

DJIBOUTI

***INTEGRATED FRAMEWORK
DIAGNOSTIC STUDY OF
INTEGRATION THROUGH TRADE***

March 2004

Executive summary

The macroeconomic and institutional environment

Djibouti is a least developed country (LDC) which nevertheless falls into the category of middle-income economies under the World Bank's classification system. Its gross domestic product (GDP) is very unevenly distributed, a situation reflected by poverty and unemployment, which in 2002 stood at 42 per cent and 59 per cent respectively. However unreliable one may consider these statistics, they nevertheless serve as a clear indicator of the need to increase the annual growth rate of GDP, which seldom exceeded 1 per cent during the 1990s, and to ensure a better distribution of the fruits of this growth among the country's 600,000 people.

The macroeconomic framework and competitiveness

International trade and poverty reduction

The heavy concentration on services – 80 per cent of GDP – is also evident in the export of services, which is 13 times higher than trade in goods. Another major feature of this small economy is its degree of openness – 50 to 60 per cent of GDP, depending on whether one looks at exports or imports. To some extent, these rates of openness are misleading, first because they include transborder trade, particularly with Ethiopia, and, secondly, because they do not reflect a smooth integration with the world economy. In other words, Djibouti must increase its volume of international trade while sustaining an economic and financial balance that will enable it to make better use of its currently underutilized human resources.

Imports from the European Union traditionally account for more than half of the value of all imports. This value is declining against transactions with the Common Market for Eastern and Southern African States (COMESA), which currently account for nearly 15 per cent of all imports. Among exports of services, a key area of activity directly linked to the country's geographically strategic situation is the income derived from foreign troops as payment for the use of military bases. France currently maintains some 3,000 men in the country in exchange for a payment to the State of 30 million euros a year until 2012. The United States of America also maintains a military base in Djibouti in exchange for a payment of \$31 million. Official transfers are also extremely important, amounting to roughly \$100 per inhabitant during the period 1999-2002, half of which are collected in the form of budgetary assistance.

From the standpoint of development finance, long-term private capital is still limited. Direct investment amounts to 600 million Djibouti francs (DF) a year, or 0.6 per cent of GDP, or \$5 to \$6 per inhabitant, a much more restricted flow than is generally observed in developing countries. The size of the local market undoubtedly helps to explain this low level of direct investment, as does the economy's lack of competitiveness within the subregion.

The problem associated with market size will diminish as regional integration progresses, particularly within the framework of COMESA. Eligibility (2000) for the American scheme under the African Growth and Opportunity Act (AGOA) may also spur this dynamism. Taking advantage of these opportunities, however, means that greater attention must be paid to making production competitive, since production determines the extent to which economic activity develops, and thus to poverty reduction. COMESA is pursuing ambitious regional objectives such as the adoption of a Common External Tariff (CET) by 2004. In addition to the hopes generated by the development of this regional institution, the CET is giving rise to some concern. The customs union might in fact lead to imported inflation as a result of demands for trade protection by partner economies, but without allowing for the rapid generation of significant traffic.

To facilitate administrative reorganization, the customs administration must be viewed as being as important as the tax and land offices, its departments must be subdivided to make them more operational by separating planning activities from management functions. The Djibouti customs administration does not have enough staff to carry out all its tasks, including inspection activities. As a result, service is interrupted, adversely affecting the flow of trade. Increasing the number of customs personnel and enhancing their skills is imperative, particularly for the inspection of oil products, which are heavily taxed. Wages must also be reviewed with a view to providing greater incentives.

One of the main concerns of the authorities must be the computerization of administrative procedures. Until the ASYCUDA system recommended by the United Nations Conference on Trade and Development (UNCTAD) becomes operational, the Integrated Customs Management System (SIGED) must be retained. However it is still incomplete, as it covers only part of the customs declaration and does not use customs nomenclature or an integrated tariff, which is at the heart of any customs clearance system. In the area of port activities, under the impetus of the new private administration the computerized information system has significantly improved administration. Further efforts must be made, particularly in the handling of conventional goods. This progress helps to facilitate trade while at the same time encouraging the Customs Service to become less reliant on paper. Customs and tax benefits are hard to regulate. The Djibouti Government has in fact increased incentives to attract traffic and investment, but the result has been a plethora of provisions that are difficult to understand at the level of parliamentary control and hard to verify by customs or tax officials. Lastly, the roles of transit authority and customs commissioner must be clarified. Specifications must indicate what computer equipment is required to obtain approvals and what penalties may be imposed if the specifications are not adhered to.

While the basic infrastructure does not derive from activities traditionally considered to be internationally marketable, they involve both an intensification of trade and poverty reduction. In this sense they also contribute to the achievement of the Millennium Development Goals by promoting job prospects for women, facilitating access to basic education and improving the population's health. The infrastructure also has an impact on poverty reduction by expanding access to public services, notably water, electricity and telephone services, which have an impact on individuals' "capacities" and "functioning".

Budgetary policy and competitiveness

Government revenues. The rate of government levies, which is the ratio of total public resources to GDP, is inadequate to maintain a satisfactory budgetary equilibrium. In 2002 grants totalling 5.9 per cent of GDP had to be mobilized and a net loan had to be contracted to cover the standard 3.5 per cent shortfall in GDP. In comparison with other developing countries, however, government levies in Djibouti are fairly high – 23.1 per cent in 2002. Following the extension of the domestic consumption tax (TIC), which since 2002 applies to locally produced goods, two new major changes will be introduced in the next few years: the adoption of the common external tariff (CET) for COMESA countries and the gradual conversion of the TIC into a value added tax (VAT). Tariffs will then be applied as a specific trade policy tool and the VAT will be used as a tool for domestic income. Together these reforms are intended to make government levies economically neutral and stimulate the production of marketable goods.

Budgetary expenditure. The structure of public spending is very important. It determines what gains in competitiveness are achieved in the short term through enhanced functioning of basic public services (justice, security). It also determines long-term productivity through spending on education and health and through investment in strong indivisibles. The absence of a medium-term expenditure framework (MTEF) poses an obstacle to the efficient management of public spending. Efforts to combat poverty are in fact based on a proper linking of the sectoral programmes in the Poverty Reduction Strategy Paper in the MTEF, which is currently the public tool of choice. Budget expenditure represented 29.7 per cent of GDP in 2001. This percentage rose to 32.9 per cent in 2002, a significant increase for one year. Such a high level of expenditure cannot be an element of sound budgetary management, while the level of government levies reflects little margin for manoeuvring.

A large share of expenditure goes for wages and benefits. In 2002 the latter accounted for 43 per cent of total expenditure. This figure is too high, despite a significant reduction since 1996. The corollary of a high level of current expenditure is a low level of investment spending. Public investment hovers at around 10 per cent and is financed largely by external resources. In its projections, the State also appears to have problems coming up with its counterpart contribution to the foreign currency resources in local currency. These problems may pose an obstacle to international assistance flows.

The functional classification of public expenditure reveals the relatively heavy weight given to general administrative expenditure but also to spending on national defence and internal security. Spending on education and health are at the heart of the poverty reduction campaign and the Millennium Goals. They also contribute to the effort to increase competitiveness through individual productivity. While the position of these two ministries is relatively positive, accounting for 29 per cent of all expenditure in 2001, the question of how resources are allocated arises. It is particularly important that spending be redirected towards training and vocational education.

Arrears. In 2002, payment arrears accounted for 83.7 per cent of budget income. It should be noted that these arrears were accumulated primarily between 1992 and 1997. This situation has had major economic and social repercussions. The arrears constitute an obstacle to the mobilization of fiscal revenues since it is always difficult to prevent unauthorized

compensation of arrears and taxes with contributions for social benefits and also to prevent their being carried over into the productive system at the risk of generating inflationary tensions and treasury blockages at the level of enterprises. The appearance of these phenomena runs counter to the objective of a globally competitive economy.

Competitiveness measured in terms of prices and factor cost

Real effective exchange rate. The movement of this index suggests that since 1990 the economy's competitiveness has been eroded by roughly 40 per cent. This erosion has taken place chiefly since 1996. ***The labour factor*** contributes to the problem both through nominal remuneration, or wages, and the quality of this factor, or productivity, which is itself conditioned by the quality of the educational system and social conventions regarding work. Total employment in the modern structured sector is roughly 67 per cent, with private sector salaries representing only 25 per cent. On average, and compared with Ethiopia or Yemen, nominal salaries in Djibouti at the current exchange rate are three to six times higher. Through a policy of hiring graduates, the private sector has tended to shadow civil service salaries. Since the advent of the public finance crisis in the early 1990s, public and private hiring has gradually stagnated, yet salaries have remained quite high independently of productivity.

Vocational education policy is hard to decipher. It is undermined by the low level of earmarked public resources and further hampered by the distribution of resources among several ministries. Another factor weighing on competitiveness is the rigidity of the Labour Code. This rigidity persists notwithstanding the provisions of Act No. 140 and is reflected primarily in the social benefit costs borne by employers: 15.7 per cent, as opposed to 4 per cent for wages. A decrease or recalculation of these rates should be considered to bring down the unit cost of this factor.

The cost of capital is itself exorbitant: 13 per cent for the "securest" loans, between 18 and 25 per cent for loans in the form of an overdraft facility. These are surely very high rates for an environment in which inflation is structurally low. Monetary stability is in fact an essential feature of domestic policy, which is tied to the fixed exchange rate of the Djibouti franc against the United States dollar and the system of a currency board in which the creation of money is automatically controlled by the balance of international payments. Thus there is an absence of risk of change apart from indirectly, through movements in the value of the dollar. The cost of mobilizing savings is also moderate, owing to the lack of obligations to open windows or individual accounts. The high cost and unavailability of credit are indicative of past failures of repayment. Those defaults led to the liquidation of several banks once it was realized that the costs of putting guarantees in place were both onerous and uncertain. The justice system operates slowly, with cases taking an average of three to four years to be settled. And the enforcement of guarantees is made unreliable by the impact of personal relations and social conventions that lead to high transactional costs.

To deal with the frustrations caused by the credit market mechanism, the authorities have set up the Djibouti Economic Development Fund (FDED), which is intended for agents who are potentially eligible for the banking system, and the Social Development Fund, which works with non-governmental organizations (NGOs). These funds offer NGOs lines of credit at a rate of 3 per cent interest. The NGOs in turn offer loans at 18 per cent interest to micro-entrepreneurs who form solidarity associations. The margin is thus 15 per cent to cover the risk and operating costs.

Intermediate consumer costs, namely commercial public services, are also considered to be very high. At current exchange rates the price of water is two to three times higher than in Ethiopia. Consumers in poorly served periurban zones are charged exorbitant prices because public water points are either absent or do not function properly. Electricity is also expensive. Prices are at least twice as high as in Ethiopia. However, more directly than water, electric consumption is built into the cost structure of businesses and imposes an additional cost on their operations. Up to 25 per cent of the price of hotel room prices goes to settle the electric bill. The reasons for these additional costs are numerous. They derive from external factors, such as the price of imported oil, but also from inefficient economic performance, chiefly in the form of poor management and a failure to assume responsibilities on the part of the sole shareholder. Serious consideration must be given to the resources that will have to be mobilized to bring down local electricity prices (institutional reform, costs and benefits of hooking up with Ethiopia, alternative sources of energy).

Telephone service is also very costly, with a particularly low level of coverage that can be measured by the density of fixed lines or the number of owners of mobile phones. In March 2003 changes in the rate schedule were adopted by the Council of Ministers without carefully considering the pros and cons. The new lower rates, while desirable for the economy as a whole, could adversely affect the profits of Djibouti Télécom unless this development accelerates the indispensable process of institutional reform.

Given the situation of available public financing, the State cannot keep a tight grip on all public services. It must work out a privatization arrangement with the private sector under terms to be worked out. Such reforms must take into account financial constraints and the country's prospects for economic development, which requires access to quality services at prices that do not stifle economic diversification and competitiveness. The general framework for privatization of such commercial services has already been established in legislation. Now the process must be moved forward by implementing this important economic and institutional reform.

Institutions for trade and competitiveness

Bodies facilitating economic activity and trade

The Ministry of Trade, Industry and Handicrafts must be provided with more human and financial resources and a significant volume of structured technical assistance. A full inventory of the Ministry's needs, and especially the needs of its Foreign Trade Service, is needed. This inventory should lead to training activities as part of a reorganization in the short and medium terms. The Foreign Trade Service should be equipped with extensive documentation and an actual unit for monitoring WTO agreements and the impact of the COMESA common external tariff.

The National Agency for Investment Promotion (ANPI) was established in January 2001 and placed under the Ministry of Presidential Affairs. Its establishment corresponds to a real need. Its initial dysfunctions would seem to have been corrected since it has been provided with an operating and investment budget. However, there seems to be some confusion as to the role of the Agency. For example, the Centre for Uniform Business Procedures duplicates the work done by the Business Procedures Centre of the Chamber of Commerce.

The Djibouti Chamber of Commerce is a legal entity having financial autonomy and is patterned on the consular enterprises of French-speaking countries. Among its projects are the establishment of an approved management centre that should be operational in January 2004. The centre is intended to help small and medium-sized enterprises follow accounting practices that are appropriate to their needs and help them meet their legal obligations in the area of tax reporting. Chamber of Commerce activities are limited primarily by the inadequacy and unpredictability of the Chamber's budget. The requisite funds, which come from increases in tax rates, are disbursed only irregularly, and then only partially, by the Treasury. Improving the Chamber's functioning will require ensuring that resources are provided on a more secure basis as well as the provision of additional staff. Technical assistance might take the form of support for institutional restructuring, further training of staff, a study of private sector training needs, establishment of a computerized information system, and the posting of information on the Internet. The Chamber of Commerce must invest more than it currently does in support for and promotion of small enterprises with a view to increasing competitive activities and reducing poverty.

The legal and judicial framework

Djibouti suffers from both an excess and a penury of legislation. Many texts coexist in juxtaposition or overlap each other. Some are obsolete, others are contradictory, while still others have no implementing legislation. This results in a level of uncertainty that fosters ambiguity and, ultimately, arbitrary decisions that undermine the credibility of the legal system.

The *Investment Code* dates from 1994. It provides for two separate regimes (A and B), which are chosen in terms of the amount of the proposed investment. The procedure stipulated in the Code for the granting of preferences has been widely criticized. The deadlines currently in use for acceptance and approval are much longer than the officially prescribed time limits. Moreover, reasons are not always given when an application is rejected, and beneficiaries complain that they are granted only some the advantages that normally accompany such preferences. Some activities are ineligible, although the provisional PRSD maintains that they could constitute a source of income. Most of these problems predate the establishment of the National Agency for Investment Promotion, but the Agency has not succeeded in solving them. A new Code is being prepared, but its current version, which represents significant progress over the 1994 Code, is still far too complex for an administration with limited means.

Free zones. Many institutional arrangements exist, some of which have remained on the drawing board while others have taken the form of texts that have had no real financial impact. The system of free zones is complex, and the zones themselves are not always operational. All that is needed is a system of free zones and a system of duty-free points that would give rise to the establishment of duty-free companies known as offshore companies, which could advantageously replace the duty-free industries and the incorporated free trade zones. The entire system must be reviewed with a view to its simplification and unification in order to make it functional and more attractive.

The Commercial Code. Most existing trade laws and regulations have not been amended since independence. A review group on the modernization of trade legislation was set up in 2001 with a mandate to reform the country's trade law. A national committee was also

established in 2002 to provide guidance in the drafting of a commercial code, and to harmonize and update the legal texts in order to create an atmosphere conducive to investment. The drafting of a modern commercial code adapted to COMESA is imperative. It is surely a factor for attracting investment and for the internationalization of the system of production.

Labour law. Djibouti's labour law is based chiefly on the 1952 Overseas Labour Code, which is obsolete and unsuited to the demands of globalization. A reform has been launched with a view to liberalizing all provisions relating to labour contracts and making them more flexible. An initial step in this direction was taken with the adoption of Act No. 140 of 1997. This Act makes hiring conditions more flexible and abolishes direct State intervention. The next step must be the drafting of a new code. A working group was set up to propose a code that would be acceptable to all social partners. After five years of study and discussion, the time has come to finalize that document. The Labour Code is in fact a key regulatory element for economic activity. In refusing to complete this text the authorities are creating an environment of arbitrariness that does not enhance the country's attractiveness.

The budget of the justice sector is not more than 1 per cent of the total State budget. Many weaknesses have been identified in the functioning of services in this area, pointing to a need for better governance. It should be noted first of all that the judiciary has no statute guaranteeing its independence or impartiality. There is little collaboration between the justice system and the judges themselves. The number of judges is insufficient to cope with the actual caseload. The same is true for court clerks. Moreover, the lack of specialization and training adversely affects the judgements handed down. Credibility is also affected by the frequency with which cases are transferred, the slow pace of proceedings and the failure to respect legal time-limits. The backlog of cases under investigation encourages partiality on the part of judges and leads the private sector to attempt to bypass the defective justice system through effective commercial arbitration mechanisms.

International trade and sectoral development

The transport chain and port services. In all, some 12,000 to 15,000 employees are involved in the transport chain, which is undergoing sweeping institutional changes. Privatization of the technical and commercial operations of the main components of the system is under way and, in some cases, completed. In the port itself (PAID) the switch to private management took place in June 2000. A similar change was recently made in respect of the airport (AID) and the same is slated for the railway (CDE). When implemented, such changes are shown to be economically effective. While it is not yet possible to determine for certain, the decision to choose a single concessionaire to run both the port and the airport – Dubai Ports International and the Jebel Ali Free Zone Authority – as well as the future free zone reflects an internal consistency. The concentration of interests is likely to create and facilitate synergies among the different components of the future regional trade centre. On the other hand, the way in which these transactions took place was not transparent. And the concentration of power within a single monopolistic executing authority means that an oversight body will actually have to be established.

Despite current problems of congestion, Djibouti would appear to be favourably situated as compared with the best port alternatives in the region. The competitiveness of its location remains uncertain, however. It is always possible that shippers will move elsewhere. The

same holds true for those investing in port facilities on the basis of observed profitability and the rate of infrastructure amortization. With the port authority participating in the creation of the free trade zone and the adaptation of the transport chain (port, airport), the proposed regional trade centre is becoming a reality. Good prospects for employment are implied, although these will depend on the quality and price of public services and an improvement in the quality of human capital through an adequate training policy.

In June 2002, the airport was privatized under a 20-year management contract awarded to Dubai Ports International (DPI). The financial solvency of the new operator is assured through the allocation of space leased to foreign airlines. As in the case of the port, minimal information was provided about the nature of the contract and the reasons for such a long duration for what would appear to be nothing more than a management contract. Good institutional linkage between the oversight authorities and the port and airport management authorities will ensure the development of multimodal liaisons. This institutionalization on the part of the regulating authority may apply to all forms of transport, including the railway, and may ultimately take the form of a ministry department responsible for that activity.

The bulk of Ethiopia's transit traffic uses the Djibouti road corridor. Owing to the disparity in cost factors with Ethiopia, shippers in Djibouti are not competitive, occupying roughly 1 per cent of the market. Yet the sector offers interesting prospects for direct and indirect employment. To maintain the road network and practise the principal of "the user pays", a highway maintenance fund was set up in 1999 on the basis of a \$15-per-truck transit fee. To date this fee has been only partially used for maintenance of the Djibouti-Ethiopia corridor. Its use to pay the salaries of the fund staff has considerably limited its usefulness for social ends. In any event, the fund must be properly used and managed.. This is imperative if a reasonable discourse is to take place with Ethiopia regarding the need for that country to make a financial contribution commensurate with the damage done to the road surface by its truck fleet. Placing the management of this corridor in private hands is an avenue to be explored.

Ultimately, Djibouti cannot be a regional trade centre and a multimodal logistical springboard unless it has a system of electronic data interchange (EDI) that will allow it to enhance the efficiency of the transport chain through greater control over the flow of foreign trade-related documents. The port authority, the customs administration and the business community must be convinced of the overriding need to achieve this objective. The new equipment at Doraleh, the container terminal and the free trade zone only serve to highlight this need.

The salt sector. The working of salt has become the principal activity involving the export of goods, with a dozen enterprises located at the Lake Assal site. This activity occupies roughly 2,000 workers. Development of this activity is explained in part by the cutting off of Ethiopia's supplies from Eritrea. In its current state, this operation faces problems occasioned by the hilly terrain, which makes it difficult to build salt tables, and the low iodine content of Djibouti salt, which does not meet current health standards set by the World Health Organization (WHO) and the United Nations Children's Fund (UNICEF).

The terms of trade on the world market indicate that Djibouti is getting a good price for the industrial salt it exports to Ethiopia. Earning \$29 a ton, as opposed to the \$20 they would get on the world market, the most efficient national operators appear to be maintaining a profit margin of approximately 30 per cent. Trade between the two countries is thus in their mutual interest, which suggests that operators in Djibouti should try to expand their share of the market in Ethiopia, where annual consumption of table salt is approximately 350,000 tons.

However, a diversification of customers might also be desirable, preferably with foreign partners who can help the country penetrate markets in Asia.

The livestock sector. The countries of the Horn of Africa together possess a significant amount of livestock. Ethiopia has the largest herd of cattle in Africa, while Somalia possesses more than 30 per cent of the world's dromedary population. Although considerably less developed than in these two countries, Djibouti's livestock sector is not insignificant. It is an important development factor for the rural, nomadic and sedentary populations, but also for the urban population, given the whole range of professional activities associated with local processing. Apart from stock raising itself, Djibouti also serves as a transit country for the export of animals from the subregion. In the hope of reactivating international trade flows that have dried up as a result of animal diseases, Djibouti must endeavour to develop facilities that will ensure that all exports have a clean bill of health. This will necessitate improving the conditions at intake and slaughter points through the development of refrigerated storage equipment.

The authorities should also focus on the creation of a single window for all formalities and procedures for the export of animals. No less than five ministries are currently involved in the international livestock trade : agriculture, trade, finance, the interior and foreign affairs. The Port of Djibouti, the Chamber of Commerce and Industry, and the embassies of importing countries also play a role. This chain of administrative interactions could be studied with a view to improving the flow of trade.

The fisheries sector. Djibouti's territorial waters possess marine resources with a potential for sustainable exploitation in the amount of 48,000 tons a year. Fishing is not generally considered to be a traditional occupation. To attract the population to this activity, the Obock fleet, whose performance to date has been lacklustre, must be strengthened through training programmes adapted to the species to be caught. Directors, senior staff and employees in this sector all reflect the inadequacy of existing training programmes, but also the inadequacy of relevant information about the sector's development potential. Small-scale fishermen, of whom there are roughly 600, are organized into five associations or cooperatives. Development of this activity is partly hampered by illiteracy, the lack of a system of credit and a limited market, owing to blockages by European entities resulting from the absence of any harmonization with international health and sanitary standards. Laboratory compliance with these standards and appropriate training programmes must be a priority objective if exports are to be developed in this area.

Another aspect of fisheries development must be the establishment of an export promotion unit. In cooperation with the Ministry of Trade, this unit should support efforts to promote and enhance the quality of exports. At the global level, fishing can make a significant contribution to the development of economic activity if external outlets are made accessible to Djibouti's fishermen with adequate resources for exploitation. Technical assistance will be necessary, however, to develop all aspects of fishing operations, from catch to marketing. Modern artisanal fishing requires the use of vessels capable of processing seasonal species with high export value.

With regard to the development of domestic consumption as related to an increase in dietary protein intake, one obstructing factor is bone content, as bones are hard for small children to detect. However, sardines are well accepted in sub-Saharan West Africa for their distinct

taste and their ease of preparation with rice. Processed, i.e. dried, salted fish offers a means of combating poverty by creating the jobs associated with this economic activity and by potential demand from the poor, for whom this food is a means of improving their diet.

The tourism and handicraft sector. At present hotel and restaurant capacities are limited, even though the hotel occupancy rate is high. An increase in demand created either by business travellers or recreational travel, which will be developed after the Doraleh port and free trade zone are created, will require a strengthening of the relevant infrastructure. Heavy financial constraints currently work against tourist facilities and their profitability. Investments are poorly served by interest rates and energy costs. Electric rates are two to three times higher than in Ethiopia. The cost of telephone service must also be mentioned, for although rates are declining, international rates are particularly high. The "open sky" policy has been a key factor in the development of competition between airlines and in the lowering of rates. However, the capacity available to tour operators still serves to limit the development of tourist flows.

According to the Djibouti National Tourist Office, tourism generates approximately 1,500 jobs, of which half are through direct employment. Indirect employment occurs mainly in the trade and handicrafts sectors as well as in fishing and, to a slight extent, agriculture. According to surveys of travel agencies, tourism provides employment for more than 600 craft artists, chiefly women. The budget of the National Tourist Office would not appear to indicate a real decision to develop tourism. In order to reinforce visibility in this area, it is indispensable that a three-year plan of action contain provision for promotional investment and resources for the Office be increased. Vocational training should also be reviewed. The Arta school was forced to suspend its activities, leading to an increase in the costs of training in the absence of potential investors. The reopening of the hotel management school must entail basic and advanced training, in cooperation with private operators.

The financial services sector. The savings mobilized by Djibouti's banks are generally sent abroad. These deposits produce very little income, however, and currently earn interest at a rate of less than 2 per cent. Greater involvement on the part of the formal banking sector in the financing of local development can only be a long-term operation carried out in conjunction with major institutional reforms, in particular of the justice system. Without such developments, creditors are inadequately protected and mechanisms for the freezing of credit are quite strong.

The authorities in Djibouti are setting up alternative finance mechanisms, primarily through the Djibouti Economic Development Fund. This Fund is a government corporation that provides credit through regulation of the eligible sectors. It is not supply-driven, as experience shows that the best financial services are provided on a demand-driven basis. To give structure to and broaden alternative sources of funding, a Social Development Fund (SDF) has also been established. This Fund works with NGOs on the basis of lines of credit, which result in loans being offered at a rate of 18 per cent interest. To facilitate its task, the Fund should be given technical support in order to have the skills it needs to ensure supervision.

Foreword

In October 1997, a ministerial meeting of the World Trade Organization established the Integrated Framework (IF) to meet the special challenges facing least developed countries (LDCs) in their efforts at integration in the global economy. This institutional arrangement should allow them to integrate trade policies more effectively in national policies as defined in their Poverty Reduction Strategy Papers (PRSP) and to seek the broadest possible technical cooperation with and through bilateral and multilateral financing agencies to carry out this integration. Six major international organizations united their efforts to this end: the International Monetary Fund (IMF), the International Trade Centre (ITC), the United Nations Conference on Trade and Development (UNCTAD), the United Nations Development Programme (UNDP), the World Trade Organization (WTO) and the World Bank.

From 1997 to 1999, the objectives of the Integrated Framework were far from being achieved. An independent review conducted in June 2000 identified weaknesses and outlined ways to integrate trade in national development strategies more effectively. This new policy was facilitated by the establishment of a trust fund, which initially benefited the three countries involved in the pilot project (Cambodia, Madagascar and Mauritania) and resulted in the Diagnostic Trade Integration Study, hereinafter referred to by its acronym, DTIS. In May 2002 the IF Steering Committee made a conclusive assessment regarding the project and took the initiative of extending the programme to 11 new countries, including Djibouti.

As the manager of the Trust Fund, UNDP was designated the lead agency for the Djibouti DTIS. A reconnaissance mission in December 2002 sought to verify that the authorities and all economic actors were committed to the principle of the study. The preliminary mission then made it possible to obtain additional information by laying the groundwork for the main mission, which took place from 6 to 21 July 2003. The participants in this analysis of competitiveness are listed below in alphabetical order with their fields of expertise given in parentheses after their names.

The team of consultants

International consultants: Ali Lilaoui (salt), Antoine Basile (investment and privatization), Jean François Brun (public finance and macroeconomic competitiveness), Gérard Chambas (fiscal policy), Michel Le Brishoual (port activities and transport), Max Henri Morel (fisheries) Fouzi Mourji (financial services), Gustave Nébié (poverty reduction policy) Patrick Plane (chief economist), Bernard Stoven (trade facilitation and customs regime) Michael Langstaff (institutional environment and private sector development), François Vellas (tourism), Michel Weizmann (port activities and transport).

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Acronyms

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| ADB | African Development Bank |
| AGOA | African Growth and Opportunity Act |
| AID | Djibouti International Airport |
| ANPI | National Investment Promotion Agency |
| API | Industrial Promotion Agency |
| BTP | construction and public works |
| CCD | Djibouti Chamber of Commerce |
| CET | Common External Tariff (COMESA) |
| COMESA | Common Market for Eastern and Southern Africa |
| CNI | National Investment Commission |
| DF | Djibouti franc |
| DINAS | National Statistical Office |
| DPI | Dubai Ports International |
| EDAM IS2 | Djibouti Household Social Indicator Survey 2002 |
| EDD | Energie de Djibouti |
| EDI | electronic data interchange |
| EPI | Expanded Programme on Immunization |
| FDED | Djibouti Economic Development Fund |
| GDP | gross domestic product |
| HDI | Human Development Index |
| IMF | International Monetary Fund |
| LDC | least developed country |
| MTEF | medium term expenditure framework |
| NGO | non-governmental organization |
| ONED | National Water Office |
| ONTD | Djibouti National Tourist Office |
| OPS | Organisation de Prévoyance Sociale |
| PAID | Port Autonome De Djibouti |
| PRGF | Poverty Reduction and Growth Facility |
| PRSP | Poverty Reduction Strategy Paper |
| SAZF | free zone limited liability companies |
| SDF | Social Development Fund |
| TIC | domestic consumption tax (Taxe Intérieure de Consommation) |
| UNDP | United Nations Development Programme |
| UNIDO | United Nations Industrial Development Organization |
| USD | United States dollar |
| VAT | value added tax |
| WCO | World Customs Organization |
| WTO | World Trade Organization |

Summary

Diagnostic Trade Integration Study

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Diagnostic Trade Integration Study

General information

Djibouti has a small economy which is rendered unique by a combination of factors. Situated at the entrance to the Red Sea, it has a surface area of 23,000 km². In the absence of any census conducted on a regular basis, the exact size of the population is unknown. It has been suggested that there are 632,000 inhabitants, of whom nearly 80 per cent live in urban areas, with two thirds of these in the city of Djibouti itself. By the same token, little is known about the pattern of growth of this population. The presence of a significant number of refugees from neighbouring countries greatly complicates any attempt to obtain a clear statistical picture. The *common country assessment* (CCA) used by the United Nations system indicates a natural annual population growth rate of 2.8 per cent, but an increase of over 6 per cent in recent years after international migration flows are added.

80% of all activity is concentrated in services

The structure of its GDP is one of the features that makes Djibouti atypical, at least among the countries of North Africa and the Middle East. The primary sector accounts for less than 3 per cent of all domestic value added. The entire economy is structured around a tertiary sector that accounts for approximately 80 per cent of GDP. A considerable share of this sector is linked to international trade, largely in the form of port activities. The country's coastline and geophysical constraints (arid soil, low annual precipitation) have favoured this activity, while the limited nature of the domestic market poses a major obstacle to the development of even the most basic industry. Given the size of its population and its geographical location, Djibouti would seem well placed to become a regional centre for trade and services that may serve as a stimulus for hinterland countries.

An LDC that is also in the lowest level of middle-income countries

With regard to the country's human development index (HDI), in 2000 Djibouti ranked 149 (HDI=0.445), behind Yemen (0.479) and the Sudan (0.499) and ahead of Eritrea (0.421) and Ethiopia (0.327). The per capita standard of living does little to change this picture. Djibouti is a least developed country (LDC) but falls within the lowest tier of middle-income economies. The *World Development Report* indicated a per capita GNP of \$840 in 2000, a figure roughly comparable to that for Yemen but considerably higher than the figures for neighbouring countries such as Eritrea (\$170) or Ethiopia (\$100). It should be noted that here more than elsewhere statistical data should perhaps be interpreted with caution. At the same time, the mean is affected by large discrepancies in distribution, reflected in significant poverty and its development between the two EDAM-IS household surveys conducted in 1996 and 2002.

Poverty and unemployment worsened between 1996 and 2002

Monetary poverty would appear to have increased drastically, rising from 45 per cent to 74 per cent between these two years. Extreme poverty affected 42 per cent of the population in 2002, as compared with 9.6 per cent in 1996. However reliable one may consider these statistics, they are nevertheless clearly indicative of a need for an increase in the annual growth rate of GDP and for a voluntary policy geared towards a rapid reduction in poverty in all its many dimensions. With an average growth rate of 1 per cent over the past decade, the population's standard of living has eroded significantly. Per capita GDP is roughly 50 per cent lower than at independence in 1978. Another indicator of the urgent need for a strong economic recovery is unemployment, which has risen to a level of 59 per cent, as compared with 44 per cent in 1996.

