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ANNEX

**Development Cooperation Strategy 2019/20 for the implementation of an individual measure in favour of the State of Eritrea to be financed from the 11<sup>th</sup> European Development Fund (EDF)**

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## **1. INTRODUCTION**

The signing of the Joint Declaration of Peace and Friendship between Eritrea and Ethiopia in July 2018 provides a major opportunity for both countries, as well as for stabilisation in the broader region. Recent high-level dialogue with the EU has demonstrated the Eritrean Government's intent to take forward reforms incrementally, such as opening up the economy and starting to demobilise people from National Service when sufficient jobs are available.

This strategy sets out the EU's proposed response to these new opportunities, both in terms of changing priorities and how they can best be delivered.

## **2. CONTEXTUAL ANALYSIS**

### **2.1 COUNTRY CONTEXT**

On 9 July 2018, the Eritrean President and Ethiopian Prime Minister signed a Joint Declaration of Peace and Friendship. This marked the end of the state of "no war, no peace"; the re-establishment of diplomatic relations; and political, economic, social and security cooperation. It also foresees the resolution of the border issue. The international community responded positively. A further demonstration of this has been the lifting by the UN Security Council of the arms embargo on Eritrea in November 2018.

This rapprochement provides major opportunities for both countries. The immediate benefits in Eritrea are already felt, with the borders opening, communications resuming, twice-daily flights between the two countries and the reduction in the price of basic commodities in Eritrea due to the flow of Ethiopian goods. This will provide some alleviation to the lack of availability of food items, though recurrent poor rains have resulted in increased household food insecurity and further impoverishment.

A key priority for both Governments is to open up the Eritrean roads and ports to commercial trade from Ethiopia. This will help consolidate the peace agreement and economic integration. In doing so, it will support Eritrea's economic development, both in terms of revenues, but also in generating jobs.

These changes provide a catalyst for realising broader reforms. Recent high-level dialogue with the EU has demonstrated the Government's interest and commitment to achieve sustainable and broad-based economic growth. The creation of jobs will also facilitate the ability of the Government to start the process of demobilising people from what is currently indefinite National Service. With the current major limitations in job opportunities, this is a significant challenge. There is also an opportunity to address human rights concerns, in particular the delivery of the recommendations that are agreed from the latest round of the Universal Periodic Review, which took place in January 2019.

### **2.2 REGIONAL CONTEXT**

The rapprochement also has potential far-reaching implications for stabilisation in the Horn. This is already starting to materialise, in particular with Somalia, though with the potential to push this further to enhance connectivity and cooperation across the Horn of Africa. Now is a critical time to ensure the drive and achievement of cooperation works at a much faster pace than countervailing forces of fragmentation. This proposed strategy is a major contribution to achieve this. Hence, it is an opportunity that needs to be seized and supported by the EU, working closely with others, including partners from the Gulf. This is reinforced with

Eritrea's assumption of the Chair of the Khartoum Process, and its election onto the Human Rights Council.

### **3. THE EU'S CHANGING APPROACH TO WORKING IN ERITREA**

#### **3.1.2 Changing approach and new pillars**

The EU has remained a constant partner to Eritrea. This relationship has ebbed and flowed in recent years, but efforts have been made to maintain political dialogue and development co-operation. The latter was reflected in the National Indicative Programme (NIP) for 2014-2020 under the 11<sup>th</sup> EDF. With an initial budget of EUR 200 million of which EUR 175 million was allocated to energy and EUR 25million to governance and support measures.

The EDF Committee agreed the first Annual Action Programme (EUR 78.9 million) in July 2017. This included: the Rural Energy Access for Communities and Households (REACH) project (EUR 73.9 million) aimed at providing access to energy for 225 000 people; and the Framework for the Accelerated Implementation of Human Rights (FAIR) project (EUR 5 million) aimed at helping improve human rights by increasing the capacity of the Government to implement the accepted Universal Periodic Review (UPR) recommendations.

These two projects did not move forward and the Financing Agreements expired at the end of 2018. Although blocked largely for political reasons, standard processes of international procurement work against the Government's central doctrine of self-reliance. The principles of engagement, which set indicators to determine whether sufficient progress had incrementally been achieved to warrant the release of co-operation support, have proved neither conducive in facilitating political dialogue nor in promoting development cooperation. With the lack of disbursement and new priorities in the region, the Mid-Term Review cut Eritrea's NIP allocation by 10 % from EUR 200 million to EUR 180 million..

However, the situation has now significantly changed and there is a need for the EU to adjust its approach and respond to these new political opportunities. Ethiopia fully backs renewed EU engagement with Eritrea, as support to delivering the peace agreement is critical for its own stability.

