e.g. technology transfers).

This linkage seems to occur depending on the absorption capacity of the domestic firms. In other words, if technologies between an EPZ and domestic firms are vastly different, little backward linkage occur because of this lack of absorption from domestic firms.

A backward linkage could be established, if in contrary there is some degree of technological compatibility. In the case of developing countries, this linkage has occurred when EPZ firms used basic production processes where domestic raw materials and intermediate inputs could be used. A successful example in this regard are the Indonesian EPZ, where the dominant garment industry uses domestic clothes and other intermediate inputs for its production<sup>3</sup>.

Profitable FDI in a zone represents a showcase for domestic firms and potential entrepreneurs to learn from and copy. It is quite difficult to estimate the return of FDI in a

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<sup>3</sup> Madani (1999), p.31

given location but, we can say that externalities from foreign investment can be both positive and negative. For instance, MNE's activities induce employment but at the same time can increase pollution levels.

### **Technology Transfer and Education Benefits**

According to Kokko (1997), much of the international transfer of technologies is linked to FDI. However, because of its nature, it has been argued that EPZs investment does not bring the same technology content as traditional FDI. Some of the reasons outlined are a lack of forward and backward linkages with the local economy as well as the low skill assembly type production in EPZs that leaves little room for technology diffusion.

As Trevino (1996) proposed, this variable should be examined from two angles. The first one is tangible transfers (such as the transfer of capital equipment and spillovers, the development of auxiliary and support industries). The second one is intangible transfers, such as the transfer of skills.

With regards to technological transfers and spillovers, EPZ are, for the most part, labourintensive, low-tech assembly firms, with little access to advanced technologies. However, through the process of sub-contracting, domestic firms would be allowed to access to technical know-how.

### **Employment Effect on Local and National Economy**

Job creation is considered one of the primary goals and one of the most important contributions of any EPZ to the economy. The EPZ is often located in economically depressed areas. Because of the low-skill assembly type activities undertaken in EPZ, employment in EPZ is usually concentrated in the lower end of the skill distribution of a country. This has several implications. On the one hand, it provides employment for those that usually face most difficulties in the labour markets. On the other hand, this low skill labour specialisation has implications for technology spillovers, wages and value added.

Having said all that, it is the use of local resources and the net benefits to the host economy as a result of EPZ activities that are relevant for the analysis of development. In economic terms, it is the excess of actual payments at market prices and the opportunity costs of the respective items that generate benefits to the citizens. For instance, there will be a contribution to net benefits if

- the prices paid by the firms for purchases exceed the social opportunity cost of supplying them;
- if a worker's actual market wages exceed the social opportunity cost of employment (shadow wages) in the zone. In this case the social benefit derived from generating an additional job outweigh the costs;
- if average electricity tariffs exceed the opportunity cost of supplying the additional power.

In contrast to this, there will be a net loss: if a host government subsidises utilities to EPLZ firms and the market price is below costs;

In conclusion, it seems that the effective utilization of EPZs as instruments of industrialization requires the availability of linkages with the rest of the economy.

#### **4.5 The implication of the WTO Agreement on Subsidies and Countervailing Measures (SCM) on EPZs**

Although EPZs are not mentioned explicitly in any WTO agreements, some aspects of the different rules that apply in EPZs relative to the rest of a national territory (with regard to issues such as preferential access to infrastructure, and provision of financial incentives such as tax exemptions or lower tax rates) may be covered by WTO provisions. Such aspects of EPZs concern, in particular, the WTO Agreement on Subsidies and Countervailing Measures (SCM) which disciplines the use of subsidies and it regulates the actions that countries can take to counter the effects of subsidies. To the extent that EPZs

provide export subsidies, they are in violation of the SCM Agreement. This is because export subsidies constitute a distortion from the perspective of WTO principle of equal treatment, since exporters from EPZs would have a special advantage over those firms not operating in EPZs.

Pursuant to Art.1.1 of the SCM Agreement a subsidy is defined as “*a financial contribution by a government or public body within the territory of a WTO member, which confers a benefit*”. In addition art.1.2 provides that WTO rules on subsidies only apply to “specific” subsidies. Thus, according to this article the concept of subsidy is characterized by four elements:

- a ***financial contribution*** or ***any form of income*** or ***price support***: this includes direct transfer of funds (such as grants and loans); provision or purchase by a government of goods or services other than general infrastructure, and a government payment to a funding mechanism or entrustment or direction of a private body;
- by a ***government*** or any ***public body***: in this manner even a financial contribution made by a private body is considered to be a “financial contribution” when the government entrusts or directs the private body to carry out one or more of the type of function listed in art.1.1
- confers a ***benefit***: according to the Appellate body in Canada-Aircraft, the existence of a benefit has to be determined by comparison with the market. In other words, a benefit is deemed to exist when the recipient has received a “financial contribution” on terms more favourable than those available to the recipient in the market;
- to a ***specific*** recipient: a subsidy is specific when it has been specifically provided to an enterprise or industry or group of industries or enterprises. The basic principle consists in the fact that a subsidy when it is specific distorts the allocation of resources within an economy and therefore should be subject to discipline. In this regard Art.2 distinguishes four types of specificity:

1. **enterprise-specificity:** when a government targets a particular company or companies for subsidisation;
2. **industry specificity:** when a government targets a particular sector or sectors for subsidisation;
3. **regional specificity:** when a government targets producers in specified parts of its territory for subsidisation;
4. **prohibited subsidies:** when a government targets export goods or goods using domestic inputs for subsidisation.