Thus Djibouti has been caught up in a spiral of poverty, which calls for a response in the form of a firm commitment to a poverty reduction policy that will of necessity give priority to international trade (pro-poor trade policy). To date this poverty has not yielded to efforts aimed at correcting major imbalances through the IMF-supported Poverty Reduction and Growth Facility (PRGF). Paradoxically, the economy is quite open. The rate of openness measured in terms of the rate of export or import of goods, services and income from related factors stood at roughly 50 per cent and 60 per cent respectively in 2001. Macroeconomic counter-performance would thus appear to contradict the generally recognized principle that the efficiency of an economy increases as its activities are exposed to global competition, selected on the basis of the principle of specialization and comparative advantage.

A currency board means no discretionary monetary behaviour

Another significant feature of this small economy has to do with its monetary stability, which is linked to the *currency board* system whereby the creation of money is automatically regulated by the balance of international payments. In other words, the obligation to back the national currency with hard currency deprives the central bank of any discretionary monetary power. The bank's role is limited to ensuring that the rules set by the "currency board" are followed by setting cautious rates. This is significant, since banks cannot hope for anything from a central bank that allows them to face potential liquidity problems or more structural problems of debt risk management. This aspect of Djibouti's monetary system explains the low level of inflation, comparable to that observed in the industrialized countries, and the authorities' long-standing attachment to a rate of 177,721 francs to the United States dollar. Over the period from March 1999 to March 2003 the overall inflation rate was less than 5 per cent, reflecting an annual rate of 1 to 2 per cent a year.

In the absence of a discretionary monetary policy, State intervention in public finance becomes particularly significant. Naturally, the authorities cannot rely on the creation of money to finance a budget deficit, but they retain considerable room for manoeuvring within the economy, either by public withdrawals and budgetary expenditure or by financing the balance of the deficit. Without resorting to monetary financing they may in fact resort to arrears in payments, or even draw on the treasuries of State enterprises, and this in a country with an extensive public sector. In all these scenarios the State's action is vital to the country's economic and financial health. Accordingly, this Diagnostic Study will take a closer look at public finance trends and on their impact on

competitiveness in Djibouti and the country's capacity to increase GDP through international trade.

This Diagnostic Trade Integration Study identifies the macroeconomic constraints facing Djibouti and explains why the country needs to improve its global competitiveness rapidly. The low level of growth is linked to the narrowness of the private sector and the economy's structural inability to increase the gross investment rate, which has fluctuated over the past six years to end up not much better than 12 per cent. Both investment and the quality of the educational system determine how competitive the economy is. The source of these impediments must therefore be studied, with emphasis on factor costs and the failure of certain institutions to promote international trade.

The macroeconomic and institutional environment

The macroeconomic framework and competitiveness

International trade and poverty reduction

Trade performance and trends in foreign accounts

Djibouti's foreign accounts reveal the economy's openness to the rest of the world. This openness is reflected both in international flows of goods, services and income, which account for 50 or 60 per cent of GDP, depending on whether one looks at exports or imports, and in the freedom to transfer international capital. Indeed, economic operators find Djibouti to be a country whose trade regime with little protectionism in the form of tariffs or quantitative obstacles, which was why the country was a founding member of the World Trade Organization (WTO), and a country whose foreign exchange regime is characterized by a highly convertible local currency, making international movements of capital entirely possible. The magnitude of this openness, which is the predominant feature of Djibouti's economy, is the main reason for its attractiveness today. Given this fact, Djibouti's integration in the global economy would appear to be a *fait accompli*. However, the reality is much more complex, for at least three reasons.

A degree of economic openness ...

First of all, trade in goods as reflected in the balance of trade includes certain imports of goods from neighbouring countries which are in fact intended for re-export. Djibouti's trade flows in live animals, which are recorded as Ethiopian exports are one example of this. A sub-category of exports listed as *exports of local products* reflects trade in goods somewhat more accurately as representing no more than 20 per cent of all exports recorded by the World Bank in 1999, or less than 3 per cent of GDP. Likewise, imports of goods are overvalued by certain purchases redirected to countries of the African interior, again starting with Ethiopia.

Importance of international transit flows ...

These figures merely reflect the low level of capacity in the light of primary and secondary activities that make it impossible to post significant trade flows. At the same time, given the position of services, which total more than 20 per cent of GDP, these figures confirm an international specialization that highlights the role of the port and transit operations as well as the role of transport and tourism. Secondly, the country's liberal reputation (no currency controls, full convertibility of the Djibouti franc) and the measures taken to attract foreign investment must be qualified. While some activities benefit from customs and fiscal advantages, most transactions give rise to extensive paperwork and ultimately offer little incentive.

Lastly, the degree of openness must be seen as relative, owing to the level of GDP, which is far from reaching its potential. This underproduction can be seen in the volume of idleness or underused labour. The structural weakness of economic growth – less than 1 per cent over the past 10 years – is another indication of the same problem. In other words, Djibouti will be fully integrated in the global economy when its economy becomes capable of generating international trade in a state of economic and financial equilibrium that is viable in the long term while allowing for greater use of currently untapped human resources. The fact that the current situation is far from this ideal situation only serves to show how uncompetitive Djibouti's economy is.

International balances and problems of statistical measurement

While the long-term growth deficit highlights the problem of an intrinsic lack of competitiveness, the balance of payments and intermediate balances make it immediately obvious. In Djibouti this picture is often clouded by the degree of economic and financial openness and by the operations of the port, which is the starting point or endpoint for goods from the countries of the interior, chiefly Ethiopia. Transit through the port is at the crux of the problems experienced in understanding the statistical data. The multiplicity of sources used and the different ways of adjusting between actual physical flow and the resulting payments create discrepancies in double-entry bookkeeping. This leads to inaccuracies which are reflected primarily in the Central Bank's inability to distinguish between what precedes movements of private capital in the short term and what happens when errors and omissions are factored in. While this item is not predetermined, it is significant because of its size. From 1999 to 2002 it accounted for 5 to 10 per cent of GDP.

Salt is the country's principal export

Local exports of goods are still minimal. According to DINAS, the principal flows registered concern the "personal effects" of French soldiers in Djibouti! During the 1980s, with the embargo imposed as a result of Rift Valley fever, exports of live animals virtually stopped. The share of goods on which Djibouti placed its hopes for the coming years, such as salt or fish products, continued to go unrecorded by the Central Bank. One estimate based on information from the Ministry of Energy and Mineral Resources suggests, however, that salt now accounts for a significant share. Between 1999 and 2001 sales of salt, principally to Ethiopia, amounted to 543.7 million Djibouti francs (DF) in 1999 and DF 739.5 million in 2001, or more than 20 per cent of local exports.

The value of exports of services is 13 times higher than that of goods

Generally speaking, Djibouti's main export markets are Ethiopia and, to a lesser degree, Somalia. International trade in services confirms this ranking. Here France is the primary consumer through services rendered to its Government, particularly to French troops stationed in Djibouti. Ethiopia follows close behind, as a user of port and transport services. The value added exported to this powerful neighbour is slight, however. It is limited to the collection of port duties (although the Port of Djibouti grants a 30-day franchise for berthing at its quays and open storage yards), the payment of handling fees in the port facility, the collection of reloading fees on a per-truck or per-railway car basis (\$110-\$180 per 20-foot equivalent unit (TEU)) and the collection by customs agents of tracking fees in respect of items passing through the Djibouti and Ethiopian customs (\$50-\$80). Port charges are in fact not that high, even if they do seem "unacceptable" to Ethiopian shippers. It should be noted that from 1999 to 2002

the average value of services exported globally was between 12 and 13 times higher than international trade in local goods. These discrepancies clearly point up the areas in which Djibouti enjoys a comparative advantage.

As regards imports of goods, it should first be noted that they are structurally higher than exports, which means that the balance of trade is disrupted, with a rate of coverage that does not exceed 30 per cent. Bearing in mind the limited range of goods that can be traded with other economies in the region, imported goods are purchased primarily from industrialized countries. The European Union is the main supplier, accounting for over 40 per cent of all imports, with France being responsible for over half of all purchases.

Trade is primarily with France and Europe, but COMESA accounts for a growing share

The share of imports from the European Union, which traditionally accounted for over half of all imports in value, is declining in favour of transactions with COMESA, which currently account for nearly 15 per cent of imports. This trend is indicative of an integration that is increasing gradually, owing to the low complementarity of productive systems and the poor quality of regional infrastructures. However, one needs to look at this gradual increase in trade with COMESA countries carefully. In the first place, there is the overwhelming predominance of Ethiopia, which sells mainly khat and, to a lesser degree, fruits and vegetables. These products are traded on terms that have less to do with market conditions than with the functioning of a regulated economy, giving rise to high transactions costs. The two countries have been forced to discuss modalities of liberalization in the Djibouti-Ethiopian Joint Commission. And secondly, there are major errors in the registration of the origin of COMESA goods.

Behind the European Union and COMESA come two other groups of countries that have a moderate impact, accounting for between 10 and 20 per cent of imports. These are the countries of the Middle East, with Saudi Arabia and the United Arab Emirates at the forefront, and of Asia, where the principal trading partners are Japan and Singapore. When completed, the Doraleh complex will be a source of development for these trade flows whose relative share is bound to increase in the coming years.

Trade in goods shows a deficit ... services show a surplus

Despite a structural deficit in its trade in goods, Djibouti presents a capacity to produce a comfortable surplus when it comes to services. Imports of services, mainly in the area of shipping, are far from offsetting the areas of credit shown in Table 1. Most of Ethiopia's foreign trade passes through Djibouti. In 2002, out of a total volume of imports of 3.5 million tons of goods unloaded, 2.7 million tons (including 1.2 million tons of oil) were destined for Ethiopia. Approximately half of the 380,175 tons processed by the port in 2002 were also of Ethiopian origin, consisting of coffee, molasses and fruits and vegetables. These transit activities lead to the production of services in the transport chain, but also services such as insurance, which have increased considerably since 1998, when Ethiopia's goods traffic was rerouted through the port of Djibouti.

The current political environment in the region thus favours Djibouti's development, but in the medium term there is a possibility of competition, which

poses a threat to the current importance of the Djibouti-Ethiopian corridor. Improvement of the road infrastructure between Berbera and Dire Dawa in Ethiopia is making it possible for the Somaliland port to take on an increasing share of Ethiopia's goods. Ethiopia has in fact begun talks with the Sudan regarding the use of its Red Sea ports. As a conduit for international transport flows, then, Djibouti is not alone and must take the fact of competition into account. The number of voyages has also risen in recent years. This development is the result not only to tourism but also of the considerable savings realized on training abroad since the opening of the Pôle Universitaire de Djibouti (PUD). Lastly, and most importantly, the volume of services is influenced by payments made by foreign Governments for the stationing of their troops.

Export earnings derived from foreign military bases

France currently maintains some 3,000 troops, for which it pays the Djibouti Government an amount that was recently doubled and will reach €30 million a year by 2012. The United States of America has also asked the authorities to let it set up a military base in exchange for a payment of some \$31 million a year. While the exact duration cannot be specified, given some uncertainty as to the commitment of the United States, it is certain that the Djibouti Government's revenues will be greater in the next few years than they were in 2000-2002. A reasonable projection puts them in excess of \$25.8 million in 2002, reaching \$48 million in 2003. Against such payments one must recall that foreign military troops enjoy privileges and exemptions from customs which constitute budget write-offs. For example, the declared value of goods imported by the French, United States, Spanish and German armies totalled DF 14,056 billion during the first six months of 2003. However, these goods were not taxed. In any case, these currency flows must not become a means of bypassing the rigours of structural adjustment. Only by engaging in this process while respecting the major financial equilibriums can there be a resumption of economic growth without which it will be difficult to reduce poverty.

Unrequited transfers total \$100 a year per inhabitant

In the past five years, notwithstanding a trade deficit, the surplus in services and unrequited transfers has made it possible to achieve a slightly negative current balance. Admittedly, official transfers are of great importance. The ratio of \$60 million a year for the period 1999-2002 to the total population, which is between 500,000 and 650,000, indicates that, on average, Djibouti has received roughly \$100 per inhabitant per year from one-way transfers. Nearly half of this amount has been obtained in the form of budget assistance. These statistics would seem to place Djibouti among the countries that benefit most from international assistance, especially if one limits this analysis to lower level middle-income countries. Such a strong presence of external resources has at least one drawback, which is that it creates tensions in the formation of local costs, namely through the payment of wages that often have no connection to local labour-market realities.

Income from services and the volume of official transfers largely explain the contained nature of the current deficit, which is covered by private capital and especially by official withdrawals from multilateral financial institutions: IDA (World Bank), the Arab Fund for Economic and Social Development (AFESD) and the International Monetary Fund (IMF), through its Poverty Reduction and

Growth Facility (PRGF). Private capital flows combine two distinctly different types of operation. Short- and medium-term transfers are related to external placements by commercial banks that utilize their excess liquidity in a way that fully illustrates the liberal nature of international movements of capital. These flows principally take the form of the acquisition or assignment of foreign assets that generally have a maturity of less than one year. Yielding a modest return, these movements of paper facilitate compliance with banks' liquidity regulations and also take care of problems associated with the reuse of domestic monetary savings locally. From the standpoint of development financing, long-term private capital is more profitable, although still somewhat limited. This is especially true of direct foreign investment that does not incur debt but yields organizational know-how and technology transfers. On account of these characteristics, such movements of capital are generally considered to be determining factors for integration in the global economy.

Direct investment: \$5 - \$6 per inhabitant, as compared with \$36 for all developing countries

In Djibouti, direct investment totals estimated DF 600 million a year, or 0.6 per cent of GDP, or \$5-\$6 per inhabitant. It is a much more restricted flow than is generally observed in developing countries. According to 2003 UNCTAD figures, developing countries received on average \$36 per year per inhabitant during the period 1992-2001, or six times more than in Djibouti. Even landlocked countries would seem to be more attractive, attracting an average of \$13 per inhabitant over the same period. Yet because it generates higher transport costs, landlocked status is known to be a deterrent to the establishment of foreign enterprises, particularly if the goods to be produced rely heavily on imported components and are intended for export.

The size of the local market undoubtedly offers one explanation of Djibouti's negative performance, but other factors include the labour unit cost characterized by wages that are nominally higher than others in the subregion against a somewhat lower partial productivity. The problem of market size will diminish as regional integration policy takes hold. Promoting integration through COMESA in fact consolidates the advantages offered by the strategic location of the port while expanding potential outlets for Djibouti. The same is true of Djibouti's recent (2000) eligibility under the United States Africa Growth and Opportunity Act (AGOA). These structural advantages of location need to be combined with enhanced productivity, which implies a change of attitude and a more effective training policy.

Official debt running at 67.5% of GDP

To date, the use of international capital movements has not yet led to excessive indebtedness, even if the past 10 years have seen a significant increase in the rate of indebtedness and debt servicing. At the end of 2001 total external debt contracted or guaranteed by the State stood at DF 69 billion, or 67.5 per cent of GDP. This debt consisted of bilateral loans (one third of the total) and multilateral loans (67 per cent). Italy was Djibouti's largest donor, while the Arab Development Fund and the World Bank were its principal multilateral creditors. The external debt-servicing ratio, defined as the ratio of principal and interest to exports of goods and services, amounted to 5.9 per cent in 2001. This low level is entirely representative of the concessional nature of debt flows.

TABLE 1. DJIBOUTI BALANCE OF PAYMENTS (1999-2002)

| Balance of payments | | | | |
|---|----------------|----------------|----------------|-----------------|
| in millions of Djibouti francs | | | | |
| | 1999 | 2000 | 2001 | 2002 (a) |
| <i>Balance of trade</i> | -32.425 | -34.625 | -33.297 | -36.270 |
| Exports, manufactured | 12.307 | 13.406 | 13.460 | 14.667 |
| Imports, manufactured | -44.732 | -48.031 | -46.757 | 50.937 |
| Services and income (net) | 20.746 | 18.131 | 21.742 | 24.256 |
| Credit | 35.878 | 34.307 | 36.948 | 39.391 |
| Debit | -15.132 | -16.176 | -15.206 | -15.135 |
| Unrequited transfers (net) | 11.140 | 9.427 | 9.191 | 9.455 |
| Official | 12.155 | 10.656 | 10.238 | 10.097 |
| Private | -1.015 | -1.229 | -1.047 | -642 |
| Current balance (incl. off. transf.) | -539 | -7.067 | -2.365 | -2.559 |
| Current balance (excl. off. transf.) | -12.694 | -17.723 | -12.602 | -12.656 |
| Current balance (excl. budg. transf) | -5.982 | -12.011 | -7.094 | -7.690 |
| <i>Capital</i> | -216 | 5.418 | 666 | 1544 |
| Direct investment | 754 | 584 | 600 | 628 |
| Official capital | -970 | 4.834 | 66 | 916 |
| <i>Errors and omissions</i> | 2.262 | -1.764 | 9.327 | 8.984 |
| TOTAL BALANCE | 1.507 | -3.412 | 7.629 | 7.969 |
| FINANCING | -1.507 | 3.412 | -7.629 | -7.968 |
| Off. net reserves (increase = neg.) | -333 | 951 | -58 | 77 |
| Commercial banks | -2.494 | 3.029 | -8.389 | -8.045 |
| Exceptional financing | 1.298 | -568 | 818 | 0 |
| Pro memoria GDP at market prices | 95.275 | 98.267 | 102.329 | |

Source: BCD

TABLE 2. BREAKDOWN OF INTERNATIONAL TRADE IN SERVICES (1999-2000)

| <i>Balance of trade in services</i> | | | | |
|-------------------------------------|---------------|---------------|---------------|---------------------|
| in millions of Djibouti francs | | | | |
| | 1999 | 2000 | 2001 | Var. 2001/00 |
| Transport | -1.061 | -1.310 | -716 | 594 |
| Travel | 614 | 339 | 946 | 607 |
| Communications | 776 | 590 | 588 | -2 |
| Insurance | 1.214 | 1.357 | 1.465 | 108 |
| Other services | -1.088 | -997 | -905 | 92 |
| Public administration | 18.116 | 15.350 | 18.193 | 2.843 |
| Total | 18.570 | 15.329 | 19.571 | 4.242 |

Source: BCD

| <i>Balance of transport services</i> | | | | |
|--------------------------------------|---------------|---------------|-------------|---------------------------------|
| in millions of Djibouti francs | | | | |
| | 1999 | 2000 | 2001 | Change from 2000 to 2001 |
| Shipping | -2.095 | -2.511 | -1.762 | 749 |
| Air transport | -536 | -119 | 17 | 136 |
| Other transport | 1.570 | 1.320 | 1.029 | -291 |
| Total Transport | -1.061 | -1.310 | -716 | 594 |

Source : BCD

Trade facilitation and customs administration

The port is operated by the Djibouti and Ethiopian customs administrations

The Djibouti customs administration is responsible for recording the movement of goods entering and leaving the territory and collecting the duties and taxes on goods intended for consumption in Djibouti. The applicable tax package comprises customs duties, the domestic consumption tax (TIC), which ranges from total exemption to 33 per cent, and excise tax.

Box 1. Domestic consumption tax (TIC) rates

0% : Banknotes, gold ingots, coins, filmed news for television, personal effects, baggage and household effects, and “locally manufactured goods approved under the Investment Code”;

5% : Tobacco in transit, transshipment or for export or re-export;

8% : Basic foodstuffs, pharmaceutical products, fertilizers, computer hardware and accessories, wood and plywood, tires and inner tubes (for vehicles in transit) ;

10% : Alcohol in transit, transshipment or for export or re-export;

20% : “Intermediate goods”;

33% : “Luxury” goods (khat, fruit juices, tobacco, alcohol, mineral water (imported) and petroleum products (fuel, fuel oil and lubricants).

The Djibouti customs administration does not exercise complete control over the entry of goods into national territory. It is in fact the port authority that oversees the free zone and determines who is authorized to make use of this multiform space. It is only in the past three years, and not without difficulty, that the customs authorities have succeeded in setting up a system for registering “entries into the duty free zone”. The statute of the free zone permits the storage of goods for an unlimited period. After remaining in this area for 30 days, goods destined for Ethiopia must be moved to the storage facilities of the General warehouses, where they are held until a storage fee is paid.

The Ethiopian customs administration also maintains a presence in the port of Djibouti. Thus it can quickly stop shipments destined for Ethiopia and monitor the loading of exports. It enters the customs process after the Djibouti authorities in the case of imports and before in the case of exports. This extraterritorial location allows Ethiopia to subject shipments of goods intended for consumption in Ethiopia to rigorous customs inspections from the moment they arrive in Djibouti.

Any Ethiopian purchaser of foreign goods must obtain hard currency from the Commercial Bank of Ethiopia, which follows government guidelines in the allocation of foreign currency to priority import programmes. Once in possession of this “capacity to buy”, the potential importer signs a shipping contract with the national shipping company, Ethiopian Shipping Lines (ESL). If the port of embarkation of the foreign goods is not served by ESL, the bill of lading is contracted out to another shipping company subject to payment of a surcharge of \$600 per bill. The information is then transmitted to the Ethiopian customs authorities for a preliminary import declaration and payment of a deposit of 130 per cent of the customs value. A copy of the duly completed import declaration is sent by fax to the Ethiopian customs office in Djibouti, which verifies the declaration of the transit agent in Djibouti. This trade policy, which is contrary to World Trade Organization (WTO) rules, prevents Djibouti from playing its rightful role of marketplace or “showroom”.

The route followed by a customs declaration in Djibouti

Goods entering the port destined for Djibouti pass through two phases: presentation followed by clearance. During the first phase the shipper's manifest is delivered within 24 hours of the vessel's arrival in port. The Djibouti manifest and free zone office then proceeds to make a computerized inventory of the goods. Once this inventory is concluded, detailed declarations covering specific parts of the shipment can be made. The second phase consists of the actual clearance. Within three days of the registration of the manifest, a decision regarding the procedure to be applied to the goods must be taken (free zone, delivery for consumption, warehousing). Delivery for consumption involves a procedure that is carried out, under optimum conditions, in one day. The problems faced by customs officers in terms of the actual physical recovery of goods after duties and taxes have been paid are often attributed to the customs administration. In practice, they are often caused by poorly prepared documents and the fact that clearance, payment of port and handling fees and delivery are separate steps in the process.

In the case of goods intended for the Ethiopian market, the importer, armed with the necessary permits and currency in the amount of his purchase, makes a customs declaration accompanied by payment of a deposit totalling 130 per cent of the declared value. The unloaded goods are moved into the free zone or put in transit and are categorized according to Djibouti customs classification. When the goods are about to be transferred to Ethiopia the Djibouti transit agent/commissioner submits a transit declaration to the Djibouti authorities. A copy of this declaration is then submitted in advance to the Ethiopian authorities. The manifests are then cleared and the duties paid in Ethiopia.

Taxing and importing of Ethiopian khat.

The documents prepared by Ethiopian transit agents are submitted to the customs authorities at Djibouti airport. After the shipment is unloaded, it is weighed unofficially next to the aircraft. The customs officers then proceed to collect the taxes and duties owed by the importer. Payment is made by means of payment slip delivered to an uncomputerized service of the Public Treasury, which issues a receipt. If payment is not made, customs retains the deposit paid by the importer.

Customs and the competitiveness of Djibouti's economy

Integration in the global economy depends in part on the performance of a country's customs administration. The World Customs Organization (WCO) has adopted a number of conventions aimed at simplifying and harmonizing customs procedures and facilitating international trade. Djibouti must become a party to these instruments and must join WCO as an observer in order to benefit from the training sessions offered to its members and obtain the assistance it will need when the COMESA tariff nomenclature is adopted.

Administrative recognition of customs

Reorganization is needed. The customs administration must be viewed as playing a bigger role in regional integration, particularly through participation in COMESA meetings. The status of a port open to the world owes much to the status of the free zone and suspensive customs arrangements, such as

warehousing. From a strictly financial standpoint, the customs administration accounts for nearly half of all budget income and plays a vital role by awarding and monitoring exemptions from customs duty. The Indirect revenue unit, which is part of the Office of Revenue and Property in the Ministry of Economy and Finance, does not enjoy the status it should. This office is responsible for calculating and liquidating customs duties and taxes, both on goods intended for consumption in Djibouti as well as on the khat imported from Ethiopia on a daily basis.

Given this organizational structure, the Indirect revenue unit does not have sufficient decision-making power. Its director does not hold the rank of Director General, and many of his tasks are not carried out by the customs administration. That is the case, for example, with the publication of foreign trade statistics, even though the unit collects basic data. Likewise, the customs administration does not collect the duties and taxes it calculates and liquidates, a task which is performed by another office in the Ministry. Under any administrative reorganization the customs administration should be considered to be as important as the tax or property offices, its services should be split up so that they can perform more effectively, with substantive activities kept separate from managerial activities. The customs administration should also have substantive departments to deal with monitoring and surveillance, regional integration and information processing, and there should be a clearer separation between central and branch offices.

Inadequate resources for government bodies dealing with international trade

Djibouti's customs administration has 250 officers, of whom 150 conduct inspections. This staff is inadequate, both in number and in quality, which means that there are disruptions in service that can adversely affect the flow of trade. Moreover, all economic operators, including the Port of Djibouti, which operates round the clock, complain that the working hours of the customs administration are too short. Summer hours are 7 a.m. to 1 p.m. At a time when international logistics require concentrated flows and a high level of staff activity, this situation is an aberration. It constitutes a drag on the port's competitiveness and creates disruptions in supplies and deliveries and in the functioning of the container terminal.

Increasing the staff and enhancing skills are imperative, particularly as regards inspections associated with petroleum products, which are heavily taxed as the port at Doraleh undergoes a turnaround in its area for oil-related activities. Employee skills must also be upgraded in the drafting of complaints and analysis of customs value on the basis of the so-called GATT principles of transactional value. And while the number of staff should be increased, customs inspectors must also upgrade their equipment. The current situation does not allow for satisfactory monitoring, particularly at the borders. The Indirect revenue unit has drawn up a preliminary list of its equipment needs for which both internal and external financial support will be needed.

The salary scale for customs personnel reflects inadequate remuneration coupled with incentives. Such a system means that the best employees leave or that staff take on additional jobs, with a detrimental effect on the quality of their customs

work. The monthly pay scale goes from DF 80,000 for a head of service to DF 50,000 for his deputy. An accounts receivable clerk receives DF 32,000, a clearance officer DF 25,000. Opportunities for advancement are limited by the country's small size and the concentration of economic activity in the capital. An overhaul of wages should be contemplated, provided that it is linked to performance. In the port itself, the need for an efficient customs administration must mean continuous operation from 7 a.m. to 6 p.m., to be consistent with the hours kept by dockworkers and transit companies.

**A need to
simplify
excessive
bureaucratic
paperwork**

Administrative procedures relating to the operation of the port and surrounding areas (free zone, warehouses) and to the clearance of goods are based on data that does not exist in electronic form. What is more, documents are not standardized and their flow is erratic. Whether they come from the administration itself or from private operators, commercial documents are unwieldy, following different formats and using different weighting systems. The forms for a customs declaration for consumer goods (Model 1), for example, are printed on very thin paper that cannot be photocopied. The monopoly on these forms held by the national printing press is unlikely to lead to any innovations, even small ones. The documents and forms in use in Djibouti do not meet any international standards and are not consistent with any international recommendations relating to the processing of commercial data. This situation has a negative impact on operators in their dealings with international partners who increasingly make use of standardized formats and rely heavily on information transfers of data in electronic form. Documents and forms must follow an exceptionally long path to completion. The paperwork draws out procedures and multiplies the number of stamps required, to the detriment of efficiency.

**Long-term
computeri-
zation of
customs**

Total automation of the customs administration's information system will require a multidisciplinary team including information technology specialists and senior customs staff and the use of a realistic methodology and planning. The team should include, to the extent possible, transit operators and customs agents, shippers, importers and exporters, drawing on the most modern communication technology. Until the SYDONIA++ system recommended by UNCTAD and endorsed by the Government becomes operational, the SIGED system should be retained. Certain urgent operations may be carried out which will become indispensable once SYDONIA++ is up and running.

The tools that should be made available on the Internet are, first, the Integrated Tariff, which will allow individual users to find out quickly which rule applies to each category of the customs nomenclature and, in clear language, the practical steps for completing the procedures for the various customs schemes. Putting the system of fiscal exemptions and benefits on line would also be useful, because it would promote transparency in Djibouti. The programme to install SYDONIA/ASYCUDA costs roughly €1 million. UNDP has already expressed a desire to be the "lead donor". The French technical cooperation agency is also prepared to provide financial assistance. This project will take one year and should therefore be operational sometime between the end of 2004 and the middle of 2005.

Presentation of goods in customs is the pillar on which all customs activities are based. The level of duty is dependent on the thorough and accurate execution of this procedure. Thus there is a need for a system that can rapidly absorb the contents of manifests, which are generally contained in electronic form in shipping agents' computers. This idea is gaining ground in the most efficient shipping circles. Modern companies do not want to waste time working with paper documents or submit manifests that are picked up with major errors. The shippers encountered were in favour of new methods involving Electronic data interchange (EDI).

**Repeated
input of data
and
weaknesses in
information
systems**

While there are redundancies in the collection of data, the port of Djibouti has begun modernizing its management by interfacing with clients digitally. This positive development puts the customs administration on the spot, as its information system is neither sufficiently secure nor efficient. The information contained in such commercial documents as cargo manifests or shipping agreements are recorded by a number of different services, namely the port trade office, which records the information, and the manifest and free zone office in the indirect revenue unit of the customs administration). Such double recording is onerous, and the absence of any cross-checking encourages fraud by allowing cargo owners to evade taxes.

As in many countries, there is no coordination among the various electronic information systems in use in Djibouti. This oversight is the source of many problems of internal communication. The Government has recently become aware of this and has appointed a coordinator for new technology in the Ministry of Communication and Culture, which also has responsibility for the post and telecommunications. This development should be encouraged by placing special emphasis on standards to ensure that systems can interface. This is a prerequisite for the smooth flow and sharing of information. At the same time, competition among suppliers of services should be encouraged, as should coordination with the business community.

**Sketchy and
unreliable
computerization
of customs
operations**

It was not until 2000 that the Djibouti customs administration first experimented with using computerized information systems to manage the movement of goods – i.e. the presentation and clearance of manifests - through customs. Today it has a basic system known as SIGED (Système Intégré de Gestion de la Douane, or Integrated Customs Management System), which has created and enhanced an awareness of computerized information systems among the staff of the Ministry of Economy and Finance. One practical consequence of this development has been that Treasury staff are now demanding that their deposit and billing procedures be automated. The inadequacies of the existing integrated system are, however, obvious.

First of all, the integrated system is incomplete in that it covers only one part of the customs declaration. Furthermore, it is not based on customs nomenclature or an integrated tariff, which form the heart of any customs clearance system. It does not follow the procedure to completion, which would be the automated, as opposed to manual, liquidation, with random assignment of individual declarations to inspectors. Thus this system does not prevent the possibility of collusion between the customs officer and the party making the declaration.

Lastly, the system is not reliable in that it has no internal controls and is not secure enough. To meet these criticisms and draw on the lessons of the past, the designers of the SIGED system are currently trying to develop a more efficient version that can have different settings and can be used at different sites (port, airport, review office, exemption office, etc.).

**Progress in
the Port of
Djibouti**

Under the impetus of the new private management, the port information service has significantly improved the management of that facility. Further efforts are needed, particularly in the case of conventional goods. The port information service recently launched an EDI programme aimed at linking it to shippers so that it can follow containers more effectively. This positive initiative is based on collaboration among users and enhances the efficiency of the port as a whole. Finally, through its connection via the Internet to the port web site, the “e-terminal” project will allow shippers to follow the movement of containers through the port facility. All these developments will help to facilitate trade while at the same time forcing the customs administration to become less paper-reliant.

Warehousing conditions and tax systems hamper competitiveness

The customs administration has difficulty in compiling data on shipments. The information provided in the manifests is only partial and is slow to arrive so long as there is no electronic link between customs and the port. Customs also has difficulty in locating goods, which may be in the port, on the docks, in the warehouses or en route to the Djibouti dry port. Most goods destined for Ethiopia are stored in the general warehouses run by the Djibouti Chamber of Commerce.

