Corporate value creation, governance and privatisation

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PART III

EMPIRICAL STUDY

Chapter 6

Economic Outlook and Privatisation in Eritrea

6.1 Introduction

As a prelude to the empirical study of the manufacturing enterprises selected, we will describe the macro-economic policies of the government of Eritrea; in particular its privatisation policy and we will study the historical background of the manufacturing industries. This will help us to assess the environment in which the enterprises are functioning and to identify the progress and constraints encountered in privatising enterprises in Eritrea.

In section 6.2, we present the economic background of Eritrea and the economic policies followed by the Government. In section 6.3, we study the profile of the manufacturing industries in general as well as the cases selected for empirical investigation. In section 6.4, we describe privatisation in Eritrea and in section 6.5, we discuss and analyse the main privatisation issues. Finally, in section 6.6, we conclude the chapter by summarising and highlighting the main findings.

6.2 Economic Background and Economic Policies

Economic Background

Eritrea, located in the Horn of Africa, has a population of 3.8 million and an area of about 124,000 square kilometres. In 1997, the GDP per capita was US$ 210 [World Bank, 1998]. Eritrea was liberated on May 24, 1991 and the Eritrean population confirmed its support for independence in a referendum held in April 1993.

The Eritrean economy is largely based on agriculture, which employs about 80% of the population but which is currently contributing 22% to gross domestic product (GDP). According to UNIDO [1995b], the agricultural potential of Eritrea is promising. The western and eastern lowlands, with proper conservation and utilisation of water resources can produce large quantities of food crops as well as raw materials for industrial enterprises.

The manufacturing industries in Eritrea, which are predominantly located in Asmara, primarily produce consumer goods and consist of public and privately owned enterprises. It is expected that the manufacturing industry will use the country's valuable human resources and contribute to Eritrean economic development by strengthening its linkages with agriculture (textiles, food processing and tanneries) and the construction sector (metal and wood industries) as well as by diversifying exports and increasing the country's export earnings [GOE, 1998]. Moreover, Eritrea's strategic location (providing easy access to regional and international markets) is a major advantage for establishing a competitive industrial sector.

Since independence in 1993, the IMF [1998] shows that the Eritrean economy has recovered considerably due to the rebuilding of the infrastructure and an improved availability of essential inputs following major trade reforms. During 1994-96, real GDP growth averaged about 7% annually, and inflation averaged 7% a year. The strong recovery continued in 1997 with real GDP growing by 8%, notably in the construction and manufacturing sectors.

The government of Eritrea is now faced with immense challenges of restructuring. It has to rehabilitate and transform the war-devastated economy, while at the same time it has to lay a sound foundation of its development. The thirty years of war of liberation (1961-1991) from Ethiopian colonisation has affected the infrastructure and industries of Eritrea. After liberation, in 1991-1997, there was a good relation with Ethiopia because in 1991 the socialist government of Ethiopia was overthrown by a liberation movement known as the Ethiopian Peoples Revolutionary Democratic Front (EPRDF). This organisation was an ally of the Eritrean Peoples Liberation Front (EPLF) and both fronts co-operated in the downfall of the previous government of Ethiopia. Seven years of peaceful period gave both countries the possibility to engage in reconstruction and rehabilitation of their economies. However, starting on May 12, 1998, a border war flared up between the two countries and there was severe fighting in May 1998, in February and in March 1999 and in May and in June 2000. The war costed both nations over 100,000 persons and its effect on the economies was devastating.

The government of Eritrea is currently engaged in continuous efforts to set up and strengthen appropriate institutions to implement integrated economic development policies based on principles of a free market economy.

Macro-economic Policy Framework

The overriding national development objective of Eritrea is the creation of a modern technologically advanced and internationally competitive economy within the next two decades. To this end, the macro-policy of the Government aims at the establishment of an efficient, outward looking, private sector-led market economy, with the government playing a proactive role to stimulate private economic activities. In the following paragraphs, we will discuss the tax policy, investment policy and trade and industry policy, which influence the restructuring and privatisation of enterprises.

Tax policy: In 1994, the Eritrean government introduced a new tax system that replaced the then used Ethiopian government tax system. This new tax system narrowed the tax rate structures levied on different sources of income. For instance, the maximum tax rate charged for an incorporated business was 89% in the previous tax law, but this was reduced to 35% in the new tax law. This motivates entrepreneurs to increase their productivity and investments.

Investment policy: The Government issued an investment proclamation (No.18/1991) immediately after the liberation of Eritrea. However, in 1994, the Government replaced this law by a new investment proclamation (No.59/1994). The goal of the Government's new investment policy is to make Eritrea attractive and supportive to local and foreign investment. In order to promote a high level of investment and to assure self-sustaining growth, the government of Eritrea has adopted liberal investment policies. Foreign investment is encouraged in all sectors without restriction related to ownership or capital structure, except in wholesale and retail business and import and export business. Eritrea has no exchange controls for repatriating dividends and capital gains. The Eritrean government views foreign investment and collaboration as an important vehicle by which to supplement its limited supply of production technology, capital and management and marketing skills.

The new investment law introduced a competitive tax regime to encourage investment instead of the concessions in the form of tax holidays authorised in the previous law. According to the World Bank [1994], experiences from other countries show that tax holidays rarely influence the decision to invest: it is the business climate that plays a greater role. However, an interview with a senior officer at the Eritrean Investment Centre revealed that tax holidays do matter. According to him: "*Many neighbouring African countries' investment laws provide tax holidays for investors, but in Eritrea, we are not providing tax holidays and thus, we are not becoming competitive in attracting investors. This is becoming a constraint because if investors have equal opportunity of investing in other African countries, other things remaining the same, they invest in a country with tax holidays.*"

In order to facilitate and attract investments, the government of Eritrea established an investment centre known as Eritrea Investment Centre (EIC). This centre is an autonomous entity empowered with the duties of identifying and assisting investors, identifying and helping in implementing investment projects through consultation and agreement with appropriate bodies, undertaking promotional activities and receiving, studying and deciding on applications for investment projects. The investors have to contact only the Eritrean Investment Centre to find out the outcome of their applications. The centre helps investors to save time and money by providing information at the initiation stage and by contacting appropriate bodies at the time of processing the applications. The following table shows the number, employment potential and capital of the projects approved by the Eritrean Investment Centre during 1992-1997.