Moreover the SCM Agreement provides two basic categories of subsidies: **prohibited subsidies** and **actionable subsidies**. The latter are not prohibited but they may be subject to challenge (either through multilateral dispute settlement or through countervailing actions) if they cause adverse effects to the interests of another WTO member. On the other hand, subsidies which must not be granted or maintained by any WTO members and thus prohibited under the SCM Agreement are *import substitution subsidies* and *export subsidies*. The category of import substitution consists of subsidies contingent upon the use of domestic over imported goods.

With regard to export subsidies, art.3.1(a) defines them as “subsidies contingent, in law or in fact, whether wholly or as one of several conditions, on export performance”. In this provision, the meaning of “contingent” is “conditional or dependent for its existence on something”. Therefore subsidies that are *contingent on export performance* are dependent upon the existence of export. That is to say, beneficiaries cannot receive subsidies unless they export, so that exporting is considered to be a *necessary condition*.

Turning back to export processing zones, most of the incentives offered under EPZs which are regional specific, are considered to be subsidies prohibited under the SCM Agreement, such as:

- Provision by government of domestic products or services for use in production of exported goods on terms more favorable than for production of domestic goods if

the terms are more favorable than those commercially available on world markets: for instance, the host government provides electricity and other utilities for businesses in an EPZs at lower rates than for businesses outside the SEZ;

- Internal transport and freight charges more favorable for export shipments than for domestic shipments (if mandated by government): EPZs are provided with developed factory sites having infrastructure requirements such as container yard for sea-going containers and air cargo terminal.
- Currency retention schemes involving a bonus on exports: for instance, EPZs exporters are allowed to retain foreign currency based on export performance.
- Domestic goods are given preference over foreign goods by government directive. an EPZ is required by government to use domestic inputs when manufacturing goods for export. This is an example of import subsidisation.

These measures are prohibited under the SCM Agreement and its Annex (Annex I) which provides an “illustrative list of Export subsidies”. Furthermore, the requirement of “contingency upon export performance” of an export subsidy, does apply in the case of EPZs. Thus, provided that the nature of EPZs, the benefit of their incentives are only available if i) the recipients are in an EPZ and if ii) they export they export (after processing or final assembly), these incentives benefit is “upon export performance” within the meaning Art.31(a) of SCM Agreement.

However, recognizing that subsidies can play an important role in the economic development programmes of developing-country WTO Members, art.27 provides certain exemptions from SCM Agreement for developing countries. Thus, according to art.27.2 the prohibitions in art.3.1(a) on export subsidies do not apply to developing countries (listed in Annex VII) with a GNP per capita below \$1000 per year and other developing countries were granted a transition period of eight years from the date of entry into force of the SCM Agreement (1<sup>st</sup> January 2003). Under the Doha mandate, this transition period has been extended to four more years.

Finally, in July 2007, the WTO General Council adopted the decision of the Committee on Subsidies and Countervailing Measures to allow annual extensions of exemption from the SCM Agreement until 2015 for those developing countries listed in Annex VII. However, extension is not unconditional or automatic. Members receiving a continuation of the extension must undergo an annual review by the SCM committee. The main purpose of the review is to “verify that the transparency and standstill requirements...are being fulfilled.” Transparency is the condition requiring that governments provide a description of all export subsidy programs in operation.

Thus, the SCM Agreement will force most countries to remove their export subsidies **by 2015**. Under this pressure, developing countries will be pushed to offer incentives to the entire economy similar to those that they are offering only to EPZs. However, an alternative way to achieve WTO compliance without removing definitely subsidies, would be to change prohibited subsidies and other WTO prohibited measures into WTO non-prohibited measures. For example, in many instances, prohibited export subsidies can be converted into actionable subsidies by removing any de jure or de facto obligation to export goods produced in an EPZs and allowing zone enterprises full access to the domestic market on a duty and tax paid basis. In this regard, it is important that host governments consult with EPZs businesses and investors. This is because in some instances, incentive measures cannot be modified or repealed without the consent of existing businesses and investors that have made financial commitments in reliance on these incentives. Thus, the challenge will be to find the tools required to run effective industrial policy in accordance with WTO rules.

#### **4.6 Arguments against export processing zones: human rights' issue**

In the process of achieving a “business friendly” environment, most of the host countries have relaxed (or even actively suppressed) labour standards in order to attract foreign investments into EPZs. The idea behind of this lies in the fact that low transaction cost and ease of hiring and firing workers allow foreign firms to reduce their costs rapidly in a business framework highly prone to demand shocks<sup>4</sup>. This aspect has been highly criticized by several international organizations and NGOs for its negative impact on human rights.

While EPZs are known for their capacity to generate employment opportunities, on the other hand these zones are also known to be characterized by poor working conditions and lack of employment protection. Most of the foreign firms established in these zones are often found in industrial sectors, like textiles and electronics, with intense competition, demanding production requirements and short product life cycles. As a consequence of this pressure, these enterprises preferred to set up their business in poor countries with loose labour markets and where governments are ambivalent or hostile towards trade unions. The poorer a country is, the better terms they have to offer to the companies. Thus, these firms build its success on the exploitation of a cheap and compliant workforce.

The majority of the workforce in the zones are women. Employers in the EPZs are more likely to favour women for routine, repetitive work in the low-tech and labour-intensive industries like garments and electronics. Some consider women more compliant, disciplined and hard-working than their male counterparts. Further, women are preferred because they are paid a lower average wage than their male co-workers. With this regard, some would argue that the shadow price of the women’s work is lower since most did not have “formal” sector jobs previous to the establishment of the zone and might have stayed at home in its absence. Also, they are unskilled with no or little work experience, hence the lower wages represents their lower skills and productivity.