It is difficult to get a thorough grasp of customs and tax benefits. The Government has increased incentives to attract trade and investors. As a result, there is a welter of different provisions that are difficult to understand at the level of parliamentary control and hard to verify by customs and tax officials. Companies in the free zone enjoy duty-free storage and exemption from taxes on their storage charges. Industries in the zone are entitled to duty-free storage of goods and exemption from tax on a number of operations. Lastly, the benefits offered under the Investment Code provide for partial or total exemption from local taxes.

**Forwarding agents
and customs
brokers: making it
harder to qualify**

The entities chosen to act as forwarding agents and customs brokers have proliferated in recent years. Many are poorly equipped newcomers who have no real training in customs, fiscal or regulatory matters. The legislative and regulatory provisions are vague when it comes to specifying the minimum computer skills and equipment needed to enjoy such a preference. Consequently there are a number of forwarding agents and customs brokers who are unable to provide good service. Specifications must therefore be more thorough and accurate than is possible with the current texts and indicate in particular the hardware requirements. Candidates for preferential treatment must be selected more carefully by a joint commission (comprising the Ministry of Equipment

and Transport and the customs administration), and the regime for dealing with offences must be more rigorously defined and strictly applied.

Poverty reduction and the production of marketable goods

Poverty and trade policy in Djibouti

The current PRSP indicates that the search for strong and equitable economic growth with a high level of employment is the main objective of the poverty reduction strategy. It would seem that opportunities for rapid poverty reduction in Djibouti are limited by the country's geophysical features, which are reflected in the structure of its GDP. Poverty reduction normally entails an intensification of agricultural activities, in which roughly 70 per cent of the population of all developing countries are concentrated. In the case of Djibouti, agricultural prices and institutional reform of the production chain do not constitute a real mechanism for stimulating production in rural areas. Nor is the expansion of labour-intensive manufacturing, owing to the size of the market and the often prohibitive unit costs. Centred around port activities and logistics, the internationally marketable services sector holds out more promise, but demands competitiveness and diversification, which in turn imply a significant level of human capital development.

Integration and its ambiguous effect on social variables

While trade reforms stimulate growth, they do not automatically reduce poverty in that there are transition costs and distributional effects. Yet one can see that Djibouti's economy enjoys little protection, given the size of the port sector and the narrowness of the productive base. The effect of greater integration through trade, then, is more likely to be experienced as additional revenue rather than as the replacement of locally produced goods with imports. In other words, trade reform broadens the scope of economic opportunities by expanding the size of the market and broadening the impact of the spread of knowledge. Thus the implications of the process are not ambiguous. Openness will come through the creation of new wealth and not through the lifting of protectionist measures in respect of existing activities. Djibouti's area of specialization is primarily the provision of services. Such activities, which were formerly considered as not being marketable, are now considered to constitute a dynamic good in the area of international trade. While world trade is growing twice as fast as national income, chiefly as a result of information technologies, trade in services is experiencing a much faster rate of growth than conventional trade in goods.

The role of infrastructure and financing needs

Infrastructure contributes to the achievement of the Millennium Goals by promoting job opportunities for women, facilitating access to basic education and improving the health of the population by promoting decent housing, which is an element of social development and urban planning. Infrastructure is of interest because it is a factor of sustainable development in hitherto backward regions. It generates in the interior activities that are "not internationally marketable" that can in turn stimulate integration in the global economy. The

presence of this dynamic is important. For while Djibouti has a very high rate of urbanization, virtually all the country's rural workers live under the poverty line as defined by the consumption of less than 2,100 calories a day.

Infrastructure as a means of promoting employment ... and international trade

From this perspective, it is to be hoped that better use will be made of the resources earmarked for the highway development fund than has been the case in the past. Road maintenance is indispensable to the development of the subregion's capacity for integration. Such activities promote employment and poverty reduction, and also facilitate the play of competitive forces in the subregion. They are thus a factor in the lowering of consumer prices which helps to enhance the well-being of those living in poverty. Cognizant of the importance of the road sector for external competitiveness and combating poverty, the Government is preparing, with World Bank support, a strategic study on the long-term development of this sector. This study should lead to the formulation and adoption of a 10-year sectoral development plan. This plan will include measures for an institutional restructuring of road management, reform of the modes of financing investment and road maintenance, and a priority investment programme.

The transport infrastructure sector requires major investments that are complementary with the creation of employment. However, of the \$685 million in investment called for in the PRSP (2003-2006), \$431 million, or 63 per cent of the total, are earmarked for the transport sector. Of this \$431 million, only \$125 million (30 per cent) has been acquired. It is thus important to attract foreign investment to offset the lack of official resources, particularly for such profitable infrastructure as the port. Privatization of commercial public services should also help to offset constraints on official funding.

Human capital and basic social services

The main socio-economic objectives of the PRSP are aimed at putting Djibouti on the road to improving the well-being of the population and integrating its human resources more fully in the global economy. Raising the crude primary school enrolment rate with a view to achieving universal enrolment by 2015 supports this goal, as does, in the area of health and among other equally important targets, stabilization of the rate of HIV infection at around 3 per cent. While the poverty reduction strategy sets out a coherent set of measures, economic policy tools should nevertheless be harmonized with this choice of targets. With public policy compatible with community participation and a deadline of 2015, the PRSP will help to bring about a positive spiral: poverty reduction and declining unemployment through an enhancement of human capital and productivity, a more competitive economy and expanded production of internationally marketable goods.

Increasing productivity and competitiveness through the quality of human capital

Another section of the PRSP is aimed more particularly at increasing human capital through the implementation of programmes targeting poverty areas and the most vulnerable groups of the population by improving access of the poor to health care and primary and vocational education, which are vectors for employment promotion. However, turning intentions into results does not

happen automatically. It requires strong political commitment, but also a means of measuring the variables on which policy-makers intend to focus in order to monitor the effectiveness of public policy. In the case at hand, the statistical apparatus is poor. To improve it will entail strengthening it to ensure the development and regular monitoring of essential indicators in as transparent and participatory manner as possible. The population must be able to make these goals their own in order to create the conditions for a credible and sustainable public commitment to poverty reduction.

Poverty reduction also involves expanding access to basic commercial services such as water, electricity and telephone service. These services have a “universal” character in that they, just as much as education and health care, shape individuals’ “capacities” and modes of “functioning”. Any individual ought to be able to obtain access to these services, which shape his or her participation in the process of integration in the global economy. Here again, the commitment of the State cannot be lacking if the PRSP is to become operational. Yet it is often worth spelling out the means by which this will be accomplished.

A partnership for private and public financing of commercial services

In Djibouti, the water and electric companies are not in a financial position to expand their networks to the extent required by the objectives set. This can only be accomplished through institutional reform of the companies in question, chiefly through privatization, in forms to be determined, or through budgetary funding, which acts like a mortgage in terms of its duration. Consequently, the Government must bear in mind that implementation of the PRSP is contingent on significant progress in various interdependent areas of reform. It must also cause a culture of transparency to develop by bringing together to the extent possible the actors concerned by these changes: representatives of political parties and the private sector, but also civil society (NGOs, etc.) or donor-partners with whom dialogue is indispensable. Another aspect of poverty reduction that must be taken into consideration is access to financial resources. The formal banking system is often reluctant to grant credits that can promote investment, and even more so to operators without guarantees or small producers on the edges of the informal sector.

Integrating persons living in poverty through micro-finance

Djibouti’s experience in the area of micro-finance is still quite limited, and operators lack skill. The Government seeks to encourage the development of micro-finance as a tool for poverty reduction and a means for the economic and social advancement of women. The priority here is to establish a legal and regulatory framework conducive to the development of micro-credit, to support the development of professional micro-finance intermediaries (NGOs, agencies specializing in micro-finance) and to support the development of networks through the establishment, at the urban and ultimately national levels, systems of micro-credits targeted at the development of women’s activities (retailing, handicrafts by poor women in urban and rural areas).

Although they are not part of “the poor”, strictly speaking, small entrepreneurs in the semi-formal sector contribute to the creation of jobs and thus help to reduce

“major poverty”. Such micro-entrepreneurs do not, however, have access to bank credit for at least two reasons. One is that the amounts of the loans requested are of necessity very small and are supposed to cover the transaction fees, which banks are unwilling or unable to lower. The second reason is that, owing to their poverty/precariousness, these operators cannot provide any of the guarantees generally required by banks. It should be noted that this sector is beginning to be taken into consideration by the Djibouti authorities, first by the FDED, for large amounts, but also by the Social Development Fund, which is supporting the financing of micro-credits moving through the NGO network.

Box 2. An unfortunate micro-credit experience: the Charitas project

To structure and expand alternative sources of financing the authorities set up the Social Development Fund (SDF), which works with NGOs. Currently some eight or nine agencies operate in partnership with the Fund. In March 2003 their activities involved 900 clients. The top five NGOs are between three and five years old, and the number of their clients is insignificant in the light of the demand in this sector. The poor institutional and technical capacities of these NGOs explain this “topping out” of clients. To understand the current situation in the micro-finance sector in Djibouti a brief overview of its origins are in order. Charitas launched its first programmes in November 1995. Drawing on the experience of the Grammen Bank, like most programmes at the time, Charitas opted in favour of micro-credits through solidarity groups. The organization operated in the city of Djibouti and in the districts through partnerships with local NGOs.

The institutions that were set up lacked technical assistance to help them apply the sound practices developed around the world with regard to vision, governance, etc. Thus the procedures that were established proved to be fairly inefficient in that they failed to prevent fraud in respect of clients and the management of funds. The rate of defaulting on payments had reached 50 per cent by the time the programme came to an end in December 2001. This brief overview explains why reforms are currently being undertaken. However, the steps taken thus far to prevent fraud would seem to be inappropriate for dealing with procedures that are still too “bureaucratic” and inefficient.

cf. the sectoral report by Fouzi Mourji : Description of the financial system.

The Social Development Fund is financed with resources from ADB. Its objective is to support the Government’s efforts to reduce poverty significantly through the granting of credits, the provision of basic social services (education and primary health care, access to drinking water, etc.) and institutional capacity-building by means of a demand-led approach and active community involvement. From all of its activities it is hoped that 17,000 permanent jobs will be created with a potential impact in terms of available resources for more than 150,000 persons. For a number of reasons, however, project activities appear to be slowing down; an evaluation of the Fund is therefore in order so that problem areas and responsibility can be pinpointed.

constraints, including limited markets and low purchasing power. Considerable potential exists, however. This will be borne out later by the sectoral reports: processing of agricultural products; livestock breeding and tanning; tourism, with its implications for the development of handicraft-related activities; and fishing, which brings in direct income and has a beneficial effect on public health through improved diet. All of these activities are dependent on better vocational training.

Reducing inequalities as an objective

Inequality and poverty impacting growth

While the poverty profile shows a large number of people in Djibouti living in poverty that is often absolute, less emphasis is placed on the question of inequalities and their aggravation. Academic studies have shown, however, that deep disparities are not conducive to economic growth. Poverty is likewise no conducive to growth because it marginalizes a large segment of the active population through unemployment. Inequality and poverty, which ultimately combine to the detriment of the well-being of the population as a whole, must be studied in greater depth, particularly where they intersect with growth. Studies conducted in several African capitals have shown that poverty levels are determined more by the extent of inequalities than by differences in income. In a study of Abidjan, Bamako, Conakry, Ouagadougou and Yaoundé it was found that a 1-per cent increase in the Gini coefficient (increasing inequality) corresponded to an increase in poverty ranging from 2 to 7 per cent, while a 1-per cent increase in income corresponded to a decrease in poverty of only 0.5 to 1.3 per cent.¹ Given that the poorest 20 per cent of the population in Djibouti account for less than 6 per cent of all expenditure, an aggressive policy ought to be able to combine growth objectives with equity without upsetting the balance of public spending.

Budget policy and competitiveness

The volume of budget income

An economy's competitiveness is based in part on an appropriate supply of public goods (education, health, collective infrastructure). Financing this supply requires the mobilization of resources whose collection may create fiscal distortion. Yet the higher the rate of government levies, the more the threat of fiscal distortion may undermine competitiveness.

Global fiscal pressures and competitiveness

Government levies and fiscal performance

The rate of government levies, taken as the ratio of total public resources to GDP, cannot in itself guarantee a satisfactory balance in budgetary terms. In 2002 it was necessary to mobilize grants amounting to 5.9 per cent of GDP and

¹énod and Jean-Luc Dubois, 2002.

take out a net loan corresponding to the standard deficit of 3.5 per cent of GDP (see graph 1). Compared with other developing countries, the rate of government levies in Djibouti is in fact rather high (23.1 per cent in 2002).

One can appreciate the level of fiscal pressure when one looks at the economy's structural features affecting its fiscal potential, and thus its capacity to pay. A country's fiscal potential is a function of a set of variables that in the short term are independent of economic policy. For Djibouti, then, this means evaluating the anticipated level of government levies, while taking into account the structural features of the economy. At present, actual government levies tend to equal fiscal potential. This means that the effectiveness of the fiscal mobilization policy is comparable, on average, to that of other developing countries. In general, then, it is desirable not to change a level of government levies that corresponds to a country's capacity to pay.

The structure of government levies and competitiveness

Taxation and its impact on competitiveness and poverty

Until the reform of 2000, the indirect consumption tax (TIC) was the only tax that could be considered a form of tariff taxation. The three levels of this tax (8%, 20% and 33%) applied exclusively to import, with numerous exemptions and cases of fraud. In 1999 the contribution of TIC to all government levies was 28.1 per cent, which was close to the average contribution observed in sub-Saharan African LDCs (32.2 per cent in 1996-1998).

Tariffs as a means of applying the TIC ...

Since 2000, the TIC has changed: it now applies also to the consumption of locally produced goods. Because of this reform, Djibouti would seem to be characterized by an absence of real tariff taxation, thus highlighting the very liberal character of its trading system. However, the bulk of TIC is still collected at the border, as the income derived from the tax based on local consumption is minimal. So despite changes the legislative changes in 2000, the TIC still acts much like a tariff. As a member of COMESA, Djibouti intends to adopt the common external tariff (TEC) that is under consideration in that regional integration organization. Adoption of the COMESA TEC should generate additional tax revenues and have a positive impact on growth, since Djibouti will belong to a regional integration area that should promote trade with partner countries of the area.

The adoption of a TEC should have the effect of making the TIC into a sort of value added tax (VAT). Consistent with good practice, the country will have at its disposal tariffs that can be used as a specific trade policy tool and a VAT that generates income. Thus the reform of 2000 constituted a move towards economic neutrality and a greater stimulation of growth through the development of marketable goods.

**Direct
taxation more
onerous than
elsewhere**

In 2002 direct taxation accounted for 39.4 per cent of government levies. A comparison with other African or developing countries shows that this rate is particularly high. In Djibouti direct taxation is imposed primarily on wages, company benefits and, to a decreasing degree, real estate, which accounted for 7 per cent of direct taxes in 2002. It affects wages most of all and has the advantage of relative economic neutrality.

The reform of 2000 did not touch the schedular system of taxes on income which was easy to administer and allowed for the harmonization of the taxes on various types of income. This reform was consistent with good international practice. Now the schedular system has been harmonized across different categories of income. Moreover, the marginal tax rates applicable to professional income and wages are moderate and not likely to discourage activity or drive businesses out of the country. The link between direct taxation and poverty is hard to make out, since direct taxation is essentially based on modern activities and has little to do with the poor.

**Tax reform
anticipates the
VAT**

To the extent that legislative texts currently provide for similar taxation on imports and locally produced goods, the reform of the TIC (2000) can be considered to be a first step towards converting this tax into a VAT. Moreover, through exemptions the cascading inherent in taxes on turnover is partly avoided.

As part of the fiscal transition, and especially to make exports competitive, it is essential from an economic standpoint that the State have an income tool that is as neutral as possible, particularly where exports are concerned. A single-rate VAT is such a tool. The VAT is especially suited to competitive exports of goods and services. Through its system of calculating taxes upstream and imposing a zero rate for exports, it makes it possible to make exports free of any tax burden.

**VAT: a
neutral yet
high-yield tax**

The impact that a VAT would have on poverty should be negligible; at the outset a low VAT could be adopted, taking into account the entry into force of the TEC, which should bring in substantial earnings. The VAT rate could be even lower, provided that the Government is committed to reducing exemptions. To ensure that the VAT contributes effectively to the budget, it is essential that all goods and services that go into the final consumer product be taxed. For goods that are economically and socially sensitive, such as water or, even more, electricity, which is extremely expensive, the impact of the tax could be offset by identifying certain categories of consumer goods that could be exempted.

Implementation of a single-rate VAT is consistent with international good practice. It will facilitate the move towards an economically neutral tax that yields a satisfactory level of budget income because it is broad-based. And because it tends to make services, which constitute the bulk of Djibouti's exports, more competitive, application of the VAT should promote employment and thus poverty reduction. Adoption of the VAT will require substantial preparation, however. For this to happen, a timetable showing all the steps to be taken will have to be developed. Here Djibouti can draw on the lessons learned from many reforms that have been implemented throughout Africa. Implementation of this particular reform must be supported with technical assistance from IMF.

Declining importance of excise duties

Excise duties are an important income tool that complements the existing TIC, and they will do the same for the future VAT, if it is adopted. Excise duties are applied to tobacco, alcohol and oil products. Since 1995, and for each of these products, excise duties have been gradually declining in relative importance. The high rates imposed on alcohol and tobacco have spurred the development of fraudulent imports which are the source of lost budget income. With the exception of taxes on oil products, excise duties do not affect the economy's competitiveness. Taxation on khat has a major impact on equity. It particularly affects the most disadvantaged segments of the population who are major consumers of the hallucinogenic substance produced from this shrub. The existence of a significant tax can lead consumers to dip into their education and health care budgets.

The magnitude of budget expenses

The absence of a medium-term expenditure framework (MTEF) is an impediment to effective management of public spending. Efforts to combat poverty are in fact based on a satisfactory linkage between sectoral programmes, the PRSP and the MTEF, the last of which serves to ensure consistency over time between policy choices and the resources allocated to meet public spending objectives.

Global spending and competitiveness

In 1992-1993, global public spending accounted for 41.9 per cent of GDP. Since 1996 and the agreement concluded with the Bretton Woods institutions, global public spending has diminished as a share of GDP. In 2001 it accounted for 29.7 per cent of GDP but rose again to 32.9 per cent in 2002, a significant increase in one year. Such a high level of spending cannot be part of sound budget management when the rate of government levies over the same period shows no room for manoeuvring.

Structure of public spending and competitiveness

Current expenditure still dominated by salaries

A large share of global spending is attributable to current expenditure. Spending on salaries, wages and benefits is still high. In 2002 it accounted for 43 per cent of all expenditure. This figure is too high, notwithstanding the significant reduction that has taken place since 1996. Spending on equipment (18 per cent of total expenditure) includes the such important items as telephone service and electricity. Spending on equipment and maintenance accounts for relatively little. The functioning of government offices is currently far from satisfactory.

The corollary to a high level of current expenditure is a low level of investment spending. Apart from 1998, when it reached a level of 20 per cent, investment spending has hovered around 10 per cent and is largely financed by external resources. Moreover, the State often has trouble meeting its national counterpart obligations for projects receiving international assistance, particularly in the areas of education and health. Such problems are a potential impediment to international aid flows. The Government must pay greater attention to its existing obligations before undertaking new capital projects. Given its current

economic structure, public spending does not have the quality needed to make the economy more competitive.

Spending on education and the problem of efficiency

The functional classification of public spending reveals the fairly heavy weight of spending on general administration, defence and security. In accordance with commitments undertaken at the Estates General on education, there has in fact been an increase in spending on social services (36.9 per cent of total expenditure in 2002) and especially on education, which rose from 19.8 per cent of all spending in 1999 to 31.2 per cent in 2002. Not only does this spending lie at the heart of efforts to combat poverty, but it also plays a role in efforts to enhance competitiveness through its impact on labour productivity. In keeping with the Millennium Goals, the developing countries are placing increasing emphasis on education for all by the year 2015. Many of them have developed and begun to implement strategies to achieve these goals. In Djibouti the crude primary school enrolment rate is slightly under 40 per cent, but the dropout rate is high, as only 35 per cent of all pupils in the CM2 level go on to *sixième*.

The objective of primary education for all can have the undesirable effect of neglecting post-primary education. However, even if this level is relatively expensive in per-pupil terms, it is crucial for the future integration of young people in the labour market. It would therefore seem that the authorities ought to pay more attention to spending on post-primary education and promote technical education in particular.

Compared with Djibouti's capacities in general, spending on primary education is fairly satisfactory. The main question here, then, is what volume of public resources to redistribute for primary and technical education, taking more fully into account expenditure for teaching materials, which are an integral part of good school functioning, as compared with the current pattern of expenditure, which is focused primarily on wages. This issue must be addressed if pupils are to leave school better equipped and better able to enter the labour market quickly. Such a strategy is conducive to economic competitiveness and poverty reduction. Alongside efforts made in the area of education, the health sector has made significant progress in recent years, particularly with the establishment of an office for projects that will be part of the global strategy for the coming years.

Refocus spending on social goals and competitiveness

Public spending must be restructured in all areas, even if some significant redistribution has taken place in recent years, with greater emphasis on social spending. The Ministry of Education and the Ministry of Health accounted for 29 per cent of all expenditure in 2001, as compared with 24.3 per cent in 1995. Breaking down budget spending by type of expenditure shows the relatively important weight of the budgets for general administration, defence and internal security. Investment spending levels are still too low. With 85 per cent given over to basic infrastructure, such investment is still too low to facilitate any expansion while problems of maintaining the existing infrastructure persist, particularly in the area of the national road network. The highway maintenance fund, for example, has been long in allocating the resources needed for maintenance of the Djibouti-Addis Ababa corridor. A problem of resource allocation has thus compounded the problem posed by the meagre resources budgeted for infrastructure maintenance in this sector. The share allocated for public works is in the neighbourhood of 1 to 3 per cent of total expenditure. Yet

**Basic
infrastructure
and public-
private
partnerships**

these resources help to make Djibouti attractive as a transit country, particularly towards Ethiopia. In this sense they affect competitiveness and trade facilitation in the subregion.

While the State lacks the resources to maintain its network of public infrastructure on a secure basis, and thus to stimulate its expansion, as it must do in its capacity as owner and often the only shareholder in public service enterprises, it must face the consequences of this situation. Specifically, it must strengthen its policy in the area of disengagements and public-private partnerships. Such partnerships may take the form of BOT (build, operate, transfer) contracts or partial or even total sales of shares in the private sector. The authorities have already shown their willingness to move in this direction. In September 2001 the Government adopted a strategy for the privatization of the State electric company, Électricité de Djibouti (EDD), the National Water Office (ONED) and Djibouti Télécom. The last-mentioned is the result of the liquidation in 2000 of the Société des telecommunications internationales de Djibouti (STID). On 16 November 2003 the management of Djibouti Télécom was privatized for a two-year period (2003-2005). Basic investments must be made, and not only in the traditional public arena, if such transactions cannot be undertaken in a manner compatible with a balanced budget. Investment in infrastructure cannot be developed on the basis of such partnerships without an improvement in all aspects of the institutional environment, which will be analysed later.

Budget balances and their financing

Budget balances and sustainability

Financing the budget balance is heavily dependent on grants. In 2002 such resources amounted to 5.9 per cent of GDP. Because of their potential instability, grants are a source of vulnerability. A decrease in grant aid could be problematic for the financing of poverty reduction programmes in the long term. In 2002 the primary deficit level (3.3 per cent of GDP) seemed excessive. A worsening of this deficit could be at the origin of a loss of State solvency. Accordingly, this deficit must be reduced and there must be a return to sustainable financing of budget spending. The situation of public finance is made particularly difficult by a considerable volume of government arrears. Little use is made of monetary financing of the deficit. As conceived, the principle of the currency board provides for the financing of advances to the State by the central bank. The possibility of a backlog of arrears in payment nevertheless poses a real danger, despite the efforts made in this area in the context of the IMF Poverty Reduction and Growth Facility. These accumulated arrears might lead to further deterioration in Djibouti's competitive position by triggering an increase in the price of non-commercial goods and subsequently a change in the real effective exchange rate.

The difficult political situation in Djibouti in the 1990s had a major effect on the State budget. One result was the accumulation of a large backlog of internal arrears for the period from 1992 to 1997. This backlog accounted for 83.7 per cent of all budget revenue in 2002. These arrears led to serious economic and

social consequences. In particular, they hamper the mobilization of fiscal revenues since it is always difficult to prevent unauthorized compensation of government arrears by means of the payment of taxes or social contributions, but also to prevent these arrears from being carried over to the system of production. It goes without saying that the appearance of such problems is counter to the objectives of overall economic competitiveness.

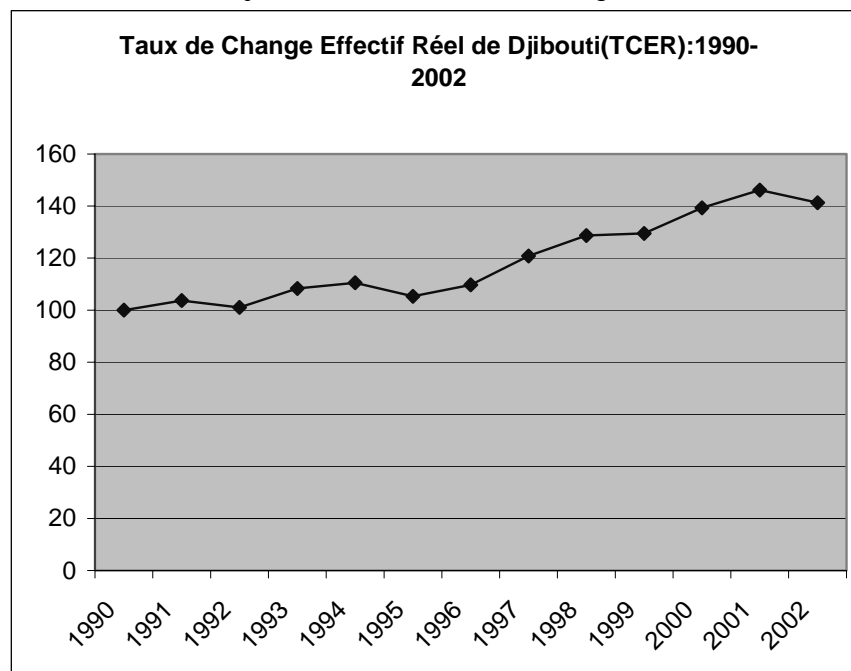
Competitiveness as measured by factor prices and costs

The real effective exchange rate index and factor costs

The real effective exchange rate

The real effective exchange rate is an important piece of data to consider when measuring a country's overall competitiveness. It reveals the extent of compensatory movements between exchange rates and relative prices. The graph below shows the movement of the real effective exchange rate during the period from 1990 to 2002. For measurement purposes, this index should, of course, be treated with caution.

Djibouti: Real effective exchange rate, 1990-2002



Source : IMF data.

There is relatively scant information available on prices. Until 1999 the only available information concerned the movement of consumer prices among expatriate households. Only in April 1999 did the pattern of consumption

become more representative of Djiboutian households. Still, it is conceivable that prior to 1999 consumer prices moved in the same way as salary costs in the formal sector. Yet it is this very sector that is directly exposed to international competition. Another difficulty specific to Djibouti is the narrowness of its productive system, which makes it difficult to compare with that of the country's trading partners. The point of reference here is a fictitious country that represents the relative importance of the top 16 countries with which Djibouti maintains international trade relations, imports and exports combined. This choice of partners results in France and Ethiopia being assigned weights of 16.6 per cent and 14 per cent. The countries of the Middle East are also represented, especially Saudi Arabia (12.4 per cent), the United Arab Emirates (2.75 per cent) and Yemen (7.3 per cent). Asia is assigned a consolidated weight of less than 20 per cent of the total.

The fixed rate of exchange between the Djibouti franc and the dollar, to which it is tied

Movement of the real effective rate of exchange suggests that since 1990, the base year for this index, the competitive standing of the economy had declined by about 40 per cent. This deterioration, which occurred primarily since 1996, and accepting the restrictive hypothesis that the exchange rate was balanced in 1990, was chiefly linked to movements in the rate of the United States dollar. The dollar appreciated by approximately 37 per cent vis-à-vis the basket of currencies of Djibouti's partner countries. It will be recalled that the Djibouti franc is exchanged at the rate of 177.721 to the dollar. In other words, and as is to be expected from a currency board system, local inflation was not very different from that observed elsewhere in the world. Generally speaking, the currency's overvaluation is apparent. In the short term, this lack of competitiveness does not constitute a significant handicap for port activities, which benefit from geography and the political context in the region. However, this expansion is crucial for the creation of employment and poverty reduction on a significant scale. In the absence of global inflation, a decline in the real effective exchange rate may result from a change in the fixed relationship that ties the Djibouti franc to the United States dollar. In theory, such a change is likely to produce effects more quickly if there is greater elasticity in agricultural pricing or there is significant idle manufacturing capacity. Djibouti does not present either of these criteria for efficiency precisely because its production system is underdeveloped. The second way to bring down the real effective exchange rate without modifying its relationship to the dollar is to affect the cost of economic and institutional factors that contribute to production costs. Naturally, this second method is compatible with the first. As the only method used, however, it has the disadvantage of pushing the efficiency of economic policy off into the distance, a move that is incompatible with the needs of poverty reduction. Thus there is limited room for manoeuvring and the outcome is uncertain.

The cost of labour

Labour has a direct impact on an economy's competitiveness. It plays a role in the formation of production costs both through nominal remuneration, or salaries, and by the quality of labour, i.e. productivity. This productivity is itself a function of the system of formation, the effort of workers who depend on social contracts, and the equipment made available to workers. The technology

of services is generally labour-intensive. The larger their share, the higher the cost of labour in an analysis of an economy's competitiveness. A relatively high proportion of services for which gains in productivity are generally low and price formation is sheltered from international competition (non-marketable economic goods) threatens to undermine the economy's overall competitiveness. This observation applies only partially to Djibouti, however. Many services are in fact of a commercial nature and internationally marketable, although subject to international competition, at least in terms of long-term price formation.

Excessive labour costs penalize employment

The constraint is heaviest on transit transport, where the competition with Ethiopia is abundantly obvious. The demands of competitiveness are low in the short term as far as port services are concerned. The port could make greater use of the natural advantage it enjoys as a result of its geographical situation and the security problems facing other ports in the region. The operator can then act like a monopoly-holder who passes on his extra production costs in the prices he charges for providing his services to consumers. The need for competitiveness is stronger in the medium term since transit opportunities can occur throughout the subregion. In particular, the development of certain segments such as transshipment activities at ports of call along the world's major shipping lanes is closely related to the cost of the call. Thus Djibouti has a service-based productive system whose development is closely bound up with labour efficiency, even if labour is less of a determining factor than port equipment and the organizational capacity to use it. Moreover, the economy suffers from underemployment of the productive force, which strikingly illustrates the problem of competitiveness of the labour factor at the local level.

One out of every two workers is unemployed

Increases in poverty are closely linked to the development of unemployment. Employment figures reveal the presence of a structural crisis in the labour market, with unemployment reaching 59 per cent, a sharp increase over the 1996 level of 44.1 per cent. (The actual level is not really clear, notwithstanding the precise figures given here.) Some 50.4 per cent of those unemployed are seeking a first job. The phenomenon affects in particular young people under the age of 30 and households headed by women (68.6 per cent), but also unskilled workers (62.9 per cent). Those with a secondary education and more are, on average, less affected by unemployment (45.9 per cent).

These figures clearly show that unemployment continues to be the most serious economic problem facing Djibouti by far. It is the product of a combination of several factors, particularly the rapid growth of an active population that is fed by immigration from neighbouring countries, the shortcomings of an educational system that fails to serve as a vehicle for providing basic education and vocational skills and, lastly, labour market dysfunctions, which merit a closer look. The modern sector functions on a narrow job base with wages that bear no relation to productivity. Rationing mechanisms are the result, with wages in which the "profit", i.e. the gap between remuneration and productivity, is protected by the social rules and conventions of urban society. This mode of functioning in the formal labour market is characterized by rigidities that impede job creation. Historically, much of the productive system was under State control, and the public sector led in employment and salary formation. One conclusion of a World Bank report on the evaluation of poverty (May 1997),

repeated in a publication by the Ministry of Labour and Vocational Training in November 1997, was that the share of civil servants or similar workers employed in the modern structured sector was 67 per cent, whereas private sector salaries accounted for only 25 per cent.

