Investment Laws in Eritrea

Mengsteab Negash[†]

[†] Visiting Lecturer in Law, The University of Wisconsin; former Head of Law Program 1993-96, University of Asmara. LL.M. 1978, Patrice Lumumba People's Friendship University; LL.M. pending 1997, University of Wisconsin; S.J.D. expected 1998, University of Wisconsin.

I. Introduction

The state of Eritrea was founded during the European colonial period. Prior to colonization, a number of kingdoms existed in the territory where present-day Eritrea is located.[1] Eritrea's strategic location on the west coast of the Red Sea and its natural resources were some of the main factors that attracted colonizers from Europe as well as from the African continent.[2] Italy, in the nineteenth century, invaded the area and issued a decree in 1890 declaring the territory as its first colony in Africa and naming it Eritrea.[3] During World War II, the British defeated the Italians in the Horn of Africa and established a protectorate over Eritrea.[4] Following a United Nations recommendation in 1950, Eritrea federated with Ethiopia in 1952.[5] In 1962 Ethiopia unilaterally abrogated the federal status and annexed Eritrea, turning it into one of its fourteen provinces.[6] The armed struggle for Eritrea's independence began in September 1961 and lasted for 30 years. In May 1991 the Eritrean People's Liberation Front defeated the

[1] *See* HAGERAWI CHARTER, ERITREAN PEOPLE'S LIBERATION FRONT, 3D CONG. 4 (1994); KENNEDY TREVASKIS, ERITREA: A COLONY IN TRANSITION: 1941-52 4-11 (1975).

[2] TESFA G. GEBREMEDHIN, BEYOND SURVIVAL: THE ECONOMIC CHALLENGES OF AGRICULTURE & DEVELOPMENT IN POST-INDEPENDENCE ERITREA 1 (1996). Eritrea has an area of over 125,000 kilometers, including over 1000 kilometers of coastline and over 300 islands. *See id.*

[3] *See* HAGERAWI CHARTER, *supra* note 1, at 4; GEBREMEDHIN, *supra* note 2, at 2; YEMANE MESGHENNA, ITALIAN COLONIALISM: A CASE STUDY OF ERITREA, 1869-1934: MOTIVE, PRAXIS AND RESULT 1 (1988).

[4] *See* TREVASKIS, *supra* note 1, at 18.

[5] *See* G.A. Res. 390(V), U.N. GAOR, 5th Sess., Supp. No. 20, U.N. Doc. A/1775 (1950).

[6] Araia Tseggai, The Economic Viability of an Independent Eritrea 85-86 (1981), (unpublished Ph.D. dissertation, University of Nebraska-Lincoln) (on file with the University of Nebraska-Lincoln Library).

Ethiopian occupation army, and took full control of Eritrea. This action was followed by an internationally supervised referendum in which the Eritrean population voted overwhelmingly for independence. Eritrea formally declared its independence in May 1993.

The generation-long war for independence has left the Eritrean economy, infrastructure, and human resources in a state of ruin.[7] Traditional patterns of social behavior are also responsible for perpetuating backwardness. Further, recurrent drought has contributed to the poverty.[8] As a result of these conditions, Eritrea has become one of the poorest countries of the world.[9] Since the country was forced to start building its economy from scratch, it is currently in the midst of national reconstruction.[10]

The economic rehabilitation, reconstruction, and development have been difficult tasks to accomplish.[11] The main constraints in this process are lack of capital, technology, and skilled manpower.[12] To remedy these problems, the government of Eritrea has designed a policy to mobilize these resources.[13] The policy identifies domestic and foreign sources for capital accumulation as well as for development of technology and skill.[14] Moreover, the policy calls for legislation encouraging private investment.[15]

This article analyzes the investment law of Eritrea, which is designed to create a climate conducive to the development of the private sector. Part II summarizes the economic history of Eritrea under Italian, British, and Ethiopian rule in order to provide background to the present economic situation of the country.[16] This Part also describes the economic situation in the aftermath of the

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7 *See* GOV'T OF ERI., MACRO-POLICY 2-3 (1994) [hereinafter MACRO-POLICY].

8 *See id.* at 4.

9 POPULAR FRONT FOR DEMOCRACY AND JUSTICE, FIRST CONFERENCE, GOVERNMENT AND ECONOMIC DEVELOPMENT IN ERITREA 1 (1995).

10 *See* MACRO-POLICY, *supra* note 7, at 2.

11 *See id.* at 12.

12 *See id.*

13 *See id.*

14 *See id.* at 16-17.

15 *See id.* at 14-16.

16 *See infra* notes 25-119 and accompanying text.

liberation war and explains the short and long-term policies and strategies of the government for rehabilitation, reconstruction, and development of the national economy.[17] Further, it analyzes the role of the public and private sectors of the economy.[18] The author attempts to show the comparative advantage for Eritrea's economic growth by presenting conflicting views of Eritrean experts and the position taken by the government.[19]

Part III analyzes the legal and institutional framework designed to encourage domestic and foreign direct investment in order to foster economic development.[20] This Part discusses the legal and judicial system of Eritrea as an introduction to the private investment laws operating in the country.[21] Further, it discusses the objectives of the Investment Proclamation No. 59/1994, the incentives and guarantees it offers to attract investors, the institutions responsible for implementing it, and the dispute settlement mechanisms.[22] Additionally, Part III discusses other laws considered important to investors.[23]

Part IV provides a brief summary and concludes that the legal and institutional framework being developed in Eritrea represents an effective means for implementing the government's policy to attract private investors.[24] It should be noted, however, that Eritrea is a newly emerging state, and it is too early to gauge the actual effects of its policies and laws. Moreover, there are no data available as the government's central statistics department is still being organized, and the other departments have not yet developed agencies for statistical analysis.

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17 *See infra* notes 120-92 and accompanying text.

18 *See infra* notes 209-15 and accompanying text.

19 *See infra* notes 193-208 and accompanying text.

20 *See infra* notes 216-499 and accompanying text.

21 *See infra* notes 216-43 and accompanying text.

22 *See infra* notes 244-499 and accompanying text.

23 *See infra* notes 387-97 and accompanying text.

24 *See infra* notes 500-27 and accompanying text.

II. Economic History and Development Policy

A. Italian Rule

The primary objectives of the Italian colonialists were to exploit the raw materials of the colony of Eritrea and to make it a market for Italian manufactured goods.[25] The Italians also planned to provide land for the Italian surplus population, mainly people from southern Italy who were demanding land reform.[26] Thus, after bringing Eritrea fully under their control, the colonizers quickly moved to assess its economic potential and its suitability for settlement.[27]

As a result of this assessment, the colonizers decided to reserve the Eritrean highlands for Italian settlement because of the prime location; the land was described "as having adequate rainfall, fertile soil, and a healthy climate."[28] Between 1893 and 1895, an area of 412,892 hectares, which is over one-fifth of the colony's total arable land, was confiscated under various decrees.[29] Ultimately, the agricultural program in the highlands failed; thus, the policy of confiscation was consequently discontinued.[30]

Among the reasons causing the change in policy were the opposition by the indigenous population to expropriation of their property and the new intention of the Italians to involve the Eritrean farmers in increasing agricultural productivity for the benefit of the colonial power's market.[31] Consequently, land was given on a concessionary basis to Italian investors, and the colonial authorities encouraged the indigenous population to produce cash crops for Italy by distributing plants and by providing other assistance.[32] The sole policy of the colonizers was

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25 *See* Tseggai, *supra* note 6, at 101-02.

26 *See id.* at 98-99 (citing Richard Pankhurst, *Italian Settlement Policy in Eritrea and its Repercussions, 1889-96*, *in* BOSTON UNIVERSITY PAPERS IN AFRICAN HISTORY, vol. 1, at 128 (Jeffrey Butler ed., 1964)).

27 *See* MESGHENNA, *supra* note 3, at 18; Tseggai, *supra* note 6, at 62-64.

28 MESGHENNA, *supra* note 3, at 93.

29 *See id.* at 101.

30 *See id.* at 112.

31 *See* TREVASKIS, *supra* note 1, at 40.

32 *See id.*

to produce cash crops; nothing was done to encourage the production of food despite Eritrea's deficiency and dependence on imports.[33] However, the objective of large scale production of cash crops was not achieved to the extent of the colonizers' design because the colonial authorities failed to attract the expected public and private Italian capital.[34]

In contrast to cash crops, livestock, which has traditionally been one of the principal sources of wealth in Eritrea, flourished.[35] The Italians provided veterinary service to combat animal diseases, and, as a result, the livestock doubled in quantity between 1905 and 1940.[36] Despite the significant increase in the quantity of livestock, little was done to exploit the country's potential wealth in animal by-products.[37]

The Italians also made considerable efforts to explore mineral and oil deposits.[38] They discovered gold, iron ore, copper, magnesium, nickel, and other minerals.[39] The colonial government focused most of its efforts on mining gold to be exported to Italy.[40] The total amount exported is unknown.[41] Non-metallic minerals such as salt and potash were also exported to Italy in large quantities and occupied an important place in the trade between the colonial power and the colony.[42] Interestingly, an estimated 200 million tons of iron ore were found, but the Italians do not seem to have extracted this mineral.[43]

Additionally, the Italians developed light industry in Eritrea–

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[33] *See id.*

[34] *See id.* at 42 (noting that during Italian occupation imports exceeded exports by 50%).

[35] *See id.* at 38.

[36] *See id.* at 39.

[37] *See id.*

[38] *See id.* at 41; RICHARD SHERMAN, ERITREA: THE UNFINISHED REVOLUTION 15 (1980).

[39] *See* SHERMAN, *supra* note 38, at 15.

[40] *See id.*

[41] *See* MESGHENNA, *supra* note 3, at 170.

[42] *See id.* at 190.

[43] *See id.* at 170 (noting that the only mineral for which there is definitive data of Italian exploitation is gold).

namely, tobacco processing, meat canning, and button manufacturing plants, and cement, salt, and potash factories.[44] However, the Italians never developed industrial enterprises in Eritrea that might compete with Italian industries.[45]

The colonial power greatly benefited from its trade with the colony by adopting a protectionist policy.[46] Italy imposed an ad valorem tax at the rate of eight percent or more on foreign products entering Eritrea while exempting its own goods coming into the colony.[47] Italy also applied a quota system and used price discrimination in its trade with the colony.[48] Under this system goods imported from Italy to Eritrea were sold at higher prices than goods from other countries.[49] Conversely, Eritrean goods were sold at much lower prices to Italy than to other places.[50] The exports to Italy included cotton, coffee, tobacco, citrus fruit, sisal, cereals, fish, salt, potash, and gold.[51] Imports to Eritrea included foodstuffs, textile, chemical, metallic, and woodwork products.[52]

Establishment of a transportation network was perhaps the most urgent task for the Italians; without such a network, the establishment of authority and maximization of exploitation of raw materials of the colony was unthinkable. Thus, they built a railway of approximately 518 kilometers.[53] This railway network connected mineral-rich areas with the highlands, reserved for Italian resettlement, and with the most fertile areas of the colony's western lowlands near the Sudan border.[54] The railway linked all of these economically strategic places with the Red Sea Port of

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44 *See* Tekeste Negash, *Italian Colonialism in Eritrea, 1882-1941: Policies, Praxis and Impact*, 148 STUDIA HISTORICA UPSALIENSIA 1, 44 (1987).

45 *See* TREVASKIS, *supra* note 1, at 36.

46 *See* MESGHENNA, *supra* note 3, at 153.

47 *See id.* at 157.

48 *See id.* at 192-98.

49 *See id.* at 197.

50 *See id.* at 154 (citing the decree by the Italian Parliament to exempt Eritrean imports to Italy from any duties).

51 *See id.* at 187-92 (charting the trade between Eritrea and Italy).

52 *See id.*

53 *See* Tseggai, *supra* note 6, at 110.

54 *See id.* at 106.

Massawa, paving the way for raw materials to be shipped to the colonial country.[55] Further, the main trading centers of the colony were linked with seasonal and all-weather roads.[56] The road construction was intensified in the 1930s as part of Italy's preparation to occupy Ethiopia.[57]

The Italians looked on Eritrea as an entrepôt for transit trade with countries neighboring Eritrea such as Ethiopia, the Sudan, and those in the Arabian Peninsula. Eritrea absorbed a large amount of Ethiopian exports.[58] Further, imports from Ethiopia and from the Arabian Peninsula were exported overseas through the Eritrean Port of Massawa.[59]

The colonizers also used Eritrea as a staging post to occupy other countries of Africa.[60] For example, Italy recruited over sixty thousand Eritrean soldiers to assist in the occupation of Ethiopia.[61] The resulting loss of forty percent of the active labor force lead to a scarcity of labor in the countryside and to a reduction in agricultural production in the colony.[62] The military preparation for the invasion of Ethiopia did provide benefits to Eritrea through the rapid growth of a war economy.[63] Public buildings, workshops, depots, warehouses, offices, shops, blocks of flats, villas, and encampments were rapidly built.[64] New roads were also constructed, and old ones were improved.[65] The Port of Massawa was linked with the capital, Asmara, by one of the longest roadways in the world: 71 kilometers long with a loading capacity of 720 tons per day.[66] The port itself was also improved and

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55 *See id.* at 106-09.

56 *See* GEBREMEDHIN, *supra* note 2, at 60.

57 *See* Tseggai, *supra* note 6, at 113-16.

58 *See* MESGHENNA, *supra* note 3, at 159.

59 *See* Negash, *supra* note 44, at 41.

60 *See id.* at 102.

61 *See id.*

62 *See id.* at 55.

63 *See* TREVASKIS, *supra* note 1, at 36.

64 *See* GEBREMEDHIN, *supra* note 2, at 60-61.

65 *See id.*

66 *See* Tseggai, *supra* note 6, at 121.

enlarged.[67]

The Italian economic activities and military mobilization led to urban development and social change in Eritrea. Peasants and nomads from all over the territory were transformed into low-level office clerks and wage earners in plantations, industries, and construction.[68] Thousands became urban dwellers as cities and towns emerged, expanded and linked by all-weather and seasonal roads, as well as by a railway network.[69] Additionally, electric power stations, sewage systems, water supply networks, and hospitals were built.[70]

Despite these advances the colonial education policy was particularly harmful to the colony's future. Education was provided to only a small percentage of the population and did not extend beyond grade four.[71] The purpose of this educational policy was to produce low-paid office workers, such as interpreters, clerks, telephone operators, and postmen, for the colonial administration, while at the same time suppressing the intellect and the growth of national consciousness of the Eritreans.[72]

Generally, Italian colonialism was oppressive.[73] It was based on a racist policy, and it highly exploited Eritrean labor.[74] Notwithstanding the oppression, the Italian colonial rule did create an Eritrean identity from nine distinct ethnic groups.[75]

B. British Rule

When the British defeated Italy and took over Eritrea in 1941, the Eritrean economy was at a standstill because of the war.[76]

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[67] *See id.* at 115-21.