Table 6-1 Approved Investment Projects from 1992-1997

	1992	1993	1994	1995	1996	1997	Total
Number of projects	15	36	76	117	179	107	530
Employment potential	428	2,056	1,765	2,143	3,968	4,134	14,494
Capital in (1,000 Nakfa)	46,702	256,391	838,247	525,950	841,568	887,229	3,396,086

Source: based on information received on request by the courtesy of the Eritrean Investment Centre (EIC).

Table 6-1 shows that the number of projects approved increased from 15 in 1992 to 179 in 1996. However, it decreased to 107 in 1997. In 1995 and 1996, local as well as foreign investors were considering Eritrea as having an attractive investment climate. The total 530 projects approved have an employment potential of 14,494 workers and an investment of 3,396 million Nakfa, about 45% of the projects were in the manufacturing sector (see table A6-1 for the sector comparison of the projects approved). An interview with the senior official in the Eritrean Investment Centre also indicated that the largest flow of proposed projects were manufacturing, followed by tourism. Entrepreneurs are mainly investing in the manufacturing of building materials, food processing, plastic and beverages. In the manufacturing sector, the labour cost in Eritrea is cheaper in comparison to that of the Middle Eastern countries and the government provides tax exemptions for exports. Moreover, according to the senior officer of the Eritrean Investment Centre, some of the factors that make Eritrea attractive to investors are investment climate, location, population, resources, an investment guarantee from confiscation, unrestricted remittance of foreign currency and licensing in one day. Eritrea, prior to the present border conflict with Ethiopia, was considered as the most stable and peaceful country in the region. This helped in attracting investors. The strategic location of Eritrea, especially for the Middle East, Europe and Africa, and its proximity to the sea give an advantage for trading locally produced goods in foreign markets. The hospitality of Eritreans to foreigners and their ability to grasp skills quickly is also an asset. In addition, there are several resources that attract investors, like cotton, fruits, hides and skins.

The new law provides investment guarantees to investors that the Government will not nationalise their businesses. In order to enhance investors confidence, Eritrea became member of the Multilateral Investment Guarantee Agency (MIGA) of the World Bank and the Hague International Court of the Settlement of International Disputes (ICSID). However, there is a clause that shows that the Government may expropriate investment for public purposes with due process of law and this may reduce the investor's confidence. The investment law allows entrepreneurs unrestricted remittance in foreign currency of their profits, capital gains and royalty income. Moreover, the new Business Licensing Office issues licenses in one day in Eritrea and there is no prerequisite for the type of business or the amount of capital needed for the formation of the business.

The Eritrean Investment Centre facilitated investment processing, however, there were some obstacles in implementing the approved projects. According to a senior officer in the Eritrean Investment Centre, only 150-180 projects are implemented so far (March 1999) out of the 530 approved projects during 1992-1997. He stated that the obstacles are a lack of land for establishing factories in the cities, the small market of Eritrea and a delay caused by the bureaucracy of customs.

One of the main obstacles is the availability of land for the establishment of businesses. Historically in Eritrea, land has been held communally by the inhabitants of the villages, subject to frequent redistribution, as often as every seven years. The farmers cultivate their plot of land for seven years and after seven years a lottery is drawn and the ownership of the fields is changed for another seven years. Traditionally, only married male inhabitants are allowed to own land. This traditional land holding system poses two problems from the point of view of the government officials. First, they believe that it discourages long-term investments since ownership of land changes every seven years and thus, it does not promote economic development. Second, the traditional land system denies women of land ownership. In order to solve these problems and in order to use land for the promotion of economic development, the new constitution of Eritrea proclaimed that all land, water and natural resources below and above the surface of the territory of Eritrea belongs to the State and usufruct rights of citizens shall be determined by law. However, the long held traditional land holding system cannot be easily changed. The villages in the outskirts of the cities in Eritrea have been traditionally owning and using the land for farming. Due to this, there was a problem of land for establishing businesses. Moreover, the master plan of many cities was not ready during the past seven years; thus, investors were not getting land for the establishment of the approved firms. Consequently, approved projects were not starting and many investors dropped their idea of investing in Eritrea.

Eritrea has also a small market and when there are already similar projects in the market, investors shy from implementing their projects. Moreover, the investors are allowed to import machinery and other capital necessary for establishment of the business at a minimum tax rate of 2%. However, the customs office employees assess the tax to be paid based on their own estimated value of the machinery rather than the actual invoice price. Since their estimate price is high, investors are complaining.

The officers at the Eritrean Investment Centre also collaborate with prospective investors interested in acquiring enterprises to be privatised. Prior to acquisition, they provide investors with information and after acquisition, they provide investors with necessary assistance such as tax exemption for capital investment imports.

Trade and industrial policy: The overall objective of the trade and industrial policy framework is to ensure the long-term integrity of the economy and to promote an efficient economic growth and structural change in the society. Trade policy refers to the direct and indirect government actions and programs that influence development and expansion of trade. The government of Eritrea is committed to pursue an open and liberal trade policy and regional economic co-operation. To encourage rapid expansion of trade and free mobility of capital and people, the Government has eliminated, or substantially reduced, trade barriers. To promote competitiveness in domestic production nearly all restrictions and prohibitions on imports have been eliminated.