The State plays the predominant role in salary formation.

The highest wages can be seen in the transport and telecommunications sector. The civil service is not negligible, however, with a wage bill considerably higher than in the countries of the Middle East. According to figures produced by IMF on the basis of data from the National Statistical Office, the salary ratio of the civil service was 45 per cent higher than the average salary in public or private enterprises in the modern sector. And on average, when compared with Ethiopia or Yemen, nominal wages at current exchange rates were three to six times higher. With its policy of hiring graduates, the private sector has a tendency to follow civil service salaries. With the onset of the public finance crisis in the early 1990s, public and private hiring gradually dried up, yet wages remained high, not in the context of a European pattern of consumption, which is expensive, but in the context of productivity, which should underlie the economic price of labour.

Lower the unit cost of wages through a more effective education system

Workers not employed in the modern sector generally end up in the informal sector. This sector does not function on the basis of a real market mechanism in which wages are the result of adjustments to offset labour supply and demand. At the current rate of exchange between the Ethiopian birr and the Djibouti franc, remuneration in the informal sector, which is higher than some wages in the Ethiopian formal sector and certainly higher than those in that country's informal sector, generates a structural flow of Ethiopian workers. Neither the wages nor the type of work offered in this sector are considered satisfactory by Djibouti's active population, many of whom attach importance to leisure and social solidarity mechanisms. For those working in the formal and informal sectors, acceptance of lower "reservation wages" is one of the major challenges facing Djibouti's political leaders.

This decline in wages would be much lower if the educational system allowed for a significant increase in the quality of this factor. Without this mobilization for productivity, which implies a profound changing of attitudes, it is possible that even with the promising prospects offered by the Doraleh complex, jobs, both skilled and unskilled, will go to workers from outside Djibouti. This mobilization goes along with a credible and effective commitment to institutional reform of the education sector. Indeed, at this stage, vocational education as such hardly seems to exist. Given little financial support, it is weakened even further by the spreading of these meagre resources among several technical ministries. For it is a fact that these ministries place very little emphasis on education in their sectoral policies, which tend instead to focus on job creation and poverty reduction, as defined in the PRSP.

Low level and scattered distribution of resources for vocational training

Examples of ineffectiveness in this area abound. In the area of fisheries, the Obock school has virtually suspended operations for lack of resources. In the hotel and restaurant sector, the same fate has befallen the hotel management school at Arta. The tenuous link between the school and a technical ministry led to institutional confusion and disruptions in the functioning of the school. Such

confusion might also result from the distribution of roles between the Ministry of Employment and Solidarity, which runs the Adult Training Centre, normally in the form of short courses of questionable effectiveness, and the Ministry of Education, which offers extended vocational training courses. The institutional framework of this type of education should be reviewed in its entirety, with greater involvement of private-sector partners and donors. The PAFIP project is undoubtedly directed towards this goal, although with obvious operational problems.

Outside of vocational training, which must be reconceived in a form more likely to improve the productive capacity of labour and its employability in a productive system facing the pressures of external competition, the goal of lowering the cost of labour must also result in completion of the new labour code and a review of the weight represented by benefit-related deductions from wages.

**Going beyond
the liberal
provisions of
the 1997 Act**

The redrafting of the labour code is sufficiently advanced that a draft text now exists; however, the social partners have yet to endorse it, and it has not been cast in the form of legislation. Act No. 140 of 1997 has already brought about greater flexibility in the labour market, greater deregulation in the fixing of wages, and the adjustment of employment to meet productive needs through the relaxing of criteria for recruitment and dismissal. Recruitment can now take place without involving the National Employment Service. However, the existing code continues to be out of synch with economic realities in Djibouti and the need for job creation; accordingly, the new text should seek to spur the reform effort ahead. Labour market flexibility must also be based on a network of temporary agencies. The current situation is unsatisfactory. Even though a number of agencies exist – the Djibclean company is in fact one of Djibouti’s top employers – there is no legal framework governing them. The precariousness of these agencies may result in a lack of transparency and the hiring of persons under conditions that do not necessarily lead to job creation with significantly lower labour costs.

**Wage
deductions for
social benefits
and employer
contributions**

The question of contributions for social benefits is more sensitive because it is conditioned by the need to maintain the financial balance of the retirement pension scheme. Even more problematic is the cost of labour, of which employer contributions to benefits form but a part. One must in fact ask why enterprises increasingly tend to under-report the number of their salaried employees to the Social Welfare Organization (OPS). In itself the development of this kind of fraud indicates that there is a need to reduce the cost of this factor, but it does not show that employer contributions for benefits are the main problem. The fact that employers tend not to believe that they will be punished for under-reporting tends to encourage that practice. The number of OPS staff involved in oversight is limited, and the organization’s methods of work, which involve “negotiating” with the perpetrators of fraud is far from transparent. In any case, the rate of employer contributions appears rather high, currently running at 15.7 per cent, as against a 4-per cent contribution from employees. A decrease in this percentage or a recalculation of the two rates should be contemplated.

The cost of capital

The cost of funds available for loans is another factor that has a significant impact on production costs and thus on economic competitiveness. Unit cost here is dependent on the market interest rate, which is itself a function of macroeconomic policy and microeconomic market mechanisms and also the efficiency of equipment use. A high real cost of borrowing and low equipment productivity are characteristic of an environment offering little incentive and little competition, a situation that is not conducive to private investment or growth. Djibouti's economy functions with a banking system consisting of three commercial banks under the supervision of a central bank.

Interest rates that heavily penalize competitiveness

It is generally held that the cost of capital is excessively high: 13 per cent for the "surest" loans, between 18 and 25 per cent for loans in the form of lines of credit. These are indeed high rates in an environment in which the rate of inflation is structurally low, the cost of the resources mobilized is moderate in the absence of any restrictive regulatory constraints on the opening of windows or even accounts, and there is no risk of change whatsoever except indirectly, in the form of movements in the rate of the dollar. Given these arguments in favour of low interest rates, the response of banks must be taken into account. It is based on the sociology and an observation of the functioning of Djibouti's institutions, which do not allow for any reduction of risk or expansion of the sphere of bankable projects.

Interest rates and transaction costs

At this point a clear picture begins to emerge. Economic operators are absent from the recent history of credit. The high rate of defaults on loans led to the liquidation of several banks and the observation that the costs of backing guarantees are extremely onerous and uncertain. Justice is slow, and the execution of guarantees is rendered uncertain by the intervention of personal relations and social conventions that increase the cost of transactions. Not only is transparency lacking, but the fact that they know each other causes agents to forbid each other to buy goods confiscated at auction. These socio-economic characteristics help to explain why only limited credit is available for anything other than short-term commercial activity. One of the country's major banks has received only five requests for financing for projects valued at over DF 100 million in the past four years. So if banks invest an equal amount outside the country, this is due in part to the absence of any meaningful demand for locally bankable projects. Two figures clearly illustrate the importance of this disconnect: while deposits from non-residents in Djibouti's banks (7,649 billion) account for only 14 per cent of all deposits made, these banks' investments in foreign banks account for nearly two thirds.

Alternatives to defaulting on bank loans

In the face of economic and social difficulties that are measured by the growth in unemployment and the limited bank financing available for projects, the Djibouti authorities have set up alternative financing mechanisms. The first of these is the Djibouti Economic Development Fund (FDED), which is designed to meet the needs of some credit applicants who have not obtained satisfaction from banks. These, then, are "local finance" or micro-credit institutions that serve the poorest groups. FDED has drawn up a plan for the mobilization of resources and the granting of loans; the principal donor is the Kuwaiti Development Fund.

Regulations stipulate that interest rates may not exceed 7 per cent, which does not necessarily make the institution more viable and threatens to encourage the development of an allocation mechanism based on the criteria for selecting customers, which do not always correspond to the effectiveness with which credit is distributed.

Even with the SDF, the cost of credit stands at 18%

Very small production units most often obtain supplier credits, which gives an idea of the interest rates practised by informal sources of financing. The interest rates are often very high. On an annual basis, they can reach several hundreds of percentage points, as the sectoral report on the financial system shows. To structure and give weight to “alternative financing”, the Djibouti authorities have set up a Social Development Fund (SDF) that works with NGOs. Currently there are nine micro-credit institutions, eight of which work closely with the Fund. The Fund provides NGOs with lines of credit at an interest rate of 3 per cent. The NGOs then issue loans at 18 per cent interest to micro-entrepreneurs who form solidarity associations. Thus there is a margin of 15 per cent to cover the risk and operating costs.

On the basis of the foregoing observations, it would seem that even with the best of intentions, credit is particularly expensive given that the FDED is not yet operational, and difficult to obtain, with the problem significantly aggravated by official regulations that set caps on rates. The reason credit is so expensive is complex, and far from being as simple as some of those who strongly criticize the performance of loan resources would suggest. A decrease in the cost of credit cannot be ordered unless one is willing to accept market-generated waste and inefficiency at a greater level than at present. As far as the formal financial system is concerned, commercial banks need a reassuring and efficient legal environment. In the event of a dispute (failure to reimburse a loan), they must be able to call in their mortgages and other guarantees from their debtors. The notion that a debtor can get away without paying his debt gives rise to a sense of impunity. This failure to impose sanctions leads to a negative externality which is detrimental to all actual and potential borrowers. Actual borrowers obtain interest rates that reflect the poor behaviour of defaulting debtors, while would-be borrowers are simply denied access to sources of formal financing.

Credit and the failure of social conventions and judicial institutions

The absence of any sanctions deriving from attitudes or dysfunctions in the system of justice is thus one source of the high cost of any potential transaction, costs that have a heavy impact on the behaviour of commercial banks. This deviant behaviour has an impact on the quality of the banks’ portfolios and makes them even more cautious. One of the three main commercial banks, which had replenished its capital after being wiped out by unrecoverable debts, adopted a profitable wait-and-see position by refusing to offer any investment credit at all. It limits itself to financing foreign trade, namely imports of khat (some \$150,000 a day) or fruits and vegetables.

Apart from risk management, which leads them to increase interest rates, banks feel that their service charges are also made more onerous by factor costs with wages indexed to inflation, and by the cost of judicial proceedings, which is considered to be exorbitant. Some disputes have been in the courts for more

than 12 years. A significant number of cases of litigation have gone as far as the Supreme Court, and one must expect to wait three to four years before a case is settled. This circuit becomes even more drawn out when real guarantees must be executed. These procedural costs contribute to high interest rates and even more to the legitimate reluctance of banks to finance economic development.

**25% - 30% of
all bank debt
ends up in
litigation**

Thus the cost of capital is not fundamentally the result of an oligopolistic structure characterized by collusion on the part of bankers that works against the common good. While it cannot be confirmed on the basis of the information available information, some bankers maintain that the ratio of interest to active credit does not exceed 6 per cent. From 25 to 30 per cent of all bank debt ends up in litigation. Even if banks are not as aggressive as they might be in a more competitive market, the cost of capital would seem, above all, to reflect the need to change attitudes and institutions that overcharge for transactional costs relating to bank intermediation. Djibouti lacks a culture of transparency, and this creates mistrust and, ultimately, the allocation of credit on costly terms and with a high degree of rationing.

The cost of commercial public services

**The cost of
public services
is high**

The price of public services determines the competitiveness of commercial goods. Actually, the cost of such services has an impact on unit cost, and thus on the profitability of products sold freely on international markets. The breakdown of Djibouti's GDP, which shows the low share of industrial activities but also the benefit of geographical situation enjoyed by the port services, can give the impression that the competitiveness of this small economy is not subject to the influence of water, electric or telephone prices. This is not at all the case, owing to the competition mechanisms that are affecting those sectors that are most promising in the medium term, in the light of the development of the large-scale project at Doraleh. Despite the attractiveness of the county's geographic position, there is the always credible threat of competition combined with the prospect that shippers will move their operations elsewhere. Moreover, the creation of jobs depends on the cost of such primary factors as labour or capital, but also on certain forms of intermediate consumption, such as public commercial services (water, electricity and telephone), which have a direct bearing on the formation of costs and profitability. Each of these public services has a well known reputation for being expensive and compromising access to growth and poverty reduction.

Water

The price of water plays a role in competitiveness, but this economic good also has an obvious social dimension. For while it is indispensable to life, it is also absolutely impossible to find a substitute for it. It is therefore necessary to create conditions for universal access at "reasonable" prices. The rate schedule of the National Water Office (ONED) has six categories. The first three apply to household consumption. The rates go up with the level of consumption in cubic metres, from DF 62 for consumption of less than 30 m³ to DF 142 when consumption exceeds 120 m³. The next three categories apply to professional use and range from DF 200 to DF 250 francs. Any comparison with the

situation in neighbouring countries is difficult to draw; one must first determine that the product has the same bacteriological properties and that, at the official price, it is supplied without any rationing.

Water is 2 to 3 times more expensive than in Ethiopia

In Ethiopia, given an exchange rate of DF 20 to 1 birr, rates range from DF 23 for residential customers (consumption of less than 7 m³) and DF 53 for industrial and commercial customers. Rate levels are thus two to three times lower. Consumers in periurban zones, especially in the most disadvantaged neighbourhoods of Balbala (PK12), must nevertheless pay much higher prices. In the absence of any properly functioning public water points, water is supplied by the private sector via tank trucks. It may be purchased at the going price of DF 500 per m³, which explains the absence of unpaid bills. Apart from connection charges and recurring fees, the rate is largely higher than the DF 250 applied to the port of Djibouti, which in turn charges its customers DF 350. Even if the prices paid by the poor do not reflect their readiness to pay, for at these prices water consumption is somewhat less than optimal, the official rates charged are not exorbitant. They could be reduced further, however, if there were a major change in attitude.

Frustration and waste

The way water is distributed is in fact paradoxical: on the one hand is a frustrated population that lacks access to public water supply, while on the other is a population that enjoys access, only part of whom pays for their water. Frustration and waste thus go hand in hand. In countries around the world, but especially in developing countries, public water supply systems suffer from inefficient organizational choices and a flawed institutional environment. Losses of this scarce commodity which is replaced only slowly are considerable and illustrate the problem. In a country like Guinea, the volume of treated water actually lost during the 1990s stood at over 50 per cent, owing to the outdated equipment, poor maintenance or illegal tapping into the supply. In Djibouti physical and commercial losses were estimated at 36.78 per cent in 2001. To these two types of loss must be added the lack of income inherent in the non-payment of water bills, particularly by many government bodies. Using their capacity for political and social pressure, ministries and certain autonomous government entities are able to resist attempts to cut off their supply. And so any public workers who are freed from any budgetary constraints engage in wasteful behaviour.

Payment of water bills: the State is hardly a model

The lack of any credible sanctions for non-payment of what is owed and the absence on the part of individual ministries of any sense of responsibility for their own water consumption contribute to the problems faced by the National Water Office. Centralizing payments in the Ministry of Finance has kept the budgetary discipline that was originally anticipated from being instituted, even if the overruns of spendthrift ministries have been somewhat curtailed. The ministries are in fact encouraged to consume more than their budget allows. They then pass the consequences of their “mess” on to the Ministry of Finance, which is forced to record arrears in payments to the National Water Office, arrears that are offset against fiscal debts. An example illustrates the seriousness of the problem: on average, taking into account all customers, only one quarter (24 per cent) of the water supplied is actually paid for. In the Ministry of Education the lack of any direct relationship between the consumer and the payer

results in a lack of internal monitoring of water use in the schools. This leads to unusual patterns of consumption, with levels as high during the school year as during school holidays! The implications of these aberrations threaten to grow more serious as the policy of opening new schools is implemented. Public connections are thus used for private ends, to the detriment of those who regularly pay their bills and those who would like to have easier access to water supply.

**Yet the State
accounts for
one quarter of
all water bills
issued by the
National
Water Office**

Improving water supply is contingent on a reduction in institutional problems, especially between the water company and its customers, including the State, which uses approximately one quarter of all water sold. Any action that can make the penalizing of non-payers credible will do much to place the Water Office on a sound, sustainable footing. For penalties to be credible, there must be a greater sense of responsibility on the part of every ministry for its expenditure, rigorous budgeting of consumption and compliance with budgetary procedures. This notion of penalties must be understood by all parties, including private operators who have taken advantage of institutional confusion to avoid making payment to the Water Office. The fishing industry, for example, seems to have hoped in the wake of privatization that its water bills would continue to be paid by the Ministry of Finance. More concretely, it would seem that the privatization of the port and the airport have been accompanied by a net improvement in customer payment relations with the Water Office.

A similar institutional development must occur in the management of water points by private entrepreneurs. Experience in this area to date has been far from conclusive. Consumers and private water suppliers have conspired to avoid any attempts to collect payment. Without maintenance, the public infrastructure has deteriorated to the point where in certain poor neighbourhoods in the capital it has become difficult to obtain water except from individual connections, which the Water Office installs at the rate of only 100 a year, or from tank trucks, at the previously mentioned onerous cost of DF 500 per cubic metre.

**Reform of the
National
Water Office**

All these initiatives aimed at improving the situation can be included or strengthened within the framework of the privatization process provided for in Act No. 12 of March 1998 and its implementing decree concerning the reform of State corporations, joint corporations and public establishments. Private entities are quite possibly more efficient in their management of productive resources and more likely to ensure that mutual commitments are honoured. In the context of production, such commitments are more likely to have a legal effect or lead to requests for arbitration, which are in fact incentives for “normal” conduct in payment relations. As the prospect of privatization looms, more attention will have to be paid to disengagement.

In the case of water, but also of electricity, as will be seen further on, the choice of supplier is privileged. In general, this type of contractual agreement is politically well received because it does not entail the sale of shares. Moreover, it offers an adequate solution if the Water Office’s problems are seen as being due largely to poor public management. On the other hand, this choice is not satisfactory if the problem at hand is the public sector’s inability to fulfil its obligations to invest in the renovation and expansion of the network. The

dilapidated state of this network and the as yet limited number of customers – approximately 21,000 with an average of 23 inhabitants per customer – suggest that a management solution will not be enough by itself to promote universal service.

Difficulty in going beyond the provision of a public service

For the water sector is capital-intensive. Water treatment and distribution account for roughly 80 per cent of fixed costs. If one compares the situation of this sector with that of electricity, the ratio generally observed of current operating costs to total cost is 10 per cent for water as opposed to 50 per cent for electricity. This would seem to indicate that in an uncertain institutional environment private operators might be reluctant to enter into privatization arrangements that could entail a high level of unrecoverable costs. Whatever form privatization takes, and to a large extent this observation holds for other public service networks, the smallness of Djibouti's economy will conceivably result in the monopolistic arrangement being retained. Transfer of ownership should therefore be accompanied by the establishment of an independent regulatory body capable of promoting a contractual relationship that is more attuned to the interests of the community by preventing opportunism on the part of private operators and possible arbitrariness on the part of the Government.

Electricity

The exorbitant cost of electric power works against diversification

Energy production and supply are limited to Energie de Djibouti (EDD), a public entity having financial autonomy. The grid provides electric power derived from thermal sources which is supplied to the capital and three rural district headquarters. As at 32 December 2001, the enterprise had 36,080 customers who were serviced by a staff of 937 plus roughly 60 temporary staff, a turnover of 8 billion Djibouti francs and a physical output of 230,000 MWh. Electricity prices are a recurrent problem to which economic operators are constantly drawing attention. Rates are set by presidential order and published in the *Official Gazette*. Unchanged since February 1983, they were readjusted by 11.6 per cent in June 2001.

Under that presidential order, consumption of low-tension power is billed according to a scale of prices that includes a reduced rate applicable to Djibouti district, which includes 90 per cent of all customers, and to all residences. The price for 1 kW of current varies, depending on monthly consumption, from a rate of DF 27 for the first category to DF 51.66 for the second. It should be noted that price levels are higher than the overall rate for the district, which is DF 35.94 for the first category and DF 29.31 for the second. The reduced rate is also higher than the rate applied to certain industrial customers whose production is intended for export, or to the agricultural industry. The reduced rate is also higher, pursuant to the presidential decree of 8 October 1997, than the rate applied to hotels having more than 100 rooms.

Under this decree, a special rate was applied to such hotels for a 5-year period beginning in October 1997. The discount applied was equivalent to 50 per cent of the general rate, yielding prices of DF 17.97 and DF 14.66 for the first and second categories of consumption. While the period during which this rate was applied has expired for hotels, and the decree in fact applied only to the Sheraton

**On average,
electric power
is twice as
expensive as
in Ethiopia**

Hotel, the principle of its application nevertheless points up the handicap where competitiveness is concerned created by the excessively high cost of electricity. As with water supply, a comparison with Ethiopia is called for and reveals an overcharging on the order of 50 per cent as compared with the rates in effect in Djibouti's powerful neighbour.

According to information obtained from the Agence Française de Développement, domestic consumption in kilowatt hours was billed at 0.273 birr in Addis Ababa, or roughly DF 5.46. For industrial and commercial customers these rates fell within a range of 0.4736 to 0.5691 birr, or DF 9.5 and DF 11.4 respectively at an exchange rate of 1 birr to DF 20. Yet electric bills are an important item in the operational costs of enterprises, particularly hotels, whose number must be increased to meet the needs of the tourist industry, which explains why the discount of 50 per cent was instituted in the final phase of privatization of the Sheraton.

**Electricity
accounts for
25% of daily
hotel room
rates**

A study prepared by USAID in 1999 and 2000 entitled "Djibouti Investors Roadmap" indicates that daily power cuts by EDD are a constant source of irritation for economic operators, but also that, on average, 25 per cent of the daily hotel room rate goes to cover the cost of electricity alone. Thus the environment does not create conditions conducive to the development of tourism. The implicit cost of energy supply is even higher than the billed price would suggest. For if the supply of electricity has improved in recent years, power cuts remain frequent and are the source of problems in production. These cuts have meant that producers have had to invest in generators having an output that is disproportionate to their needs.

**Weaknesses of
EDD**

The underlying reasons for the problems in EDD show obvious similarities to those cited in connection with water supply. Responsibilities are in fact multiple and overlapping. They have as much to do with external factors as with inefficient economic practices, primarily in the form of poor management, poorly assumed responsibilities on the part of the sole shareholder or ineffective payment relations between certain customers who account for a high volume of business.

Among the external factors, as with water, which is characterized by its scarcity and the resultant spiralling of the cost of obtaining it, the costs and benefits of thermal energy must be noted. Ethiopia can rely on cheap electric power produced by its hydroelectric dams. This infrastructure, which was costly at the outset owing to the need for major construction projects, ultimately provided access to hydropower that was cheap to produce apart from amortization. The energy produced by these dams requires little human intervention and no purchases or transporting of fuel. Yet oil prices have been particularly high in recent years, between \$30 and \$36 a barrel, increasing the cost of energy production by about 30 per cent. However, this explanation for the cost cannot by itself account for the high cost of electric power. Like Djibouti, most countries of the Sahel are also importers of oil-based fuels. And thermal energy is supplied there at much lower cost without disrupting enterprises' balance of exploitation. Additional costs, then, are partly the result of external factors and partly the result of the behaviour of consumers, chiefly the State.

The State lacks the resources to discharge its duties as sole shareholder

Thus management is partly to blame, suggesting that a further study should be made to determine where opportunities might exist for reducing the cost of expanding installed production capacity. While considering the advantages and disadvantages of the various modes of institutional development of enterprises, in accordance with the 1997 Privatization of Public Enterprises Act, such a study should first carefully explore the technical feasibility as well as the costs and benefits of linking the network, chiefly with that of Ethiopia. The international complementarity of the two networks is well known. In summer Ethiopia produces a surplus of energy that could be provided at lower cost to Djibouti, as this period coincides with peak local consumption. Conversely, Ethiopia's energy needs go unmet in winter while the limited power available in Djibouti is not entirely consumed. An international trade in energy is thus foreseeable, with each country being an importer or exporter, depending on the season. It would also be useful to consider the prospects offered by alternative sources of energy. Many observers have voiced scepticism with regard to geothermal energy. There is much more positive sentiment about wind and solar power, although the latter is handicapped by the cost of solar panel installation.

The problem of reducing costs and alternative sources of energy

Operational costs, some of which appear exorbitant, should also be reviewed. The terms of fuel purchases, which accounted for 22 per cent of all costs in 2001, must be reviewed in order to determine how effectively suppliers have competed by making clear and transparent bids. At the same time, it would be worth studying the need to reduce staff costs, which accounted for 21 per cent of expenses in 2001. Overstaffing appears to be significant. Given the nature and volume of production and the concentration of the distribution network on the town of Djibouti, many African enterprises would be able to function with half the personnel.

It should be recalled that in the electric power sector one worker per megawatt is the current norm in the most efficient networks of industrialized countries. Djibouti currently uses 10 workers. This operational surcharge created by insufficient productivity is all the more costly in that wages are relatively high. Management's responsibility is thus obvious, even if the managerial staff of the enterprise have relatively little freedom in the short term to reduce the burden of ingrained habits and acquired benefits. Management's responsibility also exists, albeit to a lesser degree, for performance when it comes to billing and recovery of payments.

Government payment of electric bills is only partial

The rate of recovery is 87 per cent for all customers. However, the percentage for 2001 is deceiving in that it applies only to bills issued during that year and thus may exceed 100 per cent. Some customers pay their bills late, which forces EDD to seek credit from the Treasury or fall into arrears with its own suppliers. This dysfunction tends to engender financial costs and encourage the passing on of the problem and the posting of further arrears, all of which are incompatible with a climate conducive to business development. These problems of late payments and arrears are difficult to combat without budgetary discipline, which implies the use of a penalizing mechanism applicable to all customers, including the State. The EDD annual report for 2001 showed that government entities in that year paid for less than 38.2 per cent of the electricity they used, while

consumption increased by 7.3 per cent. At the same time private customers paid for their annual consumption at a rate of 88.4 per cent, particularly the port and the airport, which had been poor payers before their operations were privatized. The recovery rate for the private sector improved by 9.4 per cent over 2000.

Thus the overly high cost of electricity, which contributes to the problem of competitiveness facing Djibouti's economy, could be reduced in part by improving the economic performance of the enterprise and its public and private customers. Privatization of EDD in a form yet to be determined which would nevertheless address the problems of management and under-investment could help to achieve this. Experience has in fact shown that the private sector is now more inclined than ever to invest in the energy sector. At the same time, private operators can better position themselves in relation to the State in resolving institutional issues in which public enterprises generally have very little room to manoeuvre.

Telecommunications

The quality and price of telecommunication services are a factor in an economy's competitiveness, in terms of its ability to integrate its offerings in international trade flows. In Djibouti telecommunication services are concentrated in a public enterprise that holds a monopoly offering a number of products. Djibouti Télécom is in fact a limited holding company financed 100 per cent by the State. In 1999 this structure emerged from an institutional reform that saw the merging of the national telecommunication services run by the Post Office (OPT) and the international telecommunications under the control of the Société des Télécommunications Internationales de Djibouti (STID). The enterprise currently has a staff of 600 who are responsible for a small network of fixed lines, 90 per cent of which are in the capital city, 13,000 mobile telephone subscribers whose number has been growing rapidly since the awarding of a GSM license in May 2001, and 1,700 Internet service customers.

An undersized telecommunications network

For a middle-income country, the level of development of Djibouti's network is mediocre, somewhat below the average for Africa where low-income sub-Saharan countries predominate. When the national plan of action for the development of information technology and communication was presented at Beirut on 29 May 2003, the minister for Telecommunications and Postal Services clearly acknowledged the long way Djibouti had to go to reach the level attained by countries in which new technologies were already widespread.

Table 3. A comparison of network features

| Indicators | Djibouti | Africa |
|-----------------------------------|----------|--------|
| PCs per 100 persons | 1.09 | 1.06 |
| IP servers per 1,000 persons | 0.13 | 1.38 |
| Internet users per 10,000 persons | 51.3 | 85.21 |
| Telephone density (fixed lines) | 1.54 | 2.6 |
| Mobile telephones per 100 persons | 0.47 | 5.9 |

Source : International Telecommunication Union.

Telephone line density is particularly low, as is the number of portable telephone owners; in fact, a broader distribution of mobile phones would help to offset the inadequate size of the fixed network. At present the telephone company and the authorities are trying to promote the social benefits of the network by extending it physically, primarily through a policy of universal access that contemplates providing each village with a telephone booth. Given the fact that the population as a whole is widely dispersed and the mobility of the nomadic population, this goal is consistent with the promotion of a poverty reduction policy that would accompany improvements in the areas of health care and primary education.

The poor state of telecommunications in Djibouti reflects an inability to compete at the international level that is caused by inadequate services. It is clear that the development of flows of trade in goods and services, not to mention the intensification of international investment, cannot take advantage of the current situation or its dynamic. As in the case of water and electricity, there is a distinct lagging behind that can be overcome with the use of private operators through privatization in a form yet to be determined. The State can disengage from the enterprise, but it can also break the institutional monopoly of Djibouti Télécom and promote privatization by allowing private operators to enter the market, albeit in small numbers, given the size of the market.

The public sector monopoly is increasingly questioned

Throughout the world the situation with regard to new information technologies is growing more complex. Telecommunications grow more like services with each day and now form an integral part of the category of internationally marketable goods. The transmission of signals bypasses official monopolies and is now a reality for private enterprises in a position to compete. The interaction of private market forces thus creates the conditions for adjusting quality and price in the interest of consumers. Whether Governments like it or not, the development of call-back technologies, starting with the most basic version, which consists of being called rather than calling, telecommunications via the Internet and the use of VSAT by certain embassies are all ways of bypassing official monopolies, particularly in the most profitable sector, international telecommunications. In Djibouti, as elsewhere, the institutional monopoly has been broken. Yet while telecommunications are an element of competitiveness, they are also forced to set prices in accordance with international market

mechanisms which are dominated by the competition between the world's major players.

The Government and Djibouti Télécom have begun to take the measure of these market realities. The regrouping of telecommunications within Djibouti Télécom has been a tangible indication of this. But this institutional development is not enough to combat effectively the pressures that are driving international prices down. The elimination of subsidies in favour of structural deficits in the postal system is only part of the answer. Djibouti Télécom must deal with the postal service's unpaid bills and take responsibility for part of its system's personnel costs, which amount to some DF 170 million a year. From this institutional perspective, which is made worse by the payment problems of certain public sector entities, one can see the difficulties the enterprise must deal with in conforming its own structural adjustment in the face of declining international telecommunications prices and in making the necessary investments in an increasingly wide range of services.

Although necessary, lower rates must be the result of internal adjustment

To reduce the impediment to competitiveness posed by the cost of telecommunications the Government recently invited Djibouti Télécom to revise its prices downward. This demonstration of political will resulted in the adoption of new rates that were endorsed by the Council of Ministers in March 2003. This change affected the prices of the three main services provided by Djibouti Télécom: fixed and mobile telephone service and Internet service. The subscriber connection fee fell from DF 20,000 to DF 10,000. In addition, the rate for local calls, which had been DF 35, or approximately \$0.20, for eight minutes, was revised as follows: the new rates follow a dual track, with a flat rate of DF 15 for four minutes during the day and DF 15 for every eight minutes between 8 p.m. and 7 a.m. At the same time the price of international communications also fell, to varying rates depending on the destination, ranging from 25 per cent for calls to Europe to 50 per cent to the United States and Canada.

The reduction in the price of calls between fixed and mobile telephones was also significant: DF 10 as opposed to DF 35 previously. A concomitant reduction was made in the cost of calling from a mobile phone: DF 30 as compared with DF 50 per minute during the day. Lastly, the cost of Internet access was reduced. All these measures are working to improve consumer prices and thus foster competitiveness. Nevertheless there is a sense that in comparison with trends observed elsewhere in the world, and gains in competitiveness are definitely linked to the relative movement of prices rather than to nominal reductions in national prices, the cost of telecommunication services is still too high.

The price of telecommunication services continues to stifle competitiveness

Applying the same principle of international comparison used for water and electricity, it appears that local telecommunications in Djibouti are four times higher per minute than in Ethiopia, as compared with 10 times higher before price changes went into effect in March 2003. Monthly telephone service for fixed lines is anywhere from two (Sudan, Eritrea) to five (Ethiopia, Yemen) times higher than current levels in the region. And for the same 3-minute period the comparison of local rates for calls from mobile phones is also unfavourable.