[68] *See id.* at 127.

[69] *See id.* at 105-15 (discussing the growth of the transportation systems).

[70] *See id.* at 132-34.

[71] *See id.* at 123-24.

[72] *See id.* at 127.

[73] *See* ROBERT MACHIDA, ERITREA: THE STRUGGLE FOR INDEPENDENCE 20 (1987).

[74] *See id.* at 27.

[75] *See* JAMES FIREBRACE & STUART HOLLAND, NEVER KNEEL DOWN 18 (1984) (discussing the creation under Italian Rule of "a distinct national identity in Eritrea which was to become the basis for future demands for nationhood").

[76] *See* TREVASKIS, *supra* note 1, at 39.

Italian-subsidized enterprises had closed down, and Italian imports had ceased, resulting in thousands of unemployed Italians and Eritreans.[77] At the same time, the British were caught in the battles in the Middle East with the German forces under the command of Field Marshal Rommel.[78] They determined it was more advantageous to wage war from Eritrea rather than from Palestine, the Sudan, or Kenya.[79] Some of Eritrea's advantages included: (1) it was out of range of German aircraft and yet only three days' safe sailing from Egypt; (2) it had a modern port at Massawa and excellent internal communications; (3) the highlands offered congenial climate for the Europeans; (4) it had abundant equipment and raw materials; and (5) the territory had neglected local resources and a labor force of high quality. The British were clever in exploiting these resources, and they did so mostly with American aid.[80] The Americans built an aircraft-assembly plant and an ammunition depot; they also established a naval base at the Red Sea port of Massawa and "modernized the commercial harbor."[81] For their part the British built aircraft repair and maintenance shops and hospitals in Asmara.[82] All of this was done to support the war effort. A by-product, however, was the economic boom in the territory. The projects created jobs that increased the purchasing power of the population, which, in turn, lead to the revival of former light industries and the emergence of new ones.

During this early period, before the end of the Second World War, hundreds of factories were either built or kept running, bringing even more Eritreans into the workforce. Furthermore, there was a market for Eritrean goods in the Middle East, which was cut off from Europe by the war, thus creating a scarcity of trade. But this war-based growth of the economy only lasted for a short period, from 1943 to 1945.[83] As peace returned to the world,

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77 *See id.* at 37.

78 *See id.*

79 *See id.*

80 *See id.*

81 *Id.*

82 *See id.*

83 *See id.* at 38.

Eritrean products could not compete with goods from Europe.[84] Thus, factories closed because machines could not function due to the lack of repair and spare parts, and thousands of Eritreans were unemployed. Mining and fisheries industries also deteriorated.

Crop production, however, showed considerable growth during the British occupation, mainly due to the return of ex-soldiers to their land.[85] Moreover, efforts were made by the British Military Administration to increase production in milk, fruits, and vegetables in order to secure a supply to the European populations in the Eritrean cities and towns.[86]

While the British geared the economy of Eritrea to their war needs, another economic policy stemmed from the transient nature of the British occupation of the territory.[87] The British did not commit themselves to major public investments but looked for means to increase revenues for their administration.[88] As one commentator observed, "Since they had no reason to subsidize an occupied territory, for which they are care-takers, . . . they had to sort the problem by resorting to every reasonable means of increasing revenue and reducing expenditure."[89] The British achieved these objectives by measures such as increasing taxes and imposing new fees on the Eritrean population and raising rates of duties on imported goods.[90]

The British developed a third economic policy after the Second World War. They began to work out a plan to partition Eritrea by incorporating the Moslem-populated western part into the British-ruled Sudan and incorporating the remaining territory into Ethiopia.[91] The British justification for their plan was to portray the future independent Eritrea as economically non-viable.[92] To bolster this contention, they began to destroy its economy. They

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84 *See id.*

85 *See id.* at 40.

86 *See id.* at 39-40.

87 *See* Tseggai, *supra* note 6, at 146-47.

88 *See id.* at 147-48.

89 TREVASKIS, *supra* note 1, at 44.

90 *See* Tseggai, *supra* note 6, at 148-49.

91 *See id.* at 149.

92 *See id.* at 149-50.

"removed or sold an estimated £86 million worth of industrial plant and equipment, including port facilities at Massawa and Assab, factories producing cement, potash, [and] salt, and railway equipment."[93] The sales were made to the Sudan, Saudi Arabia, Egypt, Yemen, Malta, Israel, Italy, and Pakistan, among others.[94] The dismantling of the plants and equipment, together with tax increases, led to economic crises and unemployment, thus adding fuel to the political consciousness and the formation of political parties with agendas for the country's future.[95]

C. Ethiopian Rule

1. Federation Period (1952-1962)

On December 2, 1950, the United Nations decided to incorporate Eritrea into Ethiopia under Resolution 390(V).[96] The Resolution extended federal government jurisdiction to matters such as defense, foreign affairs, currency and finance, foreign and interstate commerce, interstate communications, and ports.[97] 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.[98] But Ethiopia was determined to abrogate the autonomous status of Eritrea and to make it one of its provinces.[99] It argued that Eritrea was poor and that Ethiopia was rich and bountiful; thus, complete union, not federation, would make Eritrea prosperous.[100] After the British Administration left in 1952, Ethiopia enacted its own policy, weakening the Eritrean economy as part of the annexation process.[101] First, Ethiopia acquired the Eritrean government's revenues from customs, and Emperor Haile Selassie granted tax

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93 FIREBRACE & HOLLAND, *supra* note 75, at 18.

94 *See* Tseggai, *supra* note 6, at 151-52.

95 *See id.* at 150-53.

96 *See* G.A. Res. 390(V), *supra* note 5.

97 *See id.*

98 *See id.*

99 *See* Tseggai, *supra* note 6, at 158.

100 *See id.* at 158-61.

101 *See id.* at 153-61.

reprieves to Eritrean farmers.[102] These measures deprived the autonomous Eritrean government of the sources of revenue needed for its budget, thus paralyzing its economic power.[103] Second, enterprises were asked to relocate to Ethiopia. Several key industries were closed and moved to Addis Ababa, the capital of Ethiopia.[104] Their foreign owners were instructed to make the move or have their property confiscated.[105] Moreover, foreign investment in Eritrea was discouraged.[106] Third, enterprises that continued to operate in Eritrea stagnated due to lack of basic supplies and infrastructure, such as electricity.[107] These economic policies not only forced many foreign businesses to emigrate to other countries, but also left thousands of people unemployed and caused others to emigrate. In 1958 these policies resulted in the largest workers' strike in the history of Eritrea in which about five hundred workers were killed or wounded.[108]

2. After Annexation (1962-1991)

For Ethiopia, occupying Eritrea was not an end in itself. Its ultimate objective was to take its natural wealth, to exploit its comparatively developed economic resources and skilled manpower, and to gain access to the Red Sea.[109] This process was accelerated after annexation when Eritrea lost its autonomous status and fell under the complete control of Ethiopia, becoming one of its fourteen provinces.[110] There were over seven hundred enterprises in Eritrea before annexation, but this number continued to decline during annexation due to the relocation of the enterprises to Ethiopia.[111] In fact this was the main policy of the Addis Ababa government during the early years after

[102] *See id.* at 155.

[103] *See id.*

[104] *See id.* at 155-56.

[105] *See id.* at 156.

[106] *See id.* at 155-56.

[107] *See id.* at 156.

[108] *See id.*

[109] *See id.* at 161-67.

[110] *See id.*

[111] *See id.* at 161-66.

annexation.[112] Those who remained in Eritrea were forced to sell their shares to members of the Ethiopian Royal Family and to other high ranking government officials, and the businesses were converted into joint ventures.[113] Further, the enterprises were encouraged to produce the exportable goods necessary for foreign exchange earnings and goods that did not exist in Ethiopia.[114]

The Ethiopian government was also quick to use the strategic location of the Red Sea for the economic development of the central parts of Ethiopia and for its trade with the outside world.[115] With the help of the Soviet Union, the government built a petroleum refinery at Assab.[116] Ethiopia also gave licenses to foreign companies for petroleum exploration in the Red Sea area and encouraged the fishing industry.[117] Concurrently, thousands of skilled Eritrean workers emigrated to Ethiopia and other neighboring countries as many economic activities were shifted to Ethiopia.[118]

In short, Eritrea subsidized the development of the modern capitalist sector of the Ethiopian economy. The archaic feudal economy of Ethiopia experienced an unprecedented transformation after it incorporated the modern sector of the Eritrean economy, while the Eritrean economy faded away as a result.[119] As the war for the independence of Eritrea intensified, the economy suffered even more. After the Ethiopian military overthrew the Emperor in 1974, it brought the main industrial plants, financial institutions, and transportation services under its control. The policy of command economy and neglect, combined with the scorched earth policy of the military regime, led to the continuing decline and destruction of the Eritrean economy. To make matters worse, Eritrea was repeatedly hit by devastating droughts during the 80s and early 90s.

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112 *See id.* at 166.

113 *See id*. at 162-63.

114 *See id.* at 163-64.

115 *See id.* at 164-65.

116 *See id.* at 165.

117 *See id.* at 164-65.

118 *See id.* at 166.

119 *See id.* at 161-66.

D. Post-Independence Economy

1. Aftermath of the War

The war for independence left the country's economy, infrastructure, and human resources in ruin. Water, electricity, and telephone systems barely functioned.[120] The asphalt roads were so devastated by heavy military vehicles that they became useless for any meaningful economic activity.[121] The railway was completely dismantled; during the war the rails were used to build trenches in the frontlines.[122] Further, "port facilities of Massawa, the country's main outlet to the sea, were badly damaged by heavy bombing."[123] The few light industries that continued to operate in the country had not been maintained for twenty-five years[124] and, thus, operated at an average of twenty to thirty percent capacity.[125] As a result the number of unemployed persons in the urban areas exceeded thirty percent of the active labor force.[126] Moreover, the monetary and financial system was virtually obsolete, consisting only of branches of the Ethiopian system.

Meanwhile, the drought throughout the 1980s posed a continuous threat of famine.[127] As a result eighty-five percent of the population relied solely on donated aid for their food source.[128] The country's Gross Domestic Product (GDP) per capita was estimated at between \$70 and \$150, well below the estimated \$330 GDP of other sub-Saharan African countries.[129]

The Eritrean people themselves also embodied the destitute

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[120] *See* Dan Connell, *Eritrea: Starting from Scratch*, MONTHLY REV., Sept. 1995, at 29, 32.

[121] *See id.*

[122] *See id.*

[123] *Id.*

[124] *See id.*

[125] *See* President Isaias Afwerki, The Business Environment and Private Investment Opportunities in Eritrea, Opening Statement to the Conference on Commercial and Investment Opportunities in Eritrea 3 (Dec. 10, 1996) (transcript on file with author).

[126] *See* Connell, *supra* note 120, at 32.

[127] *See id.*

[128] *See id.*

[129] *See id.* at 33.

conditions of the country. The country inherited an adult illiteracy rate of eighty percent.[130] The destructive policy pursued by the Ethiopian rulers over the thirty-year war and the persistent drought forced many Eritreans to flee their country and live in exile abroad, half of them in squalid camps in neighboring Sudan.[131] Further, there were nearly 100,000 internally displaced persons and 60,000 freedom fighters to be demobilized.[132]

Eritrea also suffered significant environmental damage from the war and severe drought.[133] In the 1920s thirty percent of the country was covered with forest and woodlands.[134] In contrast, at the end of the war, it was estimated that forests covered less than one percent of the total land area.[135]

As shown by these economic and social indicators, Eritrea has become one of the poorest countries in the world. Along with the damage done to the economy and society, the country inherited obsolete institutions and weak instruments geared to a command economy. As a result "the Eritreans now have to design everything from passports, drivers' licenses, and postage stamps to telecommunication systems, school curricula, road and rail networks and tax policies. In effect, they are creating a country from scratch."[136]

2. Recovery and Rehabilitation Program

Following liberation in May 1991, the provisional government of Eritrea launched a program to rehabilitate the economy and the society devastated by decades of war and recurrent drought.[137] The program "covered the restoration of essential agricultural and industrial activities, the repair and rehabilitation of infrastructure,

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130 1 WORLD BANK, ERITREA: OPTIONS AND STRATEGIES FOR GROWTH 4, xi (1994) (REP. NO. 12930-ER).

131 *See id.* at ii.

132 *See id.*

133 *See* GOV'T OF ERI., NATIONAL ENVIRONMENTAL MANAGEMENT PLAN FOR ERITREA 58-59 (1995) [hereinafter NATIONAL ENVIRONMENTAL PLAN].

134 *See id.* at 58.

135 *See id.*

136 Connell, *supra* note 120, at 33.

137 *See* MACRO-POLICY, *supra* note 7, at 10.

the restoration of community assets such as schools, clinics, water systems, agricultural, tools, livestock, etc., and the building and strengthening of institutional capacity."[138] This program required billions of dollars for implementation. The Government did not have the resources to meet these needs. Further, foreign aid was not forthcoming, except for emergency food relief, because the country was not considered independent by the international community until after the referendum of 1993. However, even with extremely limited resources, the program has helped to jump-start the economy. As a result some critical sectors have started to function again, enabling the economy to meet some of society's needs.[139] Eritrea reversed the negative growth rate before independence and achieved an average GDP growth rate of over five percent per annum between 1992 and 1996.[140] Despite this growth, the country has a long way to go to improve its least-developed country status.

3. The Long-term Strategy for Economic Growth

a. Macroeconomic Policy

While the recovery and rehabilitation program was in progress, intense public debate continued about policies and strategies for future economic growth and development of the newly emerging nation. In October 1994 the National Assembly endorsed the Macroeconomic Policy.[141] The Policy defines the guidelines for measures to be taken to achieve the development objectives for the next two decades.[142] The primary "objective is the creation of a modern, technologically advanced and internationally competitive economy."[143] In order to achieve its objectives, the government defined a strategy for growth and development covering all sectors

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138 *Id.* at 9.

139 *See id.*

140 *See* Afwerki, *supra* note 125, at 3.

141 *See* Jacky Sutton, *Eritrea: The Financial Hub of the Horn?*, AFR. BUS., Oct. 1994, at 37, 37.

142 *See* MACRO-POLICY, *supra* note 7, at 10.