The interviews with senior officers in the Ministry of Trade and Industry revealed that the government of Eritrea is working with the governments in other countries in Eastern and Southern Africa to enhance free movement of goods and services. According to Afewerki [2000, p. 5] "*The global trend towards consolidation of larger trading blocs; the economies of scale and synergy offered by a unified or harmonious regional market; a certain degree of complementarity between the economies of these countries (Horn of Africa); and the advantages of institutional consultation and co-ordination to harmonise policies and to jointly address issues of collective security all illustrate the advantages of creating a solid regional organisation.*" Eritrea is a member of both Inter Government Agency for Development (IGAD) and the Common Market for East and Southern Africa (COMESA), and it is actively working to eliminate trade barriers. Both IGAD and COMESA countries have agreed to eliminate all trade barriers between them, and they are encouraging member states to undertake the necessary policy and administrative measures to implement the agreement.

There are also various constraints for trade development in Eritrea. The senior officers of the Ministry of Trade and Industry indicated that a lack of information, product quality, type of business organisation and a lack of modern financial institutions are hindering the development of trade in Eritrea. Eritrea is new and is not yet fully known in the world. On the other side also, Eritrea does not have trade directories and other pertinent information about the rest of the world. The entrepreneurs also do not converse in international languages and do not know the quality and standards required for competing in the world market. In addition, the goods produced in Eritrea are also of low quality. Moreover, there is no culture of organising business in the form of share ownership. The small one-man businesses are becoming a constraint for trade development because the capital and human resources are not co-ordinated and organised to compete in the world market. In addition, the lack of a modern banking system that facilitates trade is hampering it.

Industrial policy includes regulatory measures that affect competition, ownership and the choices relating to technology as well as the basic input/output-mix. The detailed industrial policy of Eritrea has yet to be charted. However, the broad guideline of Eritrea's industrial strategy is aiming at creating an environment that would facilitate efficient expansion of manufacturing output in industries where Eritrea has a comparative advantage. These industries include textile and garments; leather products, general agro-processing, metal fabricating, plastic processing, construction materials and other resource based industries. The unrestricted entry and exit by private firms (both domestic and foreign) is expected to promote competition to ensure that efficient production capacities are created and maintained [GOE, 1999].

6.3 Manufacturing Industries: A Profile

Background

Eritrea has a long history of industry and manufacturing. In the last one hundred thirty years, starting from the acquisition of the Red Sea Coast of Assab by the Rubatino Company (Italian) in 1869 to present, Eritrea has undergone socio-economic and politico-cultural transformations [Haile, 1992]. Manufacturing began first with large scale farming and processing of the agricultural products and with mineral extraction.

Modern industrial enterprises in Eritrea began with the advent of Italians. By the early 1930s, there were over fifty industrial enterprises in Eritrea including five flourmills, two pasta factories, three bakeries, a canned meat factory, two tanneries, a vegetable fibre plant, a button factory, a cement factory, two salt works, a soap factory, an edible oil factory and a liquor factory [World Bank, 1994]. Development of the industries suffered during the early years of the Second World War. After the defeat of Italy in Africa, British and U.S. war needs created conditions that encouraged the revitalisation of Eritrean factories and the establishment of new ones. In 1943, the number of firms increased. The major firms set-up by the assistance of the British military administration were: Meloti Brewery, Marenghi Glass Factory, Maderni Match Factory, Spinilli Boot factory, Mother of Pearl Trocas Shell Industry, De Rossi Domnut Factory and Massawa Salt Company [Haile, 1992]. The revival was short lived, however, due to a number of factors including competition from the export industries of other countries and the lack of reinvestment in Eritrean industries to bolster its competitiveness. The problem was compounded when the British military administration dismantled and sold infrastructure installations in 1945.

During 1950s to mid 1960s, light industries flourished and reached 122 in number. Moreover, they employed 13,351 workers and had a total investment of about 139 million Ethiopian dollars [Haile, 1992]. During mid 1960s to mid 1970s also the number of firms increased to 165 due to the availability of a transport infrastructure, raw materials and mineral deposits and easy access to foreign markets due to the availability of ports. However, the Ethiopian imperial government has restricted the growth of the industries, in particular during the first half of the 1970s. According to Makki [1996, p. 492] *"The Ethiopian imperial state undermined Eritrea's economy by closing down industries abrogating agreements such as one between FIAT and the autonomous Eritrean Government to establish a factory in Decemhare; and cancelling projects involving the generation of hydroelectric power, cotton plantation, and a textile factory in the western lowlands."*

In 1975, the socialist government of Ethiopia (known as DERG) nationalised more than 40 factories in Eritrea. The prospect for industrial development declined because the political climate and the prevailing economic condition did not attract private investors. Although the nationalised enterprises were mismanaged and neglected, Eritrea still retained almost 30% of Ethiopia's industrial production and continued to be one of the most industrialised areas in East Africa [World Bank, 1994]. However, by 1991, Eritrea was a devastated land. According to Africa Research Bulletin [1996, p. 12482] *"Eritrean industry, which made the Italian colony one of the most developed countries in Africa, is now obsolete and functions at only two thirds of its capacity."* Thirty years of war left the country with a per capita income that is one of the lowest in the world. Eritrea, a one time vibrant economy with an industrial base larger than that of Ethiopia, Somalia and Djibouti combined, was left with deteriorated meagre light industries and a devastated infrastructure.

The Ministry of Trade and Industry in co-operations with UNIDO conducts census of the manufacturing industries in Eritrea each year. The surveys show that the manufacturing industries in Eritrea are mainly agro-based and are found in Asmara. In addition, the census covers several factors such as size, ownership structure, employment, gross fixed asset formation, depreciation and others [MTI, 1998a]. In the following paragraphs, we will analyse the ownership profile and employment profile of the manufacturing industries in Eritrea in order to understand the background of the nature of the manufacturing industries that are studied in depth in this study.