A new dual track approach has been proposed, which has been endorsed by the European Council Africa Working Group (COAFR) on 12 December 2018. One track includes resuming political dialogue with the Government, notably encouraging reforms on national service and human rights, addressing economic reforms and migration, and other issues of mutual interest. The other track involves re-engaging in co-operation with Eritrea in ways that reinforce the peace agreement and economic integration.

This represents a shift away from conditions-based engagement to one in which both tracks would run simultaneously, though continuing to test overall progress achieved. However, the position of no direct funding to the Treasury will be maintained. The previous approach based on the "principles of engagement" did not provide the desired results. There has been very limited political dialogue and not a single Euro of Eritrea's NIP allocation spent. This is to the detriment of the Eritrean people.

In the case of cooperation, the immediate priority for Eritrea is to rehabilitate the main arterial roads in order to reconnect the two countries and provide Ethiopia access to Eritrea's ports. Other priorities include job creation, energy, economic reform and culture.

The EU's strategic objective is to support the development of Eritrea and its contribution to the broader stabilisation and prosperity of the region. In the immediate term, this requires supporting the delivery of the peace agreement through emergency rehabilitation of roads. In the longer term, it requires supporting broader reforms, notably to the economy, governance and national service. In doing so, it will help address human rights concerns, curb illegal migration, and in due course lead to the opportunity of creating an environment conducive for voluntary returns.

The four pillars proposed to address these requirements are:

1. **Pillar 1: Infrastructure: roads and energy**, with the former playing a critical role in cementing ties between the countries through opening up trade routes; both elements will boost the Eritrean economy.
2. **Pillar 2: Job creation**, mainly for youth, through skills development and the creation of small and medium enterprises, which in turn will help to integrate people demobilised in future demobilisation from the National Service.
3. **Pillar 3: Economic reforms**, so helping to improve public finance management and open up the economy to the private sector.
4. **Pillar 4: Culture**, which will help reconciliation, and benefit tourism and job creation.

### 3.1.2 Justification for using the EU Trust Fund

This dual track approach requires different cooperation arrangements in order to deliver it effectively. The EU has a limited window of opportunity in which to start re-building relations with the Government. Both tracks need to happen rapidly, at the same time and with immediate effect. The Government has repeatedly underlined the pressure it is under to deliver the peace agreement, and in particular rehabilitating roads for trade. If the EU cannot respond to this, Eritrea will look to its other partners for support.

Standard EDF programming procedures would prohibit this approach, given the short timeframes required. Hence, the EU development cooperation strategy for 2019-20 would be most effectively implemented through the "EU Emergency Trust Fund for stability and addressing the root causes of irregular migration and displaced persons in Africa"<sup>1</sup> (EUTF). The EUTF provides the required speed and flexibility, and would not undermine the political track.

The proposed approach and pillars will be fully in line the EUTF's prime objectives: migration and stabilisation. They will reinforce the historic peace agreement after twenty years of conflict. The focus on roads, vocational training, economic reform and culture will stimulate economic and job opportunities, so creating the conditions to allow incremental reforms, including national service: the main root cause of irregular migration.

Individual Action Documents for projects in each of these pillars will be submitted to the EU Trust Fund's Operational Committee using normal EU Trust Fund procedures. Hence, EU Member States will be fully involved.

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<sup>1</sup> The 4 objectives of the EU Trust Fund: i) greater economic and employment opportunities, ii) strengthening resilience of communities and in particular the most vulnerable, as well as refugees and displaced people, iii) improved migration management in countries of origin and transit and iv) improved governance and conflict prevention and reduction of forced displacement and irregular migration.

## 4. STRATEGIC PILLARS

The strategic pillars correspond to the priorities discussed and agreed with the Government of Eritrea, the EU's comparative advantage and their close links to the EU political priorities.

### 4.1 PILLAR 1: INFRASTRUCTURE: ROADS & ENERGY

This pillar will contribute to immediate implementation of the peace agreement, opening up transport and trade between the two countries and supporting Ethiopia's access to Eritrea's ports for its imports and exports.

#### 4.1.1 Outlook: sector analysis

##### Roads

One of the immediate priorities of the Government is to rehabilitate the main arterial roads leading from the Ethiopian border to Massawa port, so that they can handle a significant volume of commercial trucks. The current state of the road would result in severe delays due, for example, to the poor surface of the road and numerous bottlenecks, such as bridges and sections of the road that are single-laned.

