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Eritrea: Basic Data

Area: 121,320 square kilometers
 Population, 2001 estimate: 4.2 million
 Population, 1997-2001 average annual growth: 2.6 percent
 GNI per capita, *World Bank Atlas* method, 2000 estimate: U.S. \$ 170

	1997	1998	1999	2000	2001	2002 Est. 1/
National accounts						
	(In millions of nakfa, unless otherwise specified)					
GDP at current market prices	4,974.3	5,530.4	5,982.1	6,200.5	7,771.0	9,031.2
GDP at constant (1992) market prices	3,641.2	3,706.3	3,705.8	3,218.7	3,547.7	3,612.3
GDP at constant (1992) factor cost	3,266.8	3,394.9	3,403.8	2,996.7	3,256.9	3,218.2
(annual percentage change)	7.7	3.9	0.3	-12.0	8.7	-1.2
	(In percent of GDP at current market prices)					
Gross domestic expenditure	155.8	164.8	172.5	162.1	159.3	158.6
Consumption	123.9	138.2	138.3	143.6	130.7	132.3
Investment	31.9	26.6	34.1	18.5	28.5	26.3
Net exports 2/	-55.8	-64.8	-72.5	-62.1	-59.3	-58.6
Gross national savings	34.0	3.0	6.2	2.3	10.1	10.9
Prices						
	(Annual percentage change)					
Consumer price index (annual average)	3.7	9.5	8.4	19.9	14.6	16.9
Consumer price index (end of period)	7.7	9.0	10.6	26.8	7.7	23.8
Terms of trade (- deterioration)	0.0	-5.7	2.2	3.5	-1.2	-2.5
Exchange rates						
Exchange rate (in nakfa per U.S. dollar; period average)	7.2	7.4	8.2	9.6	10.9	14.0
Nominal effective exchange rate (-depreciation; end of period)	3.2	-4.4	-14.8	2.8	-27.2	-7.8
Real effective exchange rate (- depreciation; end of period)	7.2	2.4	-8.9	29.5	-22.5	19.0
Central government finance						
	(In millions of nakfa, unless otherwise specified)					
Total revenue	2,022.8	1,688.7	1,895.5	2,108.3	1,986.4	2,291.4
Grants	287.9	519.4	489.0	1,204.8	1,375.6	1,118.4
Total expenditure and net lending	2,558.1	4,218.8	5,467.9	4,136.4	4,545.3	5,176.9
Current expenditure	1,412.8	2,781.6	3,213.9	3,364.2	3,287.3	3,656.0
Capital expenditure and net lending	1,145.3	1,437.2	2,254.0	772.2	1,258.1	1,520.9
Overall balance, excluding special programs						
Excluding grants	-535.3	-2,530.1	-3,572.4	-2,028.1	-2,559.0	-2,885.4
Including grants	-247.4	-2,010.7	-3,083.4	-823.3	-1,183.4	-1,767.1
Overall balance, including special programs						
Excluding grants	-568.0	-2,620.8	-3,714.4	-3,195.7	-4,080.5	-3,840.4
Including grants	-280.1	-2,101.4	-3,225.4	-1,991.0	-2,704.9	-2,722.0
Overall balance, including special programs (in percent of GDP)						
Excluding grants	-11.4	-47.4	-62.1	-51.5	-52.5	-42.5
Including grants	-5.6	-38.0	-53.9	-32.1	-34.8	-30.1

Eritrea: Basic Data (concluded)