Ownership profile: According to the census result, the number of enterprises employing 10 or more persons and in operation during 1997 was 205, out of those 46 are public manufacturing enterprises. The census results show that the public sector plays a dominant role in the manufacturing industry of Eritrea, contributing to about 67% of employment and 72% of gross output (revenue from sales plus other income). This reveals that the Government runs the large (and key) industries in Eritrea. The private sector, however, is just emerging. In the years 1992 to 1997 the contribution of the private sector exhibits an annual increase of 18%, 28% and 53% with regard to number of enterprises, employment and gross output respectively (see appendix A6-2).

Employment profile: According to the census, in 1997 the manufacturing sector employed a total of 14,921 persons, out of which the administrative and technical employees account for about 14% and 5.7% respectively, while production workers including temporary employees account for about 80% of all employees. The composition of the persons that are engaged in manufacturing indicates that there is a high rate of female participation. The 1992-1996 average shows that women employees account about 42% of the total number of employees in manufacturing enterprises though this rate decreased by 3.3% and was 39% in 1997. The high rate of female participation is due to the large number of women working in the manufacturing sub-sector of finishing textiles. In 1997, women employees engaged in the finishing of textiles numbered 2,421 and accounted for about 78% of the total number of employees in the finishing textile sub-sector. They also account for about 41% of the number of women participating in the manufacturing sector as a whole.

The average annual wage of an employee increased from 2,742 Nakfa in 1992 to 5,783 Nakfa in 1997. However, average salary highly varied by occupation status of employees. In 1997, the annual average wages of production workers was 4,729 Nakfa while salaries of administrative employees and technicians were 9,774 and 10,487 Nakfa respectively. The wage and salary rates varied also by sex. In 1997, the average annual salary of male employees was 6,913 Nakfa, while that of female employees was only 4,045 Nakfa.

A Brief Historical Profile of the Selected Cases

Food Industry

Barka Canneries are a merger of three food processing enterprises, which were previously known as SOPRAL, INCODE and SARICE. The main products of the company are canned meat, vegetables and ‘Shiro’ products (chicken peas, lentils and others). During 1975-1991 the factory was state-owned and was administered by the Ministry of Defence. However, in 1991, the government of Eritrea assigned it to the Ministry of Trade and Industry, but later on in 1996 it was reassigned to the Ministry of Defence. The factory employed 669 persons in 1997. The government considers this company as strategic because it produces canned foods for the military and it is not offered for sale.

Alpha Food Products was established by Italian entrepreneurs as a flourmill in 1901 and added manufacturing and bakery in 1944. It was nationalised by the Ethiopian military regime in 1982. Since Eritrea’s independence in 1991, the company has been operating as a state-owned enterprise. In 1996, the Government assigned the factory to the Ministry of Defence, but at the end of 1998 the government offered it for sale. Asmara Food Products had 90 employees on August 31, 1998.

National Edible Oil Factory The origin of this enterprise could be traced back to 1945, when a Greek entrepreneur called Zico started the firm by buying out a number of small and isolated owner-operated oil expellers. He consolidated them and operated them as an integrated business manufacturing edible oil. In 1966, the business was sold to Mr. Boulboulis and his family, who registered it as National Oil Company. The factory’s pressing capacity is 60 tons of oil-bearing seeds per day of twenty-four hours. The primary products of the factory are edible oil, salad oil and butter. The by-products are cotton linter, husk, dust and oil cake and are used for paper manufacturing and animal feed. The main material input is mostly cottonseeds from the Aligheder Cotton Plantation. The factory employed 156 persons in 1997 and it is offered for sale.

Red Sea Flourmills are a merger of three independent entities and a new flourmill established in 1987. These entities are listed in the following table.

Table 6-2 List of the Entities Merged into the Red Sea Flourmills

No	Name	Year of establishment	Initial capital in 1,000 Nakfa	Capacity per day in quintals
1.	Mario Betti	1962	210	210
2.	Kekia	-	-	100
3.	St. George	1969	100	175
4.	Asmara Flour Mill	1987	15,500	1,300

Source: Primary data collected during interviews

The first three organisations listed above were nationalised in 1982. The factory produces wheat flour from imported soft wheat. During 1991-1995, it was administered under the Ministry of Trade and Industry. Afterwards, in 1996, the Government assigned the factory to the Ministry of Defence. The factory employed 184 persons in 1997. The Government considers this company as strategic because it supplies wheat flour to the bakeries in Eritrea. Therefore, it is not offered for sale.

Beverage Industry

Asmara Brewery was established by Mr. Lugi Meloti (Italian) in 1939. It originally produced liquor using rudimentary technology. It then progressed on to the production of beer in 1942. The quantity and quality of beer produced improved and the product lines expanded until 1975. It was brought under government control by the sweeping nationalisation measures of the Ethiopian socialist government in 1975. After Eritrea's independence in 1991, the factory has been managed as one of the state-owned enterprises. The factory produces mainly beer and liquor products; however, it also produces alcohol and corks as well. The main material inputs include malt and molasses. In 1997, the factory employed 452 persons and it is offered for sale.

Asmara Wine and Liquor Factory is a merger of Fenili and Vitale, which were established in 1947. The main products are wines, liquors, syrups and aperitifs. The factory employed 49 persons in 1997. The factory uses raisins purchased from Greece and Turkey and Alcohol form Asmara Brewery in processing wine and liquors respectively. The company is offered for sale.