These prices are twice as high as in the United Arab Emirates, Ethiopia or Yemen. Recent trends notwithstanding, these figures clearly show the reductions that must be made if regional gaps are to be narrowed. In pursuing this adjustment policy, the reductions will have to be better planned than they were in March 2003.

In other words, more scope should be given to cooperation between the State and Djibouti Télécom, perhaps in the context of an agreed plan so that subsequent fluctuations are better integrated and are mirrored by the economic behaviour of workers: lowering of costs, increased output, better recovery of outstanding bills, especially from government entities. The reductions of March 2003 were not approached with sufficient awareness of their immediate implications for the financial situation of the enterprise. Without adequate warning, the introduction of a new rate scale was in fact highly disruptive. The bimonthly turnover for the first two months for which figures are available (March/April 2003) is 28 per cent lower than for the two months immediately preceding the price change (January/February 2003). In other words, the change in prices was not painless for the enterprise in the short term.

**Need for
privatization
and an
independent
regulator**

To summarize the situation of telecommunications in Djibouti, it would seem that they need to make adjustments that the other commercial public services do not have to contend with. Taking the development of international competition and the corresponding reduction in prices into account, the development of this sector cannot be financed with the profits realized by the telephone company alone. Moreover, Djibouti has the advantage of a modern infrastructure for access to international markets with the underwater optical fibre cable (SMW). Taking advantage of this access will require political leaders to think soon about the conditions for optimizing such development. Given the level of public financing available for this sector, it is unlikely that the State will retain the total control it now enjoys. It will have to define the modalities of a privatization that will also necessitate the establishment of an independent public regulatory agency to provide oversight of all interactions in the sector.

Institutions for trade and competitiveness

Multilateral and regional integration agreements

Djibouti : A founding member of WTO

Djibouti is a member of many different bodies that seek to promote integration in the world economy through the development of international trade. The limited nature of its productive system and the small number of goods over

which it seeks to exercise trade protection facilitated its entry into the World Trade Organization (WTO) in December 1994. To make its membership effective, the authorities pledged not to raise the ceiling of the domestic consumption tax (TIC) or commercial surtaxes. For agricultural products, the consolidation of customs duty at a maximum rate of 40 per cent has been in effect since 1995 for the products covered by annex I of the Agreement on Agriculture.

The consolidated rate is equal to or more than à 50% for 11 products

A list of 11 products constitutes an exception, with the consolidated rate varying from 50 per cent for dairy products and mineral water to 250 per cent for khat. As khat is not produced locally, the tax on imports is motivated by concerns for fiscal revenues and health protection. However, a desire to protect other products also exists. The fiscal and protectionist approach to oil can be seen in rates that go as high as 230 per cent for ordinary gasoline. Membership in WTO has also meant submitting a list of services, in this case in the areas of tourism and travel, that the country intends to promote internationally. This list was accompanied by an inventory of regulations in force, namely restrictions to market access and limits on national salaries, particularly the presence of legal entities in this sector. In general, Djibouti's share commitment with WTO to openness in multilateral trade stands alongside its efforts to promote regional integration within the framework of COMESA.

Membership in COMESA

Djibouti is involved in the effort to achieve coherent regional integration through the Common Market for Eastern and Southern Africa (COMESA). This organization brings together 20 countries with a desire to develop intra-community trade. COMESA succeeds the Preferential Trade Area for Eastern and Southern Africa (PTA) pursuant to article 29 of the treaty establishing the PTA, which called for the creation of a common market. COMESA is pursuing ambitious regional objectives that have already yielded concrete results with the establishment of the Free Trade Area (FTA) on 31 October 2000.

Member of a free trade area currently composed of nine countries

The FTA was one of the first achievements of the programme under which nine countries succeeded in bringing about a gradual reduction in their tariff barriers from 60 per cent in October 1993 to 100 per cent in October 2000. The nine countries are Djibouti, Egypt, Kenya, Madagascar, Malawi, Mauritius, the Sudan, Zambia and Zimbabwe. They will soon be joined by Burundi and Rwanda, which are scheduled to join in January 2004. The internal movement of goods free of customs duty and without contingencies should lead in 2004 to the establishment of a Customs Union with a common external tariff (CET). In addition to free trade, COMESA provides for the free movement of capital and the elimination of obstacles to investment, which will lead to the final phase: economic and monetary union by 2025. This last phase of regional integration should incorporate all the elements of the common market plus provide for a common monetary and budgetary policy and the adoption of a single currency issued by a single monetary authority.

For Djibouti, one of the first consequences of ratification of the COMESA treaty has been to rethink the spirit in which much of the indirect revenue that produces a large portion of budget income is collected. Given the limited range of local production, the practical scope of the domestic consumption tax (TIC) has always been imports. Upon their presentation in customs, imported goods intended for local consumption become more expensive with the addition of a tax that can be either specific, based on the physical characteristics of the product, or *ad valorem*, calculated as a percentage of the value at customs. The TIC and surtaxes were thus similar to port duties scheduled to disappear when the provisions of the free trade zone are implemented. This disappearance will not be without financial consequences for the balancing of the State budget, especially where the income derived from taxes on imports of khat from Ethiopia is concerned.

A change in the notion of the TIC

This indirect revenue was to be preserved in a form acceptable to Djibouti's economic partners. To ensure preservation of this revenue, the authorities amended the General Tax Code by means of Act No. 108/AN00/4 of 22 October 2000. Those amendments, which go beyond the framework of intra-community trade, had the effect of expanding the income-generating capacity of taxes. The indirect duties and taxes derived from the TIC thus lost their discriminatory nature and have become indiscriminate, affecting imported and locally produced goods alike. Thus the tax no longer has the nature of a port duty but is instead a domestic tax. Not being based on value added, this tax should survive the replacement of the TIC with the VAT on the grounds that its collection meets

health objectives and is also intended to serve as a disincentive to consumption. Introduction of the VAT, as well as the TEC, which is scheduled to take place on 31 December 2004, will be a part of a radical change for which the authorities absolutely must prepare. Serious thought must be given to the implementation of these tax measures with a view to paving the way for budgetary equilibrium, but also for significant increases in consumer prices and production costs.

**Concerns
relating to the
preparation of
the Common
External
Tariff**

Against the background of these reforms, Djibouti's membership in COMESA has raised a number of questions. It will be recalled that the economy is structured in a way that implies a low level of competition from regional products. The TIC is far from the level of the trade barriers observed in other COMESA countries with a more diversified and protected productive system. The concern is thus palpable: implementation of the CET may result in a level of domestic prices much higher than that currently in existence, which would benefit only the productive systems of other COMESA members. Given its structural features, Djibouti would seem to have more to lose than to gain from the establishment of a customs union. Neoclassical economists would suggest that customs unions can improve well-being if they stimulate efficient reallocations of productive resources. At first glance, the existing situation, which is very close to free multilateral trade, is preferable to the establishment of a common external tariff (CET) that will lead to the turning away of imports when goods previously imported from non-COMESA countries become too expensive. The foreseeable economic cost is particularly important given that a small country that engages in free trade *a priori* has little negotiating leverage when setting CET rates and the additional costs associated with the customs union are not financially compensated by the other members of the union.

Given the weaknesses of Djibouti's productive base, it would also seem quite hypothetical that well-being should increase in relationship to a mechanism substituting imports from partner countries for local goods. A study should be made of this substitution mechanism; this would in fact be more related to the working of the free trade zone than to the eventual establishment of the customs union. Unless it generated informal trade flows, the risks of the customs union have more to do with the fact that Djiboutians will consume goods from partner countries that are more expensive than those they have been importing to date on terms closer to those of free multilateral trade.

To summarize a question that merits more detailed discussion, Djibouti would clearly lose more than it would gain from the finalizing of a customs union. This situation is due to the fact that it is poorly protected from the rest of the world and to the application of the CET, which will reduce consumer well-being by raising prices. The inherent fiscal nature of port duties may offset the social cost of these effects if the taxation results in a reallocation of resources to the poorest. In that case, the CET would act like a tax on the consumption of imported goods by those most well off. This redistributive aspect must be made clearer by the carrying out of a study in the near future the conclusions of which would of necessity impact poverty reduction programmes.

Another economic aspect of COMESA that Djibouti can look forward to is its activity-creating effect. Enterprises in partner countries can in fact relocate to

take better advantage of the immediate proximity of the port, which facilitates importing and exporting by reducing transaction costs. This generation of traffic is, however, more related to the existing free trade zone than to the future customs union. And exploitation of this comparative advantage of Djibouti's will not be an out and out advantage, at least at the regional level, unless domestic production costs fall sufficiently to make the economy competitive in its own environment. For Djibouti, then, the customs union does not represent progress towards integration in the global economy. A project involves three rates: 0 per cent for equipment, 15 per cent for intermediate goods or 30 per cent for finished goods.

The prospects afforded by AGOA

One institutional development that could facilitate the implanting or relocation of enterprises has to do with the authorization given to Djibouti in 2000 to export duty-free to the United States market. Djibouti is in fact one of 38 eligible countries under the African Growth and Opportunities Act, better known by its acronym, AGOA. Enacted in May 2000 by President Clinton and extended by President Bush, this Act, which seeks to promote integration in Africa through trade, is the new economic framework for relations between the United States and Africa. To date, economic specialization in services has not allowed the productive system to obtain any benefit whatsoever from an agreement that has remained merely formal.

To take advantage of the benefits offered by AGOA, products must meet certain conditions, particularly as regards origin. Articles exported to the United States must have been grown, produced or manufactured in a beneficiary developing country. The total cost of the value of goods produced in one or more countries covered by the agreement and the direct cost of processing in those countries must not be less than 35 per cent of the estimated value of the product upon entry into the United States. For new products designated as enjoying the advantages of the Generalized System of Preferences (GSP) granted to AGOA beneficiary countries, up to 15 per cent of the 35 per cent can come from American materials or components used in the production of the article in one or more beneficiary countries.

While this measure has had no tangible effect on Djibouti's economy, it is clear that Djibouti can enter into joint ventures with other eligible countries of the subregion, with Djibouti becoming the final exporter and adding to the total product cost the cost of all the services it provides. In general, while Djibouti can increase its well-being through the regional integration mechanism of COMESA, the opportunities provided by AGOA, the extension of value added to the terms of international trade - specifically the creation of permanent jobs - cannot take place unless due account is taken of the requirements for competitiveness as reflected in prices and costs, but also in overall institutional efficiency.

**Long-term
benefits will
depend on
regional
integration
and Doraleh**

Employment and trade promotion bodies

The Ministry of Trade, Industry and Handicrafts

A glaring lack of resources

This Ministry was reorganized by Act No. 102 of 25 October 2000. Apart from the offices of the Minister and the Secretary General, it consists of a Department of Trade and Standardization, which has three offices, dealing with domestic trade, foreign trade and standards and quality control, and a Department of Industry and Handicrafts, which also has three offices, dealing with industrial development, assistance to SMEs/SMIs, and handicraft promotion. The Ministry also acts as the supervisory body for the Djibouti Chamber of Commerce. However, most of its functions and mandates as defined in legislation are of a formal nature.

The Ministry of Trade, Industry and Handicrafts is the “poor sister” of the Djibouti Government. During the past decade some of its functions were taken away in the course of a ministerial reshuffling, particularly in the areas of the economy and finance. The number of professional staff in the Ministry was reduced following the departure of a dozen university graduates. The Ministry’s budget is among the smallest funded by the State budget: it ranked 13 out of 16 in 2000. In addition, the Ministry suffers from dysfunctions, most notably the absence of a Secretary General of the Ministry, the post having been vacant since July 2001. The Ministry also lacks staff and operates in cramped and outmoded facilities with a less than optimal level of equipment.

The Foreign Trade Office within the Ministry lacks adequate human, material and financial resources and is thus unable to carry out its functions properly. Two of the Office’s units (the Subregional Trade Section and the International Relations Section) do not even exist, and the Chief of Office works with just a secretary and an accountant who monitors import statistics. As for Djibouti’s diplomatic missions abroad, which fall under the Ministry of Foreign Affairs and Cooperation, they have no commercial advisors. The members of the missions are career diplomats with general skills and experience who are not specialized in economics or trade.

The Ministry and its mission of integration through trade

The inadequacies and dysfunctions that have been noted are all the more disturbing in that the Ministry is called upon to play an important role, given the general context of economic and commercial globalization, Djibouti’s international mission as a commercial hub, regional expansion under COMESA and, lastly, through the Integrated Framework, which makes it a focal point for the preparation and following up of this diagnostic study.

The Ministry, and particularly its Foreign Trade Office, should be given major support in the form of a commitment by the State to provide it with human, material and financial resources and a large volume of technical assistance. A full inventory of the Ministry’s needs, and especially those of the Foreign Trade Office, is called for. This inventory should result in training together with a programme for short- and medium-term reorganization. The Office should be equipped with much more documentation than it currently has, and a unit to monitor WTO agreements and the implications of the institution of the CET by COMESA, most likely in 2004, should be established.

The National Agency for Investment Promotion (ANPI)

An agency to promote administrative simplification ...

Established in January 2001 and placed under the authority of the Ministry of Presidential Affairs, the Agency has a broad mandate that is reflected in its structure. ANPI in fact has three sections: the Development Department, which is responsible for overseeing the Investment Code and incentives and facilitation measures; the Promotion Department, which is responsible for organizing and monitoring information, and the creation of databases; and the Centre for Uniform Business Procedures, whose function is to simplify the administrative procedures enterprises must follow, particularly at the time of their creation. This single window is also charged with informing, assisting and directing to the appropriate institutions and services any operators who wish to invest, export or learn about foreign markets.

... that lacks an operating budget

While the establishment of ANPI met a real need, it has had problems becoming operational. The biggest drawback has been the lack of a budget. The problem has been solved now that the Ministry of Presidential Affairs responsible for investment promotion has provided the Agency with the necessary materials and equipment. Other problems have to do with the lack of an implementing decree spelling out the Agency's organizational structure and the responsibilities of individual departments, and the absence of any regulations or staff rules.

Ambiguities in the missions of CDD and ANPI

The creation of ANPI also produced two ambiguities. First, the Centre for Uniform Business Procedures has been placed within the Agency. This means that there may be institutional overlapping with the Centre for Business Procedures within the Chamber of Commerce. This problem will be resolved if ANPI becomes a State institution providing public services at the express request of the private sector. Secondly, by entrusting ANPI with the provision of information and assistance to exporters, the legislature made it into a centre for the promotion of exports or foreign trade, without giving it the necessary resources.

ANPI, whose role as single window is essential to any simplification of procedures for the creation of enterprises and private investment promotion, must be made operational. Apart from the immediate provision of financial resources, which is a *sine qua non* for the acquisition of a qualified staff, decrees should be enacted to implement Act No. 114 of January 2001. These implementing decrees should define the internal structure of the Agency, the methods of operation of its constituent departments and ensure that such definitions do not introduce any confusion with other entities providing support to the private sector (the Chamber of Commerce and the Investment Promotion Agency associated with the Doraleh project).

The Djibouti Chamber of Commerce (CCD)

The Djibouti Chamber of Commerce is a public agency and a legal entity with financial autonomy, similar to the consular companies established by French-speaking countries. CCD's overall mission is to represent and lead the private sector and facilitate its integration in international trade. It also serves as a link

between the State and private sector entrepreneurs. It provides information about foreign companies, issues certificates of origin for goods intended for export and certificates of authenticity for invoices accompanying products intended for re-export.

A Djibouti-Ethiopia Business Council was established in 2002 by the Chambers of Commerce of Djibouti and Ethiopia. Mandated to investigate thoroughly any problems that the two communities might encounter in their commercial transactions, the Council is composed of 10 individuals (five from each Chamber of Commerce). Each Chamber is also supposed to provide the other with a welcome service to help with commercial transactions and business formalities.

CCD involved in vocational training

CCD recently underwent a major reform, which was chiefly characterized by greater openness to all sectors of activity and an expansion of its geographical coverage through the establishments of delegations or branches in each district of the country. CCD continues to be a public agency under the Ministry of Trade, Industry and Handicrafts. However, the statutes of 24 August 2002 abandon the former quota system for foreign representation. The Chamber of Commerce is the home of the PAFIP (Support for Professional Training and Integration) project, which seeks to enhance the technical and professional skills of human resources and optimize the employment capacity of trainees (development of new technologies). This programme, operated at a cost of 4 million French francs, or roughly DF 20 million, over a three-year period (2001-2003), has been extended through the period 2003-2004.

Support for the establishment of private accounting services

Among the Chamber's projects are the establishment of a certified management centre, which should be operational by January 2004. This centre is intended to help small and medium-sized enterprises find a system of accounting that meets their needs and their legal obligations in terms of fiscal declarations. Other projects in progress are the setting up of a space for the facilitation of business formalities, undertaken in collaboration with ANPI, and the establishment of a mediation centre. CCD also intends to establish a special support service for SMEs in the districts outside the capital.

CDD and funding constraints

The Chamber's activities are limited mainly by the inadequacy and unpredictability of its budget. The resources allocated for it, which come from tax rate increases, are disbursed only irregularly and in part by the Treasury. The CCD budget thus shows a deficit, and this has forced the institution to deal with recurring financial tensions since 1996. The non-reversible nature of the tax rate increases ends up being the same as a new tax. CCD manages to function by resorting to a loan from the general warehouse for which it has responsibility. The Chamber, which has functioned with a number of deficiencies in recent years - a lack of organizational regulations and staff rules, absence of a programme of work and annual report - is also minimally involved in the execution of decisions by the public authorities.

The Chamber's inadequacies make an institutional restructuring necessary. CCD must become an effective tool for making the private sector competitive, but also for concerted action with the public authorities. To this end resources must be provided on a regular and continued basis. CCD must invest more in support for

the promotion of small enterprises, which, experience shows, really help to expand opportunities for competitive activities and reduce poverty. In 1998 a young businessmen's club was formed, partly in order to meet the needs of small and micro-entrepreneurs for guidance and assistance. This club, which has not yet achieved sufficient visibility, operates on the basis of contributions from its members. It should develop closer working relations with CCD, which is more influenced by the dominant aspirations of large conventional businesses.

**Advisory
services to
small
enterprises**

Confronted with government bodies struggling to promote bureaucratic simplification in all areas of business activity, the Chamber of Commerce must do more to carry out its advisory mandate in respect of its members and stimulate public reform. Problems with coordination and a lack of confidence have undermined cooperation between the private sector and representatives of the State. In order to improve the functioning of the Chamber of Commerce, its funding will have to be placed on a regular footing and its staff will have to be increased. Technical assistance could be used to support institutional restructuring, advanced staff training, a study of private sector training needs, introduction of information technology and the posting of data on the Internet.

The legal and judicial framework

Djibouti suffers simultaneously from an excess and a dearth of legislation. Many texts coexist in juxtaposition or overlap each other. Some of these are obsolete or contradictory, while others have not been the subject of implementing decrees or orders. The result is a lack of certainty which promotes ambiguity and, ultimately, the risk of arbitrariness, which contributes to legal insecurity. Moreover, existing regulations are not readily accessible and thus little known. Finally, there are the general problems of the effective application of existing texts and the problem of the functioning of the justice system as a whole.

The Investment Code

The Investment Code dates from 1994. It provides for two separate regimes, depending on the amount of the investment. Regime A sets out tax benefits, exemptions or abatements for enterprises falling into 12 categories of economic, industrial or commercial activity involving investments of between DF 5 million and DF 50 million. Regime B concerns enterprises falling into the same 12 categories of activity and involving investments of DF 50 million or more. Exemption from the commercial tax is five years under regime A and 10 years under regime B. Both regimes provide for exemptions from the TIC on materials needed for the execution of projects that appear on the list of approved goods. Regime B also provides for additional temporary exemptions (real estate tax on construction, corporate tax, registration fees, etc.) Enterprises covered by regime B are subject to approval, which is not the case under regime A, where a simple declaration of investment is all that is required.

Created in 1994, the *National Investment Commission* (CNI) is responsible for ensuring that the legislation governing the Code is applied. It is chaired by the representative of the Ministry of Presidential Affairs. However, the two structures are separate. According to the relevant texts, CNI has a maximum of one month to request additional information or raise objections in cases involving a declaration and two months in cases requiring approval. Once these deadlines have passed without any response from the Commission, the investment is registered (regime A) or approved (regime B). Since 2001 ANPI is responsible for granting the benefits provided for under the Investment Code. From 2000 to 2003 it approved 20 investments under regime B and registered 5 under regime A. It would be useful to have texts that clarified the respective roles of CNI and ANPI, particularly as the former does not often meet and the approvals under regime A are issued directly by the Director of ANPI; this continues to pose a problem in the application by the services concerned (tax and customs), which are supposed to ignore this.

Approvals issued under the Investment Code are not transparent

The procedure for granting benefits under the Investment Code has been criticized on many occasions. The time limits actually observed in applications for acceptance or approval often seem much longer than those stipulated in legislation. The approval procedure under regime B most often requires an authorization from one or more ministries, when it does not go all the way to the Office of the President. Reasons for the rejection of applications are not always given, and beneficiaries do not receive all the benefits normally associated with approval. Some activities are not eligible, such as activities relating to livestock raising, which the PRSP views as a possible source of job creation owing to the reactivation of the transit of livestock through the region. In addition, there is no investors' guide that might clarify administrative procedures. Most of these problems existed before the creation of ANPI and have not been resolved by the Agency.

The Code does not afford protection against the risk of expropriation

Among the risks for which coverage is thought to be particularly important for investors are, first and foremost, the risks of nationalization and expropriation. While the risk of nationalization would seem to belong to the past, it resurfaced in Djibouti in 2001 with the appearance of a measure having retroactive effect applicable to the professions of storeman and goods handler. Under the terms of this provision, these activities were reserved for individuals who were nationals of Djibouti or corporations whose parts or shares were held entirely by nationals of Djibouti. This development is all the more unfortunate in that the Investment Code makes no mention of such situations, which are far from conducive to foreign investment.

The proposed new Code

These criticisms led to a bill establishing the "Djibouti Investment Charter", which is the preliminary version of a future draft that will amend the existing investment code. This bill distinguishes between investment regimes on the basis of sector of activity, there being five in all: industry, services, agriculture and health, tourism and "new sectors". For each sector several regimes are set out. **Industry** has six: (i) export enterprise; (ii) pioneer enterprise (technology and skills above the level found in Djibouti); (iii) strategic local enterprise; (iv) modernization and expansion; (v) industrial construction (buildings with an area of more than 1,000 m³); and (vi) small and medium-sized enterprises

(equipment valued at less than DF 10 million). Three regimes are listed for **services**: (i) service-exporting free trade zone; (ii) offshore activities (promoting tertiary finance); and (iii) port and airport free zone. The 15 regimes all have their own incentives including tax abatement or exemption, loans or overdrafts at preferential rates, duty-free import of equipment, and the possibility of repatriating profits, dividends or capital.

**Simplification
of the Code
yet a plethora
of regimes ...**

The provisions of this bill have the merit of reflecting a desire to modernize and adapt the existing Code to economic realities and needs. It also clarifies the sectors in which the public authorities intend to focus their development efforts, at least through incentives that are essentially fiscal and customs-related in nature. This breakdown by sector is consistent with the prospects for growth identified in the PRSP. And by specifying the benefits associated with each sector and each regime it limits the loss of income to the State budget. The bill also has the advantage of combining in a single document the regime for investments and the regime applicable to the various types of free zone. Yet notwithstanding these positive features, the bill is probably too complex in terms of its administration, not least of all for a service woefully short of manpower and equipment. The difficulties ANPI faces in overseeing the current Investment Code and its procedure for granting benefits have often been criticized.

Different types of free zone

Djibouti is proposing a free zone that is at once diversified and complex, comprising many different institutional arrangements, some of which have remained in the project stage while others have seen the light of day in the form of documents and have yet to produce any concrete economic impact.

The commercial free zone

Created on 3 July 1971, the commercial free zone is situated within the public area of the commercial port. It provides for exemption from indirect contributions – the indirect tax on consumption (TIC) and any indirect tax or fee while merchandise is in the free zone and during export or re-export. Enterprises do not pay port fees or storage charges. Goods may stay in the free zone for an unlimited period and the processing of goods there is permissible. Free zone facilities are provided on the basis of private rentals, either to commercial enterprises for storage of their own merchandise or for authorized transit agents, for storage of their clients' merchandise. In June 2002 the Djibouti Free Zone Authority was created; it is to become the centre for uniform business procedures in the zone. The Authority, a legal entity having financial autonomy, is responsible for administering the free zone regime and implementing the relevant legislation and regulations. Placed under the authority of the Jebel Free Zone Authority, which is responsible for its management, it is chaired by the Director of ANPI.

The port extension zone

A “port extension zone”, which is also covered by the free zone regime, was created by an ordinance of the President of the Republic on 30 July 1980. The

financial cost of this zone, which is managed by the Port Authority, is borne by the Authority's budget. In exchange, the Port Authority collects port and storage fees and the proceeds from private rentals within the zone.

Free zone limited companies

Difficulty in the administration and management of institutional mechanisms

Created in 1980, free zone limited companies (SAZF) can be set up by any legal or physical person for a maximum of 99 years. Their headquarters must be located within the Djibouti free zone and they can be established without capital. Provision is made, although somewhat obscurely, that "the proceeds of all transactions conducted by the SAZF outside that portion of the territory of Djibouti which lies outside the free trade zone shall be exempt from taxes and duties".

Extension of the port free zone

Established pursuant to a decree issued in June 2000, this extension is known as the Djibouti dry port (DDP). Constituting an enclosed space of 40 hectares, this zone is separate from the customs regime and operated by the Autonomous International Port of Djibouti (PAID).

Duty-free enterprises

Regimes that often exist only on paper

A law establishing a regime for duty-free enterprises was enacted in October 1994. Enterprises for coverage by this regime include industrial or service enterprises whose activity is intended for export. Such duty-free enterprises enjoy a number of tax exemptions, including on profits, capital gains or land acquisition, and real estate contributions. Duty-free enterprises fall under regime B of the Investment Code. The purpose of the duty-free enterprise regime is to create an environment conducive to export promotion; to date, however, no enterprise has been created under this regime.

The industrial free trade zone

The Act of 7 December 1994 established an industrial free trade zone regime applicable to enterprises working with exports in the industrial sector. Approval must be obtained from the Free Zone Commission, which transmits the request for review by the industrial free zone advisory commission. Authorized enterprises enjoy a number of benefits. These include exemption from taxes on profits or turnover for 10 years, taxes on dividend distributions and real estate contributions during the first 20 years, and the commercial tax. In terms of customs, approval confers exemption from the TIC for certain imports attached to the certificate and an exemption from all direct and indirect taxes on exports.

A decree implementing this Act was adopted in 1996; it provides for the establishment of an agency responsible for the management and promotion of the industrial free trade zone, in this case the Industrial Promotion Agency. This Agency is tasked with assisting and advising the Government on affairs relating

**The Industrial
Promotion
Agency, a
virtual
institution**

to the development of the industrial free trade zone, promoting exports and offering assistance to investors by providing a single window for information on administrative formalities. Viewing this objective realistically leads one to conclude that the industrial free trade zone regime has never been applied and that the Industrial Promotion Agency remains a virtual institution. In 2001 its tasks were transferred to ANPI, whose dysfunctions have been noted earlier.

The proposed airport free zone

A preliminary study on the creation of an airport free zone in Djibouti was conducted in 1985. Justification for the project lay in Djibouti's geographic location and the presence of a free trade zone in the port. The creation of a similar zone at the airport would result in the creation of a "privileged distribution centre, a hub for regional trade". The study indicated that the conditions required for execution of the project were partially present: proximity of the port and airport free trade zones, proximity to the workplace for employees, location of facilities within the international airport and in the immediate vicinity of the airlines' freight terminal, and allocation of adequate space for the construction of warehouses.

**The airport
free trade
zone, a project
waiting to be
implemented**

However, the study was never followed up and the project came to naught. In reality there is a bonded warehouse on the premises of the airport. This warehouse, a "temporary storage facility", is not a customs warehouse in the strict sense. The new draft Investment Code specifically addresses the goal of creating a free zone at the airport.

A critical assessment of these arrangements

The port free zone has never fully played the role assigned to it: it serves solely as a bonded warehouse for local and foreign companies and merchants who supply neighbouring countries. It has not managed to attract commercial companies and services at the regional level. The reasons given for this are many: its relatively small size and quick saturation, the high cost of production factors, the rigidity of the Labour Code, the unreliable nature of the legal system, economic slowdown and instability in the subregion, and local and Ethiopian administrative formalities for dealing with imports to be domiciled with the Commercial Bank of Ethiopia. With regard to the SAZF, the requirement that they must be physically located within the free zone where there are no residential facilities is perceived as a major obstacle.

**Free zones: an
entire range of
disparate
provisions**

There have never been any applicants wishing to establish a duty-free enterprise or industrial free trade zone. In other words, these regimes exist only on paper. The reason for this has to do with labour costs and productivity, the lack of natural resources, water supply and electric power (high cost, no long-term guarantees), few additional benefits beyond those provided under existing texts, a lack of coordination between the Government and the private sector, the lack of an industrial tradition and, lastly, economic and financial risk (bearing in mind the limited local market, the cost of credit and legal and judicial instability/insecurity).

The regimes governing free zones form an entire range of disparate provisions. The increasingly complex provisions lead to inconsistencies, overlapping texts and, to some extent, gaps. Actually, what is needed is one regime for free trade zones and one for duty-free points that would give rise to the creation of offshore companies, which could easily replace the industrial duty-free enterprises and the free zone limited companies. The entire body of legislation must be reviewed with a view to its simplification and unification in the hope of making the system operational and attractive. In other words, attracting investment requires a capacity to promote a free zone regime that is simple to implement and a tax system that provides greater incentives.

Business law

In the area of commercial legislation and regulations, most of the texts in force have not been changed since independence. A study group on the modernization of commercial legislation was established in 2001 for the purpose of reforming the country's business law. A national committee was also set up in 2002 to guide the drafting of the Commercial Code and harmonize and update legal texts with a view to creating a climate conducive to investment.

A lack of genuine legal codification in the commercial sphere

The compilation of existing texts was financed by the Administrative Reform Technical Assistance Project (PATARE). Analysis of the texts was the objective of the second phase, which was to begin in September 2003. A number of points were identified, having to do mainly with understanding the nature of the business community and exploring areas where the legislation was outdated (Trade Register, bankruptcy, judicial liquidation) or non-existent (electronic commerce, etc.).

The national committee chose to undertake a complete overhaul, involving the drafting of new texts while accepting, whenever possible, the inclusion in Djibouti's commercial law of the Uniform Acts adopted by the countries members of OHADA. This effort at opening up and modernizing local legislation seemed practical, simple and relatively inexpensive. The committee recommended that the reform of commercial law should be accompanied by reforms in other related areas (taxation, labour law, trademarks, the operation of trading companies, the justice system and commercial jurisdiction) as well as training and specialization activities, especially for judges. A review committee on Djibouti's accession to the OHADA treaty was also established on 21 October 2001.

Some doubts concerning OHADA

The drawbacks of accession are not insignificant, particularly for a country at the crossroad of civilizations where Africa, Asia and the Arab world meet. Is it necessary to become a party to OHADA if the country's integration prospects lie with the COMESA countries, to whom this law is foreign? Accession implies a partial abandonment of legal and judicial sovereignty, a constraint inherent in the adoption of international norms. It involves additional costs, in the form of contributions to the Organization's budget and, for those who must appear before the court, trips to Abidjan, where the Common Court of Justice and Arbitration is located. But the benefits of accession are not insignificant: a simplified and updated business law that is shared by one third of the members of the African Union; opportunities for members of the judiciary to undertake training and

advanced study; the possibility of an attractive and secure climate for investors; and the existence of a dispute settlement mechanism. At the conclusion of this evaluation exercise the committee recommended that the Djibouti should join OHADA “as soon as possible”. The preparation of a genuine, modern Commercial Code adapted to COMESA and to Djibouti’s international vocation is a necessity, and is one factor that is very likely to attract investors and help to internationalize the productive system. As for Djibouti’s relationship to OHADA, the adaptation of uniform legislation does not necessarily imply formal membership in that organization.

Labour law

Djibouti’s labour law is based essentially on the Overseas Labour Code of 1952. Labour legislation and regulations are thus largely obsolete and poorly adapted to the demands of an economy in development and engaged in a process of expanding its activities at the global level. Given this situation, legislative reform was undertaken with the goals of liberalizing and increasing the flexibility of all provisions relating to labour contracts.