There three main road sections that the Government has prioritised are:

- Road Section 1: Nefasit – Dekemhare – Senafe - Zelembesa, which is the main route down to Adigrat and Mekele in Tigray.
- Road Section 2: Dekemhare - Tera Imni – Mendefera - Adi Kuala, which is the fastest route down to Adwa and accessing Amhara.
- Road Section 3: Mendefera – Barentu, which is planned to be connected after Tesseney towards the border with Sudan (and on to Kassala) and Ethiopia (from the border at Humera). The road connecting Mendefera with Barentu will facilitate the movement of goods towards the Western part of the country towards Sudan and the north-western part of Ethiopia (Gondar). The priority after this will be the road from Tesseney to Humera.

In order to rapidly open up these routes and the ports to commercial Ethiopian traffic, the Government is instituting emergency procedures to rehabilitate the roads. For all sections, rehabilitation and road improvement works will consist of widening the road, laying a bituminous surface, pavement rehabilitation, improving alignment, and construction of bridges, cross drainage structures, retaining walls, passing lanes, traffic control and signage.

The EU has a history of engagement in supporting roads in Eritrea. This included the rehabilitation of the Nefasit-Dekemhare-Tera Imni road (part of Road Section 1 and 2), which was concluded in 2002.

##### Energy

Access to electricity in rural areas: 42 % of the population of Eritrea have access to electricity, falling to under 12 % in rural areas. This lack of access is a key limit to economic and social development of fishing and farming sectors. Using off-grid energy solutions will enable energy access, stimulate economic growth and reduce gender disparities.

The EU has already made some progress on this through the existing investment in off-grid energy through the "Solar Photo Voltaic Mini Grids for Two Rural Towns and Surrounding Villages in Eritrea" project. The Government has indicated that it is in the process of developing a new master plan for the energy sector. One of the priority areas of focus is

energy for the ports to respond to their increased capacity to handle increased commercial traffic from and to Ethiopia. There is also the potential to look at cross-border energy connectivity with Ethiopia.

#### **4.1.2 Priorities for engagement**

##### Roads

The objective of EU support will be to improve transport connectivity for commercial trade along the arterial roads between Massawa and the Ethiopian border, in order to help reinforce peace and economic integration between Eritrea and Ethiopia.

The Government has requested the EU to support the procurement of equipment and material, so that it can significantly scale and speed up the rehabilitation work. This would involve international procurement for equipment, plant and materials, such as bitumen, as well as local procurement, such as for sand, gravel and fuel.

In undertaking this support, particular attention will need to be given to making sure minimum safeguards are met, such as ensuring adequate remuneration is given to those people working on the roads.

The primary partner for this would be UNOPS, working closely with the Government.

##### Energy

The objective of EU support will be to improve the socio-economic development of communities by providing access to energy to households, basic services and private sector.

The specific elements need to be explored, but could consist of building on the EU's prior engagement, with the aim of improving rural electrification through renewable energy. In addition, there is the potential to support the generation of energy for Eritrea's ports to respond to the burden of handling increased trade flows from Ethiopia.

#### **4.2. PILLAR 2: JOB CREATION**

This pillar will contribute to the creation of jobs, mainly for youth and primarily in the agricultural sector. It will boost livelihoods and food security, but also provide the means by which the Government can integrate people demobilised from the National Service.

##### **4.2.1 Outlook: sector analysis**

Eritrea is one of the poorest countries in the world. Basic infrastructure and livelihoods have deteriorated considerably during the extended period of conflict with Ethiopia and its isolation. Limited job and livelihood opportunities have provided a constraint to the Government's ability to start demobilising people from the National Service, which now acts as a form of social protection to approximately half a million people under its conscription.

Pressure on jobs is further increased by the 2.2 % annual increase of youth entering the labour market. Currently roughly 60 % of the population is under the age of 25. The future potential for voluntary returns of refugees should also be taken into account.

Access to employment and economic development is limited by human capital. Capacities need to be strengthened at all levels, and training is the most effective way to build this. Gender-balanced, quality technical and vocational education and training (TVET) linked to

economic opportunities have the potential to catalyse economic growth. Moreover, to prepare and encourage young entrepreneurs to start their own business, other supporting measures will be required, such as business incubation, the development of business skills and mentoring in the preparation of business plans.

The agriculture sector remains a dominant part of the economy. Approximately 80 % of the population live in rural areas and earn their livelihood through rain-dependent farming and animal husbandry, which is practiced on small plots using traditional techniques. Agriculture also engages large numbers of unemployed youth. The Government has long prioritised agriculture to ensure food security, poverty reduction, and national self-reliance.