Red Sea Bottlers Share Company was established in 1964 as the National Soft Drinks Corporation. It started operation using second hand machinery and produced Coca-Cola, Sprite, Fanta Orange and Fanta Tonic. It was nationalised in 1975 and during 1975-1991 sales declined. After independence the government rehabilitated the factory and resumed production, but the obsolescence of machinery and distribution tracks were causing problems. In January 1997, the government of Eritrea and the Coca-Cola Company entered into a joint venture, creating a new company under the name of Red Sea Bottlers Share Company. Since then US$ 13 million has been invested to build a completely new bottling facility, making it one of the most modern Coca-Cola factories in Africa. The new bottling line has a production capacity of 8,000 cases per day in comparison to the 1,500 cases produced by the old bottling line. The factory also added a new product-line, Krest and there are plans of introducing other new flavours. The company employed 175 persons in 1997. The Government of Eritrea is a majority shareholder (55%) and the shares will be offered for sale to the public in the future.

Footwear and Leather Industry

Dahlack Shoe Factory was established in 1964 by Raffaele Bini (Italian). It is the largest shoe manufacturing plant in the country. It produces leather, plastic and canvas shoes and plastic housing utensils. The factory employed 539 persons in 1997 and it is offered for sale.

Deluxe Shoe Factory: Initially, it was established as a tannery in 1963 by three Italians and 36 Ethiopian nationals with a paid up capital of 240 thousand Birr. The two Italian founders, Mario Margeti and Santo Faleta started a footwear industry known as Ethiopian Footwear Factory and merged it with the already existing business. The factory produces leather, plastic and canvas shoes and except for leather the other raw materials are imported. It employed 178 persons in 1997 and it is offered for sale.

Keih Bahri Tannery was established in 1964 by Mr. Baldini and Mr. Lugi (Italians). The main line of business of the factory is tanning hides and skins. The factory obtains its supply of hides and skins from the domestic markets. Since 1966 the tannery has been exporting wet blue hides mainly to Italy and the United Kingdom and providing local footwear factories with shoe-uppers and soles. The factory employed 113 persons in 1997 and it is offered for sale.

Asmara Pickling Tannery was established in 1961 by private investors. It has three main products, pickled sheepskins, wet blue goatskins and lining. The factory employed 105 persons in 1998 and is offered for sale.

Textile Industry

Eritrea Textile Factory is a merger of two companies, Ethiopia Textile Industry and Ethiofile, which were both established in 1964. The company produces cotton yarns, knitted fabrics and garments, cotton wool, sanitary towels and related products. The factory employed 449 persons on August 31, 1998 and it is offered for sale.

Asmara Textile Factory was established in 1954 by Mr Roberto Baratollo (Italian). Initially the unit specialised in producing cotton yarn only. It expanded to gradually integrate the various production steps from spinning, bleaching, winding, knitting and dyeing. Before its nationalisation in 1975, it used to grow all the cotton it needs in the western low lands. It also has a blanket weaving section, a sanitary towel section and a ginning plant. It is the largest textile factory in Eritrea. After independence in 1991, the farm and the manufacturing activities were made two separate entities, each owned and managed by the Eritrean government as separate state-owned enterprises. The factory's main lines of products are the ginning of raw cotton and the manufacture of yarn, cotton fabrics, knitwear, blankets and sanitary towels. The factory employed 2,119 persons in 1997, which is the largest number of workers in a factory in Eritrea, and it is offered for sale.

Lalmba Sack Factory was established in 1964 by Mr. Camerino (Italian). The business purpose of this firm is the manufacturing and selling of different qualities of sacks to hold grain products, coffee, sugar, salt as well as hessian cloth for wrapping purposes and twine for sewing sacks. The main raw material (jute) is imported from East Asian countries. However, the company also uses doum fibre from Agourdet Doum Fibre Plant in Eritrea. It employed 415 persons in 1997 and it is offered for sale.

6.4 Privatisation in Eritrea: Background, Progress, Prospects and Constraints

The government of Eritrea is committed to the process of privatising public enterprises in keeping with its stated policy of promoting private sector led growth. Eritrea's leaders agree that public enterprises will function more efficiently and produce greater output of higher quality goods once they are privatised. The development of a vibrant free enterprise system and the expansion of privately owned firms are among the highest priorities of Eritrea's leaders in order to achieve accelerated economic growth in the future.

Historical Background

Prior to 1975, Eritrea had a flourishing private industrial sector accounting for 40 % of the industrial output of Ethiopia [GOE, 1994, p. 4]. In 1975, the socialist Government of Ethiopia adopted a command economic system and nationalised the large industries in the country. Since Eritrea had been a colony of Ethiopia, the socialist Government of Ethiopia nationalised 41 large manufacturing enterprises (see appendix of the preceding chapter A5-1 for the list of enterprises). During 1975-1991, it deliberately neglected the factories and drained their resources without giving necessary inputs to develop the industries such as new investments in machinery. The regime imposed strict price controls and introduced import restrictions, which further reduced the scope for efficient business operations. The Ethiopian Government policy had been to destroy the value of the Eritrean industries in order to prove that Eritrea is not economically viable and thus, could not be an independent nation. On May 24, 1991, the Eritrean People's Liberation Front (E.P.L.F) freed Eritrea from the serfdom of the Ethiopian colonisation and adopted a free market policy to resuscitate the economy.

At the time of liberation, the government of Eritrea inherited the 41 state-owned enterprises, which were nationalised by the government of Ethiopia and started rehabilitating them. The Government rehabilitated the Eritrean Steel Sheets Factory, which was closed for over 20 years to meet the demand of corrugated sheets for housing roofs. In addition, in 1995, the Government liquidated Denden Glass Works due to environmental problems. The government of Eritrea liberalised trade and prices, reformed its tax and investment policies and started privatisation of public enterprises. In the following, we will discuss the privatisation policy, progress and prospects and constraints of privatisation in Eritrea with an emphasis on the manufacturing sector.