143 *Id.* at 12.

of economic and social life.[144] The private sector will lead an export-oriented and market-based economy, and efforts will be made to establish Eritrea as an international and regional financial center.[145] The government will also adopt monetary and fiscal policies for the mobilization and allocation of resources in order to stimulate growth.[146] This growth will be harmonized with fair distribution of income among individuals.[147] The policy also pledges to encourage domestic and foreign direct private investment, and to liberalize trade.[148] To meet these ends, Eritrea will encourage regional and international economic cooperation.[149] The government will work for the promotion of elementary, secondary, vocational, technical, and selected tertiary education to provide the required skills.[150] Additionally, the government promises to restore and protect the badly damaged environment in order to maintain the sustainability of growth.[151]

b. Growth Potential and Constraints

There are several factors that Eritrea can exploit for its development. First, the country's main resource is its people. The Popular Front for Democracy and Justice (PFDJ) says that

> it was the dedicated fighter who defeated Ethiopian colonialism which was armed by the super powers and won the victory in the struggle which the whole world considered as unwinable . . . . However, the decisive role of human beings has been confirmed not just in wars; it is also true that human beings, not natural wealth, capital or foreign aid, play the decisive role in economic development.[152]

Historically, Eritrea has been a nation of skilled people with a wealth of experience in entrepreneurship, commerce, and

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[144] *See id.*

[145] *See id.*

[146] *See id.*

[147] *See id.*

[148] *See id.*

[149] *See id.*

[150] *See id.*

[151] *See id.*

[152] HAGERAWI CHARTER, *supra* note 1, at 16.

international trade. This tradition "left a positive legacy in terms of inventiveness and creativity, which was put to good use during the armed struggle for liberation. This incentive, genius and drive of the people can be used in the peace time reconstruction and development of [the Eritrean] economy."[153]

Eritrea's skilled manpower, however, has been undermined by the generation-long war and by Ethiopia's misguided educational policies. For example, eighty percent of the Eritrean population is illiterate.[154] Thus, many people, young and old, have had "little or no exposure to formal or informal schooling."[155] Moreover, there is a lack of schools, books, and teachers.[156] The entrepreneurship and craftsmanship of the Eritrean population was also devastated by Ethiopia's annexation of Eritrea, war conditions, and the policy of command economy pursued by Ethiopia.[157] It will take time to reverse these problems.

Eritrea can also use its location as an important factor in its economic development. It has about 1200 kilometers of coastline along the Red Sea and over 350 islands.[158] The Red Sea links commercial shipping between Europe, Africa, the Gulf States, and Asia.[159] This ideal location has made Eritrea a trading nation for centuries.[160]

Although agriculture is the mainstay of Eritrea's economy, productivity is very low. The share of agriculture, including livestock and fisheries, decreased from 28.7% of GDP in 1992 to 11.1% in 1995.[161] As a result the country has depended on foreign food aid throughout most of its independence.[162] There are many factors that contribute to the low productivity. First, Eritrea's

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153 *Id.*

154 *See* WORLD BANK, *supra* note 130, at 109.

155 *Id.*

156 *See id.*

157 *See id.* at i-ii.

158 *See* GEBREMEDHIN, *supra* note 2, at 1.

159 *See id.*

160 *See id.*

161 *See Eritrea: Recent Economic Developments*, IMF Staff Country Rep., app. III, at 43.

162 *See id.* at 5.

agriculture is a rain-fed, subsistence economy characterized by traditional farming.[163] Agricultural output has declined because of natural and man-made causes such as war, displacement of farmers, recurrent drought, and frequent infestation of pests.[164] Environmental degradation caused by the cutting of trees for construction of houses and fuel, soil erosion, and overgrazing further weakened agricultural production.[165] Despite this land destruction, potential to increase production of food and cash crops does exist. According to the Ministry of Agriculture, the arable land of Eritrea is twenty-six percent of the total land area, but only eleven percent of it has been utilized so far.[166] These figures suggest that Eritrea will be able to increase substantially the supply of food crops both through increased yields on existing agricultural land and by extending the amount of land under cultivation.

Further, livestock is a principal source of natural wealth and formerly made significant contributions to the Eritrean economy.[167] However, livestock numbers have declined for decades as a result of the war, drought, and lack of veterinary services.[168] Eritrea also has a productive fishing coastal area.[169] The fishing industry suffered during the liberation struggle, with the number of fishermen falling from twenty thousand to a few hundred.[170] Nevertheless, according to government estimates, sustainable fish production can be increased from the present six thousand to ninety thousand tons per annum.[171]

The industrial sector at present consists mainly of light manufacturing industries. Public and private enterprises produce a variety of goods, including processed food, beverages, textiles, leather goods, chemical products, construction materials, glass,

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163 *See id.* at 4.

164 *See id.*

165 *See id.*

166 *See* WORLD BANK, *supra* note 130, at 69.

167 *See Eritrea: Recent Economic Developments*, *supra* note 161, at 5.

168 *See id.*

169 *See id.*

170 *See id.*

171 *See* Afwerki, *supra* note 125, at 7.

ceramics, and metal products.[172] Public enterprises are much larger.[173] They provide more employment than private enterprises, despite the fact that there are only forty-two public enterprises, as compared to hundreds of private ones.[174] The majority of the public enterprises are import-substituting industries.[175] Industrial exports are at present primarily limited to salt, glassware, ceramics, textiles, leather, and leather products.[176] A large proportion of the products are exported to Ethiopia, while imports from Ethiopia include raw materials such as cotton, sugar, oilseeds, tobacco, wood, iron bars, corrugated iron, yarn and threads, cattle, and skins.[177] All machinery and tools and most intermediate goods, such as crude oil, plastics, and metals for Eritrean industries, are imported from other countries.[178] Until independence most public enterprises were non-operational because of war conditions, neglect, and mismanagement; the private sector suffered as a result of the inappropriate policies of the past Ethiopian regime and a severe lack of investment.[179] Since independence, however, public enterprises have increased capacity utilization to seventy percent as compared to twenty to thirty percent before liberation.[180] The government continues to pursue a policy of encouraging small and medium scale enterprises.[181]

The size of mineral resources is not yet known.[182] The history of Eritrea's mining industry shows that there are gold, copper, iron ore, potash, magnesium, zinc, and marble mineral deposits, among others.[183] There are also indications of the existence of oil and gas

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[172] *See* WORLD BANK, *supra* note 130, at 48.

[173] *See id.*

[174] *See id.*

[175] *See id.* at 48-50.

[176] *See Eritrea: Recent Economic Developments*, *supra* note 161, at 6.

[177] *See id.*

[178] *See id.*

[179] *See id.*

[180] *See* Afwerki, *supra* note 125, at 3.

[181] *See Eritrea: Recent Economic Developments*, *supra* note 161, at 6.

[182] *See id.*

[183] *See id.*

deposits.[184] Several foreign companies have been given licenses, and they are currently operating in the prospecting and exploration of these natural resources.[185]

Because of its heritage as one of the most famous civilizations in Africa, the ancient Axumite Kingdom, Eritrea also has potential for a tourist industry.[186] It has nine nationalities with fascinating cultures and traditions, and the Red Sea offers beautiful beaches and diverse marine life.[187] But the tourist industry has not been developed. There is an acute shortage of trained manpower, developed hotels and resorts, and developed historical sites. Roads, telecommunications, water supply, energy, and other services are also underdeveloped. Thus, development of this sector of the economy, which started after liberation, will take time and require significant capital investment.

At independence Eritrea inherited weak financial institutions entirely owned by the defunct Ethiopian government.[188] Under the Ethiopian command, the government directed the economy credit policy with interest rates set administratively and differentiated across economic sectors as well as between the public and the private sectors.[189] The financial system is still weak. The Bank of Eritrea is the central bank responsible for monetary policies and controls the other financial institutions.[190] The other institutions include the Commercial Bank of Eritrea, the Housing and Commerce Bank of Eritrea, the Development and Investment Bank of Eritrea, and the National Insurance Corporation of Eritrea.[191] Except for the Housing and Commerce Bank, the government owns all of these institutions.[192] Future plans include the privatization of these banks and the operation of new local, as well as foreign, banks and insurance companies.

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184 *See id.* at 6-7.

185 *See id.*

186 *See* Afwerki, *supra* note 125, at 8-9.

187 *See id.*

188 *See Eritrea: Recent Economic Developments*, *supra* note 161, at 16.

189 *See id.*

190 *See id.*

191 *See id.*

192 *See id.*

c. The Issue of Comparative Advantage

Eritreans agree that the country's strategic location can play a major role in its economic development.[193] It has direct access to major world shipping lanes through the Red Sea, making import and export trade convenient and cost-effective.[194] It also puts the country in a good position to be a hub for production, distribution, and financial services for the region.[195] These economic activities involve the development of infrastructure such as storage facilities for goods to be exported and imported to and from the region, efficient transportation and telecommunication networks, and adequate supplies of water and energy. These activities in turn lead to the development of technically-skilled manpower, transfer of technology, and efficient public administration, all of which also require great investment in education.

Some analysts seem to disagree whether priority should be given to agriculture or industry for the economic growth of Eritrea. Tesfa Giorgis Gebremedhin sees agriculture as "the base for economic development in Eritrea."[196] Gebremedhin argues that agriculture in Eritrea is labor-intensive, which is Eritrea's current comparative advantage, and that the majority of its population depends on agriculture for their livelihood.[197] 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

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193 *See* MACRO-POLICY, *supra* note 7, at 1.

194 *See id.*

195 *See* Yohannes Habtu, *Regional Economic Cooperation and Integration Prospects for Development in the Horn of Africa: The Case of Eritrea and Its Immediate Neighbors*, *in* EMERGENT ERITREA, CHALLENGES OF ECONOMIC DEVELOPMENT 3, 3, (Gebre Hiwet Tesfagiorgis ed., 1993).

196 GEBREMEDHIN, *supra* note 2, at 192. Some analysts say that Eritrea must produce most of its own food relying on its own agricultural sector. *See id.* For example, Gebremedhin writes that

> Eritrea must rely more on its own agricultural sector to produce the food consumed by its own people. It should not rely heavily on foreign exchange earnings or charity to feed its people because total dependency on foreign trade for imported staple food is dangerous to a nation's economic health.

Id. at 254-55.

197 *See id.* at 192-93.

misallocation of resources, unemployment, poverty, and other negative social consequences.[198] Conversely, Gebremedhin warns that no wall should be created between agriculture and industry–the two sectors must complement each other, and the development of agriculture must lead to industrialization since the latter is "the ultimate engine of growth in the economy."[199] In a paper presented to an economic conference held two months after liberation, two commentators, Gebre Gebrekidan and Tsegay Moges, agreed: "Agriculture is the principal source of employment and income in Eritrea. As such any industrial development will have to be structured to complement the country's agricultural potential."[200] However, another commentator, Woldai Futur, does not believe that agriculture can be the base for economic development in Eritrea.[201] In a paper presented at the same economic conference, he notes that "continued soil degradation and unfavorable and uncertain climatic conditions have substantially reduced Eritrea's agricultural potential."[202] Instead, Futur feels "the need for a rapid shift in Eritrea's economic base towards other sectors (industry, trade, finance, tourism and transport, etc.) is becoming increasingly apparent."[203]

The government also places high importance on agriculture. President Isaias Afwerki feels that agriculture is the mainstay of the Eritrean economy because it is the "means of livelihood for the large majority of the population."[204] The Ministry of Agriculture is putting great effort into promoting agricultural production by using modern farm inputs, encouraging commercial farming, and providing veterinary services.[205] Farms under government

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198 *See id.*

199 *Id.* at 192.

200 Gebre Gebrekidan & Tsegay Moges, *Strategic Planning for Industrial Development of Emergent Eritrea*, *in* EMERGENT ERITREA, CHALLENGES OF ECONOMIC DEVELOPMENT, *supra* note 195, at 198, 203.

201 *See* Woldai Futur, *Importance of Trade and Industrial Policy for Socioeconomic Development: Reflections on the Eritrean Economy*, *in* EMERGENT ERITREA, CHALLENGES OF ECONOMIC DEVELOPMENT, *supra* note 195, at 176.

202 *Id.*

203 *Id.*

204 Afwerki, *supra* note 125, at 6.

205 *See Eritrea: Recent Economic Developments*, *supra* note 161, at 4;

ownership are in the process of rehabilitation prior to privatization.[206] Moreover, many new commercial farms of private investors are emerging, mainly in the fertile western lowlands.

Despite its investment in agriculture, 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.[207] In its Macroeconomic Policy, the government observes that the conventional way of listing priority sectors may not be appropriate in the present circumstances of Eritrea; practically all sectors have an equally critical need for rehabilitation, reconstruction, and development.[208] Given that the country is just starting to build its economy, and because of the gravity and complexity of the economic situation created by the war and recurrent drought, it is extremely difficult to decide where to start. Ultimately, however, the author believes that manufacturing industry will prevail as an engine of economic growth with the diminishing contribution of agriculture to GDP growth.

d. The Role of Public and Private Sectors

Eritrea's objectives of assuring sustainable growth and improving the living standards of the people are currently seriously hampered by the lack of capital, technology, and skilled manpower. In order to develop these resources, the government has designed a liberal economic policy to encourage the private sector.[209] The Macroeconomic Policy states that the private sector and market forces will lead the country's economy.[210] 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 inflation,

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GEBREMEDHIN, *supra* note 2, at 189.

206 *See* GEBREMEDHIN, *supra* note 2, at 192-93.

207 *See* MACRO-POLICY, *supra* note 7, at 10.

208 *See id.*

209 *See id.* at 12.

210 *See id.*

stable interest rates, and realistic exchange rates; and providing the necessary political and institutional framework and safeguards for the promotion and protection of private investment.[211]

Unfortunately, in Eritrea the lack of capital co-exists with a lack of capable entrepreneurial business community.[212] Therefore, it will take time to develop a strong private sector. Given this situation, the government must make direct investment in selected strategic industries and use market principles to strictly guide these economic activities.[213] This direct government participation is not designed to replace or weaken the private sector but is dictated by its absence.[214] The ultimate objective of the government is to withdraw completely from these activities and leave them to the private sector.[215]

III. The Legal and Institutional Framework for Private Investment

A. The Legal System

Eritrea is a civil law country. Unlike the common law system where judges can base their judgments on both statutes and rules of law developed by higher courts, the Eritrean judges apply only statutes. Court decisions in Eritrea (as in other civil law countries of the world) are enforceable only on the parties to the dispute. Thus, they do not establish binding precedents, although they can be used to persuade judges.