The sector is therefore a top priority for long-term development. However, its contribution to gross domestic product (GDP) is only around 20 % and accounts for about 44 % of commodity exports. Productivity remains low, but it has the potential for growth and increased productivity through the introduction of improved and modern crop management practices, improved mechanisation and increased investment, as well as through developing value chains, such as food processing. This would require investing in extension services, irrigation networks, rural infrastructure (energy and transport), and facilitating farmers' access to agricultural inputs, seeds, markets and finance. Private investments to build value chains should be encouraged.

Youth and women face special challenges in accessing business opportunities in agriculture. Youth are not attracted to farming because of the perceived low returns, and are constrained by limited access to land and other factors of production. Moreover, there are limited space and opportunities for innovations and investments, resulting in low productivity and incapacity to exploit successfully profitable market opportunities.

At the same time, the institutional and regulatory frameworks are not conducive to promote investment and entrepreneurship, with limited investments along the agriculture value-chains. Hence, the success of this pillar will depend on progressive economic reforms to improve the business environment, it will be linked to initiatives under Pillar 3.

#### **4.2.2 Priorities for future engagement**

In line with the strategic objectives of the Africa-Europe Alliance for Sustainable Investment and Jobs<sup>2</sup>, the EU support will be to help the Government generate inclusive growth by stimulating employment and business opportunities for young women and men in the agricultural sector, including skills development and entrepreneurship.

EU support will contribute to stimulating youth to start businesses along selected agricultural value chains in both rural and urban areas. It will encourage the identification, promotion and support of sustainable businesses and employment opportunities in agribusiness for young women and men. This will be achieved through agribusiness incubation and business acceleration activities, as well as providing support to young entrepreneurs in preparing agribusiness plans and loan applications. It will promote access to finance, which will be implemented through national financing institution. The EU will also contribute to improve the delivery of quality TVET opportunities linked to the labour market and local economic potentials. Public private partnerships for the delivery of TVET will be sought.

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<sup>2</sup> COM(2018) 643

One potential vehicle that will be explored for supporting this is the African Development Bank's ENABLE Youth programme. This is in the design phase, and will create business opportunities and employment for young women and men along priority value chains, including through providing entrepreneurship skills, access to finance and business linkages.

This support needs to build on previous EU investment in agriculture, notably through its "Support to the Agricultural Sector/Food Facility in Eritrea" program (EUR 42 million), funded under the 10<sup>th</sup> EDF, as well as the EU's good relations with the Ministry of Agriculture

### **4.3. PILLAR 3: ECONOMIC REFORMS**

#### **4.3.1 Outlook: sector analysis**

One of the (11<sup>th</sup> EDF) NIP's focal sectors is Governance and Public Finance Management (PFM). This includes strengthening macro-economic policies geared towards the creation of decent jobs, increasing productivity and improving investment climate. These remain priorities, particularly with the need to support the normalisation of relations with Ethiopia and promote broader regional economic integration. Making the country more attractive and conducive for investors, both national and international, including the sizable diaspora, will help ensure that Eritrea capitalises on these new opportunities.

The Government recognizes the need to introduce incremental reforms to enhance its capacity for economic, fiscal and financial management, to develop further the policy and regulatory framework for the private sector, and to improve productivity and employment. These progressive reforms will contribute to economic growth.

The Government has already requested technical assistance to improve its capacities in PFM, in particular in the areas of: revenue administration; budget preparation; financial sector regulation and supervision; monetary and exchange rate policy; national payment systems; and macroeconomic and financial statistics. This assistance would mainly be provided through training, which is currently led by the International Monetary Fund (IMF) AFRITAC centre for Eastern Africa.

The Government has also expressed its interest to re-engage with the IMF and World Bank. The World Bank is developing a Country Engagement Note. This will need to consider the process for arrears clearance. The IMF has undertaken several missions to Eritrea to define possible areas for re-engagement, including confirming the willingness of the Government the potential to conduct Article 4 consultations to assess economic and financial developments and discuss the country's economic and financial policies.

#### **4.3.2 Priorities for engagement**

The objective of EU support will be to assist the Government to improve its capacities in PFM, and create a more attractive and conducive business environment for the private sector.

EU support could include advice and technical assistance on reforms supporting macro-economic stability and strengthening PFM capacities of key institutions, such as the Ministry of Finance and the Bank of Eritrea, notably along the areas highlighted above. There will be need to further defined in consultation with the Government and the IMF.



In addition, EU support will focus on developing framework conditions and providing advice and technical assistance to make the business environment and investment climate more attractive and conducive for the private sector. This will benefit both national enterprises and international investors, including the sizeable Eritrean diaspora. The IMF's AFRITAC centre would be a key partner through which to provide this support.