Privatisation policy

Eritrea has opted for an open, private sector led, free market economy. The Eritrean Government, as stated in its macro-policy, is aiming at developing a capital and knowledge intensive and export-oriented manufacturing sector as part of its socio-economic transformation. The Government has been taking necessary policy and other supportive measures to promote, encourage and develop the private sector and to protect its interests. To this end, the Government issued proclamation No. 83/1995 for the establishment of the National Agency for the Supervision and Privatisation of Public Enterprises, hereafter referred as NASPPE, to reduce the number of public enterprises. The objectives of the privatisation policy are increasing the role of the private sector in the economy, accelerating the adoption of new technology and production techniques, and improving the overall efficiency, competitiveness and product quality.

The objectives of NASPPE as stated in GOE [1995, p. 4] are “to privatise public enterprises and until such events, implement an appropriate management policy, function, duties to vitalise, optimise and transform productivity and establish a competitive and conducive economic ambience in all public enterprises for and in the enhancement of their privatisation.” There is a Board of Directors consisting of five members appointed by the President who administer NASPPE. The Board members are all ex-E.P.L.F members. In 1996, The Government divided the 41 state-owned enterprises into three groups: (1) those that are retained by the state as strategic industries; (2) those that are assigned to the Eritrean Peoples Front for Democracy and Justice (EPFDJ the ruling political party) and (3) those that are offered for domestic as well as foreign buyers publicly.

The Government retained four food processing enterprises (Alpha Food Products, Red Sea Flourmills, Decemhare Flourmills and Barka canneries) as strategic and assigned them to the Ministry of Defence. However, the Ministry of Industry transferred Alpha Food Products back to the NASPPE. In addition, the government retained a printing press (Dogali Printing Press) and assigned it to the Ministry of Information for publishing the daily newspapers. The government also assigned a printing press (Adulis Printing Press) to the EPFDJ.

The government assigned a scythe factory (Asmara Scythe Factory), which was non-operating and two meat and milk processing plants which were previously under the Ministry of Agriculture to the NASPPE. In addition, the government assigned the newly rehabilitated doum fibre plant (Agourdet Doum Fibre Plant) to the NASPPE. All in all, the NASPPE owned 39 state-owned enterprises in 1996. At the end of 1996, the Board announced that 39 state-owned manufacturing enterprises were slated for privatisation (see appendix A6-3).

Progress.

After the liberation of Eritrea in 1991, the Government has taken a number of steps to improve the control framework of the public enterprises, and there has been a movement away from the centralised arrangement, which existed before. These include: (i) the disbanding of central marketing organisations so that the enterprises are now responsible themselves for marketing their products; (ii) disbanding of the central planning functions (which determined production targets) so that enterprises are responsible for determining the composition, level and quality of output produced; and (iii) the placing of each public enterprise under a government department. In addition, many enterprises replaced the Ethiopian managers who had left and measures have been taken to deal with the problems of working capital and foreign exchange requirements of the enterprises [World Bank, 1994].

Based on its free market policy, the Government of Eritrea began to sell small co-operative shops in 1993 and liquidated a distribution agency known as Ethiopian Domestic Distribution Corporation (EDDC). This corporation was engaged in distributing goods produced in the country. In addition, it has also returned nationalised housing residences and other buildings to their owners. In the early stages, the Government approached privatisation on a case-by-case basis. To a certain extent, the process was demand driven and investors who could buy the small-scale shops were available locally. The sale of state-owned small-scale firms to private entrepreneurs began in 1993, and by the end of that year all 700 small-scale shops were already privately owned.

The Government faced a more difficult position with regard to larger enterprises in the industrial sector, particularly those with monopoly positions or considered strategically important. However, the sale of large state-owned manufacturing enterprises was delayed till preparation for privatisation was made. In the mean time, in 1995 enterprises were made autonomous and the Government established the NASPPE to administer these enterprises. Managers were responsible for the operating decisions. There was less Government intervention in the routine daily operations of the factory. These first steps have given public enterprises more autonomy in the way they select their business partners, in marketing approaches, and in the setting of prices for their products (although this is still not the case in the food industry).

The Board of Directors of NASPPE started to privatise 39 manufacturing enterprises in 1997 and planned to finalise the sales program by the end of 1997. However, by the end of 1997, only 3 enterprises were sold and thereafter, 15 enterprises were sold, which brought the number of enterprises sold to 18 manufacturing companies in June 1999. Thus, the privatisation process is still going on.

Generally, the Government has been using a direct sales method. Enterprises are auctioned and investors bid for the companies. The Board evaluates the sales price offered and business plans of investors regarding investments, technology transfer and job creation and makes its decision. Usually, companies are advertised in local as well as international newspapers such as the Economist magazine. The bids are open for two months. Moreover, the interview with the Director of NASPPE revealed that the agency directly contacted two previous owners (restitution). According to him: *"The first one said he is not interested in buying back his business while the second one accepted the offer and agreed on the price. However, when the problem of trade with Ethiopia started in November 1997 due to the introduction of the new currency, Nakfa, the entrepreneur dropped his offer."* The following table shows industry-wise the number of companies sold, their sales price and employment as well as the number of enterprises still owned by the state and the number of employees of these companies.

Table 6-3. Comparison of Privatised and State-Owned Enterprises to be Privatised (on June, 1999).

	Privatised SOEs			**SOEs to be privatised**		**Total**	
Sector	N[a]	E[b]	Sales (million Nakfa)	N[a]	E[b]	N[a]	E[b]
Foods	1	62	5	5	849	6	911
Beverages	1	47	8.8	2	627	3	674
Tobacco & Matches	1	136	52.7	1	104	2	240
Textiles & Fibre	2	731	15.2	4	2,513	6	3,244
Leather & Shoe	1	121	5.4	4	964	5	1,085
Metal & Wood Products	8	365	36.4	2	309	10	674
Non-metallic Minerals	-	-		3	600	3	600
Chemicals	4	219	32.7	-	-	4	219
Total	18	1,681	156.2	21	5,966	39	7,647
Percent	46%	22%		54%	78%	100	100

Source: based on information received on request by the courtesy of the NASPPE
a. N represents the number of enterprises
b. E represents the employment number of the enterprises.