At present, Eritrean laws are passing through a transitional phase. After liberation in May 1991, Eritrea inherited the basic codes of Ethiopia as modified to suit the new Eritrean reality. Among the main Ethiopian statutes that were modified and adopted by the Provisional Government of Eritrea are the Civil Code, Commercial Code, Maritime Code, Penal Code, Civil

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211 *See id.*

212 *See* Conference Proceedings in Asmara, Eritrea (Dec. 12-14, 1995), *in* NATIONAL BUSINESS CONFERENCE AND EXHIBITION, PROCEEDINGS 126-29 (1995). (unpublished, on file with author).

213 *See* MACRO-POLICY, *supra* note 7, at 12.

214 *See id.*

215 *See id.*

Procedure Code, and Criminal Procedure Code.[216] The laws entered into force on September 15, 1991 after a Commission revised them.[217] The laws were received as transitional, aimed at shaping the new economic and social life of Eritrea until the country developed a legal system of its own.

The government continues to revise the transitional codes and to issue new Proclamations and regulations addressing various aspects of life. During the first six years of independence, over ninety Proclamations and nearly twenty regulations were promulgated.[218] These legislative measures brought law and order to the newly emerging state and helped to shape the society disintegrated by the thirty-year war. A new constitution was also drafted after much debate between Eritreans living in the country and those living in the Diaspora.[219]

Customary law and Sharia law are the other sources of law in Eritrea, both of which are restricted to areas of private life, specifically, marriage, divorce, and inheritance. The Transitional Civil Code severely restricts the various local customary laws, leaving little room even in these areas.[220] In practice, however, ancestral customary law prevails given its popular appreciation and historical perseverance. Sharia law, which was ignored by the Ethiopian Civil Code, operates almost without restriction in the field of family law under the Transitional Civil Code of Eritrea. Moslems constitute fifty percent of the country's population and they attach great significance to this religious Sharia law, particularly with respect to marriage and divorce. Thus, a contrary policy would put hard won national unity at risk.

The court system reflects the legal pattern described above. The regular courts are structured as follows: the High Court at the top, followed by the Regional Courts and the Sub-Regional Courts.[221] At the bottom of the hierarchy, Village Courts adjudicate

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216 *See* GOV'T OF ERI., GAZETTE OF ERI. LAWS, VOL. 1, NO. 1 (1991).

217 *See id.*

218 *See* HADDAS ERI. NEWSPAPER, May 24, 1997, at 1.

219 *See generally* ERI. CONST.

220 *See* ERI. PROC. NO. 15/1991 (1991).

221 *See* ERI. PROC. NO. 1/1991 (1991); ERI. PROC. NO. 25/1992 (1992).

minor civil and penal cases on the basis of customary laws.[222] The Sharia Courts parallel the regular courts, deciding marriage and divorce cases based on Sharia law. In the past, discriminatory policies pursued by successive Ethiopian regimes, which considered Ethiopia (including Eritrea) as a "Christian Island" in a region of Moslems, marginalized the role of Sharia Courts.[223] The number and territorial spread of the Sharia Courts have increased since independence, but lack of qualified personnel has prevented widespread distribution.

B. Private Investment Law

1. Background

On December 30, 1991 the Provisional Government of Eritrea passed the country's first law on private investment.[224] Eager to speed up economic growth, the government enacted Investment Proclamation No. 18/1991[225] seven months after Eritrea's liberation from forty years of colonial rule by Ethiopia and more than one and a half years before the country declared independence. The measure was a step towards reversing past restrictive policies by allowing the participation of the private sector in business activities.[226] Investment Proclamation No. 18/1991 encouraged both nationals and foreigners to invest in Eritrea.[227]

The Eritrean Investment Center (EIC) used the law as a basis for approving investment projects.[228] Under this law the EIC handled or processed over two hundred investment projects.[229] However, the nature of these projects, the capital invested, the jobs

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222 *See* PROC. NO. 1/1991; PROC. NO. 25/1992.

223 Interview with the Chairman of the Sharia High Court, in Asmara, Eri. (date unknown).

224 *See* ERI. PROC. NO. 18/1991 art. 5 (1991).

225 *See id.* pmbl.

226 *See* ERITREA INVESTMENT CENTER, REPORT ON THE REVISION OF INVESTMENT PROCLAMATION NO. 18/1991 (1994) (pages not numbered).

227 *See* PROC. NO. 18/1991 art. 18.

228 *See id.* art. 29.

229 *See* ERITREA INVESTMENT CENTER, *supra* note 226.

created, or the impact on the country's economy remains unknown. After a little less than three years, Investment Proclamation No. 59/1994 replaced Investment Proclamation No. 18/1991.[230]

The Committee that drafted the new Proclamation gave the rationale for the change. The old law, which required high minimum capital for incentive purposes, discouraged small businesses.[231] For example, it provided for income tax holidays from two to five years only for investments whose capital exceeded $100,000 in agriculture and exceeded $250,000 in other areas of economic activity.[232] A country impoverished by decades of war and continuing drought found this capital requirement unattainable.[233] The Committee found the twenty-five percent cash deposit requirement in the Investment Proclamation to be an unnecessary restriction on investment.[234]

The EIC, established by the Proclamation, disseminated information about the country's legislation, policies, and regulations concerning business and investment.[235] However, serious concerns arose about the EIC. The "Proclamation appeared to enable the [EIC] . . . [to] almost usurp the powers and duties of other departments," thus, creating a need for a clear demarcation of the EIC's responsibilities and competencies vis-à-vis other departments of the government.[236] Definition insures that the EIC is more than a discretionary screening mechanism to manage the direction of private investment.[237]

The provisions of Investment Proclamation No. 18/1991 regarding investment guarantees and dispute resolution mechanisms were also questioned. The Code lacked statements indicating Eritrean participation in treaties such as the Multilateral Investment Guarantee Agreement (MIGA), designed to give

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230 *See* ERI. PROC. NO. 59/1994 (1994).

231 *See* PROC. NO. 18/1991 arts. 6.

232 *See id.* art. 8, § 5(1).

233 *See* ERITREA INVESTMENT CENTER, *supra* note 226.

234 *See* PROC. NO. 18/1991 art. 6, § 1(3).

235 *See id.* arts. 28-35.

236 ERITREA INVESTMENT CENTER, *supra* note 226.

237 *See id.*

investors more confidence.[238] Contrary to the purposes of the treaties, the Proclamation did not require that investment projects needed to be economically viable before approval.[239]

In addition, the procedure for project approval itself was destined to be discouraging to investors. It was crucial to provide for a screening procedure to allow brisk approval of projects. Further, rationalizing investment approval procedures, especially to attract foreign investment by ensuring transparency and establishing a clear standard application procedure to avoid the impression of discrimination among applicants, is important.[240] The Proclamation imposed a joint venture model, which required indigenous participation.[241] The reviewing committee recommended that the government continue to actively encourage foreign investors to seek local equity participation in joint ventures with the Eritrean private sector.[242] It cautioned that there should be no legal imposition on foreign investors to that effect.[243] In other words, changing the restrictive provisions of Proclamation No. 18/1991 reflected the need for a new investment law that mirrors the Macroeconomic Policy and encourages a more open, market-oriented economy led by the private sector.

2. Investment Proclamation No. 59/1994 and Related Laws

a. Objectives

Investment Proclamation No. 59/1994 was promulgated on August 24, 1994 and repealed the 1991 Proclamation.[244] Reflecting the objectives of the Macroeconomic Policy, the investment code provides for a liberal regime of private investment.[245] It eliminates many of the restrictions and deficiencies of the previous

238 *See* PROC. NO. 18/1991.

239 *See id.*

240 *See* ERITREA INVESTMENT CENTER, *supra* note 226.

241 *See* PROC. NO. 18/1991.

242 *See* ERITREA INVESTMENT CENTER, *supra* note 226.

243 *See id.*

244 *See* ERI. PROC. NO. 59/1994 art. 33 (1994).

245 *See id.* pmbl.

Proclamation. The preamble of the new Proclamation describes the aims and motives of the government that induced it to promulgate the new law.[246] It states that Eritrea has adopted an open and market-oriented economic policy.[247] 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.[248] The government reaffirms its determination to promote, encourage, safeguard, and protect investments by the private sector.[249]

The objectives of the Proclamation are:

> (1) to encourage investments so as to develop and utilize the natural resources of the country; (2) to expand exports and encourage competitive import substituting businesses; (3) to create and expand employment opportunities; (4) to encourage the introduction of new technology . . . ; (5) to encourage equitable regional growth and development; and (6) to encourage small and medium scale businesses.[250]

The government aims to solve the problems of lack of capital and technology and also to tackle the problem of unemployment facing the country.[251] The Proclamation reflects the government's policy of building an export-driven economy.[252]

Eritrea needs to build an export-oriented economy for several reasons. First, Eritrea has the potential for expanding exports, as evidenced by its past performance,[253] although it will take time to reestablish the export base. Second, Eritrea has a small domestic market with a population of about 3.5 million. Export expansion would become the engine of growth once domestic needs have been met. Third, greater openness to international markets could be an important channel for transfer of technology. Fourth, the country needs foreign exchange to raise its purchasing power.

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[246] *See id.*

[247] *See id.*

[248] *See id.*

[249] *See id.*

[250] *Id.* art. 4.

[251] *See id.*

[252] *See* MACRO-POLICY, *supra* note 7, at 32.

[253] *See id.* at 30-31.

Unlike the previous Proclamation, the new code encourages equitable regional growth and development, in addition to small and medium scale enterprises.[254] This change reflects the evolution of the economic and development policy of the government to include a wider range of sectors of the Eritrean society.

b. Investment Areas

Unlike many other developing countries' investment codes, Eritrean Investment Proclamation No. 59/1994 does not differentiate between local and foreign investors.[255] All areas of investment are open to both domestic and foreign investors.[256] The Proclamation imposes no local ownership requirement; foreign investors are allowed to maintain one hundred percent ownership of their investment.[257] In practice many foreigners still find it useful to form joint ventures with local investors. The use of joint venture provides the foreign investor numerous advantages, including better access to local marketing practices, labor, and financial institutions, and a reduction in cultural and language barriers. No fade-out provisions require foreign investors to reduce ownership within a specified period of time.[258] The only exception in the Proclamation restricting foreign investment reserves domestic retail and wholesale trade, import, and commission agency solely for Eritreans.[259] However, these areas may be open to foreign investors when Eritrea has a bilateral agreement of reciprocity with the home country of the foreign investor.[260] Ultimately, the government may waive this restriction on foreign investment.[261]

The rationales behind the restriction seem to be that retail and wholesale trade occupy a significant portion of the Eritrean business community and the need to protect these small

254 *See* PROC. NO. 59/1994 art. 4, §§ 5, 6.

255 *See id.* art. 5, § 1.

256 *See id.* art. 5, § 1.

257 *See id.* art. 11, § 4.

258 *See id.*

259 *See id.* art. 5, § 2.

260 *See id.* art. 5, § 2.

261 *See id.*

businesses. These types of business do not require as much skill, technology, or capital as others and can be carried on reasonably competitively by nationals who otherwise might not have such opportunities. Opening up the business to any person, without the slightest restriction on foreign investors, could drive a huge number of Eritreans out of business. The drafters of the Proclamation recommended to the government that the exclusion of foreigners from the businesses in question not apply to the Ethiopian community in Eritrea in order to avoid a possible retaliatory reaction from Ethiopia, since the latter hosts a large number of Eritreans engaged in similar businesses.[262]

c. Technology Transfer Agreement

The Proclamation defines Technology Transfer Agreement to mean agreements with investors regarding, but not limited to, "(1) the use of patents, trademarks, trade names, and copyright; (2) training for and provision of technical knowledge and information; (3) technical services including but not limited to, technical assistance engineering, and consultancy; and (4) acquisition of managerial and marketing skills."[263] The agreement must be approved by an authorized government body and registered with the EIC.[264] The EIC is also authorized to renew the agreement which otherwise expires after the lapse of its duration.[265]

The provision for agreements on the transfer of technology commits the government to take several steps to implement them. The legal framework for the protection of intellectual property rights in Eritrea is weak in its current state. The country has neither comprehensive legislation to govern the area nor any patent law. The Transitional Commercial Code of Eritrea, inherited from Ethiopia, states, "Patents shall be subject to the provisions of special laws."[266] But the successive Ethiopian governments have never enacted this "special law." To date the Eritrean government also has not issued one.

262 *See id.*

263 *Id.* art. 7, § 1.

264 *See id.* art. 7, §§ 2-3.

265 *See id.* art. 7, § 4.

266 ERI. PROC. NO. 6/1991 art. 148, § 1 (1991).

Eritrea does not have a law governing trademarks either. The Commercial Code is deficient, lacking clear provisions that regulate trademarks as such. The Code regulates "distinguishing marks," which it defines as "the name, designation, sign or emblem affixed on the premises where the trade is carried on and which clearly designates the business."[267] Although some elements in the given definition are similar to those of trademarks, there are basic differences between the two concepts. While a distinguishing mark, as defined by the Commercial Code, is affixed to the premises of the business and designates the business, a trademark is affixed to the goods or products, moves with the goods, distinguishes them "from those manufactured or sold by others, and indicate[s] the source of the goods, even if that source is unknown."[268] Further, "[t]he critical element in trademarks is that they identify and distinguish one company's product from another's."[269] Trademarks help consumers select goods no matter where the goods go.

There may also be service marks to identify and distinguish the services of one company from another. "A service mark is to services what a trademark is to products."[270] The two may coincide. For example, "Mobil" is a trademark when it is affixed to products sold by the Mobil company; it is a service mark when labeled on the services rendered by that company. However, like trademarks, there is no provision regulating service marks in Eritrea.

The Commercial Code does regulate trade names, but it defines a trade name as a name used to identify a business: "A trade-name is a name under which a person operates his business and which clearly designates the business."[271] However, "a trade name may also be used to identify products–and a trade name may be used as a service mark to identify services."[272] Illustratively, "the IBM company uses IBM as its company name, it uses IBM to

[267] *Id.* art. 140, § 1.

[268] SIEGRUN D. KANE, TRADEMARK LAW, A PRACTITIONER'S GUIDE 2 (1987).

[269] *Id.* at 1.

[270] *Id.* at 2.

[271] PROC. NO. 6/1991 art. 135, § 1.

[272] KANE, *supra* note 268, at 2.

identify its computer products, and it uses IBM to identify its computer leasing services."[273]

Another aspect of intellectual property rights is copyright, which is governed by the Transitional Civil Code of Eritrea. Copyright is defined by the Code as the right of the author over literary and artistic works as works of the mind.[274] The Civil Code gives a fairly wide coverage of the types of works that are deemed to be works of the mind.[275] However, the Code seems to lag behind and does not reflect the requirements of modern technology. For example, it does not provide that computer software is able to be copyrighted.[276]

Needless to say, Eritrea will benefit greatly from access to technology in the modern age. One of the most important factors to this potential access is the effective functioning of intellectual property rights law. Eritrea, therefore, must have comprehensive legislation on intellectual property in order to match its policy on the transfer of technology. It needs to enact a patent law to regulate not only patents of importation, but also to encourage inventions and improvements or additions to inventions by nationals. It also needs to have a trademark law to avoid the confusion between the terms such as "trademark," "distinguishing mark," and "trade name." It is important to regulate service marks in order to include the growing service industry. Further, Eritrea should also modernize the provisions regulating copyright.