	1997	1998	1999	2000	2001	2002 Est.
Money and credit	(Annual change in percent of beginning-of-period broad money stock)					
Domestic credit	12.0	40.4	38.0	18.0	19.0	18.4
Government (net)	3.0	35.6	45.1	25.0	3.7	15.2
Private sector	11.3	16.6	-3.1	-2.3	4.8	4.7
Broad money (including foreign currency deposits)	30.6	18.2	40.9	13.0	26.4	18.5
Balance of payments	(In millions of U.S. dollars, unless otherwise specified)					
Current account balance (including official transfers)	14.4	-177.1	-204.7	-104.5	-131.4	-99.6
Current account balance (excluding official transfers)	-37.0	-235.9	-282.1	-206.8	-252.1	-179.9
Exports, f.o.b.	53.5	28.2	20.1	36.7	19.9	51.8
Imports, c.i.f.	494.6	526.8	494.6	470.3	536.7	533.4
Trade balance	-441.1	-498.6	-474.5	-433.5	-516.7	-481.7
Services (net)	55.4	12.9	-57.3	32.4	94.2	102.3
Income (net)	-3.4	4.3	6.1	-1.4	-4.6	-6.1
Current transfers (net)	403.5	304.2	321.0	298.0	295.8	285.8
Capital and financial account (net)	90.5	80.3	205.6	98.7	102.1	68.2
Capital account (net)	0.0	2.7	0.6	0.0	7.3	3.6
Financial account (net)	90.5	77.7	205.0	98.7	94.8	64.6
Overall balance	146.7	-174.1	-14.7	-15.2	7.2	-39.0
Current account balance (in percent of GDP)						
Including official transfers	2.1	-23.6	-27.9	-16.2	-18.4	-15.4
Excluding official transfers	-5.4	-31.5	-38.4	-32.0	-35.4	-27.8
Gross official international reserves (end of period)						
In millions of U.S. dollars	243.3	69.0	54.3	36.6	50.6	33.1
In months of imports of goods and services	5.0	1.4	1.1	0.9	1.1	0.7
External debt						
Stock of external debt (end of period) 3/ (in percent of GDP)	11.0	18.8	37.5	51.4	60.8	78.6
Net present value of external public debt 3/ (in percent of exports of goods and services) 4/	25.2	51.7	135.4	225.9	247.8	198.3
Scheduled external debt service 3/ (in percent of exports of goods and services) 4/	0.3	0.8	5.7	3.8	5.3	15.1

Sources: Eritrean authorities; and IMF and World Bank staff estimates.

1/ Actual data for prices and exchange rates.

2/ Goods and services.

2/ Public and publicly guaranteed debt.

3/ Three-year average of exports of goods and services used.

I. INTRODUCTION

1. This selected issues paper and statistical appendix provide background information on the 2003 Article IV consultation discussions with Eritrea (SM/03/.../04/.../03). The staff report discusses the many demanding economic policy challenges confronting Eritrea. It points out, in particular, that the period since gaining independence in 1993 has not been long enough for the authorities to gain a full understanding of the functioning of the economy and develop the necessary skills and expertise to successfully implement the complex mix of economic, financial, and development policies needed to strengthen growth and reduce poverty. The policy making environment was further complicated by the border conflict with Ethiopia during 1998-2000, which created its own momentum and rationale, and interrupted the continuity of the development process. It also delayed the full implementation of laws that were intended to provide a solid foundation for the roles and objectives of government institutions, including the Bank of Eritrea (BE), the country's central bank.

2. In this environment, economic and financial policies were often driven by immediate needs and expediency, rather than funded by sound analytical concepts and medium-term policy objectives. The result has been a serious deterioration in the country's fiscal and external balances and an accumulation of distortions in the economic system that have impaired growth and skewed incentives, notably in the private sector. Realization of these circumstances has motivated the staff to prepare the four analytical documents presented in this paper. Drafts of these documents were sent to the authorities ahead of the mission and were discussed with officials during a full-day workshop that clarified a number of issues and sharpened the focus of the documents.

3. The large fiscal deficits observed over the past years are the root cause of many of the macroeconomic problems observed in the country, not only because of their size, but also because of the severe distortions they have caused in the monetary and exchange rate systems. They are also clearly unsustainable. In the document, on the sustainability of the public finances, an assessment is made of the causes of the fiscal deficits and how they have influenced the usual indicators of fiscal and external debt sustainability. However, the analysis does not stop here. Instead, the document also seeks to identify how and through which channels fiscal and other economic policies have affected the behavior of endogenous variables that in one way or another influence sustainability. By doing so, it looks at the sustainability issues from a dynamic perspective in which the endogeneity and interdependence of economic variables are highlighted and the potential for vicious or virtuous circles regarding sustainability is examined.

4. Monetary policy in Eritrea is completely subordinated to fiscal policy so that the statutory independence of the BE has been de facto suspended. This situation does not represent an approach that will permit the BE to successfully pursue the key stability objectives of stabilizing the domestic and external values of the nakfa under its 1997 law. The document on monetary policy and management clarifies the risks of this approach and also discusses the statutory role of the BE in relation to international best practices. It then turns to a comparison of statutory role and actual practice. In doing so, it clarifies the