The data presented in table 6-3 evidence that the Eritrean Government has sold 18 out of the 39 manufacturing enterprises before July 1999. This is 46% of the total number of manufacturing industries slated for privatisation. The enterprises sold constitute 22% of the total labour force of the industries slated for privatisation. The Government has raised 156.2 million Nakfa from the sales of the enterprises out of this 52.7 million Nakfa (34% of the total sales value) was received from the sale of Gash Cigarette Factory. The other 17 companies were sold for 103.5 million Nakfa. This shows that the enterprises sold are small and in fact, most of the large manufacturing enterprises are still owned by the state.

Sector analysis of the above data shows that the metal and wood products industry and the chemical industry (soap factories) are privatising fast. The buyers can also be categorised into three types (1) foreigners, Coca-Cola company (acquired 45% in Red Sea Bottlers), Rothmans Company (acquired Gash cigarette factory for 100%) and Mr. Bini (acquired Eritrea Shoe Factory with other nationals); (2) Eritreans returning from foreign countries (such as Baroko Company that acquired Mereb Textile Company); and (3) local businesspersons (Erie Bus, Nakfa Corporation and others). Only Gash Cigarette Factory was purchased in full by a foreign investor; the two other companies with a minority foreign investors are Red Sea Bottlers and Eritrea Shoe Factory. The others are sold to Eritreans.

The state still owns 21 large manufacturing enterprises that employ 78% of the total employment of the manufacturing enterprises slated for privatisation. Sector analysis of the above data indicates that food, textiles, leather and shoe and non-metallic minerals (cement, and salt factories) industries are hard to sell.

Prospects and Constraints

Although sales of small and medium enterprises is quick, the sales of large manufacturing enterprises has yet to come. Some companies were already auctioned four times such as Asmara Milk Factory and three times such as Africa Match and Paper Factory, Dahlack Shoe, National Edible Oil and others, but they are not sold yet. They did not attract investors (for instance, Lalmba Sack Factory, Africa Match and Paper Factory, Sembel Household Utensils Factory, Asmara Ceramics and others) or the Government did not accept the buyers’ offer (such as Asmara Milk Factory, Asmara Brewery and others).

The interview with the Director of NASPPE revealed that the agency is facing problems in selling material stocks and in collecting the agreed prices. The Board of NASPPE asks the buyers to acquire the usable stocks at its cost. However, the buyers try to take the stocks that are selling at a higher market price and leave the stocks that are selling at a lower market price. Since the stocks cannot be used for other purposes, the Board is facing problems and the buyers try to force the government to sell at a very low price. In addition, the buyers also delay payment of the agreed price. In order to make the buyers pay on time, the Agency has started charging interest on delinquent payments and has amended the contracts to include a clause which states that contracts can be revoked if payment is delayed.

6.5 Discussion

The macro-policy of Eritrea indicates that the Government is aiming at an efficient private sector-led market economy. The investment policy of the Government also stresses on making Eritrea attractive and supportive to local and foreign investment. However, foreigners are restricted from investing in wholesale and retail and in import and export businesses. These businesses play a vital role in distributing locally manufactured products in the domestic and export markets and in purchasing material inputs needed. As the interview with the senior officer of the Ministry of Trade and Industry indicated, the culture of one-man businesses of the traders and the non-willingness to co-operate and grow in the form of partnerships and share companies is limiting the competitiveness and efficiency of these businesses. Since they are protected from foreign competition, they try to charge higher profit margins from the products of the manufacturing enterprises in Eritrea. This makes manufacturing products less competitive in the domestic as well as in the export markets. Liberalising foreign investment in the wholesale, retail and import and export business may benefit the manufacturing enterprises in Eritrea because it would help manufacturing enterprises in finding export markets and also in purchasing the materials needed as input. Moreover, the threat of foreign competitors would make local businessmen more efficient and would help them to improve their skills by learning from the foreigners.

The historical profile of the manufacturing enterprises selected for this study revealed that at the time of nationalisation some entities were merged and grouped under one company name. For instance, Barka Canneries is a merger of three entities, which were competing against each other prior to nationalisation. Breaking up of conglomerates into smaller units facilitated the sales of companies in the Central and Eastern European countries. Breaking up entities that are integrated horizontally can make companies small and saleable in Eritrea as well.

Most of the manufacturing enterprises did not strengthen their backward and forward linkages with suppliers and customers respectively. In 1970s, Asmara Textile Factory invested in cotton plantation and this helped the company to reduce its material costs and to improve its profitability. Lalmba Sack Factory also started a doum fibre plant to reduce its dependency on imported jute from the East Asian countries.

The privatisation policy listed several methods of selling companies, but in practice the Board of NASPPE is using so far only the direct sales method using auctions, (the joint venture of Red Sea Bottlers Share Company is an exception). As discussed in chapter two of this study, this method helps in getting a strategic investor who will be able to restructure the company after sale. This method is also helpful in selling small enterprises. However, for large enterprises in Eritrea, it is becoming difficult. There is a lack of capital in the domestic markets and the foreigners are less interested in particular in those industries that can generate for exports as in the case of Central and Eastern European countries. The literature reviewed indicated that offering shares of companies could facilitate the selling of large enterprises. Share issue privatisation was successful in countries with developed financial markets, but it is also used in the transition countries of the Central and Eastern Europe. It also helps to make individual participation in companies small when there is a large number of shares and encourages broad participation of the people. The large enterprises in Eritrea can be sold using share floatation where many local as well as foreign investors can participate. However, it requires careful design and institutional building such as strengthening banks and establishing financial markets.