Additionally, regional and international cooperation is necessary in order to effect substantial transfer of technology from the developed world to developing countries.[277] "Centralized filing, search and examination systems would reduce the cost for foreign applicants and would strengthen the value of the patent obtained."[278] Further, "centralized depository offices and regional

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[273] *Id.* at 3.

[274] *See* ERI. PROC. NO. 2/1991 (1991).

[275] *See id.* art. 1648.

[276] *See* PROC. NO. 2/1991.

[277] *See* Thomas C. Creel & Drew M. Wintringham, *Patent Systems and Their Role in the Technological Advancement of Developing Nations*, 10 RUTGERS COMPUTER & TECH. L.J. 255, 293 (1984).

[278] *Id.*

reference centers would alleviate each nation's administrative burden."[279] Moreover, Eritrea should become a member of the various international intellectual property organizations and signatory to the treaties. "Foreign technology holders are accustomed to dealing under these established rules and, therefore, would be more likely to make their technology available in countries that adhere to those rules."[280]

What is most important, however, is that the technology to be transferred to Eritrea must be the kind of technology that fits the needs of the country and helps build a modern and internationally competitive economy. Transfer of technology is a complex process. Like any other area of transaction, both the seller and the buyer of technology must know with precision what type of technology they are dealing. To be able to specify, purchase, and implement technology successfully or to be able to absorb foreign technology, less developed countries like Eritrea need:

> (1) engineering companies to do the detailed engineering of any kind of plant and specify its equipment; (2) purchasing agents to buy, inspect, expedite and transport equipment; (3) project managers and construction supervisors to carry out the field work; (4) plant managers, production and maintenance superintendents to run the plants; [and] (5) groups working in daily contact with the plant to improve and keep up to date the purchased technology.[281]

But, as indicated, Eritrea's human resources, like the other sectors of its economic and social life, have been devastated by the war. Approving the transfer of technology will not be an easy task. Although the Investment Proclamation says a duly authorized government body shall approve the transfer of technology,[282] no institutes or councils of technological or industrial research exist to help such a body. The University of Asmara is at its early stage of revitalization, although it is showing progress in curriculum

[279] *Id.*

[280] *Id.* at 294.

[281] Carlos M. Varsavsky, *Transfer of Technology and the Development of Host Country Infrastructure*, *in* 2 NEGOTIATING FOREIGN INVESTMENTS: A MANUAL FOR THE THIRD WORLD § 7.4D 1, 7 (Robert Hellawel et al. eds., 1982).

[282] *See* ERI. PROC. NO. 59/1994 art. 7, § 3 (1994).

development, recruiting qualified teachers, expanding its library collections, and improving infrastructure.

The big question, therefore, is where can Eritrea find these skills? There is no easy answer. The University of Asmara has been helpful in training government functionaries in public administration, financial management, personnel management, and project management. The government will continue to use the resources of the University. However, the capacity of the University is limited and cannot meet the country's urgent needs in skilled manpower. The government has announced that it will recruit foreign experts to solve key problems in manpower shortage. This solution may help in meeting the immediate needs for skilled manpower, but there is no substitution for the development of indigenous resources. Therefore, the process of developing the University of Asmara and other Eritrean research and training institutions must be enhanced.

d. Administrative and Entry Control

The laws of most developing countries try to avoid free entry of capital and to regulate the entry of foreign investment. Government organization and entry control regarding investment is critical in determining a country's effectiveness in attracting and/or controlling foreign investment. But it may equally affect domestic investors too. "The importance of the organization arises from the costs incurred by prospective domestic and foreign investors in securing government approvals."[283] Further,

> many branches of government–ministries of finance, labor, and commerce–and public sector corporations see their interests affected by foreign investments and insist on a role in formulating foreign investment policies and in negotiating individual entry agreements when their agency's interests are at stake . . . . But government attempts to involve each branch in the entry process can discourage investors.[284]

The organization for the administration of investment varies

[283] Ndiva Kofele-Kale, *Host Nation Regulation and Incentives for Private Foreign Investment: A Comparative Analysis and Commentary*, 15 N.C. J. INT'L L. & COM. REG. 361, 370 (1990).

[284] *Id.* at 362.

between centralization and decentralization. Eritrea utilizes a decentralized system of administering investment. Investors first visit the EIC for information about investment opportunities in the country as well as for administrative and legal advice before sectoral ministries approve their projects.[285] Investment Proclamation No. 59/1994 does not clearly mention the government agency authorized to approve investment proposals, but article 28 says that "[a]ppropriate Bodies of the Government" are obliged to assist and cooperate with the EIC in the fulfillment of its investment-related duties.[286] However, the function of approving investment proposals is governed by Proclamation No. 72/1995, issued to control the business licensing system and to establish the office that issues business licenses.[287] Article 23, section 1 of that Proclamation provides that "[a]ll competent regulatory bodies shall, in accordance with the law, set all conditions/requirements for engaging in any business activity under their jurisdiction, and make these conditions/requirements available to all persons engaged or expecting to engage in any business activity."[288] These regulatory bodies certify qualification for engaging in any business and also inspect, monitor, and supervise any licensee.[289] A regulatory body is defined by article 2 of the same Proclamation as any ministry, authority, commission office, and any other national and local agencies or institutions of the State of Eritrea empowered by law to regulate any activity.[290] Thus, approval of investment projects is not centralized under one government agency. This means that investors must have their projects approved by the ministry or other government department according to the area in which they want to make their investments. But investment projects accepted by the concerned government agency are required to register with the EIC and receive a certificate to that effect if they are to benefit from the incentives and guarantees provided by the Investment

[285] *See* PROC. NO. 59/1994 art. 7, § 2.

[286] *Id.* art. 28.

[287] *See* ERI. PROC. NO. 72/1995 (1995).

[288] *Id.* art. 23, § 1.

[289] *See id.* art. 23, § 1.

[290] *See id.* art. 23, § 2.

Proclamation.[291]

The EIC is empowered with the duties of interpreting, implementing, and facilitating the Investment Proclamation.[292] This provision gives the EIC an important power that could make significant impact on domestic and foreign investment in the country because the terms "interpretation" and "implementation" could be given broad meanings. This function empowers the EIC to make discretionary decisions that affect investors. An Advisory Committee is entrusted with assisting the EIC in implementing its duties.[293] The Committee is composed of members representing the Office of the President, the Ministry of Finance, the Customs Authority, the Income Tax Authority, the Ministry of Trade and Industry, the Bank of Eritrea, the Chamber of Commerce, the Managing Director of the EIC, and a representative from any pertinent ministry.[294] The Advisory Committee is required to meet every three months, which leaves the EIC to make the day-to-day decisions.[295] Further, the Committee has only an advisory role, which suggests that the EIC is not bound by the decisions of the Advisory Committee.[296] However, the EIC is directly responsible to the Office of the President, to which it must submit its reports.[297] But, when there is no proper report, the decisions of the EIC may go unchecked. The lack of qualified staff in the EIC may further create this undesired situation.

Another government agency that governs the administration of investment is the Business Licensing Office (BLO), established by Proclamation No. 72/1995.[298] Prior to the enactment of this law, the Ministry of Trade and Industry and other government agencies issued licenses for businesses under their areas of concern. The old licensing system created delays in granting licenses and led to frustration for investors. The aim of establishing the BLO was to

[291] *See* PROC. NO. 59/1994 art. 17.

[292] *See id.* art. 21.

[293] *See id.* art. 22.

[294] *See id.* art. 22, § 1.

[295] *See id.* art. 22, § 3.

[296] *See id.* art. 22, § 4.

[297] *See id.* art. 20, § 3.

[298] *See* ERI. PROC. NO. 72/1995 art. 25 (1995).

avoid this defect in administration and to create an atmosphere conducive to economic activities by having a "one-stop shop" in issuing licenses.[299] The BLO has been recognized as a swift organization that does not waste investors' time in issuing licenses. However, the agency lacks overall administrative capacity.

e. Investment Incentives

Chapter 4 of Proclamation No. 59/1994 deals with investment incentives.[300] The incentives may be classified into three categories: fiscal incentives, financial incentives, and other incentives.[301] Fiscal incentives deal with duties and taxes on imports and exports, as well as taxes on income.[302] Financial incentives involve loans, allocation of foreign exchange, and remittance of foreign exchange.[303] Investment guarantees and additional facilities fall under other incentives.[304]

i. Fiscal and Financial Incentives

Investment Proclamation No. 59/1994 provides financial and other incentives relevant only to foreign investors.[305] Nevertheless, the Proclamation does not provide for separate tax incentives; it simply duplicates the rates from the tax system operating in the country.[306]

The Tax Code itself is designed to promote investment and economic growth through liberal trade.[307] It offers low rates on

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[299] *See id.* art. 4, § 3.

[300] *See* PROC. NO. 59/1994. art. 4.

[301] *See id.*

[302] *See id.* arts. 8-9.

[303] *See id.* arts. 10-12.

[304] *See id.* arts. 13-14.

[305] *See id.*

[306] *See* ERI. PROC. NO. 62/1994 (1994) (Income Tax); ERI. PROC. NO. 67/1994 (1994) (Rural Agricultural Income Tax and Cattle Tax); ERI. PROC. NO. 64/1994 (1994) (Sales and Excise Tax); ERI. PROC. NO. 18/1994 (1994) (Custom Tariff Regulations).

[307] *See* PROC. NO. 62/1994; PROC. NO. 67/1994; PROC. NO. 64/1994; PROC. NO. 18/1994.

import tariffs for manufacturing inputs.[308] Similarly, Investment Proclamation No. 59/1994 provides for a nominal customs duty of two percent on imports of capital goods and industrial spare parts.[309] Raw materials and intermediate inputs are taxed at three percent, while duties and taxes on inputs and other materials used for exports are rebated.[310] The Proclamation provides no exemption from import duties on the material and equipment inputs to production.[311] Some writers do not favor this type of exemption. According to one commentator, governments lose a substantial amount of revenue as a result of tax exemptions.[312] Moreover,

> exemption of duties on capital equipment favors the use of capital over labor, since labor not only is usually taxed, but is also often subject to a minimum wage greater than its opportunity cost. Thus, the exemption will tend . . . to increase the capital intensity of the production process . . . . Highly sophisticated imported technology could also increase dependence on expensive expatriate technical staff.[313]

Only time will tell whether Investment Proclamation No. 59/1994 can avoid the deficiencies of exemption.[314]

Eritrea's export trade is even more liberal. There are no duties or taxes on exports, which is indicative of the export-oriented economic policy of the government.[315] The policy of export-driven economic growth is supported by the financial incentives provided for in Investment Proclamation No. 59/1994.[316] The Bank of Eritrea, for example, is obliged to give priority to exporters in the allocation of foreign exchange.[317] Moreover, investors may retain

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308 *See* PROC. NO. 18/1994.

309 *See* PROC. NO. 59/1994 art. 8, § 2.

310 *See id.*

311 *See id.*

312 *See* Alice Galenson, *Investment Incentives for Industry: Some Guidelines for Developing Countries*, WORLD BANK STAFF WORKING PAPERS, NO. 669, at 8 (1984).

313 *Id.*

314 *See* PROC. NO. 59/1994 art. 8.

315 *See id.* art. 8, § 3.

316 *See id.* arts. 8-11.

317 *See id.* art. 11, § 3.

up to one hundred percent of their export earnings in Eritrea.[318]

The export-oriented investment incentives are expected to improve Eritrea's poor balance of payments deficit and trade deficit, which resulted from high levels of imports and low levels of exports.[319] The International Monetary Fund (IMF) reported that Eritrea's external position deteriorated significantly in 1995.[320] For the first time since independence, the country recorded an overall balance of payment deficit of $65 million.[321] The trade balance deficit was recorded at $323 million, although it showed slight improvement.[322] These figures suggest that the development of exporting industries supported by investment incentives may benefit the Eritrean economy.

ii. Incentives and FDI

Eritrea opened its door to Foreign Direct Investment,[323] thus raising the question of double or multiple taxation on income. As each country asserts its rights to tax income generated within its borders or income derived by its residents, including resident corporations, foreign businesses are, legally speaking, subject to

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318 *See id.*

319 *See Eritrea: Recent Economic Developments*, *supra* note 161, at 25.

320 *See id.*

321 *See id.* at 24.

322 *See id.* at 66.

323 The term "Foreign Direct Investment" is not, as such, mentioned in Investment Proclamation No. 59/1994. *See* PROC. NO. 59/1994. However, article 3 defines foreign capital as "investment of foreign origin, foreign convertible currency, negotiable instrument, plant machinery, equipment, buildings, spare parts, raw materials, and other business assets brought into Eritrea and includes profit converted into capital[.]" *Id.* art. 3, § 4. In addition, a "foreign investor" is defined by the same article as "any physical person of foreign nationality or any juridical person registered outside Eritrea who, or which, respectively, has invested foreign capital and goods and equipment in Eritrea and may include Eritrean nationals residing abroad, foreign governments, and non-Eritrean regional or international organizations[.]" *Id.* art. 3, § 4.

The International Monetary Fund (IMF) suggests Foreign Direct Investment secures a lasting interest in a foreign enterprise, thus having an effective voice in its management. *See Foreign Private Investment in Developing Countries*, IMF Occasional Paper No. 33, at 1 (Jan. 1985). Foreign direct investment includes indirect capital contributions, such as net loans from companies to their subsidiaries and reinvested profits. *See id.*

taxation by separate taxing authorities.[324] The first tax burden on FDI is imposed by the government of the country where the investment is located.[325] Many countries, such as the United States, Great Britain, and Japan, also assert the right to tax the income generated by their residents, regardless of where the income is derived.[326]

To prevent the problem of double taxation, developed countries employ three methods: (1) the tax credit method; (2) the exemption method; and (3) the deduction method. Under the tax credit method, "those countries that tax on income on a worldwide basis offer a credit for income and withholding taxes paid to foreign governments."[327] This method eliminates double taxation, but it does not prevent the home country from taxing the income that is exempt from taxation in the host country. In other words tax holidays or reduced tax rates offered to the investor by the host country may be nullified by the home country of the investor, which means revenue will merely be transferred from the host to the home country.[328] In order to prevent this from happening, some countries have negotiated "tax-sparing" agreements whereby the investor's home country gives credit for taxes that would have been paid in the host country if no tax exemption had been given.[329] Unlike European countries the United States does not negotiate "tax-sparing" agreements.[330] However, income of foreign subsidiaries is not taxed as accrued because these companies are not treated as U.S. taxpaying entities as long as the foreign subsidiaries did not repatriate dividends or earnings to their U.S. parent companies.[331] Eritrea also has not negotiated "tax-sparing"

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324 *See* Joel Slemrod, *Tax Policy Toward Foreign Direct Investment in Developing Countries in Light of Recent International Tax Changes*, *in* FISCAL INCENTIVES FOR INVESTMENT AND INNOVATION 289, 290 (Anwar Shah ed., 1995).