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<sup>4</sup> Madani (1999), p.43



A more matter of fact analysis is that firms erroneously (or opportunistically ) believe that women's salaries is supplementary to the main family income (husband's income), and therefore need not be as high as their male counterparts. In spite of this, it has been recognized that in some zones, in countries, like Philippines and Thailand, have been successful in offering women a route into formal employment. However, female workers often face a number of barriers at work, including discrimination in hiring, wages and benefits, and sexual harassment.

Although there are no international laws that apply specifically to export processing zones, many countries have signed and ratified UN Human Rights Treaties in which there are articles that directly relate to workers right and women's rights. For instance, art.7 of the International Covenant on Economic and Social and Cultural rights affirms that *"the States Parties to the present Covenant recognize the right of everyone to the enjoyment of just and favorable conditions of work which ensure, in particular: (a) remuneration which provides all workers, as a minimum, with: fair wages and equal remuneration for work of equal value without distinction of any kind, in particular women being guaranteed conditions of work not inferior to those enjoyed by men, with equal pay for equal work. (b) Safe and healthy working conditions; (c) Equal opportunity for everyone to be promoted in his employment to an appropriate higher level, subject to no considerations other than those of seniority and competence; (d) Rest, leisure and reasonable limitation of working hours and periodic holidays with pay, as well as remuneration for public holidays."*

Concerning the principle of equal pay for work of equal value, this is also contained in one of the ILO's core labour standards, a convention that many governments have signed up to. This gender discrimination is also shown in many cases where the division of labor within firms leaves men in supervisory and managerial positions while women's jobs tend to be clustered on the production floor, where there is less opportunity for advancement and promotions.

In addition to this, women workers face also discrimination in hiring and firing practices. This has been most fully demonstrated and publicized in the context of forced pregnancy

tests, either at the point of hiring, where pregnant women are discriminated against in hiring decisions, or during employment, where pregnant workers may be sacked without warning. In this regard, short-term contracts are used for flexible hiring and firing and for avoiding costs such as maternity and redundancy pay.

Moreover, excessive working hours (up to 15 hours per day in some cases) are common across EPZs. Tight delivery schedules encourage employers to underpay workers and to force them to work extremely long hours. Additionally, it has been reported that excessive overtime is a consistent problem in EPZs which in some cases (like Madagascar) is paid at the same rate as normal pay or even unpaid. According to the ILO, this is due to poor supply chain management, periods of peak of seasonal demand, and last-minute adjustments caused by poor quality control in the production process. As a consequence, these excessive working hours makes it also difficult for women to both work and care for family members.

Low wages and excessive working hours mean that many workers cannot get any proper rest nor afford decent food and medical care. Moreover, another issue of considerable concern relates to the health and safety standards. The question of health and safety in the workplace implicates not only labour rights issues but also the human rights to life and health. EPZs have been associated with high levels of machine-related accidents, dusts, noise, poor ventilation, and exposure to toxic chemicals. Job stress levels are also high from monotonous, repetitive movements, associated to lack of sanitary facilities and restrictions on their use. These intense production quotas, productivity incentives and inadequate controls on overtime create additional pressure to highly stressful work, resulting in cardiovascular and psychological disorders. In the young women who often work in EPZs, the stress can affect reproductive health, leading to miscarriage, problems with pregnancies, and poor fetal health. Additionally, many firms restrict access to toilets to discourage time-wasting and disturbance of work patterns. Perhaps the most appalling breach of health and safety legislation in the zones consist in the practice of factory managers locking employees within factories in order to combat a perceived risk of theft,

with disastrous consequences in case of fire. In other cases, employers have denied workers the provision of medical treatment and sick leave.

Furthermore, another best documented issue has to do with workers' freedom of association and the effective recognition of their right to collective bargaining. In this regard art.2 of the ILO convention C087 states that “ *Workers and employers, without distinction whatsoever, shall have the right to establish and, subject only to the rules of the organisation concerned, to join organisations of their own choosing without previous authorisation*”. Unfortunately this right has not been respected: workers in EPZs are prevented from mobilising against labour rights abuses for fear of losing their jobs. This is because, employers regularly use the threat of dismissal to control the workforce. To this end, short-term contracts are used by employers to wield the threat of dismissal when the workforce engages in union activity. Employers often disguise the real reason for the workers' dismissals by quoting cancellation of orders or a dip in production. Some workers who reveal that they have signed up to the union risk serious reprisals such as intimidation, assaults and death. In its most extreme form, dismissal is used to sack an entire workforce when unions approach success in organising a factory. Consequently, trade unions face great practical difficulties when trying to gain access to zones. In several countries, companies operating in the zones employ private security guards, sometimes armed, to prevent trade union officials from entering production units.

As we seen, there seems to be a definite relaxation of domestic labor laws to accommodate zone firms. The reasons for this consist in the fact that in some countries zones are exempted from compliance with national labor whilst in others there's a lack of governmental supervision where the zones are not exempted, and therefore labour laws are not enforced. This said, it is a duty of the host State to take appropriate steps to prevent corporate-related interference with human rights and to ‘investigate, punish and redress it where it occurs’ – with the implication that, where all reasonable or appropriate steps have been taken to protect individuals against human rights abuses in the context of EPZs, the state will not be liable where such interference nevertheless occurs. Therefore a more

consistent implementation of regulations and monitoring of activities by States are recommended to improve workers' living standards and productivity.