The Government considers food processing enterprises, flourmills and canned food processing enterprises as strategic. These enterprises were established by private entrepreneurs and had been operating as private entities prior to their nationalisation. The experience of privatising industries in the United States shows that contracting-out was used in those industries where the military is the major consumer [Donahue, 1989]. Privatising companies and letting the Ministry of Defence contract their services would have been a better option for these industries in Eritrea as well. Moreover, for enterprises where the privatisation of ownership is not considered the appropriate policy, at least in the short to medium term, a reform option is the privatisation of management. This can take the form of management contracts, leases, or concessions and can result in considerable efficiency gains and facilitate eventual privatisation as discussed in chapter 2.

The government is also assigning companies to the EPFDJ (the single Eritrean political party). The Government has already assigned Adulis Printing Press to EPFDJ and the transfer of Eritrea Textile Factory had also been started. However, the experience of the Central and Eastern European communist countries revealed that a political party involvement was the main problem faced in managing the state-owned enterprises. The political influence on the appointment of managers and on operating the business made the companies less competitive and the government of Central and Eastern European countries are privatising these enterprises to eliminate the political influence and to let companies be managed by the principles of the market. Assigning companies to a ruling political party may hinder the emphasis on a private sector-led economy in Eritrea as well. According to Makki [1996, p. 487] *"The EPLF congress of 1994 called for a formal separation between state and party and several leading members of the government resigned from their government posts in order to direct the EPFDJ. Despite the formal separation, the osmosis between the EPFDJ and the state continues."* According to Africa Business [1997, p. 34] *"The EPFDJ's justification for this extensive involvement is to kick-start the economy and to promote business in areas where there may not be interest or willingness to invest by outside investors. However, a corruption scandal at the end of 1996, in which over 90 people in the EPFDJ's Red Sea Trading Corporation and local businessmen were arrested raises questions of the manageability of these extensive business operations."* The Red Sea Trading Company is still continuing under party ownership and the persons imprisoned are tried for the crime they have committed. Involvement of the EPFDJ in business may hinder competition between the party's enterprises and the private sector.

The Government has established NASPPE to oversee the privatisation and restructuring of the public enterprises in Eritrea. However, the Board concentrated mainly in selling companies and they are political appointees rather than competitively selected managers from the market. The Board of NASPPE meets monthly and its Director, who follows the daily activities of the organisation, works part-time at the agency. The interview with the Director revealed that the agency has a limited budget and that they were not able to fill approved vacancies in the organisation structure. Due to this, the Board is concentrating on selling companies only and there was no attempt made to assess the performance of managers. During the interview, the Director explained: *"The present managers are those who were appointed prior to the establishment of the NASPPE. No* *attempt was done to retrench the managers because we were thinking that the privatisation process would last only one year. Due to this, no attention was paid to the evaluation of managers and no effort was done to retrench them. Even when managers leave for various reasons, no attempt is made to hire new managers. We simply let one department head of the factory serve as an acting manager."*

6.6 Conclusions

The Eritrean economy is largely based on agriculture and the manufacturing industries are mainly agro-based. The Government aims at the establishment of an efficient outward looking, private sector-led market economy. The Government also issued a liberal investment policy, though it restricts wholesale and retail trade as well as imports and export business to local businesspersons only. Liberalising this restriction may help manufacturing enterprises to get skilled foreigners who can find export markets and who can import material inputs at a competitive price. The Eritrean Investment Centre approved several projects during 1992-1997, which could double the employment in the industrial sector in Eritrea. However, many projects were not implemented due to a lack of land assigned for establishment of industry. The facilitation of the preparation of the master plans of the cities can increase the implementation of the number of new investment projects approved. The membership in various regional organisations such as IGAD, COMESA and others can help manufacturing enterprises in Eritrea, to find export markets, though the profit margin they can charge in the participating countries will be low due to the purchasing power of the consumers in those markets.

The analysis of the progress of privatisation in Eritrea revealed that the government had a plan of completing privatisation in one year in 1997, but only 3 enterprises were sold in that year. In 1998, an additional number of 15 enterprises-most of them small and medium manufacturing companies-were sold. In June 1999, the government still owned 21 enterprises (most of them large manufacturing companies). The experience of Eritrea also shows that small enterprises are easily sold because there are local investors who can afford to buy them while the selling of large enterprises is difficult. This evidences that privatisation of large manufacturing enterprises where there is a weak private sector such as in Eritrea is difficult. Moreover, similar to the experience of the Central and Eastern European transition countries, the experience of Eritrea also showed that privatisation has so far attracted only limited foreign investments. The foreigners who purchased enterprises, moreover, bought mainly companies that have domestic markets rather than those oriented towards exports.

The Board of NASPPE is selling companies mainly by using the direct sales method of an auction. The use of other methods such as share floatation can help in selling large enterprises because several investors can own shares and this broadens the participation of local people. However, it requires a careful design and institution building such as banks and financial markets.

The assignment of enterprises to the Ministry of Defence and the EPFDJ (a political party) may hamper private sector-led growth in Eritrea. With regard to food processing enterprises retained by the state as strategic companies, it is better to follow the experience of the USA, selling them to private owners and contracting-out their services. In addition, the historical profile of the cases selected revealed that some enterprises such as Barka Canneries, Red Sea Flourmills, Asmara Wine and Liquor Factory and Eritrea Textile Factory are mergers of two or more businesses, which were previously competing against each other. Restructuring these horizontally integrated companies into smaller units in Eritrea may also help in making companies small and consequently facilitate sale.

Though the Government entrusted NASPPE to transform the productivity of the enterprises and to enhance their privatisation, the Board of NASPPE did not restructure enterprises. It is selling them “as they are”. The Director of NASPPE during the interview commented: “*We are offering the state enterprises at a very cheap price to attract buyers.*” He also indicated that the NASPPE is understaffed and under-funded. Such a weak institution is thus likely to hamper the restructuring of enterprises during transition.