325 *See id.*

326 *See id.*

327 *Id.*

328 *See* TIMO VIHERKENTTA, TAX INCENTIVES IN DEVELOPING COUNTRIES AND INTERNATIONAL TAXATION 135-39 (Kluwer Law and Taxation Publishers 1991).

329 *See id.* at 140.

330 *See id.* at 142.

331 *See* Slemrod, *supra* note 324, at 291.

agreements with developed countries.

The exemption method is another way in which countries avoid double taxation.[332] It may be based on territorial principle.[333] Under this principle, "a country's jurisdiction extends only to income arising within its borders,"[334] which results in an exemption from taxation for all foreign source income.[335] Major developed countries do not base their international tax jurisdiction entirely on the territorial principle.[336] Certain European countries, such as France and the Netherlands, are sometimes said to espouse the territorial principle.[337] These countries exempt several kinds of foreign income from taxation, but they do not categorically limit their taxing jurisdiction to domestic income.[338] On the other hand, developing countries are fully committed to the territorial principle.[339] The perception is that the exemption method is beneficial to enterprises and, thus, may induce more investment in low-tax countries.[340] This approach also leaves tax policy to the discretion of the host country and does not interfere with its sovereignty in economic policy.[341] Further, exemption does not nullify the effectiveness of tax incentives granted by the host developing country.[342] However, "exemption may induce firms to early repatriation of profits."[343]

The third method mitigating double taxation is the deduction method. This method denotes a mechanism whereby foreign income taxes are deducted as expenses in the calculation of taxable income.[344] It does not fully eliminate double taxation because

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[332] *See* VIHERKENTTA, *supra* note 328, at 51.

[333] *See id.*

[334] *Id.* at 50.

[335] *See id.*

[336] *See id.*

[337] *See id.* at 50 n.2.

[338] *See id.*

[339] *See id.* at 50.

[340] *See id.* at 69.

[341] *See id.*

[342] *See id.*

[343] *Id.*

[344] *See id.* at 178.

"foreign taxes are only partially compensated for in the home country."[345] Unlike the tax credit method, the deduction method does not give the taxpayer a dollar-for-dollar reduction in the home country's tax for the tax paid in the host country.

The cost of income tax incentives may be high. Nevertheless, tax concessions granted to a locally incorporated subsidiary are rarely lost to the home country of the investor. This is largely due to the fact that enterprises find their own ways to salvage the benefits of the incentives from being nullified by their home countries.[346] In particular, subsidiaries can defer the repatriation of their income until they find the right time to repatriate it to their home countries,[347] although the deferral is subject to limitation in countries such as the United States. Where the income qualifies as an exemption, no wash-out of incentives takes place.[348]

Eritrea's income tax incentives should be seen from the international perspective discussed above. There are no separate tax incentives for investors in Eritrea. Both the Proclamation and the Tax Code provide for a low tax rate on corporate income at twenty-five percent to thirty-five percent.[349] Reinvested corporate profit from any activity is taxed at twenty percent.[350] The corporate tax rate is low by international standards, although it is not as low as the tax rates in the fast growing economies of East Asia, in which rates range from twenty percent to thirty percent.[351]

It has been suggested that Eritrea must not give further income tax incentives and that its current policy of keeping import tariffs on manufacturing inputs at a nominal level and excluding export tariffs should be maintained in order to encourage exporting enterprises.[352] Theodore D. Setzer, a proponent of this view, gives

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345 *Id.*

346 *See id.* at 228.

347 *See id.*

348 *See id.* at 228-29.

349 *See* ERI. PROC. NO. 59/1994 art. 9, § 2 (1995); ERI. PROC. NO. 18/1994 (1994).

350 *See* PROC. NO. 59/1994 art. 9, § 3.

351 *See* THEODORE D. SETZER, U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT, INVESTMENT INCENTIVES IN ERITREA: ANALYSIS OF ECONOMIC AND POLITICAL ISSUES 31 (1996).

352 *See id.* at 34.

several reasons to support it.[353] First, it is difficult to measure economic costs and benefits of tax-based incentives.[354] Eritrea is a small country with a low level of administrative capacity, thus the potential for error is even higher.[355] Collection and analysis of data by the EIC and other government agencies is in the early stages.[356] Second, administration of income tax incentives is costly.[357] For Eritrea, the costs of monitoring compliance and resolving disputes would be great because governmental operation is at a primitive level.[358] But, at the same time, the costs for the administration of reduced import and export tariffs are lower than the costs resulting from the administration of income tax incentives because goods pass through narrow gates that are easier to control.[359] Third, world tax credit systems can nullify income tax-based incentives designed to attract FDI, and "tax-sparing" agreements to mitigate the effect of such systems cannot be negotiated with some industrialized countries, such as the United States.[360] On the other hand, tax credit systems do not apply to Eritrea's import and export duty, and investors will continue to benefit from incentives granted through them.[361] Fourth, since generous tax incentives for certain investors tend to lead to the increase of the marginal tax rate for taxpayers not covered by those incentives, the increased rates will result in increased tax evasion, which will worsen the present budget deficit of Eritrea.[362] In any case income tax evasion is more likely because taxpayers report their income voluntarily, but they usually do not keep books of account properly.[363] The potential for tax evasion is less with regard to custom tariffs because they are easier to collect at specific locations with visual

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353 *See id.* at 32.

354 *See id.*

355 *See id.* at 33.

356 *See id.* at 32.

357 *See id.* at 32-33.

358 *See id.* at 33.

359 *See id.*

360 *See id.*

361 *See id.*

362 *See id.* at 33-34.

363 *See id.* at 33.

inspections.[364]

f. Investment Guarantees

In addition to the fiscal and financial incentives, Investment Proclamation No. 59/1994 provides guarantees for investors against political risks: "[I]nvestment 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."[365] In the event of expropriation the government is obliged to pay full and fair compensation.[366]

The Convention that created the Multilateral Investment Guarantee Agency (MIGA) covers four non-commercial risks: those risks arising from (1) currency transfer; (2) expropriation and similar measures; (3) breach of contract; and (4) war and civil disturbance.[367] Losses caused by war and civil disturbance is defined by some analysts as losses resulting from damage to, the destruction of, or disappearance of tangible assets caused by politically motivated acts of war or civil disturbance in the host country.[368] "This may include losses or damages due to insurrection, revolution, rebellion and civil strife."[369] As a result, "[d]ue to the inherent unpredictability of these risks, private insurers generally refuse to provide such coverage."[370] Investment Proclamation No. 59/1994 does not mention terms such as political risk or political insurrection. This omission, however, is

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364 *See id.*

365 ERI. PROC. NO. 59/1994 art. 13, § 4 (1994).

366 *See id.* art. 13, § 2.

367 *See* Convention Establishing the Multilateral Investment Guarantee Agency, April 12, 1988, art. 11, T.I.A.S. No. 12,089, at 6-7. *See infra* notes 391-97 (discussing the creation of MIGA and Eritrean participation in MIGA).

368 *See* George Thomas Ellindis, *Foreign Direct Investment in Developing and Newly Liberalized Nations*, 4 J. INT'L L. & PRAC. 299, 314 (1995) (citing Daniel Wagner, *A New World for Political Risk Investment Insurance*, RISK MGMT., Oct. 1994, at 32).

369 *Id.* at 314 (citing OVERSEAS PRIVATE INVESTMENT CORPORATION, OPIC PROGRAM HANDBOOK 12, at 23 (1994)).

370 *Id.* (citing Daniel Wagner, *supra* note 368, at 32).

offset by the membership of Eritrea in MIGA, which provides insurance for investors against political risk.[371]

Expropriation is the taking of property with inadequate or no compensation to the owner.[372] Article 13 of Investment Proclamation No. 59/1994 requires the government to compensate investors who have been denied their rights to property if the denial is related to government action.[373] Further, the Proclamation restricts expropriation only for public purpose.[374] If and when compensation happens, it can take place only when two conditions are met: (1) full and fair compensation, and (2) due process of law.[375]

What does full and fair compensation mean? How full is full, and how fair is fair? What are the methods of valuation? How fast and effective should the compensation be? Countries have faced difficulty with respect to the standard meaning of compensation. They use different formulations in treaties and legislation to set the standard. The United States has adopted the traditional rule expressed in the so-called "Hull formula" which says that compensation must be "prompt, adequate, and effective."[376] "Other states argue that 'prompt, adequate and effective' is not the proper measure of 'fair compensation.' Many of the countries in the United Nations believe that the appropriate standard is that of 'just compensation.' Alternatively, 'appropriate compensation' is a standard that has received much international support."[377] But the term "appropriate" itself is also unclear. The difficulty in finding a plain meaning of compensation demonstrates that there is confusion in international practice as to what accurately represents the "fair compensation" standard following nationalization or

371 *See* ERI. PROC. NO. 76/1995 art. 2 (1995).

372 *See* Ellindis, *supra* note 368, at 313.

373 *See* ERI. PROC. NO. 59/1994 art. 13 (1994).

374 *See id.*

375 *See id.*

376 Davis R. Robinson, *Notes and Comments: Expropriation in the Restatement (Revised)*, 178 AM. J. INT'L L. 176, 176 (1984).

377 Ellindis, *supra* note 368, at 315 (citing RALPH H. FOLSOM ET AL., INTERNATIONAL BUSINESS TRANSACTIONS 882-99 (1991)).

expropriation by the host government.[378]

Consequently, FDI investors are apprehensive that they may be subjecting themselves to the risk that they will not receive full and fair compensation if their investment is [nationalized or] expropriated. This argument raises serious questions in the minds of potential investors considering FDI in high risk regions. Most investors would rather avoid or protect against these types of situations.[379]

However, developing countries are moving towards a liberalization in economic policies. The international trend is such that they are not likely to take harsh measures against investors and run the risk of forcing the outflow and curtailing the inflow of capital from their countries when they need it most. This trend is even more apparent in Eritrea. Given an economy devastated by war, drought, and a lack of capital, and the government's determination to encourage and promote private investment, it is highly unlikely that businesses and property of private investors will be nationalized or expropriated.

The risk of currency inconvertibility in host countries is another major concern of foreign investors.[380] This risk arises from the investor's inability to convert local currency returns such as profits, principal, interest, royalties, capital, and other remittances into foreign exchange for transfer outside the host country.[381] The inability to convert local currency creates detrimental consequences for investors. For example, inconvertibility, reduces the ability of the investor to meet financial commitments, such as the payment of dividends and debts, or to withdraw profits from the host country. The risk is bound to reduce the flow of FDI into high risk nations. As indicated, Eritrea has eliminated this risk by the guarantee provided in Investment Proclamation No. 59/1994 articles 11 and 12.[382] The Proclamation provides that investors may open foreign exchange bank accounts in Eritrea.[383] They may

[378] *See id.*

[379] *See id.*

[380] *See id.*

[381] *See id.*

[382] *See* ERI. PROC. NO. 59/1994, arts. 11-12 (1994).

[383] *See id.* art. 11, § 1.

contract foreign exchange loans with the Bank of Eritrea.[384] They have the right, in accordance with the rate at the time, to "remit net profits and dividends accrued from investment capital" in foreign exchange outside Eritrea.[385] Nevertheless, the IMF reasons that the divergent policies of Eritrea and Ethiopia concerning the exchange rates for the Ethiopian Birr might have affected capital movements from one country to the other.[386]

g. Entities that Provide Political Risk Insurance

FDI presents a foreign investor with a number of potential economic benefits in developing countries. However, foreign investors also view developing countries as nations of high political risk. Several capital-exporting countries have created national agencies that provide an opportunity to obtain political risk insurance.[387] The Japanese national insurance agency, the Export Insurance Division of the Ministry of International Trade and Industry (EID/MITI), covers loss caused by a breach of a contractual obligation of a host government where one of the following events have occurred: (a) incapability of continuation of business; (b) bankruptcy or similar causes; (c) suspension of transactions by banks or other similar causes; or (d) suspension of business operations for over six months.[388]

The role of the private sector in political risk insurance is also growing.[389] The ultimate goal of these agencies is to encourage FDI by creating a favorable investment climate in developing countries.[390] MIGA also provides insurance for foreign investors against losses caused as a result of breach of contract by the host

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384 *See id.* art. 10, § 2.

385 *Id.* art. 12, § 1(a).

386 *See Eritrea: Recent Economic Developments*, *supra* note 161, at 19-21.

387 *See* Malcolm Rowat, *Multilateral Approaches to Improving the Investment Climate of Developing Countries: The Cases of ICSID and MIGA*, 33 HARV. INT'L L.J. 103, 118-36 (1992); *see also* Ellindis, *supra* note 368, at 321-32 (discussing the development of U.S. and Canadian-led agencies to provide political risk insurance).

388 *See* Rowat, *supra* note 387, at 118-36.

389 *See id.* at 125.

390 *See id.* at 103.

government.[391] MIGA was created by forty-two World Bank member nations in 1988.[392] The Agency was created to fill the gap left by national insurance programs and private insurers, but it surpasses many national programs in volume despite its short period of operation.[393]

Article 15 of Investment Proclamation No. 59/1994 guarantees political risk protection through MIGA.[394] The MIGA Council of Governors admitted Eritrea as a passive member under a resolution adopted on July 3, 1995.[395] The resolution classified Eritrea as a Category Two (developing country) member of the agency.[396] The membership entitles foreign investors in Eritrea to insurance against political risk for their investments. Eritrea joined MIGA to further its goals of collaboration with other sovereign states and competent international organizations in the monetary and financial arena.[397] Although the admission of Eritrea to MIGA is relatively recent, given the growing role of the Agency, it may help to make a positive impact on foreign investment decisions in Eritrea.

h. Investment and Land Allocation

Investment Proclamation No. 59/1994 article 6 provides that land is to be allocated to investors by government bodies in accordance with Eritrean laws and regulations.[398] The reasoning behind this method of allocation is that land ownership belongs to the State under Land Proclamation No. 58/1994, passed with the Investment Proclamation on August 24, 1994 by the fourth session

391 *See* Convention Establishing the Multilateral Investment Guarantee Agency, *supra* note 367, at 6-7.