Labour market flexibility: Act No. 140 of 1997.

An initial, and perhaps decisive, step was taken with Act No. 140 of 1997. This Act provides that contracts are the result of a market mechanism operating between the supply and demand of labour. It also makes the conditions for hiring workers less stringent and abolishes direct intervention by the State. The second phase, which was more ambitious, is the redrafting of the Labour Code. An ad hoc working group was set up in October 2001 to propose a Code that would be acceptable to all social partners. A draft was prepared and submitted in final form in January 2002. This document is the fourth version since the review process began. The Code was considered by the trade unions and representatives of management and submitted to the International Labour Office (ILO) for opinion.

Finalization of the new Code

ILO formulated a number of recommendations, as did the Employers Association of Djibouti. The Employers Association felt it necessary to go further in the effort at liberalization by emphasizing the modalities of fixed-term labour contracts, dismissals for economic reasons, notice, and the settlement of collective disputes. The Government seems to have taken the employers’ observations into consideration. The trade unions (UDT and UGTD) have not yet submitted any written observations, although they have shared their concern that the general provisions of the 1952 Code should be retained. After more than five years of study and deliberations among the social partners, it is time to move on to the adoption of a legal text. In the formal sector, the Labour Code is one of the key elements governing economic activity. It is thus in the interest of all parties to conclude this project and thus make the country more attractive.

The justice system and arbitration

The Ministry of Justice drafted a plan of action for the period 1998-2003 which had as its objective the implementation of a judicial policy guaranteeing the rule of law through the independence of judges. A study day on the topic of justice was held in February 2000, after which it was decided that an Estates General of

Justice should be convened to review the system of justice and put forward recommendations with a view to enhancing its functioning. The Minister of Justice initiated an internal review, which led to the preparation of a summary report that was transmitted to the President of the Republic. An organizational committee was established and met for the first time in October 2000, one month before the Estates General was convened.

Many inadequacies were identified which relate to good governance. It should first be noted that judges have no statute that guarantees their independence and impartiality. Cooperation between the justice system administration and the judges themselves is minimal. There are not enough judges to cope with the volume of cases; the same is true of court staff. Moreover, the lack of specialization and training adversely affects the quality of the decisions rendered. The credibility of the work done is undermined by the frequency with which cases are dismissed, the slow pace of proceedings and the frequency with which legally prescribed time limits are not respected. The backlog of cases contributes to partiality among judges.

Inadequate human and material resources allocated to the justice system

Courtroom facilities are cramped, as can be seen from the Palais de Justice in Djibouti, where the Supreme Court, the Appeals Court and the Court of Instance are located. Material resources, whether furniture or office supplies, are inadequate. Access to legal information is not always guaranteed. There is no legal library, and registers – namely the commercial register and the register of trademarks and other industrial and intellectual property - are not computerized. This sad state of affairs has its source in the budget of the justice system, which represents less than 1 per cent of the State budget. Total allocations for the justice system prevent it from implementing structural reforms.

Arbitration: a series of disparate implementing texts

Foreign investors generally prefer international arbitration to pursuing the matter in the local courts for reasons of speed, confidentiality and impartiality. This method of settling disputes is favoured by the international business community. Arbitration can thus be viewed to be a tool that is likely to enhance Djibouti's presence in the context of globalization and give it the visibility it needs to attract investment. It is unfortunate in this regard that Djibouti has not provided for such a mechanism in its investment code. On the other hand, Djibouti has its own international arbitration code and has publicly recognized the usefulness of the Centre international des services arbitraux (CISA). These initiatives seem to have yielded no results, probably because of foreign investors' marked preference for procedures, regulations and institutions whose universal character has already been demonstrated.

International commercial arbitration was established by Act No. 79 of 1984. The text of this Act describes, in 32 articles, the terms of arbitration proceedings and provides for the establishment of an arbitration appeals board that would rule on rejected or pending appeals. Although the legislation exists, however, it would appear that this Act has never been implemented and that the procedure for international commercial arbitration is not operational. Moreover, the treaty establishing COMESA has created a Court of Justice with competence in matters relating to arbitration clauses, although within a limited scope.

Arbitration or mediation

OHADA has established a Common Court of Justice and Arbitration whose decisions have the force of judgement and are enforceable as of the day they are rendered. However, Djibouti is not a member of OHADA. The CCD has made its Bureau aware of the existence of the Mediation and Arbitration Centre created by the Paris Chamber of Commerce and Industry and has proposed that CCD should base itself on that institution and create its own mediation centre. The settlement procedure would be an amicable one, as opposed to arbitration, which is a litigious dispute settlement procedure. A study is currently being undertaken with the Paris Chamber on the financing of such a centre by the French technical cooperation agency.

The manner in which the system of justice is currently organized does not provide for a justice capable of ensuring the security of persons and property and attracting investors. The private sector is unanimous in complaining of delays, inefficient and opaque procedures, inadequate separation of powers, the lack of an independent judiciary and the lack of good governance in the system of justice in Djibouti. While improvements have been noted, such as the recent provision of facilities and better salaries for judges, much remains to be done to establish the rule of law, which will foster legal and judicial security.

On the whole, it would be desirable to follow up all the observations and recommendations that were made at the Estates General. It would in fact be a good idea to move quickly towards a single jurisdiction. The duality that exists between the customary and formal justice systems is increasingly perceived as an annoyance. The former is a potential factor of instability in decision-making, for it is dispensed by persons who are not under oath and on the basis of criteria that are not always compatible with the development of economic affairs. The persistence of this duality is an impediment to the development of a homogenous national space, in contrast to the desire for regional integration. A single jurisdiction was demanded by nearly all the participants in the Estates General of Justice.

**The Estates
General of
justice and
consolidation
of the rule of
law**

At the same time, the system for the administration of justice must also be restructured and provided with adequate resources. This would entail the preparation and enactment of a true statute of the judiciary, the recruitment of new judges with advanced training, and the provision of such training to judges already on the bench. These objectives would doubtless be better served by the presence of a training institute for the legal profession. Lastly, consideration must be given to the possibility of creating new institutions that can enhance efficiency of the system of justice and improve and accelerate judges' decisions. This step is necessary to bring down the cost of transactions which are linked to random judgements that are often difficult to enforce.

International trade and sectoral activities

The transport sector and trade facilitation

The operation of Djibouti's transport system creates 6,500 to 7,000 direct permanent jobs (national employment) corresponding to a wage bill in excess of DF 7 billion, of which DF 5 billion correspond to payments to transit operators during customs operations. This sector is even more significant if one includes the 4,000 jobs created by the urban and interurban transport network of taxis, buses and minibuses. To direct employment should be added temporary and secondary employment, particularly in the development and maintenance of major transport infrastructures (public works sector). Overall, some 12,000 to 15,000 Djibouti nationals hold jobs associated with the operation of a transport network that is undergoing sweeping institutional changes. Privatization of the technical and commercial operations of the main components of this system is under way, and in some cases has been completed.

Institutional reform has been taking place in the port for the past three years. A similar process was recently begun at the airport (AID), with similar changes promised for the railway (CDE). Once in operation, these changes have shown a certain economic efficiency. Moreover, while no data are yet available to form a judgement, it would seem that the choice of a single concessionaire to run both the port and the airport, in this case Dubai Ports International, along with Jebel Ali Free Zone Authority to manage the future free trade zone, has been wise. This convergence of interests is likely to create and facilitate synergies between the different components of the future regional trade centre. The manner in which these operations have been carried out have been lacking in transparency, however. And the concentration of power in a single executing authority that operates like a monopoly calls for the establishment of a genuine public regulatory authorities. These authorities can have responsibility for all modes of transport and must be able to prevent disputes and promote the interests of the entire Djiboutian community.

The International Port of Djibouti (PAID)

Activities

The port of Djibouti, which currently has 1,143 employees and 3,000 dockworkers, can play a major role in East Africa. To do this, however, it must demonstrate an ability to capture and retain the transit and transshipment traffic that accounts for more than 85 per cent of the 4.5 million tons processed annually. With the arrival of the operations of the Pacific International Line (PIL) from Aden and increased movements of food aid, the port facilities are becoming increasingly crowded, as indicated by a berthing occupancy rate of 80 per cent. Given this congestion, the pace of loading and unloading, which had

reached the very good rate of 25 cycles per hour per berth, has fallen to 10-12 cycles per hour.

This situation cannot continue. It must be improved through better management of equipment and storage areas. This may lead to better anticipation by the community of the movement of vessels in the port and more efficient functioning of the customs service, which currently operates only eight hours a day, whereas the port operates round the clock seven days a week. In the long term the decline in productivity attributable to congestion shows that beyond the improvement of port management inherent in the institutional changes of recent years, there is an obvious need to make the investments that fully justify the Doraleh project.

A lack of clarity in the legal and institutional framework

In June 2000 a “management concession” agreement for the port (PAID) was concluded between the Government and Dubai Ports International (DPI) for a period of 20 years. The terms of this contract are confidential, and so it is difficult to say what the parties’ mutual obligations are, but there is in any event no obligation on the part of the private operator to invest. In this sense, then, it is a management or leasing contract for which such a long duration can only be contemplated in the light of the Doraleh project for which Dubai was recently engaged. Until that time the port was a public institution of an industrial and commercial nature (EPIC). To this absence of contract transparency should be added a certain lack of clarity in the philosophy of the mission of the representative of the Government. While the latter does indeed oversee and evaluate the concessionaire’s fulfilment of his contractual obligations, he also “assists” him and facilitates his relations with the government services and even “represents” him, thus running the risk of being both “judge and judged”.

New demands for regulation

The institutional change in which port activity is taking place have created a real need for regulation of the private monopoly, probably by a key office within the ministry responsible for ports and maritime transport. This is where the implementation of port policy should be planned, including monitoring of compliance with the concession’s mandate and evaluation of its investment policy. This implies that a regulatory body be created and that it be provided with all the information needed to carry out its mission successfully. Along with this need to complete the process of institutional reform by establishing a regulatory body, a clearer definition of DPI and its role are needed, since this entity has been incorporated into the public industrial and commercial establishment in the absence of any text spelling out its legal status and its relationship to the public authorities. Such clarification would make it possible to prepare its personnel rules and internal regulations. Thus there is a need to define, through a legislative act, the institutional arrangement that covers port activities, including the responsibilities of the regulatory body and the conditions under which port management responsibilities are exercised.

Traffic in the port of Djibouti has long been under 1.5 million tons a year, with national traffic (exclusive of hydrocarbons) fluctuating between 200,000 and 400,000 tons. Until 1996, transit traffic to Ethiopia was marginal, or less than 150,000 tons, exclusive of oil. The installation of the first container gantry cranes and the subsequent development of open storage yards for the container terminal

showed how right it was to focus development on subregional transshipment activities involving containerization. With the outbreak of war with Eritrea in 1998 virtually all Ethiopian traffic shifted to Djibouti, resulting in a significant upsurge in activity. From 1997 to 2002 total traffic increased by 160 per cent, with transshipment activity reaching 800,000 tons in 2002 out of a total volume of 4.5 million tons, of which 69 per cent was with Ethiopia. Forecasts for 2003 indicate a potential of 5 million tons, with activity stimulated by the arrival of PIL.

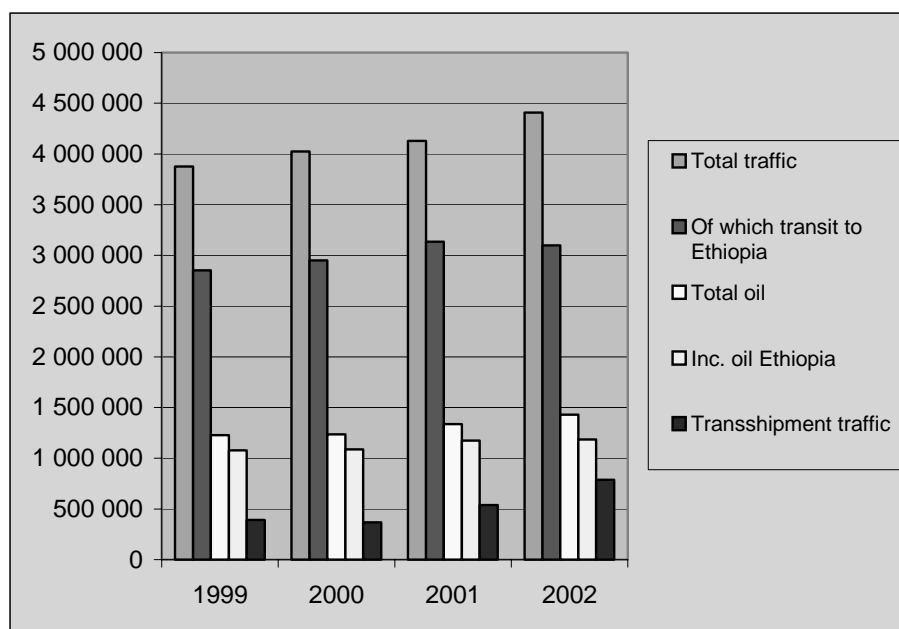
Table 4. Traffic in the port of Djibouti from 1999 to 2002

| | 1999 | 2000 | 2001 | 2002 |
|------------------------------|-----------|-----------|-----------|-----------|
| Port activity | | | | |
| Total traffic | 3 878 373 | 4 026 917 | 4 129 087 | 4 409 434 |
| of which transit to Ethiopia | 2 853 000 | 2 950 000 | 3 134 200 | 3 097 300 |
| Total exclusive of oil | 1 225 600 | 1 235 990 | 1 337 026 | 1 428 232 |
| Including oil (Ethiopia) | 1 077 000 | 1 088 000 | 1 174 000 | 1 184 333 |
| Transshipment traffic | 390 920 | 367 529 | 538 507 | 788 335 |

Source: PAID

Following an accident involving the *Limbourg* in October 2002, the Singaporean shipping company rightly felt that Djibouti offered more secure conditions in which to develop its business. The container terminal is enclosed and kept under particularly good surveillance. Implementation of a security programme under the International Ship and Port Facility Security Code (ISPS code) of the International Maritime Organization should therefore not pose any problem. Security is another asset like geographical location that makes port facilities internationally attractive. This is the case with the largely captive transit traffic that exists as a result of the current political situation in the region - specifically, the strained relations between Eritrea and Ethiopia. These arguments are, however, circumstantial. For the port and the transport chain to become the source of employment it is hoped they will, the port's attractiveness must be based on more structural economic elements. Apart from the adaptation of infrastructure, the institutional and operational framework must be clarified and the conditions for productivity must be improved.

Graph 1. Volume of traffic in the port of Djibouti from 1999 to 2002



To accomplish this, emphasis must be placed on job creation, which are determined by the port's competitiveness, but less in terms of transit traffic to Ethiopia, for activities in this area will remain captive in the medium term, than in terms of the transshipment of goods. Djibouti must remain a port of call, an obligatory stopping point on the major international shipping lanes. As noted earlier, this will require a concerted effort to bring costs down by improving the quality of infrastructure and equipment in the area of services and by a reduction of the wage bill for a certain level of activity. Success in this effort to make the site attractive has probably been ensured by the direct foreign investment associated with the Doraleh project (see below), but also by the port's current competitiveness.

Despite the problems of overcrowding mentioned earlier, it would in fact seem that Djibouti is favourably placed as compared with the best alternatives in the region. In addition to the investment in Doraleh, which is now a certainty, efforts should be made to ensure that the equipment in the operational phase is profitable. The competitiveness of a place is always fragile and is subject to reactions by competitors. There is also the possibility that shippers may relocate, as may investors, depending on the perceived profitability of a port and the rate of amortization of its infrastructure. This profitability will be largely determined by the actions of the private port operators, but also by the economic and institutional environment in which the port operates. This obligates the State to create conditions for the favourable development of factors not under the control of the port management.

Any comparison of costs can only be theoretical, based on official rates that never correspond to the real cost of passage through the port. Shipping

companies are given confidential rates that include substantial discounts, depending on the volume of goods processed, the number of calls and the number of containers handled. Moreover, not all ports present the same features. They do not all have the same draught, which can limit their competitiveness by limiting the size of vessel they can accommodate. Even with a common benchmark, in this case a deadweight of 10,000 tons, the assessment must be viewed with caution and says nothing about Djibouti's eventual competitiveness in handling much larger vessels with the most heavily containerized cargo, as will be the case when Doraleh is completed. Subject to such major reservations, the following table compares the costs of a one-day stay in the ports of Aden and Djibouti.

| Comparative costs of a stay in port (US dollars) | | |
|--|--------------|--------------|
| | Aden | Djibouti |
| Port dues | 647 | 564 |
| Piloting | 360 | 289 |
| Towing | 300 | 200 |
| Boating | 200 | 121 |
| TOTAL | 1 507 | 1 174 |

Source: ports of Aden and Djibouti

While no breakdown of expenses is given, the same services at Jeddah would cost \$1,468 and \$1,200 in the port of Salalah, in Oman, where towing and piloting are billed by the hour. This comparison of port costs suggests that the port of Djibouti is in a better position than its competitors in the region. As for container handling rates, the port of Djibouti, like ports around the world, uses a descending scale determined by the number of containers a shipper sends a year. When the annual TEU exceeds 40,000, as is the case with Pacific International, the rate is \$45. The average rate in effect in the Middle East region, including the Gulf of Aden (cf. Drewery Shipping Consultants), is \$106 per import/export container and \$85 for transshipment. Rates in the port of Salalah are given below by way of comparison.

| 50 000 movements | 20-ft. container | 40-ft. container |
|------------------|------------------|------------------|
| Transshipment | \$87 | \$116 |
| Import/export | \$66 | \$ 90 |

Source: port of Salalah

Composition of traffic

Of the 3.5 million tons of imports, which accounted for 78 per cent of all traffic in 2002, the main elements are: liquids in bulk (41 per cent), solids in bulk (17 per cent), containers (27 per cent), bagged and palletized goods (14 per cent). Of the 850,000 tons of exports, representing 19 per cent of all traffic apart from fuelling and watering, containers account for 84 per cent, with bagged, boxed and palletized goods accounting for 14 per cent. Though already significant, containerization can be developed further. The current distribution of traffic (47 per cent in transshipments) and its share of total traffic in the port of Djibouti

will develop as transshipment traffic and activity generated by the finished Doraleh project increases.

Changes in the direction of trade flows

Goods entering the port generally come from the Middle East, mainly large imports of oil (54.9 per cent), the Far East (14.2 per cent) and the European Union (13 per cent). Goods leaving the port are headed primarily for the Middle East (28.9 per cent), the Far East (26.45 per cent), Eastern and Southern Africa, from the Sudan to South Africa (22.25 per cent) A general redirection of trade had been observed over time, with more traffic headed to the Middle East and less to Europe. In the late 1980s, trade with Europe accounted for half of all traffic leaving Djibouti. Today it accounts for only 19 per cent.

Prospects for development of the port and port activities

Doraleh is slated to be the site of a port complex with an industrial and commercial free trade zone that should mobilize \$US 350 million in financing. Some \$50 million has been programmed for the oil terminal and \$300 million for a 2,000-metre container terminal with a 20-metre berthing space and a 400-hectare free zone that can accommodate up to 165 businesses. For many companies the operation will simply involve a move from Jebel Ali in Dubai. These companies will thus find themselves closer to the major shipping lines and can conduct much of their business without ever having to go through customs with goods that can be stored for an unlimited period. The oil terminal will be ready by late 2004 or early 2005 and will have a storage capacity of 220,000 m³. Work on the container terminal is scheduled to begin in 2004 and should take two years. This is a particularly ambitious investment project which will be carried out with external financing provided jointly by Dubai Ports International and the Emirates National Oil Company (ENOC), for the oil terminal.

Container terminal and free zone

Among the region's ports, Aden, in Yemen, and Salalah, in Oman, are direct competitors as regional transshipment hubs. Box 4 briefly describes Djibouti's strengths and weaknesses as compared with its two main competitors.

Box 4. Djibouti's regional competitors

The port of Aden and its traffic

While currently penalized by additional insurance premiums for "war", the port of Aden has managed to retain a number of major shipping companies who have remained loyal. The container terminal in Aden is operated by the Port Authority of Singapore Corporation, which is known in the business world for being a serious and aggressive player. A review of the traffic recorded in the *Aden Port Statistics* is revealing. The port of Aden handled nearly 11,320,000 tons of cargo in 2001, an increase of 11 per cent over 2000 (10,194,300 tons). The number of ships calling at the port was 2,332, as compared with 1,748 in 2000 and 1,782 in 1999. Lastly, the number of containers handled by the Aden Container Terminal in 2001 was 377,708 TEU, a significant increase over 2000 (248,177 TEU). These figures, unfortunately, do not reflect the situation in 2002, when PIL left for Djibouti after the security problems it experienced with the attack on the *Limbourg*. It is feared that this incident, the impact of which has not yet been measured quantitatively, will affect the port's attractiveness.

The port of Salalah : a strong competitor

While the port of Aden is competitive in terms of container transshipments, the port of Salalah should not be underestimated. This port is operated by Maersk Sealand, the world's largest shipper, through its affiliate APM Terminals. As at 1 January 2003 this enterprise had 326 vessels with a capacity of 818,850 TEU. It should be noted that traffic in bulk goods exceeded 1 million TEU in 2002, a significant increase over 2001, and that the number of ships calling at this port was 518 in 2002 as compared with 589 in 2001. During the first six months of 2003 some 279 ships called at Salalah. The port currently employs 830 people, as opposed to 930 a year ago. It is thus looking to increase its productivity.

Plans to develop the port at Salalah include the construction of two additional quays 400 metres long and a new 2,500-metre seawall. These projects will make it possible to increase annual capacity by 35 per cent and accommodate much larger vessels. The goal of the port, and of Maersk, is to process 2.7 million TEU instead of the current 2 million and to be able to accommodate ships 400 metres long, capable of transporting 10,000 containers. Once completed, this project will make Salalah the largest container port in the region. Alongside this expansion, the creation of a major free zone is planned, which will be open to distribution and storage companies and light industry (pharmaceuticals). These enterprises can be wholly foreign-owned and will be exempt from taxes on profits as well as import and export duties.

The port of Aden, operated by the Port of Singapore Authority Corporation (PSA Corp.) is currently experiencing difficulties associated with a lack of security (see box 4), which are having an impact on insurance costs and have undermined the port's attractiveness to the point that Pacific International Lines transferred its activities to Djibouti. As for the port of Salalah, it was developed as a joint venture between the State of Oman and an affiliate of Maersk, the world's leading container shipper, with 13.5 per cent of the world fleet. Competitors are naturally reluctant to have their vessels processed at Salalah by an affiliate of Maersk.

Run by an independent operator, the port of Djibouti thus constitutes an alternative that offers promising opportunities for development with the combined building of the new deep-water port and a free zone. With Dubai Ports International involved in the creation of the free zone and the adaptation of the transport chain (port/airport), the project is becoming a reality with good prospects for employment, provided that the transport and telecommunications sectors offer quality services at competitive prices and the State makes an effort to provide training adapted to the needs of the productive system. A specific study should be made of the job skills required for development of the free zone; this would require close cooperation with the professionals concerned and, at the outset, detailed surveys of the companies established in Dubai.

Djibouti International Airport

Apart from military activities, airport traffic entails 5,000 to 5,500 movements of aircraft. It generates a flow of 200,000 passengers, including 50,000 transit passengers, and 7,000 to 8,000 tons of freight. The International Airport must become an important element of the multimodal logistical platform around which a regional trade centre can be built. The decree of 8 January 2001 established "open skies" over the airport, lifting restrictions on frequency of flights imposed on airlines and facilitating the development of air links and the introduction of service to new destinations. Its implementation should be accompanied by negotiations with other East African States with a view to imposing coherence on this liberalization policy at the regional level, but also with foreign and domestic airlines, with a view to facilitating the flow of trade and expanding service. The development strategy for services will also require close collaboration between the airport management authority and the Ministry of Transport and Equipment.

In June 2002 the airport was privatized under a 20-year management contract awarded to Dubai Ports International (DPI). The financial stability of the new operator was ensured through the allocation of facilities formerly leased to military missions, chiefly the German army, whose departure threatens to create problems for the new management. As in the case of the port, it is unfortunate that not even a minimum of information was provided concerning the nature of

the contract and the reasons for the exceptional length of what would appear to be a standard management contract.

Total traffic volume increased from 2001 to 2002. Freight rose from 13.6 per cent, of which more than half consists of daily imports of khat (a traffic shared between the two national airlines under conditions of strict reciprocity). Passenger traffic increased by 8.5 per cent and the number of commercial flights by 28 per cent. This increase in commercial traffic is due to the policy of low fares pursued by the Daallo Airlines and by the appearance of small airlines such as Yemenia and Africa One. The airport has only one bonded warehouse, which is considered insufficient by the director. A review of aircraft movement in 2002 reveals the importance of military flights: there were 913 movements of military aircraft during the first quarter of 2003 as compared with 3,332 commercial flights, or nearly 22 per cent of all first quarter traffic. Real development of the airport will depend heavily on the success of the Doraleh complex. The establishment of a major free zone should attract industries and businesses from all over the region who can only travel by air and who should be encouraged to relocate by means of a policy that would entail an increase in hotel capacity.

To oversee the activities of the new operator, a representative of the State has been appointed whose responsibilities are comparable to those of the representative at the port and are thus subject to similar criticisms. The Government's representative can only act as a "facilitator" in the management and operation of the airport. The institutional framework should therefore be clarified, the Civil Aviation Administration should be given a mandate for development, and a genuine regulatory body should be established that would determine the rules and monitor their application in the area of air transport. At the same time the legal status of the new airport operator should be defined, as should the staff regulations, which have yet to be developed.

A satisfactory institutional linkage between the oversight authorities and the management of the port and airport, and even of the railway, which will be dealt with in the next section, would appear to be necessary. It would then be possible to ensure the development of air routes and increase linkages with the development of the regional trade centre and freight movements. These efforts at institutionalization and regulation could be undertaken jointly by all services and be headed by a single office within the Ministry of Transport. The idea of a multimodal authority that could accommodate the complementary or competing interests of the different modes of transport merits consideration. An advisory board that would bring together all the major infrastructure users could also be set up with a view to facilitating the convergence of interests between the private monopolies and users.

The Djibouti-Ethiopian Railway (CDE)

The railway's loss of influence

The railway (CDE) linking Djibouti and Addis Ababa is a non-electrified network 781 km long, of which only 1 per cent lies in the territory of Djibouti.

The steep terrain means that freight must be frequently offloaded and pulled, a serious impediment to the normal movement of goods. The company's rolling stock consists of 5 railcars, 17 locomotives, of which 7 are in service, 27 passenger cars, 382 freight cars and 111 tank cars, most of which are in poor condition. There would appear to be no rolling stock in operation that could provide customers with reliable service. The railway has some 2,600 employees, a figure that is totally out of proportion to the volume of business and thus detrimental to the operation's competitiveness vis-à-vis road transport. In 1985/1986 traffic reached 350,000 tons of freight and over 1 million passengers. These figures have declined steadily, falling sharply in 1998/1999 to reach 200,000 tons of freight and 81,000 passengers. Stabilization of the railway will undoubtedly require major financial support from both parties but could in fact offer cheaper transport of transit traffic than the road corridor. Ultimately, such a project will depend on greater political will on the part of the two owner States.

Recovery

Properly run, the Djibouti-Ethiopian railway could be an important and competitive complement to road transport, especially for the transport of heavy goods over long distances. However, as a result of the poor physical state of equipment and mismanagement, CDE today carries only 5.5 per cent of Ethiopia's transit traffic. The European Union has allocated 40 million euros for rehabilitation of the line between Addis Abba and Djibouti. It is also financing a study on the possibility of placing the railway under concession. To end the railway's decline, Djibouti proposed initiating privatization early in 1998. This privatization would take place in the context of a European Union project and should be completed by 2006. Transitional measures have been proposed and should be taken promptly to improve the railway's operations, functioning and general management.

The international road corridor

Conditions of use and their effects on the state of the network

Most of the Ethiopian transit traffic that comes through the port of Djibouti (nearly 3.1 million tons a year) moves by road. This is also true for the Lake Assal salt trade. In all, nearly 100,000 heavily laden vehicles annually travel the north-south corridors of the national network. Since the Ethiopian traffic from Assab shifted to Djibouti in 1998, the national highway (RN 1) has deteriorated significantly and is in need of repair, with some repairs currently in progress. The southern corridor, which is better for traffic to Ethiopia, will be improved with financing from the European Union and should make the route through Djibouti more competitive than the Assab alternative. Along RN 1 Djibouti's trucks carry 13 tons per axle, while Ethiopia's carry 10.5. Given the narrowness of the highway (6.5 m), it is recognized that the road was not built to carry such loads. Studies by American researchers have demonstrated a relationship between load per axle and road surface deterioration. This varies proportionally by a factor of 4 times the load per axle. In other words, a three-axle truck weighing 30 tons does as much damage to the road surface as 240,000 automobiles!

In an effort to maintain the road network and apply the principle of "the user pays", a highway maintenance fund was established in 1999, becoming operational in 2000. The fund generates income of approximately DF 260 million on the basis of a \$15-per-truck transit fee. To date this fee has been only partially used, as intended, to maintain the Djibouti-Ethiopia corridor or even for road maintenance at all. Its use to pay the salaries of the fund's many employees has considerably limited its social usefulness. In any event, the fund needs to be properly administered. This is in fact one of the reasons for promoting a reasonable dialogue with the Ethiopian side concerning an adjustment of their financial contribution to offset the damage done to the highway by their trucks. An amount of between DF 550 and DF 600 million will most likely be needed to maintain the 220 km of road along the corridor. The figure of DF 10 billion has been suggested as the amount needed to make it into a major artery.

It is estimated that the construction of one kilometre of road generates on average 50 jobs (unskilled and skilled workers, drivers, crew leaders, etc.). The highway maintenance fund must therefore be adequately funded and the requisite amounts must be devoted to road maintenance. The conditions for proper use of the fund would seem to be present now that users are involved in the management of the fund. Measures are being contemplated to turn the management and maintenance of the international corridor over to a private company specializing in this field. Any institutional change aimed at a more effective use of resources deserves support. The proposed concessional arrangement just mentioned surely goes in this direction.

Ethiopian transit traffic

Owing to the difference in factor costs with Ethiopia, Djibouti road transporters are not competitive. The sector could be of interest, however, given that much employment, both direct and indirect, is associated with transport activities. Under current economic conditions, the trip from Djibouti to Addis Ababa should cost \$3,000 for a single 4-ton truck, whereas market conditions bring a price of only \$1,500. For want of appropriate measures, namely a tax on fuel and vehicles or spare parts, trucking companies in Djibouti can only be marginally active, accounting for less than 1 per cent of the market. In addition to fiscal measures, greater attention must also be paid to vocational training objectives. Some positive steps are now being taken by the Ministry of Education in the form of a technical diploma in transport and logistics and a baccalaureate diploma in logistics and international trade, but there should be more of them, developed jointly with the Chamber of Commerce (CCD) and staff from every area of the transport chain and port services. Training is one way of reducing the labour unit cost while increasing productivity by enhancing worker skills.

An example serves to illustrate more clearly the problem of competitiveness inherent in Djibouti's road transport sector. The supply of drivers is low and naturally leads to higher wages. At the current rate of exchange, the wages of a driver from Djibouti are DF 70,000, more than three times what an Ethiopian driver earns, which is roughly DF 20,000. To these wages must be added the significant gap in employer contributions for benefits. Yet the productivity of workers in Djibouti is relatively low, and lower than that for Ethiopian workers. Moreover, workers are poorly trained in general mechanics and therefore cannot undertake emergency repairs along the road. This results in a greater amount of down time. It would seem that road transport workers in Djibouti do not know how to calculate cost price. They should therefore be provided with additional training that will enable them to monitor costs by means of a simple calculation that takes into account all elements of their price.

Looking at more than just the road transport sector, one could say that the prospects that will be opened by the Doraleh project call for a revitalization of the educational system. The Ministry of Education, working with representatives of the private sector, should seek to promote vocational education at all levels to increase the employability of Djiboutians in a way that ensures economic and financial profitability.

Facilitation of transport along the Djibouti – Ethiopia corridor

After the sensitization seminars on transport facilitation that were held in Djibouti and Addis Ababa in March 2000 with financing from the French cooperation agency, a number of recommendations were made that formed the basis of a facilitation programme.