#### **4.4. PILLAR 4: CULTURE**

##### **4.4.1 Outlook**

In 2001, Eritrea ratified the *United Nations Educational, Scientific and Cultural Organisation (UNESCO) 1972 Convention concerning the Protection of the World Cultural and Natural Heritage*. The Tentative List of potential World Heritage sites included Asmara. From 2014-2015, with Norwegian and UNESCO support, the Government developed its first legislation on the protection of cultural and natural heritage. The development of Master Plan for the conservation and management of the Modernist City of Asmara started in 2016, followed by discussions on the urgent rehabilitation and conservation needs of fourteen prominent buildings<sup>3</sup>. The preliminary estimate for the cost of their rehabilitation is USD 80 million. In July 2017, [Asmara](#) was inscribed on the UNESCO World Heritage List. The finalisation of the conservation master plan and the mobilisation of resources for implementing it are ongoing through support from the EU, "Capacity building for safeguarding Asmara's historic urban environment" project, and from the Netherlands funded UNESCO for the "Conservation of Asmara: A Modernist City of Africa" project. This includes the intention to host an international conference and donor meeting in early May 2019 – linked to Africa World Heritage Day – to seek funding, technical expertise and capacity building.

##### **4.4.2 Priorities for engagement**

The objective of EU support would include contributing to the urgent conservation and rehabilitation needs of World Heritage-listed buildings in Asmara, and, in doing so, also create jobs and enhance tourism. EU support could be used to help leverage contributions from other donors and the private sector.

In addition to supporting sustainable development goal (SDG) 8 (Good Jobs and Economic Growth), the rehabilitation of these buildings would also support SDG 9 (Innovation and Infrastructure) and SDG 11 (making cities and human settlements inclusive, safe, resilient and sustainable).

The primary partner for this would be UNESCO.

#### **5. GEOGRAPHICAL SCOPE AND BENEFICIARIES**

The overarching objective is that these pillars will have an impact throughout Eritrea and benefit the whole population. However, Pillar 1 will support in particular those people engaged in the transport sector and those within the catchment area of the rehabilitated roads or installed energy supply. Pillar 2 will mainly benefit residents of Asmara.

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<sup>3</sup> These include: Teatro Asmara; Fiat Tagliero; Cinema Capitol; Alfa Romeo Building; Cinema Odeon; Cinema Impero; Post Office Fish and Vegetable Market; Ministry of Education; Banco di Roma; Former Liyoid Building; Ministry of Trade and Industry; Mieda Eritrea Square; and Palazzo Menecci.

All actions will have a gender-balanced approach. They will target youth population to improve their access and opportunities to engage in the economy and anchor them in the society, particularly those that are demobilised from National Service.

## 6. IMPLEMENTATION MODALITIES AND IMPLEMENTING PARTNERS

Action under the four pillars will be implemented through the EU Emergency Trust Fund for Africa.

The EU will consult EU Member States and involve the National Authorities in the preparatory phase of actions aligned with the strategy and discuss with them the objectives and expected results, the activities, and by whom and how projects are to be implemented. Adequate visibility of the Government will be sought during all phases of implementation.

The main implementing partners proposed are expected to include:

- Pillar 1 (Infrastructure): United Nations Office for Project Services (UNOPS) for roads and potentially energy.
- Pillar 2 (Jobs): African Development Bank and its ENABLE programme.
- Pillar 3 (Economic reforms): IMF AFRITAC centre and UNECA.
- Pillar 4 (Culture): UNESCO

### Donor engagement and coordination

There are few donors with bilateral programmes in Eritrea. The EU Delegation will reach out to all donors, including those from the Gulf. There is an existing Eritrea Partners Forum, led by the United Nations Development Programme (UNDP), where most donors with a presence are represented. Information on the projects in these pillars will be shared through this forum, and possible synergies with other interventions sought.

## 7. INDICATIVE BUDGET AND TIMETABLE OF COMMITMENTS

Sector	Allocation (EUR million)	% of the total Budget
Pillar 1: Infrastructure	130	72
Pillar 2: Jobs	30	17
Pillar 3: Econ reform	5	3
Pillar 4: Culture	15	8
<b>Total</b>	<b>180</b>	<b>100%</b>

It should be noted that this breakdown is the indicative proposal of the Commission, which has been discussed and agreed with the Government. Any adjustment in the priorities and allocations will be agreed with the EUTF's Operational Committee.

Given the limited time left under the 11<sup>th</sup> EDF, the funds transferred to the EUTF would need to be allocated and Action Documents approved by end of 2019, otherwise these resources will need to be reallocated within the EUTF for priority projects agreed by the Operational Committee.