## 5 The potentialities of Massawa Export Processing Zone

### 5.1 Prerequisites for a successful export processing zone: what makes Massawa port best for an export processing zone?

Massawa's strategic location along the Red sea, confers to its newly established Export Processing Zone a superb logistical and cost advantage in accessing global international markets. Together with the port of Asab, the port of Massawa lies in the busiest shipping lane of the world. Thus, the Massawa port helps the easy exports and imports of goods, thereby encouraging foreign direct investment.

Massawa EPZ was announced in 2001 and later nominally opened in 2006. Job creation and provision of foreign exchange earnings from all the zones activities, are the main objectives which are behind the establishment of the zone. Like all EPZs, businesses based within the Massawa EPZ Authority and the Massawa Port Authority benefit from excellent conditions and incentives such as:

- Free provision of enhanced physical infrastructure and streamlined administrative services: the Massawa EPZ is located next to the Primary port for the import and export of goods of the Eritrean market. Founded during the 19<sup>th</sup> century and later damaged by the Ethiopians, this port has been rehabilitated and restored with facilities and services. As the main service port of Eritrea, **the port of Massawa** is served by national registered coastal vessels (*Eritrean shipping line*), includes a computerized container terminal and provides cargo handling and storage service

including IMDG (dangerous goods). The port also provides international telephone communication, telex and fax facilities as well as radio communication from port to vessel and viceversa. Furthermore, trading offices and warehousing are provided to be leased for import, export and re-export operations. In addition to seaport access, the zone offers the **Massawa International airport** which is a newly built international airport with a greater capacity than Asmara airport.

- Allowance of foreign firms to participate in all sectors of the economy with no restriction and discrimination: that is, the zone can be 100% foreign owned or can be a joint ventures between a foreign firm and domestic firm.
- Low rates of imports tariffs of raw, intermediate input and capital goods necessary for the production of exports: capital goods industrial spare parts are subject to nominal customs duty of 2%. Raw materials and intermediate inputs are subject to 3% sales tax. However, all sales tax will be rebated on all materials and inputs that have been used for export production.
- Exemption from all export duties and sales taxes;
- Up to 100% retention of foreign currency earning: pursuant to art. 34 of the Eritrean Free Zone proclamation NO 115/2001, investors are permitted to deal in all currencies, i.e. to transfer, receive, pay open letters of credit and engage in all types of bank activity without any restriction. Also, they are permitted to open and operate a foreign currency account with a bank in Eritrea and use it for investment and procurement. Furthermore, foreign investors are exempted from national foreign exchange controls and priority of foreign exchange allocation given to exporters.
- Free profit repatriation for foreign companies: according to art.32 of the Eritrean Free Zones proclamation foreign investors may repatriate without restriction, income and profits arising from licensed activities in the zone. Also, there are no taxes on income, profits or dividends (art.31).
- Less governmental red-tape, including more flexibility with labor laws for the firms in the zone than in the domestic market;

Moreover, unlike other EPZs of middle income countries, foreign investors in Eritrea will enjoy selling their products in the world markets without any constraints because Eritrea is not subject to restrictions on market entry of its free zone products by the World Trade Organization (WTO) and all fees and charges are less expensive than any of the other free zone competitors in the region at all levels.

Moreover, it has been widely recognized that if a country is a regional economic hub or a signatory to a regional integration (RIA), the enlarged size of the potential market may be an added incentive for firms targeting this market to invest in a EPZ<sup>5</sup>. In light of this, Eritrea entered into active membership in regional organizations such as IGAD (an eight.country political-trading bloc based in horn of Africa) and COMESA (Common Market for Eastern and Southern Africa) in order to expand the market for import and export potentials.

With regard to investment opportunities, Eritrea has comparative advantage in: **agriculture, fisheries/marine resources and mineral resources.**

### **Agriculture**

Agriculture, animal herding and fishing remain the primary source of income and food for the majority of the population Eritrean farmers traditionally cultivate grains, legumes, fruits and vegetables and raise goats, cattle, sheep, camels, donkeys and horses. Most operate at a subsistence level, consuming most of what they produce and selling only a small surplus in local markets. However, despite plenty of arable land and significant water resources, currently a small proportion is under cultivation and farming is practiced on the basis of archaic and traditional method. Infact, 1.6 million hectares of land suitable for rain fed or irrigated cultivation are not now being farmed.

Under these conditions, the government is pursuing a three-pronged strategy to increase agricultural output: increasing land under cultivation, raising productivity, and encouraging the production of higher-value crops for export and domestic consumption. With concern

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<sup>5</sup> Madani (1999), p.69

of the last point, the Ministry of Agriculture is encouraging small-holder farmers to produce high-value crops and livestock for export, such as flowers for Europe and sheep and goats for Middle East markets. Horticultural products with great potential include cotton, oil seeds, cut flowers and some fruits and vegetables. The strategy for increasing livestock production is to raise the productivity of herds by enhancing rangeland and water resources management, promoting superior animal breeding systems, improving animal health and nutrition, and developing higher quality animal feed and fodder systems. Efforts are also underway to expand marketing outlets and encourage the use of refrigerated transport services, particularly in the expanding dairy industry.