392 *See* Ellindis, *supra* note 368, at 316-17.

393 *See* Rowat, *supra* note 387, at 127. For the foreseeable future, MIGA will continue to complement rather than compete with national insurance plans. *See id.* at 136.

394 *See* ERI. PROC. NO. 59/1994 art. 15, § 2 (1994).

395 *See* ERI. PROC. NO. 76/1995 (1995).

396 *See id.*

397 *See id.* pmbl.

398 *See* PROC. NO. 59/1994 art. 6.

of the National Assembly, the Eritrean legislature.[399]

Historically, three types of land ownership existed in Eritrea. Under the *terra demaniale* system, land is owned by the State and can be leased for renewable periods of twenty to fifty years for commercial purposes.[400] Italian colonizers introduced this system, which became more prevalent in the lowlands where fertile land was abundant.[401] The *diessa* system provided for land to be collectively owned by the village community and re-allocated on a lottery basis every five to seven years to all the heads of families.[402] This system existed mainly in the highlands.[403] The *resti* system involved land ownership by families.[404] The rights of family members owning land varied under the *resti* system because the concept encompassed a full range of rights, from individual ownership to family ownership as a whole.[405] Even though the individual had absolute ownership of land subdivided among family members, he was practically restricted from mortgaging, selling, or giving away the land since he had to seek the consent of the extended family.[406] The *resti* system also existed in some areas of the highlands.

At the time of liberation in 1991, remnants of many of the tenure systems discussed above existed.[407] The periodic redistribution of land among village members and the polarization of land tenure systems created land fragmentation, low agricultural productivity, and environmental degradation, while unclear land rights led to prolonged and costly litigation.[408] The situation was "a recipe for chaos in the countryside," and a serious obstacle to

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399 *See* ERI. PROC. NO. 58/1994 (1994).

400 *See* WORLD BANK, *supra* note 130, at 67-68.

401 *See* MESGHENNA, *supra* note 3, at 145, 148.

402 *See* WORLD BANK, *supra* note 130, at 68.

403 *See id.*

404 *See* MESGHENNA, *supra* note 3, at 107.

405 *See id.*

406 *See id.* at 108.

407 *See* Sandra F. Joireman, *The Minefield of Land Reform: Comments on the Eritrean Land Proclamation*, 95 J. ROYAL AFR. SOC'Y 269, 273 (1996).

408 *See* ERI. PROC. NO. 58/1994 pmbl. (1994).

agricultural development and economic growth of the country.[409]

Consequently, the government's Eritrean Land Commission began discussing land policy in March 1993 before the official declaration of independence.[410] As a result Land Proclamation No. 58/1994 was issued after this long period of study and consideration of several models of land allocation.[411] The systems considered included privatization, returning to the *diessa* system but increasing the period of allocation from five or seven years to twenty years, and maintaining the traditional *diessa* system.[412] All of these systems were rejected, and the system of usufruct rights was adopted.[413] The Proclamation has eliminated the periodic redistribution of land under the *diessa* system, as well as with the *resti* system.[414] Ownership of land has become the exclusive right of the government.[415] Individuals are granted usufruct rights with the ultimate right of dispossession resting with the state.[416] However, this state control raises the question whether this type of limited property right is a sufficient incentive for investors.

Under the Land Proclamation, land is allocated to individual Eritrean citizens for lifetime use, and leftover or expropriated land returns to the government for various purposes such as forest reserves and allocation to investors.[417] Investors do not have to be Eritreans; foreigners have usufruct, or lease rights on land, as well.[418] Individual land holdings are allocated to all Eritreans reaching the majority age of eighteen years, regardless of their ethnic origin, gender, marital status, or religious background.[419]

409 Joireman, *supra* note 407, at 273.

410 *See id.*

411 *See id.*

412 *See id.*

413 *See* PROC. NO. 58/1994 art. 4, § 1.

414 *See id.* art. 39, § 1.

415 *See id.* art. 3, § 1.

416 *See id.* art. 4.

417 *See* Joireman, *supra* note 407, at 273.

418 *See id.*

419 *See* PROC. NO. 58/1994 art. 4, § 4 (entitling all Eritreans to enjoy land rights regardless of sex, religion, race, or clan); art. 7 (allowing usufruct land right upon reaching the age of 18).

The individual holdings can be inherited, but the successor must give away any other land allocated to him by the government.[420] The landholder can also lease his right of usufruct to others or enter into sharecropping arrangements but cannot sell or grant the land as a gift.[421] Further, the Proclamation requires that the government pay compensation when it takes land from citizens.[422] The Land Proclamation has not been fully implemented; it is pending on educational campaigning in the countryside and testing of the policy in some areas.[423]

As stated in the preamble of the Land Proclamation, the intent behind the land policy, which is based on state land ownership, is to stimulate agricultural and industrial development; to give usufructuaries, the lessee, and other producers the opportunity to increase agricultural production; to encourage private investment; to eliminate conflicts and disputes between individuals and villages; to pave the way for raising the living standard of the Eritrean people; and to introduce uniformity in land holding in Eritrea.[424] Some writers have regarded the new land-use policy as substantially progressive compared to the land-tenure systems that existed previously. In particular, Sandra Joireman, a commentator, observes that the Land Proclamation clarifies some of the previous confusion over land rights in the countryside as part of the development strategy of the Eritrean Government.[425] First, the new system eliminates the polarization of tenure systems and gives uniformity of tenure throughout the country by giving individuals the right to use land.[426] Second, the new mechanism encourages individuals to make long-term investment in their land, which will pass to their children.[427] Third, the Proclamation has been praised

[420] *See id.* art. 24, § 3.

[421] *See id.* art. 18, § 3 (allowing for lease of land granted under a usufruct right); art. 26, § 1 (allowing the right to use land under a sharecropping agreement); art. 24, § 1 (stating that land allotted to a usufructuary shall not be sold or donated).

[422] *See id.* art. 50, § 4.

[423] *See* Joireman, *supra* note 407, at 274.

[424] *See* PROC. NO. 58/1994 pmbl.

[425] *See* Joireman, *supra* note 407, at 284-85.

[426] *See id.* at 274.

[427] *See id.* at 284-85.

as "revolutionary" and "positive" by Joireman and the World Bank for "put[ting] women on an equal footing with men with regard to right of access to both farming and housing land."[428]

However, the new land policy has also raised criticism from writers, including Joireman herself and the World Bank. The World Bank notes that "in many countries the lack of inheritance rights has discouraged investment."[429] Specifically, in the case of Eritrea, it believes that "the potential disincentive effects of lack of inheritance rights may be compensated to some extent by the right to request a transfer of land to another family member–although there may be no definite assurance that such transfer will be approved."[430] Joireman's criticism is that the Land Proclamation is based on the modernization theory of increasing agricultural production by investing in projects, technology, or import substitution.[431] According to her this approach is not sound since production increase is achieved not through such investments, but when land is used by small holders, resulting in an increased level in labor inputs.[432] Gebremedhin, recognizing that the new land-use policy is a substantial improvement compared to the system that existed before, argues that it may restrict long-term investment and create stagnation in agricultural development and food production, because the Proclamation "does not permit private ownership."[433] He also criticizes the Proclamation for failing to solve the issue of land rights of nomadic pastoralists.[434] He states, that "[t]he new land-use policy is also an agrarian reform which attempts to solve the land-tenure problems of settled farming. However, the Proclamation fails to address the unique land-use issues of nomadic pastoralists, who raise livestock and migrate through the regions in search of water and grazing land."[435]

Choosing the right land tenure system and type of land reform

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428 Joireman, *supra* note 407, at 284-85.; WORLD BANK, *supra* note 130, at 68.

429 WORLD BANK, *supra* note 130, at 68.

430 *Id.*

431 *See* Joireman, *supra* note 407, at 275, 283.

432 *See id.* at 283.

433 GEBREMEDHIN, *supra* note 2, at 238.

434 *See id.*

435 *Id.*

has been difficult for governments and continues to be the subject of debate in literature, the discussion of which is beyond the scope of this Article. Many writers agree that private ownership of land is the best stimulant for agricultural production, some of them citing the experience of East Asian countries.[436] But there are those who do not see private ownership of land as the only way for agricultural production growth. John Bruce argues that both private ownership and leasehold from the state can be viable options if the beneficiaries of the redistributive programs are provided with security of tenure: "Both Kenya (freehold) and Zambia (leasehold) seem to have satisfactory experiences in terms of production once some unevenness in the transition [from former European land owners to the indigenous African population after independence] was past."[437] He cautions, however, that in the case of leasehold "much depends upon the terms of the lease and upon the effectiveness of the land administration."[438] Bruce also warns that another important point which governments need to keep in mind is that "[l]and distribution and land tenure reform only achieve positive impacts on production in coordination with appropriate arrangements for access to inputs, credit, extension services, and markets."[439] Any reform may fail to achieve its desired aim if access to these other needs is not made to the beneficiaries of the reform: "Attempts to increase farmer incentives through tenure and land reform have often been nullified by cheap food policies favoring urban consumers."[440]

As indicated the Eritrean Land Proclamation provides state ownership of land but guarantees lifetime rights to the

[436] *See* GEBREMEDHIN, *supra* note 2, at 233-34 (citing ANNE O. KRUEGER ET AL., AID IN DEVELOPMENT (1989)). Private ownership also helped relieve some of the glaring disparities in income between the rural and urban population in East Asia. *See id.* at 36 (citing FRANCIS LAPPE & JOSEPH COLLINS, TWELVE MYTHS (1986)).

[437] John Bruce, *The Variety of Reform: A Review of Recent Experience with Land Reform and the Reform of Land Tenure, with Particular Reference to the African Experience*, *in* INSTITUTIONAL ISSUES IN NATURAL RESOURCES MANAGEMENT 13, 47 (Henrik S. Marcussen ed., 1992).

[438] *Id.* at 47.

[439] *Id.*

[440] *Id.* at 48.

landholder.[441] While this policy emanates from good intentions, it is yet to be seen whether this type of land tenure will bring the desired economic growth. This may depend on various factors. Convincing farmers to make long-term investments on land owned by the government is not easy. Administration of such land tenure is perhaps the most difficult task. Although the government is allocating land to investors on long-term lease basis, the Proclamation has not been implemented with respect to farmers.[442] While land ownership belongs to the State in accordance with Proclamation No. 58/1994, villages continue to use land on the traditional *diessa* basis, pending the implementation of the Proclamation.[443] Thus, implementation of the Land Proclamation has been a very challenging task for the government, which faces the lack of qualified personnel and financial resources.[444]

On the other hand, the issue of nomadic pastoralism is very important and needs to be properly addressed. Livestock has always been a principal source of natural wealth.[445] Seventy-five percent of the total population, whether agro-pastoralists or pure pastoralists, depends on livestock and livestock production.[446] Cattle population, however, has declined as a result of the prolonged war, recurrent droughts, and inadequate veterinary services.[447] After independence there was a significant rise in livestock population through improved animal husbandry, including an expanded program of veterinary services.[448] Yet, by accounts of the government, limited veterinary service is the only social service available to people living on rangelands, and no

441 *See supra* notes 415-23 and accompanying text (discussing the Eritrean system of land ownership).

442 *See* HADDAS ERI. NEWSPAPER, June 4, 1997, at 1.

443 *See id.*

444 *See id.* Recently, a new Ministry of Land, Water, and Environment has been created. *See id.* Obviously, one of the tasks of the new Ministry is to deal with the new land policy. *See id.*

445 *See supra* notes 167-68 (discussing livestock as a source of wealth despite its decline during the war).

446 *See* NATIONAL ENVIRONMENTAL PLAN, *supra* note 133, at 55.

447 *See Eritrea: Recent Economic Development*, *supra* note 161, at 8.

448 *See id.*

development program has been carried out in those areas.[449] Article 45 of the Land Proclamation authorizes the concerned villages and the central government to allocate grazing lands.[450] But again, no regulation has been issued to implement the provision of the Proclamation.

i. Investment and Regulation of Labor

According to the World Bank, "Eritrea's most valuable resource is its people, and the lack of adequate investment in capital and land . . . [makes] labor the most important asset" for the country's economic growth.[451] Further, "[l]ike the other sectors, decades of war, negligence, and the centrally planned policies of the Ethiopian regime had a devastating impact on the functioning of labor markets."[452] Eritrea inherited acute skill shortages in all sectors and a high rate of employment.[453] Labor immobility was reduced to its lowest level, and many Eritreans were forced to leave the country in search of work.[454]

The labor market is governed by Proclamation No. 8/1991, which was slightly amended by Proclamation No. 15/1991.[455] Under these provisions employers are free to hire whomever they want to employ.[456] Article 4 of Proclamation No. 8/1991 provides that undertakings that operate for a period of not more than three months and those that have less than ten workers are free to employ any person from the market and are not obliged to report to the Labor Department.[457] In other cases Proclamation No. 8/1991 requires that employers must hire one of three persons

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449 *See* NATIONAL ENVIRONMENTAL PLAN, *supra* note 133, at 15.

450 *See* ERI. PROC. NO. 58/1994 art. 45 (1994).

451 WORLD BANK, *supra* note 130, at 91.

452 *Id.; see also supra* notes 109-19 and accompanying text (discussing Ethiopia's exploitation of Eritrea).

453 *See* WORLD BANK, *supra* note 130, at 91; *see also supra* notes 101-08 and accompanying text (discussing the effect of the Ethiopian economic policies on Eritrea).

454 *See* WORLD BANK, *supra* note 130, at 91.

455 *See* ERI. PROC. NO. 8/1991 (1991); ERI. PROC. NO. 15/1991 (1991).

456 *See* PROC. NO. 8/1991; PROC. NO. 15/1991.

457 *See* PROC. NO. 8/1991 art. 4.

selected by the Labor Department from its list of job seekers based on the need of the employer, who is required by law to report job vacancies to the Labor Department.[458] However, the employer is free to hire anyone if the Labor Department does not make the selection and communicate it to the employer within fifteen days from the date of notification.[459]

In all cases the employer and the employee are free, within the limits of the law, to determine the conditions of labor in a labor contract.[460] For example, Eritrean law does not require a minimum wage.[461] Employers can terminate the labor contract, and the severance payment depends upon tenure.[462] A probationary period lasts three months, during which time the employer can fire the employee without compensation.[463] Advance notice before dismissal is only fifteen days for employees with less than one year of tenure and two months for others.[464] The law also provides for collective bargaining and dispute mechanisms.[465] The Labor Department resolves disputes, and unresolved disputes are taken to court.[466] In practice most disputes have been individual in nature, and most of them are settled through conciliation even before going to the Labor Department.[467] 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.[468]

Overall, labor market issues have not been considered a significant constraint for entrepreneurs because they provide a

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458 *See* PROC. NO. 8/1991.