Customs in transit and transport legislation

One of the main recommendations was the adoption of a transit customs regime in keeping with the Kyoto convention on the harmonization of customs procedures, taking into account COMESA procedures (a single and uniform declaration for imports, exports and goods in transit and a system of security deposits to improve the security of transit operations and protect the interests of the “transited” country). The follow-up to these recommendations was not conclusive. Both partners chose to stay with their previous provisions, which allowed Ethiopian customs to carry out inspections in the port while the Djibouti authorities conducted no physical inspections. As noted in the section on customs facilitation, this is an exorbitant privilege and an extreme form of facilitating transit operations. Djibouti should be more vigilant in looking after its own interests and make a greater effort to convince its Ethiopian partner to adopt the COMESA regime.

Incoterms 2000 and multimodal transport

Ethiopia would like to develop multimodal transport in the context of trade conducted on the basis of Incoterms by using Ethiopia’s **inland dry ports**, which are nearer to the shipping agent. Following this logic, which is the ultimate form of facilitation, imports entered in Djibouti would be immediately transferred (bonded transport under the transit regime, sealed containers) to the dry port or inland clearance depot. The fact that time in port would be kept to a minimum would not only increase port productivity, but also eliminate the need for the Ethiopian customs to be present in the port.

The authorities and private operators in Djibouti are not in favour of this development at present. They would first like to see the stranglehold on the maritime segment created by the Ethiopian Shipping Lines monopoly lifted and, more generally, the establishment of a competitive environment, which alone can generate the positive effects of multimodal transport described above. The stakes for Djibouti are high, for Ethiopia’s volume of foreign trade will not always be so low (currently less than 0.05 tons per inhabitant, as compared with 0.5 tons per inhabitant for many sub-Saharan African countries).

Establishment of an EDI system for transport along the corridor

Ultimately, Djibouti will not be able to serve as a hub for regional trade or a multimodal logistical platform unless it has an EDI system that allows it to enhance the efficiency of the transport chain through better control of the flow of paperwork relating to international trade. PAID, the customs administration and the business community must be convinced of the importance of this objective. The new facilities at Doraleh, the container terminal and the free zone only serve to underscore this need. Here both the Ministry of Transport and Equipment and PAID should play a driving role. As noted above, the way ahead involves contemplating the establishment at the port of an independent documentation

service working with PAID and the customs administration. For the users of the port facilities, this service will help to make procedures as paperless as possible.

The salt sector

Real export potential without altering the environment

Mineral resources are found primarily in the region of Lake Assal, some 100 kilometres from the capital. The lake is surrounded by a 52-km shelf of salt some 60 metres thick. The salt reserves are constantly being replenished, with an annual yield of 6 million tons; thus this output does not pose a threat to the environment. Mobilization of these resources can be contemplated in the context of sustainable development without any special modification of the site, which also has obvious potential for tourism. For this exploitation to be effective, it must be considered to have economic and financial viability, which is entirely dependent on export capacity. Of the 6 million tons of potential commercial salt output, only 5,000 tons can be consumed locally. Other uses will therefore have to be found for sea salt, perhaps in connection with the development of a type of local handicraft associated with leatherworking, for which there is considerable local demand, thereby freeing producers from reliance on external markets.

An activity that already employs 2000 people

In June 2003 there were 27 enterprises involved in salt production, of which at least 10 were actually located at the Lake Assal site. This represents some 2,000 jobs. The harvested salt is initially placed on the deposit shelf. It is then transported by truck to a higher elevation some 25 kilometres away for packaging in 50-kilogram bags. The lake is actually located in a depression 153 metres below sea level. This method of operation has thus far made it possible to ensure the protection of the salt deposit. In some areas the shelf is beginning to show cracks caused by the motorized equipment.

Making Ethiopian customers loyal

Salt working is not new. This activity existed during colonial times and was halted for reasons of cost and distance from European markets. The past sheds light on the problems that may confront any attempt to develop this sector with a strategy that entails distribution outside the region. The resumption of production today has to do with the tumultuous history of the Horn of Africa, and is largely explained by the disruption in Ethiopia's supplies from Eritrea. This disruption enabled Djibouti to increase its output to 127,000 tons in 1999 and to 162,000 tons in 2002, making the country a net exporter.

Three companies account for 75% of all production

The volume of salt produced gives Djibouti an infinitesimal share of the world market. Even assuming that it could market 600,000 tons, its market share would remain negligible, less than 0.3 per cent of a world output that was estimated at 205 million tons in 1999 and projected to reach 215 million tons by 2005. Yet outlets are not necessarily easy to identify. During the past four years local production was carried out by three main companies which accounted for more than 75 per cent of all output in 2002: the Société Sel de Djibouti, the Société du Lac and the Société Moussa Ali.

Regulation and limitation of the number of operators

Concentration of salt mining around so few operators is likely to facilitate a rationalization of production by reducing fixed costs that make the product less

competitive. It also helps to facilitate official regulation and marketing that is environmentally friendly and consistent with international health standards, something also sought by the authorities. After a period during which temporary permits for exploitation of the salt deposit were issued, a policy of issuing licenses was instituted; ultimately, only three of the companies proving themselves to be most economically and financially apt to develop national resources would be allowed to continue operations. The entrepreneurs concerned were invited to submit tenders that involved the preparation of technical documents by 20 January 2002. The evaluation committee ultimately chose four companies, including the three mentioned above. During the first half of 2003 the evaluation committee failed to reach a definite conclusion, thus causing the period of temporary permits to be extended.

Obstacles to export: health standards and the cost of electricity

What are the problems facing development of the salt sector? There is the uneven terrain, which makes it difficult to build evaporation tables. There is also the low iodine content of Djiboutian salt, which means that the product is unsuitable for consumption, according to the recommendations of WHO and UNICEF. The low iodine content also limits exports to Ethiopia and even more so to countries that are more demanding and where competition is great. To produce a salt more suitable for dietary consumption would require investments and make extensive use of water and electricity, two commodities for intermediate consumption that are both scarce and expensive in Djibouti. Outside the regional market, Djibouti salt might also face serious problems posed by the combined effect of quality and processing costs.

Transport costs make Europe inaccessible

It is hard to imagine marketing this product in Europe, where markets are already saturated by certain major countries that already export high-quality salt. The fact that the product is heavy also works against its being transported over long distances, especially if the amounts exported at international rates are not intended for dietary consumption. The difference in the price per ton FOB is in fact quite significant: \$45 for table salt and \$14 - 20 for industrial salt, depending on whether it is sold in bulk or bagged. Djibouti's industrial salt is sold in bags, which means that shipping costs to Europe would be exorbitant. On the basis of information obtained from a Spanish shipping company, it would seem that shipment via Marseille would entail shipping costs of \$25 - \$30 per ton, depending on the quantities delivered. This information tallies with information obtained concerning the cost of shipping very small quantities to Japan, which would cost nearly three times the world price.

At current prices, trade with Ethiopia is profitable

The terms of trade on the world market show that the price currently obtained for shipments of industrial salt to Ethiopia are relatively profitable. At \$29 a ton, as opposed to \$20 on the world market, Djibouti's most efficient operators manage to realize a profit margin of 30 per cent. Ethiopia gains by this trade, since imports from sources other than neighbouring countries (Eritrea) entail costs higher than \$29. In fact, table salt imported from Yemen costs at least \$45 a ton but involves unloading at the port of Djibouti, storage on the docks, customs duty, reloading onto trucks, and insurance for shipping by sea and road. All these costs explain why salt from Djibouti is preferred, even though problems having to do with its health properties may arise.

Trade between the two countries is thus in their mutual interest, which suggests that operators in Djibouti should endeavour to expand their share of the Ethiopian market, where annual consumption of table salt is on the order of 350,000 tons, perhaps by making better use of the railway. It must also be borne in mind that the Ethiopian authorities will continue to manage their imports by avoiding the potential cost of a trading relationship that might imply the choice of a single supplier. Currently Ethiopia imports goods from Yemen but also from Jordan. Not only are other COMESA countries potential exporters, as is the case with Egypt, Somalia or the Sudan, but one must also assume that relations with Eritrea will not always be frozen. In other words, there is a future in trade for two former rivals. Faced with such a promising Ethiopian market, which is almost natural given the ease of access, Djibouti must nevertheless think of diversifying its international customers.

Diversification of customer base with net importers from Asia

Diversification would have the advantage of reducing the country's dependence on a country whose payment arrangements in respect of imports are constantly causing major problems. Djibouti requires that its Ethiopian customers open letters of credit that are irrevocable and sometimes payable on demand. When the bill of exchange is in order, the export transaction is concluded within one week. The problem with this method of financing international trade has to do with the obligation imposed by the Ethiopian bank on the importer to leave a deposit in an amount equivalent to the value of the imported goods. The purpose of this deposit is simply to protect the financial institution against a possible default on payment by the importer.

Conclusion of new foreign partnerships

Diversification of the customer base could be accompanied by a search for foreign partners in the local development of the salt industry. South-East Asia continues to be a net importer of large volumes of these minerals. Partnership agreements with countries in this region could help to promote capital investments and establish a reputation for Djibouti's salt based on its health properties. Doing so with private operators is complicated, however, by the presence of transport costs, discussed earlier. The process will require time, but also real help from the State, which must invest more in the regulation and promotion of this national product. Such initiatives can justify the establishment of an ad hoc institutional support unit that would assemble collective expertise to provide real supervision over this sector.

The livestock sector

Reactivate the use of Djibouti as a port for exporting cattle from Ethiopia

The countries of the Horn of Africa taken together possess a considerable amount of livestock. Ethiopia has Africa's largest herd of cattle, while Somalia accounts for more than 30 per cent of the world's dromedary population. Djibouti's livestock sector is significantly less developed than those of its neighbours, which share a climate and economic environment as well as borders, yet it is nevertheless of interest to the country. It is an important factor for development among the nomadic and sedentary rural populations but also among the urban population, given the range of professional activities associated with the local development of production and with international trade, an area in

which Djibouti is called upon to play the role of regional transit centre. Nomadic herding, which accounts for 90 per cent of this sector, is characterized by mobility governed by rainfall. Sedentary stock-raising is practised in the vicinity of population centres and water points. It involves 1,000 farms, principally dairy, of which 340 are located in Djibouti district.

The cost of epizootic diseases

Activity in this sector is a factor for demographic stabilization of the population. It generates monetary income and provides a steady source of animal protein in the diet. It also allows workers without bank accounts to constitute their own savings in kind. According to some estimates, nearly one third of the world's population live by raising live animals, a consideration that fully justifies the attention paid to this activity by the State through the Department of Agriculture, Livestock and Veterinary Services. This Department provides important services in the area of health coverage, improving grazing land and developing the rural water supply, healthy food and control of zoonoses (diseases that can be transmitted to humans). Missions to ensure animal health are essential to a reactivation of international trade. During the mid-1990s, before an embargo was placed on imports of animals from the Rift Valley, the port of Djibouti exported up to 350,000 head.

Conforming to international health standards

The regional crisis of epizootic diseases was decisive in reducing trade flows to the countries of the Near and Middle East. The reactivation of trade in livestock is thus an essential area for State intervention, which must entail a strengthening of veterinary services and training in international quality standards in order to regain importer confidence. The active participation of Djiboutians in the work of the Red Sea Commission should certainly help these efforts, which must be perceived as real investments in reputation. The Commission holds out good prospects in the form of the partnerships that it seeks to promote between public and private agents and between exporting countries and importers in the Middle East.

Emphasis on infrastructure

One of the Commission's programmatic objectives that is of vital importance for the development of intra-regional trade is the opening of a reference laboratory in Cairo to supervise the work done by private veterinary laboratories in exporting countries, which are themselves under the immediate supervision of their national veterinary services. In view of the way the sector functions, these institutional innovations should complement each other by improving and expansion at the local level of existing infrastructures, whether for the intake of live animals that have been exported or for slaughtering and refrigeration. At present, livestock can be adequately accommodated at the Balbala facility, which can hold an estimated 7,000 head of small ruminants and 3,000 head of large ruminants. Feed is billed to the exporter or the owner of the animals.

From the time the facility was opened until the embargo on animal exports was imposed, Balbala took in between 100,000 and 350,000 head of cattle and small ruminants a year. The record high was reached in 1989 and 1990, with the lowest figure posted in 1996, when the embargo was declared. There was a slight increase in exports of livestock in 2003, particularly to Yemen, which does not require documentation certifying that the animals do not carry Rift Valley fever. Resumption of these activities will require a strengthening of

infrastructures and human potential. A laboratory for diagnosing animal diseases already exists, built and equipped by the European Union. Its staff is still inadequate to establish a reputation for diagnosing key illnesses that condition international trade flows.

**Facilitate
export
procedures**

The need for a quarantine centre and a transit centre near the port is another reason to complete the existing facilities at Balbala. In March 2003, in the context of the Djibouti-Ethiopian Technical Commission, the authorities also formally agreed to build a rest area for animals in transit. Such infrastructures are of significance for the development of international trade and could lead to creation of hundreds of jobs. In the same spirit of expanding or renovating existing facilities, it would be useful to look at the refrigerated slaughterhouse in Djibouti, which was initially financed by AFESD. In operation for 14 years, the slaughterhouse is currently in a state of decay. Lastly, in the context of international trade facilitation, the authorities should consider the creation of a single window to gather together in one place all the formalities and procedures relating to the export of animals.

**Currently, 5
Ministries are
involved in
exports of
livestock**

As noted above, the current situation is characterized by excessive bureaucracy and too many transaction costs that are the result of too many government services being involved in the process. No less than five ministries are currently involved in the international trade in animals - Agriculture, Trade, Finance, the Interior and Foreign Affairs – and the port of Djibouti, the Chamber of Commerce and Industry are also involved, not to mention the embassies of importing countries (currently Yemen and Egypt), who certify the certificates of origin and health clearances for nominal fees. This chain of administrative interventions could be reconsidered with a view to making trade more fluid without harming the quality of the products exported. The authorities are fully aware of this situation, and in February 2003, on the basis of a note from the Prime Minister, appointed the Ministry to be the focal point for the simplification of administrative procedures. Apparently, the intensification of international trade will be based first on the quality of the products, the effective application of the measures adopted by the Red Sea Commission and serious efforts by all local and international health control mechanisms.

The fisheries sector

General framework and current exploitation

In its territorial waters Djibouti has fishery resources that are currently exploited in a limited way or not at all, with a potential on the order of 48,000 tons. The latest scientific data indicate that, without affecting stocks, sustainably renewable catches can be taken in amounts of 1,800 tons of exportable demersal species, 4,600 tons of large pelagic species (tuna and mackerel) and 7,000 tons of small pelagic species (sardines). As the Fisheries Department has no means of collecting data, statistics on the unloading of catch are only fragmentary and not very accurate. Sources of available information are fishermen's associations

and various operators in this sub-sector. The most frequently cited figures indicate a catch of 500 tons a year, more than half of which is processed at the Mer Rouge Pêche plant at Boulaos. This catch is absorbed almost entirely by the domestic market.

The organization and public management of the sector is under the supervision of the Fisheries Department, which is part of the Ministry of Agriculture, Livestock and Marine Affairs. Only artisanal fishing is authorized, and this is divided into three categories (A, B and C), which distinguish between types of vessel. The fishery code only permits artisanal fishing, which excludes, inter alia, trawling. The artisanal fishing port was built with financing from the African Development Bank (ADB). Its objective is to facilitate the unloading and marketing of the catch. The port functions well below capacity, owing to a lack of economically viable outlets, particularly the impediment to access to the natural market that is the European Union. The refrigerated warehouses at the commercial port were designed for the transit of frozen fish, particularly tuna from foreign shipping companies and small pelagic species unloaded by foreign fleets for subregional consumption. As these projects have not been entirely successful, the refrigerated facilities have been rented and are no longer available for the storage of fish.

The only fishing enterprise situated near the Boulaos zone of Djibouti is Mer Rouge Pêche. In 1996 the company began to export to the island of Réunion, but in 1998 these export flows were suspended with the end of the period of exemption from the health requirements for fishery products exported to the European Union (EEC Directive No. 91/493). During the past six years the company has processed roughly 280 tons annually. In view of the limited space available, it is not possible to install a processing unit on the company's current site that meets European Union sanitary norms. Construction of a new facility would seem to be the solution of choice, but the problem lies in demonstrating that the project is bankable. More generally, the fisheries sector suffers from a lack of institutional financing. For example, the lack of technical and financial resources makes it very difficult to organize a distribution system toward the interior, even though such a system would promote poverty reduction and improved food security.

Conditions for intensifying fishing activity and developing trade flows

Compliance with health standards

To develop exports to the European Union, Djibouti must become one of the “third countries” that has harmonized its health regulations with regard to fish products. The Department of Agriculture, Animal Husbandry and Veterinary Services is awaiting the construction of a laboratory to be financed by the African Development Bank. Harmonizing health standards with international norms is a priority if international exports are to be increased. A laboratory for health inspections must be established and its technical, administrative and legislative apparatus set up. Setting up of the laboratory must be accompanied by the development of programmes to train its staff. Accreditation of the authority that will represent Djibouti’s health organizations to the European Union must also be a priority. This will entail expanding the Department of Veterinary Services (at the port and the airport) and the Department of Fisheries. Appropriate measures are needed to manage the country’s fishery resources in a dynamic way. Another step should be the establishment of an export promotion unit for fishery products that would provide useful information about prices, products and potential markets. In cooperation with the Ministry of Trade, it should support operators and their efforts to improve the quality and promotion of their exports.

Rethinking fishing technology

Djibouti’s rocky coast and narrow continental shelf limit the possibilities of trawling. That is why the authorities do not permit industrial fishing. It is, however, possible to use vessels aboard which the fish caught by artisanal fishermen can be processed. Deep-sea species (demersal and pelagic) are difficult of access for those who lack the proper equipment, and the unpredictable catch is costly in terms of fuel expenditure. Given the limits imposed on vessel size, however, small deep-sea craft 12 to 14 metres long with powerful motors would permit long-line fishing, inter alia, for pelagic ocean fish having a high commercial value (tuna, swordfish, etc.). These vessels would contribute greatly to the development of port and fishing activities in Djibouti. They could also be introduced at Tadjoura or Obock, where they could supply the proposed plant for the drying and salting of fish for domestic consumption.

In general, fishing can make a significant contribution to the development of this activity virtually all year long, with the development of external markets that are accessible to Djiboutian operators with the right equipment. Technical assistance is needed, however to develop any fishing operation from catch to market. Artisanal fishing must be strengthened. To this end, modern vessels are needed, and seasonal species with a high export value must be targeted.

Internal and intra-regional market constraints

One of the factors limiting domestic consumption of small pelagic species is their bone content, as the presence of bones is difficult for small children to

detect. However, the sardine is very popular in sub-Saharan West Africa because of its distinctive taste and because it is easy to prepare with rice. Fish is an important source of protein in combating dietary deficiencies. Dried salt fish offers one means of combating poverty by creating jobs in the fishing industry and by meeting the potential demand of the poor, who can use it to improve their diets. In this way small pelagic coastal fish could be made available to all segments of the population.

Fishing and diet

Djibouti does not have a strong fishing tradition. Despite a high unemployment rate and widespread poverty, the population is not attracted to this sector. To encourage this activity, the Obock fishing school, largely inactive to date, should be reinforced with specialized training programmes tailored to the species to be caught. A study should be carried out to assess the interest in providing general training, perhaps through the national education system, leading ultimately to a specialization in maritime affairs, of which fishing would be a main component.

The need to develop exports

There are many factors constraining exports, and the vocational and administrative sides of such an operation would require daily updates on the status of international markets where there was unmet demand. Conditions of access to these major foreign markets boil down to three key points having to do with the products sought by the target markets and the techniques needed to penetrate these markets successfully: variety, regularity and quality.

The import of fishery products in the European Union is subject to health inspections of the products when they enter the Union: this is pursuant to EED Directive 91/493 of 22 July 1991, as revised by Directive 94/356/EC of 20 May 1994.

Fish exports and cash-flow requirements

Exports of fresh fish have a high commercial value, but such export involves significant risks against which exporters must be able to cover themselves. Exports of frozen fish require a significant outlay of resources but are made possible by transport infrastructures. Use of the Djibouti airport as an intermediate destination offers good prospects for the export of fresh fish, even though the airport's facilities are fairly inadequate (no refrigeration). Exports by sea can make use of container ships that are generally equipped to transport frozen goods.

Modernization and development of fishery products

A priority objective might be the construction of one or more all-purpose processing plants that met international health and commercial standards and be technically capable of supplying different types of export operations. A promoter could set up a facility to coordinate all operations that supported proper catch management. Construction of complementary facilities would be imperative to start the processes that would enhance the value of the species exported to international markets. Djibouti thus finds itself in the position of being able to satisfy domestic demand for fish, thereby reducing poverty, and to export the rest of its exploitable potential to Europe, Asia or North America.

To do this, the sub-sector of artisanal fishing must be strengthened as a matter of priority, another priority being the installation of a “mother ship”². This kind of operation can meet pressing development needs, particularly with regard to the exploitation of tuna for the Japanese sashimi [Japanese term for high quality fresh fish intended to be eaten raw] market, where prices range from \$4,800 and \$35,000³ a ton on the Tokyo wholesale market. While this species is seasonal in Djibouti, tuna fishing could yield 500 to 600 tons a year, bringing in export earnings of \$5 to \$6 million.

Training and creation of viable jobs

**An opportunity
to create 4,500
jobs**

In general, the managers, supervisors and workers employed in the fisheries sector reflect the weaknesses of existing training programmes, but also the lack of relevant information about the potential of this sector for economic development. In terms of employment, the catching and unloading of 4,000 tons of fish per year should create up to 4,200 jobs for fishermen and other fishing-related jobs, plus an additional 200 jobs, at least once the processing plant is installed. Artisanal fishing can create many direct and indirect jobs, but these are penalized and limit the country’s integration in international trade. In addition, certain fish species found in Djibouti’s waters are capable of generating significant foreign currency earnings for the country. These prospects should serve to encourage the development of more training programmes and perhaps lead to the active involvement of the Chamber of Commerce in local efforts to develop this resource and cultivate its major export markets.

The tourism and handicraft sector

Djibouti has a wealth of tourist offerings. Apart from such outstanding sites as Lake Assal or the Seven Brothers, it has extremely varied wildlife and is less than seven hours away from the world’s largest pool of tourists: the European Union. Supply in the area of tourism is fairly low, but highly diversified, with popular thematic products, such as diving and fishing, and products such as the discovery of nature and environmental treasures. Tourism in the subregion continues to be extremely limited. In 2000, some 136,000 tourists visited Ethiopia and 70,000 visited Eritrea. Figures are not available for Somalia and Somaliland. Arrivals in Ethiopia rose from 79,000 in 1990 to 136,000 in 2000. At the same time they declined significantly for Eritrea after peaking with 315,000 arrivals in 1995. These statistics, though incomplete, indicate that tourism in these countries is not currently able to serve as a springboard or relay point for the development of tourism in Djibouti. On the other hand, the Arabian Peninsula, especially Saudi Arabia and the United Arab Emirates (Dubai in particular), represent tourist potential that must be tapped.

² A ship that operates like a commercial fishing vessel (non-active mother ship), i.e. accompanied by a fleet of smaller conventional fishing vessels whose catch is processed aboard the mother ship, which supplies one or more units on land in Djibouti.

³ Price variations are dependent on the origin, size, species and quality of tuna.

**Inadequate
tourist
infrastructure**

Supply in the tourism sector. Hotel and restaurant capacity is currently limited, with a total of only 685 hotel rooms, one major hotel with 185 rooms, and a restaurant capacity outside the hotel infrastructure of between 400 and 600 seats. Such low capacity is offset by high occupancy rates, ranging from 50 to 79 per cent annually. An increase in demand, from either business or recreational tourism, which should expand following the building of port and free zone at Doraleh, would be difficult to meet with the existing infrastructure. The supply of tourism products is currently provided by a dozen local entities including five main agencies in Djibouti town. The products on offer fall into four categories: diving, sport fishing, beach activities and bush trekking.

All these providers offer quality products, with small intake capacities in all cases. Fishing and diving are based on a total supply of 100 to 120 persons a year, with an equivalent supply for beach and excursion products, for a total capacity of 300 to 400 customers. With capacities in use 25 weeks out of the year, Djibouti can host 7,500 to 10,000 recreational tourists in facilities other than the hotels in Djibouti town.

Tourism, and the hotel industry in particular, is analogous to heavy industry, with long periods of down time and a labour force that must be increasingly skilled. Under these conditions, investments require a stable environment but also financial conditions appropriate to the sector. The current financial climate is not really compatible with opportunities for predictable profits from investments in tourism. Bank interest rates are between 14 and 16 per cent.

**The demand for
tourist services
is not known**

Demand. The demand for tourism is especially hard to determine using the criteria of the World Tourism Organization. The Organization's definition of a tourist is essentially based on length of stay (at least 24 hours and no longer than one year), and not on the reasons for travel, such as leisure and vacation, but also visits to family and friends and business trips. Members of the armed forces and their families are not included in tourism statistics, unlike the relatives and friends who come to visit them. Also not counted are Ethiopian truck drivers and, in a broader sense, citizens of neighbouring countries who arrive by land. Travel in Djibouti is currently organized by more than a dozen tour operators (TO), for the most part companies specializing in thematic travel. In 2002, according to official statistics, there were an estimated 21,000 entries, including 2,000 recreational tourists and holidaymakers whose travel had been professionally organized. Since 2002 airport statistics also show a sizeable increase in air passenger traffic.

**A sector that
holds out good
prospects for
employment**

Employment and the relative weight of the sector. According to the National Tourist Office, tourism employs some 1,500 workers, of whom 50 per cent represent direct employment throughout the sector: hotels, other lodging and campgrounds, restaurants, cafés, travel agencies, airlines and tourism

administration. The main employer in the sector is the Sheraton Hotel, with 175 permanent employees. For the sector as a whole, direct employment can be broken down as follows: hotels, including hotel restaurants - 50 per cent; restaurants, bars, cafés and discothèques – 20 per cent; travel agencies, airlines, airport workers, car rental and tourism administration – 30 per cent.

Indirect employment is essentially in the commercial and handicraft sector as well as in fishing and, only slightly, agriculture. According to surveys of associations, tourism provides work for 600 artisans, chiefly women. The potential for handicrafts could be developed further if a more direct linkage with tourism existed. Tours and visits focusing on handicrafts have yet to be organized, particularly in connection with women's associations, as in the region of Tadjoura. Likewise, an indirect link with tourism should be developed by creating new Internet sites that link craftsmen's associations directly with the National Tourist Office web site. Similarly, a number of hotels might conclude annual contracts based on guaranteed prices and quantities for types of products that also help to reduce food dependency.

The development of tourism micro-projects, particularly within the country's interior, has already led to specific poverty reduction efforts. One example is the Local Association for the Development of Sustainable Tourism at Assamo, which has developed nature tours centred around Beira gazelle-watching. These tours are organized with the direct participation of camel drivers, farmers and artisans, who receive 80 per cent of the revenues from these trips. Such micro-projects, which are a source of monetary income, attack poverty directly and are compatible with sustainable development.

Tourism administration is the responsibility of the National Tourist Office (ONTD), which has direct ties to the Ministry of Sports and Tourism. ONDT has a broad mandate. It seeks to structure supply and promote international tourism. Promotional and marketing activities are especially important and include the publishing of thematic brochures and management of an Internet web site. The Office is represented abroad through Djibouti's embassies, which gives it access to tourist information about the principal markets.

Lifting the many constraints to development

Capital costs. Financial constraints are severe. Many development projects in the field of tourism are never finished for lack of adequate financing. In Europe an establishment's profitability (EBIDTA) is reached, on average, with a return on investment of 14 per cent. This 14 per cent is broken down into amortization (4.5 per cent), financial charges (5 per cent) and pre-tax profits (4.5 per cent). In the case of Djibouti, taking into account the high level of interest rates, the predictable profitability of investments is transformed by the financial charges, which absorb 10 per cent of the gross profit. This low level of profitability has a disruptive effect on efforts to increase hotel capacity in the main areas: business hotels in Djibouti town, resort hotels on the periphery, and hotels and other accommodation in the main tourist areas, primarily beaches.

Profitability issues such as intermediate consumption affect production factors

Energy costs. These are additional energy costs. Electric rates are three times higher than in neighbouring countries, particularly Ethiopia. As a result, hotel electric bills are extremely high. The Sheraton's bill in July 2003 was \$66,000. Given an occupancy rate of 48 per cent during the first half of the year, the cost of electricity alone accounted for \$24 per occupied room per night. No hotel benefited from the 50-per cent reduction in rates, as it applied only to hotels with more than 100 rooms for a limited period of five years. The problem of competitiveness is currently the principal obstacle to the development of tourism. As regards electricity, the reductions applicable to hotels with more than 100 rooms should be applied to all hotels and gradually phased out over time, although the end result should not be that everyone pays 100 per cent at the end of five years.

Wage costs. Given the high prices, some hotels have to pay their employees, even those who are unskilled, at a level far above the basic wage level. On average, the wages of skilled workers range from DF 45,000 (\$254) to DF 70,000 (\$395), to which must be added social benefits of approximately 19 per cent. Wage levels are five to six times higher than those in comparable Ethiopian hotels. Some hotels pay their employees a minimum, with wages ranging from DF 38,000 (\$214) at a hotel in Djibouti town to DF 18,000 (\$102) for guards at the tourist camps at Tadjoura. Wage costs are thus exorbitantly high and constitute a significant handicap for competitiveness.

Other additional costs. Telephone service and car rentals should be mentioned. The cost of telephone service is particularly high, especially for international calls, even though rates are going down. In 2003 the rates applicable to hotels in Djibouti town were DF 45 (\$0.25) for local calls and DF 565 (\$3.20) a minute for international calls to Europe. The cost of various stamps and taxes constitute another obstacle. For a family of five, the additional costs add \$330 on to the cost of a two-week hotel stay.

**A dynamic
Tourist Office
with limited
resources**

The budget of the National Tourist Office would not appear to reflect a conscious choice to develop tourism. It has in fact grown smaller over the past 10 years, largely because of declining government subsidies. These subsidies, which amounted to DF 80 million (\$452,000) between 1993 and 1995, fell by half in 1996 and 1997, to DF 40 million (\$226,000) and were halved again in 1998 (\$113,000). The result has been a significant drop in the financial resources of ONDT, considerably reducing its prospects for commercial activities. To increase the visibility of Djibouti's tourism, promotional investment and the resources allocated to ONTD must be increased. A three-year commercial plan must be developed which includes the following three elements: production of promotional materials, active participation in national events; and the establishment of a team of travel agents specializing in nature tourism, diving and fishing.

**The hotel
management
school suspends
operations**

The hotel management school at Arta offered training to classes of 18 students a year. Run in cooperation with France, it helped meet the country's needs for hotel and restaurant personnel and supplemented the on-the-job training received in the major hotels. With the departure of the foreign cooperation personnel, the Arta school was forced to suspend its activities, a move which caused the cost of

private training to go up for potential investors. The closing of the school, even temporarily, was a setback that must be overcome as a matter of urgency. Reactivation of the hotel management school must emphasize basic training and continuing education, both in the school and in hotels and restaurants, working with professionals in the field.

Inadequate air transport capacity

Air transport impacts tourist flows through fares and airline capacity. The open sky policy that was officially adopted in January 2001 is a key factor for the development of competition between airlines and lower airfares. Four international airlines are struggling to conquer the market by reducing the price of their services: Daallo, Yemenia, Air France and Ethiopian. However, the supplied capacities place a major constraint on the development of tourism, as there are few seats available for tour operators or individual tourists. The experience gained on air routes to other Indian Ocean destinations, such as Seychelles or Mauritius, show that the open sky policy is not in itself always enough to solve problems of air access or the problem of tailoring fares and capacities to needs. Strategic alliances with major international airlines can be quite helpful in this regard.

Environmental management

While Djibouti is a destination for nature and environmental tourism, there are many problems that prevent the development of tourist flows. The most edifying example is the industrial exploitation of salt at Lake Assal, which must remain compatible with the use of the site as a tourist destination. More generally, Djibouti town must address the many problems associated with high population growth and its concomitant pressures on the environment. A political commitment to clean up the urban environment and maintain the cleanliness of tourist sites is indispensable.