### **Fisheries and marine resources**

The Eritrean coastal waters are among the most productive fishing ground in the Red sea. its coastline elongates 1,300 kilometers rich with commercially important marine life. The Red Sea is home to more than 1,000 species of fish, including tuna, red snapper, kingfish, sardines and other prime food fish, and over 220 species of coral. There are also large stocks of high-value species, such as lobster, crab, oyster, and shrimp. However despite its lucrative potential, this sector is considered to be one of the most underdeveloped sectors of the Eritrean economy. The fact that almost 52,000 square kilometers of largely unexploited waters means that is very rich in abundance. It is, therefore, with this in mind that the Government of Eritrea created a favorable condition of investment in the sector. In the last nine years a number of investors are encouraged to invest on various fisheries sectors either independently or in joint venture with the Ministry of Fisheries. In 1998, a joint venture of the government with European investors established a modern fish-processing plant in Massawa. By 2000, Eri-fish, was exporting frozen fish to markets in Europe. By 2002, new ice plants were added, with a combined production capacity of more than 150 tons of ice per day. Furthermore, the main potential sectors for fisheries investment in Eritrea are Acquacolture and wild fisheries. Thus, in 1999, Eritrea embarked on one of the most innovative, commercial aquaculture ventures in the world-Seawater Farms Eritrea. A joint undertaking with a U.S. firm, the project uses untreated seawater instead of fresh water to produce shrimp and fish, together with salicornia, a salt-tolerant



crop that can be eaten as a vegetable while young. The mature plant also yields a high-protein edible oil, particle board and animal fodder.

### **Potentials in the Mining industry**

Geological works and recent investigations have proved that Eritrea is endowed of favorable geological settings. In the last six years, the Eritrean mining sector has been the area of attraction for many international mining companies and support institutions active in the mining industry. Rich deposits of base metals, industrial and construction mining is prospects that attract for private investment. The exploration activities and the recent commercial mining are operated by different multinational companies in varied commodities. The mining potential in country is diverse ranging from precious metals (gold, silver, copper, zinc, iron, nickel and chromium) industrial raw materials (potash, sulfur, silica, gypsum, sand, feldspar, kaolin, cement and salt) as well as construction materials (marble, granite, chalk and basalt) and energy source both from potential carbon deposits and geo thermal energy at the Alid geothermal field.

In 2008 The Bisha Mining Company, a mining conglomerate between the Eritrean National Mining Corporation (ENAMCO) (40%) and a Canadian company (NEVESUN) (60%), has been formed for the development of Bisha mine. a large, high-grade volcanogenic massive sulphide (VMS) deposit located 150km in western Eritrea, The company declared commercial production in 2011 and produced low-cost gold-silver doré until mid-2013 After two years of low cost gold production, the Bisha Mine transitioned to low-cost, high-grade copper There are many more mining contracts on the making. The potash mine in Danakil Depression with a planed output of up to 10,000 ton a day life span of over 150 years, the Zara and Dubrba gold mining Eritrea stands to share in hundreds of billions of dollars in mining profits.

Among all these leading sectors, it has been argued by some analysts that priority should be given to agriculture. According to Gebremedhin, an Eritrean economic analyst, “agriculture is the base for economic development in Eritrea since is labor intensive and

the majority of the Eritrean population depends on agriculture for their livelihood. He believes that “in an agrarian country like Eritrea, where there is scarcity of capital and skilled manpower, ignoring agriculture and starting development strategy with capital-intensive industrialization will create misallocation of resources, unemployment, poverty, and other negative social consequences”. This view has been also shared by the government which has invested largely in agriculture. Regardless these investments, the government does not take sides in the industry-first or agriculture-first polemics. It is working to increase agricultural production while simultaneously encouraging industrial development.

This said, the Massawa EPZ will help to develop and utilize natural resources of the country. Thus in the context of the zone, manufacturing will focus on agro-industrial products (such as textiles, cotton, leather, garment and food processing), industrial and construction raw materials (potash, cement and salt, marble, granite..) and marine resources.

## **5.2 The legal framework for Private investments: the Eritrean Investment proclamation No.59/1994**

Seven months after Eritrea's independence the provisional government enacted the first law on private investment: the “Investment Proclamation No. 18/1991”. The measure was a step towards reversing past restrictive policies by allowing the participation of the private sector in business activities. After three years the Investment proclamation No.18/1991 has been revised and replaced by the Investment proclamation No.59/1994.

The rationale behind this revision was that the previous proclamation required high minimum capital for incentive purpose, thus discouraging small businesses. The old law discouraged also foreign investors by imposing a joint venture model, which required indigenous participation. Therefore, on the 24<sup>th</sup> August of 1994, the government

promulgated the new Investment code which reflected the government macroeconomic policy that encourages a more open, market oriented economy led by the private sector. In light of this the preamble of the new Investment code affirms that: “assigning the private sector a leading role in the economic activities of the country, the Proclamation allows private investment to function with no restrictions or discrimination”.

By stating so, the government is intended to assume a “hands off” approach. In other words, the public sector will be restricted to those areas that the private sector may tend to avoid because of externalities. Thus, the public sector is assigned the roles of providing the necessary infrastructure, human capital, and financial and credit institutions; maintaining macroeconomic stability by maintaining predictably low inflationstable interest rates, and realistic exchange rates; and providing the necessary political and institutional framework and safeguards for the promotion and protection of private investment. With regard to the objective of this policy, the main aims of the government consist solving the problems of lack of capital and technology and the problem of unemployment facing the country. Within this broader objectives, the proclamation illustrates other objectives such as:

- encouragement of investments so as to develop and utilize the natural resources of the country;
- expansion of exports and encouragement of competitive import substituting businesses;
- creation and expansion of employment opportunities;
- encouragement of new technology introduction in order to enhance production efficiency and thereby optimize resource exploitation;
- encouragement of equitable regional growth and development;

These objectives reflect the government's policy of building an export-oriented economy. Having a small market with a population of about 4 million, export expansion would become a engine growth once the domestic needs have been met. In addition, openness to international markets could be an important channel of transfer of technology. Through foreign exchange the country would also have the chance to raise its purchasing power.