459 *See id.*

460 *See id.*

461 *See id.*

462 *See id.*

463 *See id.*

464 *See id.*

465 *See id.*

466 *See id.*

467 *See* Roberto Zavatta, Eritrea Private Sector Review, Prepared for the International Finance Corporation 30 (June 1994) (unpublished, on file with author).

468 *See* ERI. PROC. NO. 59/1994 art. 7 (1994).

reasonably open and flexible framework for employers.[469] However, some aspects of the labor law have been regarded as biased towards the workers. For example, the severance payment increases sharply with tenure.[470] Another point of concern for employers is that they are required to report job vacancies to the Labor Department for the purpose of hiring workers.[471] One possible rationale behind this legal requirement is to avoid discrimination in hiring job seekers in the country where unemployment is very high. Currently, the labor code is under review with the aim of making it more consistent with a market economy.[472]

j. Investment and Privatization

At independence Eritrea inherited a variety of public enterprises from the Ethiopian regime, which had adopted a policy of command economy for nearly two decades.[473] In 1993 there was a total of 932 industrial enterprises in the country; forty-two of these were state-owned manufacturing enterprises.[474] Average employment in these public enterprises was more than 250 employees with average capital investment of Birr 2.2 million.[475] In contrast "[p]rivate enterprises . . . were mostly small, employing on average six people with an average capital investment of only [Birr] 90,000."[476] The public enterprises were outdated, suffering from lack of maintenance, spare parts, and the shortage of skilled human resources.[477] They operated at only twenty-two percent of their capacity.[478]

In December 1995 the government established a National Supervision and Privatization Agency that would be responsible

469 *See* Zavatta, *supra* note 467, at 30.

470 *See id.*

471 *See* PROC. NO. 8/1991.

472 *See* WORLD BANK, *supra* note 130, at 91.

473 *See id.* at ii.

474 *See id.* at 48.

475 *See id.*

476 *Id.*

477 *See id.* at 49.

478 *See id.*

for the divestiture or liquidation of the enterprises wholly or partially owned by the state.[479] The Ministry of Trade and Industry devolved the management of these enterprises to the National Privatization Agency.[480] Sectoral boards, sectoral committees, and management teams of each enterprise operate under the supervision of the national agency.[481] The agency is empowered by Proclamation No. 83/1995 to evaluate the status of production and technological capability of each enterprise, to take measures to vitalize their productivity and to prepare them for privatization.[482]

The agency is expected to prepare a number of methods of privatization including competitive tender, public offering, management/employee buyouts, and sale of assets.[483] The privatization process has been delayed until 1997. In addition the agency lacks qualified personnel necessary to implement the Proclamation. Privatization for state-owned enterprises is also under consideration.[484] Specifically, the Ministry of Tourism is to privatize all hotels.[485] Several hotels already have been privatized, and others have been put under private management.[486]

Privatization of state-owned enterprises should not be seen as a change of economic policy by the Government of Eritrea, which pursues a market-based economy led by the private sector. The problem of centralized state ownership has been inherited from the previous Ethiopian regime. However, there is no doubt that the privatization policy should further encourage private investment.

k. Dispute Settlement Mechanism

Article 15 of Investment Proclamation No. 59/1994 provides for investment dispute settlement.[487] Modes of dispute settlement are stipulated in the agreement signed between parties to

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479 *See* ERI. PROC. NO. 83/1995 arts. 3, 5 (1995).

480 *See Eritrea: Recent Economic Development*, *supra* note 161, at 8.

481 *See id.*

482 *See* PROC. NO. 83/1995 arts. 3, 5.

483 *See id.*

484 *See id.*

485 *See id.*

486 *See id.*

487 *See* ERI. PROC. NO. 59/1994 art. 15 (1994).

investment agreements.[488] The Proclamation also pledges to accord foreign investors further protection by entering into bilateral and multilateral protection treaties.[489] Foreign investors can choose to resolve disputes through mechanisms stipulated in investment agreements made between the government and the investor, through modes of settlement provided in bilateral treaties concluded between the Eritrean Government and the home Government of the investor, or through mechanisms created by multilateral treaties, such as International Centre for Settlement of Investment Disputes (ICSID).[490] Although the Proclamation pledges ISCID membership, Eritrea has neither ratified nor signed the ICSID Convention.[491]

Despite the importance of treaty membership in building confidence of foreign investors, there is no substitute for a sound domestic mechanism for settlement of disputes. Foreign investors

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488 *See id.* art. 15, § 1.

489 *See id.* art. 15, § 2.

490 *See id.*

491 *See International Centre for Settlement of Investment Disputes*, 1998 ICSID ANN. REP. Annex 1 at 17-19 (providing a list of all countries signatory to the Convention). The Convention creating ICSID entered into force on October 14, 1966, following ratification by twenty governments. *See* Rowat, *supra* note 387, at 106. The purpose of the Centre was "to provide facilities for conciliation and arbitration of investment disputes between Contracting States and nationals of other Contracting States in accordance with the provisions of this Convention." Convention on the Settlement of Investment of Disputes Between States and Nationals of other States, Mar. 18, 1965, art. 1, para. 2, 17 U.S.T. 1270, 1273, 575 U.N.T.S. 159, 162. "However, ICSID does not resolve disputes directly; rather it relies on Conciliation Commissions and Arbitral Tribunals empowered by the provisions of the Convention and by the Rules adopted pursuant to it." Rowat, *supra* note 387, at 107.

The impact of ICSID on FDI is growing as more countries are resorting to the international agency for resolution of disputes with foreign investors. ICSID's membership is increasing steadily. *See International Centre for Settlement of Investment Disputes*, *supra* at 4. At the close of the 1996 fiscal year there were 144 signatory States of the Convention and 129 member countries of ICSID. *See id.* Clauses calling for ICSID arbitration to resolve disputes have become commonplace in Bilateral Investment Treaties (BITs), local investment codes, and individual investment agreements. *See id.* The widespread use of these provisions indicates that ICSID has contributed materially to the increase in investor confidence and the attractiveness of developing countries as places for FDI. Host governments have benefited, both from FDI levels that are probably higher than they would be without a dispute resolution mechanism that was perceived as neutral and cost effective, and from ICSID's providing a forum to seek redress against foreign investors who have failed to meet their obligations.

are, on a daily basis, involved in negotiations and transactions with public and private agencies as well as individuals of the host country. Foreign investors are suspicious, however, about being treated discriminatorily by local courts and other agencies vis-à-vis their domestic counterparts. These investors are sensitive about the level of reception, efficiency, and speed of the services rendered them by domestic institutions and officials.

l. Legal Profession

At present Eritrea's judicial system and legal profession are at their early stage of development. The Ministry of Justice acknowledges that the legal services currently being rendered to the public are far from adequate, let alone sufficient to cope with future development and growth in Eritrea.[492] In a 1994 report, the Ministry counted one hundred judges: seventeen in the High Court, fifty-four in the Awraja (provincial courts), and twenty-nine in the Woreda (district courts).[493] Further, there are only thirty-one prosecutors in the country.[494] Sixty-six practicing lawyers appear in courts found in the capital, Asmara, but they hardly serve the public in other regions.[495] The judges, the prosecutors, and the practicing lawyers are not only small in number, but also the level of their professional training and skill is also very low.[496] Moreover, they lack facilities and equipment, such as buildings, computers, and photocopiers.[497] In short, they are not well equipped to solve complicated legal disputes in which foreign investors are involved.

Additionally, legal education is just getting organized. The Law Program at the University of Asmara, the only university in the country, has not been elevated into a full-fledged degree-offering law school, although the University has approved a

492 MINISTRY OF JUSTICE, DEVELOPMENT PLANS AND STRATEGY PROPOSAL (1994) (pages not numbered).

493 *See id.*

494 *See id.*

495 *See id.*

496 *See id.*

497 *See id.*

curriculum.[498] The Law School graduated the first class of LL.B. degree graduates at the end of the 1997-98 academic year.[499] Although the graduates can help to alleviate the shortage of legally trained personnel, it will take some time until the whole system of the administration of justice is able to meet Eritrea's needs for skilled legal experts.

IV. Conclusion

Since its independence, Eritrea has been in the midst of national reconstruction.[500] Nevertheless, Eritrea has acquired considerable experience in creating a democratic government and a viable economy. The Popular Front for Democracy and Justice (PFDJ) has ruled the country overall, but it has also involved the public in governing the country at national and local levels. This transitional period has culminated in the creation of a constitutional government.[501] A number of reforms have been taken to improve administrative capacity. Despite these reforms, the government agencies are at their early stage, and they have a long way to go until they reach an acceptable stage of operation.

The most difficult tasks for Eritrea today are on the economic front. The Recovery and the Rehabilitation Program has helped to normalize an economy torn by years of war and drought. The country, however, must deal with a lack of capital, technology, and skilled manpower for long-term economic development. In order to mobilize these resources, the government adopted a liberal, export-oriented market economy led by the private sector.[502] The government plays a proactive role to make the private sector the engine of economic growth in Eritrea.[503]

Efforts are being made to create the legal and institutional framework to encourage the development of a market-oriented economy in Eritrea.[504] A four-tier judicial system has been

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498 *See* UNIVERSITY OF ASMARA, LAW SCHOOL CURRICULUM 1 (1996).

499 *See id.*

500 *See* MACRO-POLICY, *supra* note 7, at 2.

501 *See generally* ERI. CONST.

502 *See id.* at 12.

503 *See id.*

504 *See supra* notes 216-23 and accompanying text.

established.[505] In addition, Eritrea has joined various international and regional economic and financial institutions, such as MIGA,[506] and has promised to join ICSID.[507] These measures mark significant steps towards the establishment of a legal framework necessary for the economic development of Eritrea.

Investment Proclamation No. 59/1994 is expected to stimulate the mobilization and the development of capital, technology, and skilled manpower that Eritrea lacks from domestic and foreign sources.[508] The Proclamation provides investors with the same tax incentives as the Tax Code.[509] But the Tax Code itself is designed to encourage investors by providing them with reduced tariff rates on import duties on industrial inputs, by eliminating export duties, and by keeping the corporate tax low, all of which reflect the export-oriented policy of the government.[510] Further, the Proclamation treats domestic and foreign investors equally, illustrating the liberal investment policy of the government and the significance that it attaches to FDI.[511]

Investment Proclamation No. 59/1994 is a liberal and attractive investment code. However, the actual effect of the Proclamation will depend on the country's general legal framework, and several other factors. The legal system is at its early stage of development. The absence of patent law and trademark law, as well as the outdated copyright law, show that Eritrea's intellectual property law is far from complete.[512] Legislation guaranteeing these property rights is a necessity for investors. Eritrea also must join the international organizations on intellectual property.

Land Proclamation No. 58/1994 is an important advancement in several respects.[513] For example, it has introduced uniformity in land tenure in Eritrea by putting an end to the various types of

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505 *See supra* notes 221-23 and accompanying text.

506 *See supra* notes 371, 394-97 and accompanying text.

507 *See supra* note 491 and accompanying text.

508 *See* ERI. PROC. NO. 59/1994 (1994).

509 *See supra* notes 306-11 and accompanying text.

510 *See* PROC. NO. 59/1994 art. 12, § 4.

511 *See supra* notes 255-62 and accompanying text.

512 *See supra* notes 263-82 and accompanying text.

513 *See* ERI. PROC. NO. 58/1994 (1994).

tenure that led to the fragmentation of landholdings.[514] It has also guaranteed equality in the rights to own land.[515] Investors and farmers, however, may be affected by the way the new land law is implemented. Although the government is allocating land to investors, the effect of the leasehold tenure on investment remains to be seen. The villages will be most affected by this type of tenure. However, farmers may be reluctant to make long-term investment on their leasehold lands. The lack of administrative capacity also poses potential problems for the implementation of the Land Proclamation. The villages must play the decisive role in the administration of land; incentives such as credits, training, and the introduction of new technology to increase agricultural production must also be available to farmers.

The regulations of the labor market[516] have been well received. Although relations between employers and employees have been positive thus far, the degree of government intervention in the labor market needs to be carefully evaluated and brought to the lowest level possible.

Another factor that could affect investment law in Eritrea is the judiciary, which is understaffed and unequipped to handle complicated investment matters.[517] Although the Law School at the University of Asmara has begun to provide legal training,[518] it must be upgraded to produce qualified legal personnel to fill the huge gap in the judicial system.

Further, institutional and infrastructure resources must expand if Eritrea's investment laws are to produce the intended effects. The financial service is not developed. Almost all of the banks are owned by the government; private banks have only recently been allowed to operate.[519] Moreover, the country suffers from a chronic electricity shortage.[520] The transport infrastructure has been dilapidated by the thirty years of war. The roads and the ports,

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[514] *See supra* notes 398-450 and accompanying text.

[515] *See supra* notes 419, 428 and accompanying text.

[516] *See supra* notes 452-72 and accompanying text.

[517] *See supra* notes 492-97 and accompanying text.

[518] *See supra* notes 498-99 and accompanying text.

[519] *See supra* notes 188-92 and accompanying text.

[520] *See supra* note 120 and accompanying text.

which at one time represented a well-developed system, need to be rebuilt.[521] Telecommunication systems are underdeveloped and unreliable.[522] Further, there is an overall shortage of water, and it is unevenly distributed over regions and seasons.[523] All of these factors constitute serious disincentives for investors in Eritrea. Although the government is aware of these obstacles, and is working hard to remove them, it requires a great deal of time and resources to bring the situation to an acceptable level.

Despite all of the impediments that it must overcome, Eritrea has numerous advantages that make it attractive to investors. As noted above, the investment code is liberal. Further, Eritrea has potentially extensive natural resource wealth.[524] Moreover, its strategic location gives it access to a major world shipping lane.[525] These factors can be achieved when the disincentives are removed. However, because its most valuable resource is its people,[526] investing in education and development of skilled manpower will be the most important contributing factor to Eritrea's objectives in economic growth.[527]

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[521] *See supra* notes 121-23 and accompanying text.

[522] *See supra* note 120 and accompanying text.

[523] *See supra* note 8 and accompanying text.

[524] *See supra* notes 182-85 and accompanying text.

[525] *See supra* notes 158-60 and accompanying text.

[526] *See supra* notes 152-53, 451 and accompanying text.

[527] *See* WORLD BANK, *supra* note 130, at 91; *supra* note 451 and accompanying text.