Unlike other many developing countries' investments code, the Eritrea Investment proclamation 59/1994 does not differentiate between local and foreign investors. Both local and foreign investors are allowed to participate in all sectors of the economy without discrimination. The only exception in the Proclamation restricting foreign investments regards domestic retail and wholesale trade, import and commission agency which require bilateral agreements of reciprocity with the country's investor. The reason behind this restriction lies in the fact that since the whole sale and retail occupy a significant portion of the Eritrean business community, the government intend to protect these small businesses. Furthermore, contrary to the previous one, the new proclamation give equal opportunity to both domestic and foreign capital. Thus, foreign investors are allowed to maintain 100% ownership of their investment or form joint venture with domestic investors. The use of a joint venture model would give foreign investors advantages in terms of labour, financial institutions, better access to local marketing practices and a reduction in cultural and language barriers.

With regard to the incentives offered to foreign investors, these include:

- **Duties and taxes levied on imports and exports:** 1) capital goods, intermediates, industrial spare parts and raw materials are subject to nominal customs duty of 2%. 2) Raw materials and intermediate inputs are subject to 3% sales tax (however all sales tax will be rebated on all materials and inputs that have been used for export production). 3) Exports are exempted from export duties and sales taxes;
- **Income tax:** 1) any loss incurred during the first two years of operation by an investor may be carried forward for three consecutive years; 2) marginal tax rate on personal income from 2%-38%: on non-corporate profit from 2%-38%; 3) on corporate profit from 25%-35%; on commercial agriculture from 2%-320%; and on rent income from 1%-48%. 4) Corporate profit that is set aside from reinvestment taxed at the rate of 20%. No taxes on dividends declared.
- **Allocation of foreign exchange:** in accordance with the Bank of Eritrea, foreign investors may 1) open and operate foreign account in Eritrea; 2) use foreign exchange in their account for the operation of their investments, including

necessary procurements; 3) be granted foreign exchange allocations with priority given to exporters; 4) retain up to 100% of their export earnings in foreign currency.

- **Remittance of foreign exchange:** foreign investors may remit foreign exchange out of Eritrea for: 1) net profits and dividends accrued from investment capital; 2) debt-servicing payments for a foreign loan incurred; 3) fees or royalties in respect of any technology transfer agreements; 4) proceeds received from liquidation of investment and/or expansion; 5) payments received from the sale or transfer of shares.

In addition to these incentives, Investment proclamation No.59/1994 provides guarantees for investors against political risks: “investment and/or expansion allowed under this Proclamation and all property on such investment and/or expansion shall: a) not be nationalized or confiscated; and, b) not be attached, seized, frozen, expropriated, or put under custody by the government except for public purposes and with the due process of law. In the event of expropriation the government is obliged to pay full and fair compensation”(Art.13). In this connection Eritrea has signed the convention establishing MIGA which however covers four non-commercial risks such as: those risks arising from (1) currency transfer; (2) expropriation and similar measures; (3) breach of contract; and (4) war and civil disturbance.

Furthermore, the Proclamation has established the Eritrean Investment Centre (EIC) which is the legal body that approves investment projects, and aims to promote and facilitate investment activities in Eritrea. Another government agency that governs the administration of investment is the Business Licensing Office (BLO), established to create a centralized, “One-Stop”, licensing center to facilitate the speedy formation of business ventures as well as the issuance and renewal of licenses.

As regard to labor law, Eritrea is a signatory country of ILO. Moreover the country has enacted its labor law: the “Labour Proclamation of Eritrea No.118/2001”. Pursuant to art.6

employers are free to employ any jobseeker directly, through the employment services unit of the Ministry or a private employment agency. Further the employer and the employee are free, within the limits of the law, to determine the conditions of labor in a labor contract. For instance, Eritrean law does not require a minimum wage. Investment Proclamation No. 59/1994 further allows domestic and foreign firms to employ expatriates where qualified Eritreans are not available for the job, but they are required to train Eritreans.

Concerning labor rights, art.20 provides that employers are obliged to: “respect the employee's dignity, by taking all the necessary occupational safety, health measures and appropriate measures early on to ensure that all work place do not become a source or cause of hazards to the health and safety of the employees; to bear the cost of medical examination, whenever such medical examination is required by law or the appropriate authority”. Moreover, employers shall not discriminate against women as regards opportunity or treatment in employment and remuneration, on the basis of their sex (Art.65). Also, pursuant to art.86 workers have the right to form and join trade unions. Overtime pay provisions are also provided under the Labor proclamation.

### **5.3 Self-reliance: a basis for a successful development or a self-destructive behavior?**

The Eritrean Self reliance ideology has its roots in the 30 years armed struggle. For the Eritrean government self-reliance was not a choice but a necessity. Self-reliance was part of its survival strategy during its liberation struggle as a rebel with the former Ethiopian Military regime. Whilst the Ethiopian government received international assistance from the world's greatest powers such as US and Soviet Union, Eritrea enjoyed no international support. By relying on classic "peoples war" tactics of strategic withdrawals followed by

sudden, concentrated, overwhelming counterattacks when their enemy was overextended and vulnerable, the Eritrean guerrillas destroyed every Ethiopian offensive.

The term self-reliance is often confused with self sufficiency albeit they are not the same. Self-sufficiency is defined as being able to maintain oneself or itself without outside aid. A self-sufficient country is thus a country that need not depend on other sources to fulfill the needs of its citizens and enterprises. That the country produces all the goods and services it requires without depending on others. Self-reliance, on the other hand, means reliance on one's power, abilities and resources. It implies that the country generates sufficient surplus to buy what it needs and therefore, it does not have to bank upon the loans and aids of outside organizations or countries for resources or funds to acquire them. Further, if self-sufficiency rules out imports, self-reliance allows a country to import, provided it has the capacity to pay for it.

The concept of self reliance has been also defined in the PFDJ charter one year after the *de jure* Eritrean independence:

*“Self-reliance in all fields - political, economic and cultural - is a basic principle. Politically, it means to follow an independent line and give priority to internal conditions; economically, to rely on internal capabilities and develop internal capacities; and culturally, to have self-confidence and develop one's own cultural heritage. Self-reliance does not mean to isolate oneself from the international community. It only means being as independent and self-confident a player as possible in the international community”.*

The basic principle of Eritrea's development strategy is self-reliance hence, the government of Eritrea believes that aid dependency could only worsen the poverty situation in Africa. With regard to this, in an interview with Double Standards President Iseias Afewerki said: *“Helping people is not bad at all as an idea, but using this as a pretext and using the organizations created in that environment for their own ends makes it unacceptable. It's a very complex situation because you get trapped in it: if food aids*

*come in and the population is deprived of even working they will be waiting for hand outs. Waiting for hand outs for years cripples communities, and once communities are crippled, they are so dependent and it becomes an addiction. Governments are subsidized because of this food aid or humanitarian aids, they are not engaged in real production activities, they don't mobilize their own population”.*

Currently, a growing number of scholars and development workers approached this view that aid is failing to bring about the desired change in the developing nation. According to William Easterly, a former World Bank economist, developing countries are imprisoned in the trap of international aid. He categorized foreign donors aid in two groups: “planners” and “searchers”. Planners announce good intentions but don't motivate anyone to carry them out and raise expectations but take no responsibility for meeting them. Contrarily, searchers find things that work and get some reward, and accept responsibility for their actions<sup>6</sup>. Thus, searchers have a much better chance to succeed because they look for bottom-up solutions, by understanding the culture on the ground, providing what the poor need and want, and insisting on accountability as evaluated by effectiveness. Thus, in his view planners, who represent most of the aid agencies, fail because they attempt utopian goals and develop top-down big plans with little input or accountability from those they desire to help. Furthermore, once the financial plan fails, planners began to make aid conditional to free markets, macroeconomic stability and no interference in pricing. However, introducing market from the top down is destined to fail: this because, markets emerge in a spontaneous way adapting to local circumstances and culture and not through reforms designed by others.

This view has been also approached by Kwame Akonor, director of the New York's Center for African Studies and the African Development Institute, who believes that dependence on foreign aids and their conditionality has compromised the sovereignty of African countries. Therefore, African leaders instead of relying on foreign aid, they should take control of their countries' economic destinies and find creative ways to finance

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<sup>6</sup> Easterly, *The White Man's Burden* (2006), p.5



development by harnessing the continent's collective resources for the benefit of their people<sup>7</sup>.

Therefore, given that aid is failing to make any significant change in developing countries, exploring the idea of self-reliance to promote meaningful change in developing countries is gaining consideration. There are a few countries trying to promote self-reliance as a strategy for their countries development. For instance, India after having realized that the vicious circle of foreign aid has dulled India's capacities of domestic effort, promoted self reliance with an active participation of the private sector, and managed to improve its economy. Similarly, Eritrea is taking the road to self reliance with the help of its macroeconomic policy which gives a leading role to the private sector.

According to the U.S. Department of State Office of Foreign Assistance, since 2005 Eritrea has stopped requesting direct aid from US and since 2006 fully stopped taking any aid from third party NGO's supported by US. Nevertheless, Eritrea is one of a few countries in Africa which achieved three of eight Millennium Development Goals (MDGS) ahead the 2015 date. The three MDGs Eritrea has achieved are all health-related: reducing infant child mortality by two-thirds (MDG 4); improve maternal health (MDG 5); and combating HIV/AIDS, Malaria and other diseases (MDG 6). The country managed to create this opportunity despite the unavailability of foreign aid and the sanction passed on by the UN for its alleged involvements with the Somali terrorist groups.

Some argued that by pursuing self-reliance and rejecting aid, Eritrea will risk isolation and lose the positive effect of lasting relations and accumulated knowledge. However, self-reliance is not a synonym of isolation: it is about being able to interact confidently in the international community by relying on your own abilities and potentialities and not consider aids as a secure mean of addressing your concerns. Knowledge and skills can be also gained through trade relations. In light of this, Eritrea expanded its foreign relations portfolio by encouraging foreign firms to invest and creating a business-friendly

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<sup>7</sup> Akonor, Foreign aid to Africa: a hollow hope? [Vol. 40:1071, p.8

environment especially in the mining sector. Infact, more than a dozen companies (especially from China, Canada and Australia), are now investing in the country.

#### **5.4 Lessons from two opposite experiences of an EPLZ in Africa: the cases of Mauritius and Senegal**

##### **Mauritius**

At the time of its independence in 1968, the economy of Mauritius was in poor conditions. However the establishment of the EPZ in 1971, became the engine of the Mauritian fast growth and the country managed to accomplish a great development. Despite its size, the island became Africa's most competitive economy.

The failure of import substitution policies and the concern about a rapidly growing population and mono-commodity export (sugar), renders the establishment of the EPZ necessary<sup>8</sup>.

In return for tax benefits, duty-free imports of raw materials and machinery, free repatriation of capital, the owners of EPZ enterprises agree to export all their products. Furthermore, initially enterprises were not subject to corporate tax for 10 years and income tax on dividends for 5 years. However, later this has been changed: now enterprises must pay 15% corporate tax over the lifetime of the company but there is a compensating increase of income tax exemptions on dividends from 5 to 10 years. The zone also provides firms flexible labour laws.

The Mauritius EPZ is considered an example of a successful EPZ because the country has managed to achieve the primary goals of employment creation, gross and net export increase, attracting FDI and export diversification. Early on, Mauritian EPZs focused on

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<sup>8</sup> Madani (1999), p.72

sugar exports, then expanded to textile and apparel exports in the early 70s as Chinese firms began operations. By 1976, 84 firms had started production. By 1995 the number of firms had dropped back to 481 and employment stood at 80,466 workers or 17.10 percent of the national labor force. The zone firms have also been successful in increasing the gross and net exports of the country. The share of the EPZ in gross exports has grown steadily. In 1986, EPZ gross exports constituted 54 percent of total exports. In 1992 it reached 63 percent and in 1995, 67 percent. The ratio of net exports to exports has also increased from around 22 percent in 1985 to over around 40 percent in 1995. This last statistic points to the fact that a certain degree of backward linkage has occurred, increasing the domestic content of EPZ exports.

The Mauritian EPZ success is due a number of factors. First, its strategic location in the Indian Ocean renders the country particularly suitable as a platform for business between Africa and Asia. Further, the incentive “package” was attractive and abundant skilled workers were available. An efficient industrial policy was also undertaken, with a strong involvement of the government as a facilitator providing a transparent and well defined investment code and stream-lined services. Luck has also played a big role: the country has benefited from a preferential trade arrangement with the European Union (Lome) and the Multi-Fiber Arrangement (MGA). In addition, the country hit upon idea of setting up EPZs “at the right time”: Mauritius was one of the first countries to implement the EPZ concept in modern time, and thus didn’t have many other developing country zones to compete with in order to attract foreign firms<sup>9</sup>

## **Senegal**

The EPZ established in Dakar in 1974 has been considered as an example of an unsuccessful zone. Despite its ambitious intentions and promotional efforts, the zone did not achieve its goals in creating employment, foreign exchange or attracting FDI.

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<sup>9</sup> Madani (1999), p.75

Employment reached a high of 1200 in 1986 to drop back down to 600 in 1990. The incentives provided by the zone were similar to those of its competitors such as: exemption from taxes on corporate income and dividends; exemptions from customs duties and taxes on machinery, inputs and semi-finished and finished goods; and unrestricted repatriation of capital and profits.

There are several reasons for the zone's failure. First of all, the zone suffered from excessive bureaucracy involving different institutions in the country, especially customs. There were also long delays for investors in obtaining necessary permits. Third, rigid and constraining labor regulations made hiring and firing of workers difficult. Furthermore, while the Senegalese hourly wages and salaries were competitive with other countries such as Tunisia and Egypt, local workforce turned out to be unproductive and overly expensive. Factor costs such as energy, water and transportation, were also high. Furthermore, the government did not provide standard rental factory space. It required investors to lease and build their own factories, thus discouraging FDI through imposition of increased business risks.

## 6 Conclusion

As we seen, EPZs can be a valid tool in fostering economic growth in developing countries. In light of this broad goal, industrial policy and backward linkages with the host economy play a key role in the success of an EPZ. Thus, an industrial policy approach using better sequencing and incentives to use local inputs with the encouragement of joint ventures between FDI and local capital should be put in place to provide an environment conducive to the growth of foreign investment, generate employment opportunities, foreign exchange, backward linkages, training and technological spillovers. This will have a significant potential impact on the structural and institutional transformation of developing economies. In line with this, the government of the host country should play the role of facilitator by enabling environment for private sector, and intervene as a regulator to protect the economy as well as vulnerable groups from shocks.

Further, strong backward linkages such as local purchases of goods or services involving subcontracting between foreign and domestic firms, are considered beneficial for sustainable economic development. These are defined as transactions that go beyond one-off relations and involve longer-term relations between firms. In fact, a very large proportion of intra-industry transactions in every country involves linkages in this sense, characterised by sustained exchanges of information, technology, skills and other assets. Linkages are of particular significance to developing host economies, because they provide a means of diffusing valuable knowledge in the economy, through direct flows to the linked firms as well as spillovers to and from the latter.

Furthermore, it has been noted that issues such as labor rights, wages and workers' safety also have an impact in the effectiveness of EPZs performance. Addressing these issues

improves workers' living standards and productivity while reducing absenteeism and labor turnover.

This said, the establishment of an EPZ can be a valid strategy for Eritrea to promote its sustainable economic development. With its strategic location, its natural resources and attractive incentive "package" the country has the potential to be a gateway for trade and investment in Africa, as evidenced by its past performance. However, as EPZs are an established concept that already exists in other countries, the Massawa EPZ (as well as the EPZ in Assab) will have to show its forefeet to be competitive.

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