The limits of international cooperation agreements

International cooperation agreements have been concluded with neighbouring countries (Ethiopia and Yemen), but their highly restrictive nature must lead Djibouti to take greater advantage of regional cooperation with Gulf States, especially Dubai, which operates the port and the airport. Active cooperation must be developed with Dubai on joint products and the specific promotion of Djibouti to the resident population. Tourism has not taken sufficient advantage of domestic demand; it ought to be possible to mobilize more effectively the potential resource represented by a high-income expatriate population of some 10,000 individuals, who represent 2 per cent of the total population.

The financial services sector

Commercial banks and formal financing

The banking sector contributes roughly 5 per cent of GDP. Three commercial banks are currently in operation: the Banque pour le Crédit et l'Industrie–Mer Rouge (with capital held largely – 51 per cent - by BNP), the Banque IndoSuez–Crédit Agricole–Mer Rouge, an affiliate of Crédit Agricole de France, and the Commercial Bank of Ethiopia, whose capital is held entirely by the Ethiopian Government. The current number of accounts opened in these banks is 26,226. They are fairly concentrated, since of the three banks, 53.4 per cent of these accounts are managed by the first, with the two others accounting for 24.3 per cent and 22.3 per cent, respectively. The gross coverage rate of banking services, defined as the number of banks against the total population, is approximately 4 per cent, or close to 8 per cent, if one counts only the population over age 20.

Banks are concentrated and the range of services is limited

Given the risky environment caused by the narrow domestic market and problems of external competitiveness, the relative inefficiency of the judicial system and the difficulty in enforcing guarantees, the banking sector prefers to make its investments outside the country. These investments are low-yield, however, currently bearing an interest rate of between 1 and 2 per cent, albeit with no risk. This strategy is probably reinforced, although one should not stress this argument unduly, by the currency board system in effect which holds that every Djibouti franc issued must be backed by its equivalent dollar value. This system results in a lack of real possibilities for refinancing of the commercial banks by the Central Bank, but also in the need for commercial banks to cover themselves by holding Djibouti francs or foreign currency. This allows them to meet the liquidity needs inherent in the withdrawal of deposits. The Central Bank seeks to ensure that these cautious rules are followed.

Involving the formal banking sector to a greater degree in the financing of local development can only be viewed as a long-term project. It entails the creation of a culture of transparency, which is currently lacking. The information that can be obtained on companies is insufficient in terms of both quantity and quality, a situation that has to do with the good governance of enterprises and the development of internal and external auditing mechanisms. The justice system, too, has a duty to ensure that its decisions are handed down more rapidly and are enforced, so that the guarantees underpinning loans are meaningful. Without this step, creditors are inadequately protected and formal banks are thus constrained from taking greater risks. Experience with bankruptcies and the large volume of risky debt shows that the responsibility of commercial banks in the current state of affairs is the consequence of underdevelopment rather than a desire on the part of banking professionals to extricate themselves from their financing obligations.

The rate of financing of the economy is low. In 2002 total credits extended as part of GDP did not exceed 22 per cent. Currently, 77.5 per cent of all facilities

or credits granted are short-term and are used primarily to finance trade-related activities. One bank has explicitly stated that it will not grant loans for a term longer than 12 months. There are those who will say that by being renewed, these short-term loans and lines of credit end up becoming medium-term loans. In reality, though, the underlying logic is not the same, for a real medium-term loan allows for the financing of equipment while placing fewer constraints on cash flow.

Alternatives to bank financing

Creation of the FDED

Given the prevailing economic and social problems (especially the increase in poverty and unemployment) and the limited availability of bank financing for projects, the Djibouti authorities have established alternative financing mechanisms, particularly through the Djibouti Economic Development Fund (FDED). This Fund is a government corporation of a commercial nature, and as such it is required to repay its loans. The economic and financial viability of this institution suggests that it should be provided with adequate governance bodies.

The Fund has a Board of Directors which provides guidance and ensures that procedures are followed, with the help of an independent auditor. It is responsible for ensuring that projects are correctly evaluated and that applicants actually put up 30 per cent of the financing required for their execution. The FDED target population comes from a relatively comfortable stratum of society. Loans amounting from DF 2 million to DF 50 million are thus granted to promoters who can mobilize 30 per cent of their total project cost and own property that can be serve as a guarantee. The sectors eligible for Fund financing and the amounts to be allocated to each are regulated. This supply-driven approach runs the risk of introducing bias in the Fund's operation. Experience in fact shows that the best financial services are demand-driven.

SDF initiatives

Generally micro-enterprises turn to spontaneous and informal financing mechanisms. These are supplier credits, small two-person micro-enterprises, pawnbrokers and, finally, "rotational savings" systems. To structure and expand alternative sources of financing, the Djibouti authorities have set up a Social Development Fund (SDF) which works with NGOs. There are currently nine micro-credit institutions in Djibouti, eight of which operate in partnership with SDF. These organizations represent some 900 customers. SDF has found it useful to work with NGOs by providing them with lines of credit that result in loans at 18 per cent interest in amounts significantly smaller than those handled by the FDED.

SDF should be supported so that it can have the necessary competencies to play a supervisory and advocacy role with NGOs in loan operations by helping to build their institutional capacities. In particular, NGOs should have effective operating procedures and a reliable system of reporting which can serve as the basis for computerizing their data. At present there is a gap between written procedures (which are also less than thorough) and those followed in practice.

At this level, SDF should choose between two main forms of intervention. The first represents continuity and involves working individually with each NGO. The second, and more innovative, method uses economies of scale and instils responsibility by encouraging the formation of groups of NGOs that can share in the responsibility of self-management.

General Conclusion

The extent to which unemployment and poverty feature in Djibouti's economy show how necessary employment creation is, even though this is not feasible in an economy with a GDP growth rate of roughly 1 per cent a year. The problem facing the economy today is not the export of protected industrial goods or agricultural products that can easily be expanded by price incentives so much as the need to create conditions for the emergence of new activities. This situation has caused this diagnostic study to be undertaken from within a specific perspective. The first part has been largely devoted to diagnosing the competitiveness of prices by looking at the cost of primary factors and intermediate consumption. Attention has also been drawn to the functioning of institutions whose weaknesses affect competitiveness through transactional costs. Given the country's small size and its opening on to the Indian Ocean, a resumption of economic growth must entail above all the development of services, particularly those relating to the port and to transport. These activities contribute to the flow of trade in the subregion in an atmosphere of insecurity that currently benefits Djibouti. This situation is, however, only temporary, and its benefits will gradually ebb as international relations in the subregion normalize. Looking ahead to this change and the development of the facility at Doraleh, which will make Djibouti competitive in attracting new traffic, the overall objective of enhancing competitiveness takes on particular importance.

Movements in the real effective exchange rate suggest that since 1990 Djibouti's competitiveness has fallen by some 40 per cent. In addition to the inherent impact of the tied currency, the cost of intermediate consumption is partly responsible for this change, particularly where the high prices of commercial services are concerned. The price of water is twice what it is in Ethiopia. The same holds true for electricity and telephone service, which have an effect on cost formation and profitability. Lowering the price of commercial services must involve institutional reforms, and especially privatization in forms that involve the taking over of investments by private operators. At the same time, this "taking over" will make it possible to expand services without undermining the State's efforts to improve its financial situation.

In the effort to enhance competitiveness, institutional changes will be one of the key means of lowering the cost of primary factors, especially labour. Djibouti's abundant human resources must be better developed in order to be exported. The inherent problem of labour has to do with nominal wages, and quality – here, productivity – which is itself determined by the quality of the educational system and social conventions regarding effort. On average, nominal wages in Djibouti are three to six times higher than in Ethiopia or Yemen. In the wage formation of persons holding diplomas, the private sector tends to align itself

with the public sector. As the public finance crisis took hold in the early 1990s hiring gradually stopped, yet wages remained high, and bore no relationship to productivity or the balance of the labour market. Assuming that the exchange rate is to remain tied to the dollar, enhancing competitiveness will result in a portion of public expenditure being more effectively aimed at improving the health of the population and the training of workers.

With regard to training, public efforts should focus on vocational education, the budget for which appears inadequate and whose effectiveness is undermined by the spreading of resources among several ministries. This dispersal is a handicap to a coordinated mobilization of resources. The question of training is crucial for reducing poverty and making labour exportable for the development of trade in goods and services. Independently of any emphasis on the quality and employability of the labour force with a view to the development of trade, emphasis should also be placed on the acceleration of certain institutional reforms, particularly the establishment of the new labour code, for which the groundwork has been laid over a number of years. Beyond certain specific laws that have instilled a degree of flexibility in the labour market, completion of the code will serve as a stimulus for local and foreign entrepreneurs. Codification will make more visible the rules that underlie the way the community expects to see this abundant resource managed. Enhancing this institutional framework must involve efforts to make the investment code more effective, simplify the free zone regime, and increase understanding of the rules relating to the commercial code. These legal texts will make the institutional environment more transparent. And in this way they serve to stimulate the creation of enterprises and jobs in marketable activities.

Yet all these formal rules are only valuable to the extent that they can be implemented as a result of the effective functioning of government departments and the system of justice. Here again many reforms are called for. The goal must be to reduce the transactional costs that are generated, for example, by the functioning of the system of justice. This system must be better able to settle disputes within reasonable amounts of time and with a certain degree of fairness that will bring parties to accept the judicial decisions handed down. The development of a more effective judicial institution is thus an element of competitiveness and an incentive for the creation of activities in the area of international trade. Public institutions are also important facilitators of trade. From this perspective, the role of the Ministry of Trade, Industry and Handicrafts would appear to be fairly inadequate. This Ministry must be provided with increased human and financial resources, and a significant volume of structured technical assistance. A thorough inventory of its needs, and especially those of the department of foreign trade and handicrafts development, is needed. This inventory should lead to training activities in the context of a programme of reorganization in both the short and the medium terms. This department must be provided with a large database and a full-fledged unit for monitoring international WTO agreements, and it must be able to assess the more rapidly impact of the COMESA common external tariff. Assuming that the initial timetable is adhered to, the COMESA common external tariff should be applied as of this year. There are still many questions as to the consequences this may have for Djibouti. Given the narrowness of the local productive base, regional

integration should make it possible to reduce trade protection to a level that reflects the interests of the partner economies. This will result in the rerouting of traffic with a redistributive effect that is likely to be adverse for consumers in Djibouti. On the other hand, the effects of such changes in traffic patterns may be limited in the short term owing to the very weakness of Djibouti's productive base and the problems of competitiveness in the regional context. Such uncertainties suggest the need for a quick study of the pros and cons of the common external tariff.

To support administrative reorganization, there should be an increase in the staff and resources of the customs service. Some current areas of dysfunction are causing interruptions in service that are harmful to trade flows. An increase in the number of personnel and an enhancing of skills is therefore indispensable, particularly for the inspection of oil products, which are heavily taxed. One of the authorities' concerns must also be to computerize administrative procedures. Progress in this area will help to facilitate trade while at the same time making the customs service less paper-based. Trade will also be facilitated by the quality of infrastructure. Infrastructure is not normally associated with activities that are traditionally considered to be internationally marketable, but it is conducive to an intensification of trade and poverty reduction. In this it is also a factor in the achievement of the Millennium Development Goals because it promotes potential employment for women, facilitates access to basic education and improves the health status of the population. Infrastructure also contributes to poverty reduction by expanding access to public services, namely water, electricity and telephone services, which affect individuals' "capacities" and "functionality".

The transport chain and port services alone account for 12,000 to 15,000 jobs. While there are no criteria for strictly assessing how effective the privatization contract in the form of a concession for the port and airport is, the choice of Dubai Port International (DPI) and the Jebel Ali Free Zone Authority for the future free zone reflects an internal logic. The concentration of interests is likely to create and facilitate synergies among the various components of the future regional trade centre. On the other hand, the concentration of power in the hands of a single executing agency acting as a monopoly will require the setting up of a public regulatory body. Good institutional linkages between the port and airport oversight and management authorities will make it possible to ensure the development of multimodal links. The establishment of a regulatory body could involve different modes of transport and take the form of an office within the Ministry responsible for this area.

Despite the current problems of congestion, the port of Djibouti would seem to be favourably situated as compared with the alternative port facilities in the region. The competitiveness of the site, which is related not only to the management of lesser risks, is nevertheless uncertain. The relocation of shipping companies is always a possibility. Investments in port facilities, too, can relocate, depending on profitability and the rate of infrastructure amortization. With DPI involved in the creation of the free zone and the modification of the transport chain (port, airport), the planned regional trade centre is becoming a reality. The project also holds out bright prospects for employment, although

these depend on the quality and price of public services and an improvement in the quality of human capital achieved through an adequate training policy, the importance of which has already been noted. Port activity is closely linked to Ethiopian transit traffic, which uses the Djibouti road corridor. Owing to the gap with Ethiopia where factor costs are concerned, Djibouti's haulers are not competitive, capturing no more than 1 per cent of the Ethiopian market.

Ultimately, Djibouti will not be able to play the role of regional trade centre and logistical multimodal transport hub if it does not have an electronic data interchange (EDI) system that allows it to make the transport chain more efficient and monitor the flow of documents relating to foreign trade more effectively. PAID, the customs service and the business community must all want to see this objective achieved. The new facilities at Doraleh, the container and the free zone make this awareness urgent.

In addition to the port and road transport activities, which can be better developed than is currently the case, the salt sector is one of the most promising productive sectors. It currently employs roughly 2,000 people. This development can be explained in part by the disruption in Ethiopia's supply from Eritrea. In its present state, this activity faces problems related to the uneven terrain and the low iodine content of Djibouti salt, which keeps the product from meeting WHO and UNICEF health standards. While the country's most successful operators show a comfortable profit margin in their trade with Ethiopia, a diversification of customers is both desirable and difficult, given the cost of transport to potential markets in Asia.

The livestock sector likewise represents an area of development that should be amplified or reactivated, given that the Djibouti corridor was frequently until the outbreak of disease cut back the transit of animals from Ethiopia drastically. To reactivate international trade flows, Djibouti must endeavour to develop all facilities so that it can ensure the proper intake of animals and provide health guarantees in respect of exports. The authorities must also focus on the creation of a single window to group together all formalities and procedures for the export of animals. No less than five ministries are currently involved in the international livestock trade. This chain of administrative interaction must be reviewed with a view to making trade more fluid.

The fisheries sector is also promising, with a potential for sustainable exploitation of 48,000 tons a year. Djibouti has little in the way of traditional fishing. To attract the population to this activity, the fishing school at Obock, vastly underutilized to date, must be strengthened with specialized training programmes targeting specific species of fish. Artisanal fishermen suffer from illiteracy, the absence of a system of credit and market access that is limited by European institutions owing to the lack of harmonization with international health and hygiene standards. Compliance with these standards and the development of appropriate training programmes must be a priority if exports are to be developed. Technical assistance is needed to develop all fishing operations from catch to market. Modernization of artisanal fishing also requires the use of vessels capable of processing seasonal species with a high export value. Domestic consumption can also offer a good outlet, resulting in an increase in

protein intake in the diet of Djiboutians. Dried salt fish offer a means of combating poverty by creating jobs associated with this economic activity and by potential popular demand for the product.

Increasing demand in the tourism and handicrafts sector will require a beefing up of the hotel infrastructure. Heavy financial constraints currently weigh on hotels and their profitability. Investment is not encouraged by interest rates and factor costs, regardless of whether they are primary factors or intermediate consumption costs. According to the National Tourist Office, tourism generates some 1,500 jobs, of which 50 per cent represent direct employment. Surveys have shown that tourism would provide work for more than 600 artisans, chiefly women. To strengthen this sector it is imperative that a three-year plan of action provide for increased investment in promotion and increased resources for the Office. Vocational training should also be reviewed. The Arta hotel management school has been forced to suspend its operations, resulting in an increase in private training costs for potential investors.

Lastly, the financial services sector requires a modification of behaviour on the part of all actors, creditors and debtors alike, in order to channel savings more effectively into local investments. The stability and convertibility of the Djibouti franc make it possible to attract foreign currency that is generally reinvested outside the country. Such investments generate little income, however, currently bearing interest at a rate of less than 2 per cent. Greater involvement of the formal banking system in local development financing can only be a long-term operation, carried out in conjunction with the major institutional reforms, particularly of the justice system. Without this debtors are not sufficiently protected and the mechanisms blocking credit continue to be powerful.

The main proposals contained in this study are listed in the operational matrices (see annex). The table which follows the annex contains a recapitulation of projects that could be considered as priority. The need for action is particularly urgent in the case of 10 projects which have been highlighted in bold and underlined.

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| Type of activity and implementation timeline | | | Lead agencies/potential external support |
|--|---|---|--|
| ST | MT | LT | |
| Matrix 1: Strengthening of customs | | | |
| <p>Establishment of a Customs Reform Committee composed of (public and private entities involved in port activities). Objective : to prepare a programme for modernization of the customs service, with a view to:</p> <ul style="list-style-type: none"> - putting documents and administrative forms in electronic form, - creating a n on-line integrated tariff - Computerization of customs and utilization of EDI <p style="text-align: center;">Working Group on computerization and the migration from applications currently in use to SYDONIA ++</p> <ul style="list-style-type: none"> - Adaptation of the legislative and regulatory framework to COMESA - Computerization and gradual abandoning of paper documents. - Training of customs administration staff with a view to the preparation of an integrated tariff. | <p>Programme for the modernization of customs by the Reform Committee</p> <p>Master plan showing stages in the migration to SYDONIA++ and refinement of applications already developed (movement of goods into customs and into and out of the free zone)</p> <p>Ensure that the information technologies and applications introduced in the customs service are compatible with those of the port information system</p> <p>Institution and collection of an information technology fee</p> <p>Training courses on:</p> <ul style="list-style-type: none"> - taxation of petroleum products (supervision of the Doraleh Terminal), - customs value, - origin, - random inspections, - the functioning of bonded warehouses, - general accounting and auditing <p>Establishment of a salary scale for customs officers that acts as an incentive</p> <p>Reinforcement of customs inspections; Placing Djibouti's integrated tariff on line (web site)</p> <p>Ensure that the integrated tariff is included in the SYDONIA/ASYCUDA++ database.</p> | <p>The Customs Reform Committee should plan for:</p> <p>An increase in the number of staff and material resources of the customs administration (border surveillance and efforts to combat tax fraud and smuggling)</p> <p>Ongoing electronic transfer of data relating to the presentation, clearance and transit of goods loaded or unloaded in Djibouti</p> <p>Modification of laws and regulations to take account of the conversion of documents and forms from paper to electronic form</p> | <p>Technical assistance to help the Reform Committee prepare the plan relating to the conversion to electronic form of documents and the inspection regime, rules for authentication and certification by UNCITRAL.</p> <p>Technical assistance in the introduction of EDI in customs administration: expertise in EDI.</p> <p>Technical assistance in the form of foreign customs experts (3 to 4 experts)</p> <ul style="list-style-type: none"> ● Establishment of special anti-fraud and smuggling units, ● Training of staff from the Indirect Revenue Unit (Customs) ● UNDP, French technical cooperation |

| Type of activity and implementation timeline | | | Lead agencies/potential external support |
|--|----|----|--|
| ST | MT | LT | |

Matrix 2: Budget policy

| | | | |
|--|--|--|---|
| <p>Assessment of the anticipated impact of the move from the domestic consumption tax (TIC) to a combination of the COMESA Common External Tariff (CET) and a value added tax (VAT)</p> <p>Institution of the VAT:</p> <ul style="list-style-type: none"> • implications of the VAT for price movements and consumption/budgets of the poor, • impact of the VAT on the competitiveness of potential exports, • seminars and sensitization of the private sector to the implications of the VAT <p>Audit of public spending with a view to a quantitative and qualitative improvement in social expenditure and redistribution to the poor. Review of spending by the Ministry of Education with a view to strengthening vocational training. Expansion of investment (basic infrastructure) and regularization of national counterpart contributions to project assistance.</p> <p>Technical support for institution-building within the Ministry of Justice.</p> <p>Continue with the elimination of arrears.</p> | <p>Establishment of a Medium-Term Expenditure Framework setting out the objectives of the PRSP and the Millennium Goals (consolidation of the education, health and sanitation budgets)</p> <p>Regularization of public spending on training in conjunction with export sectors and completion of the Doraleh project.</p> <p>Ongoing evaluation of public spending on social sectors and the Ministry of Justice</p> <p>Mid-term assessment of the plan to reduce arrears</p> | | <p>Ministry of Finance Technical assistance from IMF and France</p> <p>Ministry of Finance IMF</p> <p>Ministry of Finance Technical assistance CCD</p> <p>Ministry of Finance IMF, World Bank</p> <p>World Bank</p> <p>Ministry of Finance IMF, World Bank, bilateral and multilateral cooperation</p> <p>Ministry of Finance IMF</p> |
|--|--|--|---|

| Type of activity and implementation timeline | | | Lead agencies/potential external support |
|--|----|----|--|
| ST | MT | LT | |

Matrix 3: Commercial public services and competitiveness

| | | | |
|--|--|--|---|
| | <p>Regularize supply to the rural and urban populations</p> <p>Gradually increase coverage of the population, in accordance with the Millennium Goals</p> <p>Resumption of the policy for the installation and management of water points by the private sector</p> <p>Study of the impact of water prices on budgets/consumption among the poor</p> | | <p>Ministries ??????</p> <p>World Bank, UNDP, bilateral cooperation</p> <p>Ministries ???</p> <p>World Bank</p> <p>Ministries ??????</p> <p>World Bank, UNDP, bilateral cooperation</p> |
| <p>Comparative study of available supply and demand resulting from the growth objectives of the PRSP</p> <p>Identification of alternative sources of energy (wind power, solar energy)</p> <p>Possibility of interconnection with Ethiopia</p> <p>Audit of the management and supply of oil</p> <p>State disengagement in relation to available financing for network expansion</p> <p>Feasibility study on price reductions and recalculation of rates in the current institutional context</p> | | | <p>Ministries ??????</p> <p>Agence française de développement (ADF), USAID, World Bank</p> <p>AFD, USAID, World Bank</p> <p>World Bank</p> <p>Ministry of Telecommunications ??????</p> <p>World Bank, ITU, bilateral cooperation</p> <p>World Bank, UNDP, ITU</p> <p>World Bank, UNDP, ITU</p> |
| | <p>Establishment of a regulatory body and implementation of the privatization programme</p> <p>Increase telephone density, both fixed and mobile</p> <p>Study of the most cost-effective coverage among the rural population</p> | | |

| Type of activity and implementation timeline | | | Lead agencies/potential external support |
|--|----|----|--|
| ST | MT | LT | |

Matrix 4: Institutions for trade and competitiveness

| | | | |
|--|--|--|--|
| <p>Support for the restructuring of CCD Training programmes for newly elected members Analysis of information technology needs (hardware, software, databases)</p> <ul style="list-style-type: none"> - Implementing decree: internal structure, methods of operation. - Clarification of the differences between CCD, CNI, ANPI as a single window (creation of enterprises) - Reassessment of needs and budget allocations for human and material resources | <p>Private sector training</p> <p>Formulation of a multiyear strategy and preparation of annual action plans</p> | | <p>Ministry of Trade, Industry and Handicrafts (MCIA) French cooperation, French Chamber of Commerce, CCI</p> <p>Office of the President of the Republic, Ministry of Presidential Affairs UNCTAD, World Bank, bilateral cooperation</p> |
| <p>Re-evaluation of institutional missions and internal reorganization Establishment of a DTIS unit Promotion and monitoring of international trade flows Training in international trade regulations and familiarization with standards, in conjunction with the relevant ministries</p> | <p>Constitution of a database on Djibouti's international trade and collection of documentation relating to the country's principal exports (salt, livestock, fish) with a needs assessment relating to compliance with international health standards</p> | | <p>UNDP, UNCTAD, CCI, WTO</p> |
| <p>Adoption of the draft Labour Code Study on the possible establishment of a Commercial Tribunal Establishment of a functioning arbitration/mediation mechanism</p> | <p>Simplification of the regimes governing free zones</p> <p>Completion of work on the Commercial Code and adoption of a position regarding OHADA rules</p> | | <p>Office of the President of the Republic, Ministry of Employment and Solidarity Ministry of Justice, CCD ILO</p> <p>Office of the President of the Republic, Ministry of Presidential Affairs Finance IMF/World Bank</p> <p>Ministry of Presidential Affairs, MCIA, CCD CCI, UNCTAD, WTO, World Bank</p> |
| <p>Promulgation of a statute of the judiciary and training Recruitment of new judges Increase budget allocations for the justice system</p> | <p>Ending of the dual system of justice Establishment of a training centre for the legal profession Establishment of a Court of Audit and Budgetary Discipline separate from the Supreme Court</p> | | <p>Office of the President of the Republic, Ministry of Justice World Bank, bilateral cooperation</p> |

| Type of activity and implementation timeline | | | Lead agencies/potential support |
|--|----|----|---------------------------------|
| ST | MT | LT | |

Matrix 5 : Transport

| | | |
|---|--|---|
| <p>Identification of the institutional framework for port activities (bearing in mind regulatory responsibilities)</p> <p>Preparation of the legal text establishing the existence of the port management authority; statute and internal regulations</p> | <p>Preparation and implementation of a plan for the gradual retraining of staff, with social plan</p> <p>Establishment of an independent documentation service (within the port community)</p> | <p>Ministry of Transport (MET) APD</p> <p>PAID/DPI</p> <p>PAID/DPI</p> <p>MET, CCD PAID/DPI, APD</p> |
| <p>Identification of the institutional framework for airport activities (bearing in mind regulatory responsibilities)</p> <p>Preparation of the legal text establishing the existence of the airport management authority; statute and internal regulations</p> <p>Clarification of the conditions for the financing of air-traffic control operations and the operations of the National Weather Service</p> <p>Negotiations aimed at diversifying and expanding air links</p> | <p>Development and implementation of a plan for the gradual retraining of staff, with social plan</p> | <p>MET, legal expert APD</p> <p>PAID/DPI</p> <p>MET State</p> <p>MET PAID/DPI</p> <p>MET PAID/DPI</p> |
| <p>Negotiations (Transit agreement with Ethiopia): (a) for the gradual reduction of protectionist measures giving preference to agents of the Ethiopian shipping company in the handling of transit traffic; (b) with a view to the adoption of the COMESA transit customs regime; (c) to confirm the updating and harmonization of transport legislation in the two countries.</p> <p>Adoption of the necessary measures (chiefly fiscal) to give operators in Djibouti access to the road transport market along the corridor</p> <p>Study of the professional skills required for employment in the Regional Trade Centre (particularly in the future free trade zone) and development of appropriate training</p> | | <p>MET PM</p> <p>MET PM</p> <p>Ministry of Education Jebel Ali Free Zone Authority CCD, APD</p> |

| Type of activity and implementation timeline | | | Lead agencies/potential external support |
|--|----|----|--|
| ST | MT | LT | |

Matrix 6: Salt

| | | | |
|--|---|--|--|
| Study of the conditions for creating loyalty within the Ethiopian market | <p>Study on market diversification</p> <p>Assessment of the impact of regulation and operating licenses and feasibility study on the modernization of technology to enhance competitiveness</p> <p>Export promotion</p> <p>UNICEF/WHO health standards</p> <p>Development of domestic consumption through a diversification of uses (hides and skins, tourism, fisheries)</p> | | <p>MCIA, CCD CCI, UNCTAD, World Bank</p> <p>MCIA, CCD CCI, UNCTAD, World Bank</p> <p>MCIA, CCD CCI, UNCTAD, World Bank</p> |
|--|---|--|--|

| Type of activity and implementation timeline | | | Lead agencies/potential external support |
|--|----|----|--|
| ST | MT | LT | |

Matrix 7: Livestock

| | | | |
|---|---|--|--|
| <p>Strengthening of the capacities of veterinary services and adoption of OIE standards with regard to animal diseases</p> <p>Improvement of the holding conditions for live animals intended for export (livestock holding centre)</p> | <p>Improvement of slaughtering conditions, compliance with international health standards</p> <p>Regularization of herding and promotion of livestock industry in periurban areas</p> | | <p>Ministry of Agriculture, Livestock and Fisheries (MAEM) USAID, European Union, World Bank</p> <p>MAEM USAID, European Union, World Bank</p> <p>MAEM ADB MAEM World Bank</p> |
|---|---|--|--|

| Activity | Type of activity and implementation timeline | | | Lead agencies/potential external support |
|----------|--|----|----|--|
| | ST | MT | LT | |

Matrix 8 : Fisheries

| | | | | |
|--|--|--|--|--|
| Formulation of a strategy for the development and promotion of exports of fishery products, taking account of potential and the promotion of species | | | | CCI/ITC |
| | | <ul style="list-style-type: none"> *Technical support for the Livestock and Fisheries Departments *Laboratory (evaluation of fishery/livestock synergies) *Wholesale fish market *Revision and adaptation of the legislative and environmental framework of the fisheries sector *Development of an operational framework with the Ministry of Health and the Commissariat for Poverty Reduction *Development of a training programme for supervisors and staff in each office | | ADB |
| | | Evaluate the potential for the exploitation of demersal and pelagic species and commercial outlets for them | | CCI, FAO, Japanese cooperation, E |
| Development of training programmes for heads of enterprises, supervisors and production staff (international market prospects, international sanitary and health standards, and product promotion) | | <ul style="list-style-type: none"> Study for the development of artisanal deep-sea fishing and the use of a mother ship *Study on the establishment of a semi-industrial fleet (small craft with high-powered motors and a mother ship) *Development of a training programme for fishermen Feasibility study on the establishment of an all-purpose processing plant and export facility for Djibouti's marine resources *Study of interest in building such a plant | | CCI, ADB/FAO, French cooperation, European Union |
| *Campaigns to encourage fish consumption and increase general dietary intake of animal protein | | | | Cooperation with Japan, France and |
| | | | | FAO, ADB |

| Type of activity and implementation timeline | | | Lead agencies/potential external support |
|--|----|----|--|
| ST | MT | LT | |

Matrix 9: Tourism

| | | | |
|---|--|--|--|
| <p>Rehabilitate tourist sites Strengthen vocational training Develop a strategic commercial vision</p> <p>*Elimination of impediments *Clean-up of beaches * "Pavillon Bleu" *Study of a scheme for training in the tourist and hotel management industry *Preparation of a 3-year commercial plan of action (PAC)</p> <p>*Organization of a national meeting on tourism and inventory of experiences in the area of solidarity tourism</p> | <p>Carry out technology transfers with a view to marketing local products more effectively (packaging)</p> | | <p>Technical assistance from the World Bank, NGOs, European Union cooperation</p> <p>UNCTAD and the World Tourism Organization</p> <p>Ministry of Tourism, Ministry of Trade, Industry and Handicrafts, WTO and the private sector</p> |
|---|--|--|--|

| Type of activity and implementation timeline | | | Lead agencies/potential external support |
|--|----|----|--|
| ST | MT | LT | |

Matrix 10: Financing of the economy

| | | |
|---|---|--|
| <p>Improvement of the legal environment: acceleration of procedures</p> <p>Technical assistance for the development of:</p> <ul style="list-style-type: none"> - Marketing (“demand-driven” approach), with a view to reaching different niche markets and ensure wide geographic coverage of credit applicants - Analysis of project follow-up (preliminary design of a guarantee fund) - Estimation of the cost of credit - Review of the institutional structure and functioning and governance in respect of loans (Board of Directors, customer participation on FDED Board, internal audit with report to Board) - Establish an organizational chart for governance in accordance with mission - Develop capacities for the preparation of growth plans (estimation of targeted demand and alignment with funds to be mobilized, recruitment) <p>Technical assistance for:</p> <ul style="list-style-type: none"> - Organization of special training workshops (cf. CGAP courses), - Study tours and exchanges of experience - Development of an appropriate electronic reporting system - Identify an optimal legal framework: an opportunity to make NGOs into “mutual savings and loans”? or existing forms of NGO supervision? Creation of a federation? - Individual loans for certain groups - Other financial services (micro-savings, micro-insurance, housing loans ...) | <p>Binding force of judicial decisions Promote the use of guarantees in granting credit</p> <p>Incentives (e.g. tax measures) for the introduction of certification and auditing procedures Adaptation of the legal framework to permit innovation/introduction of financial instruments (leasing, negotiable instruments, government bonds...)</p> | <p>Ministry of Justice, Ministry of Handicrafts, Ministry of Bank, commercial banks</p> <p>Ministry of Finance, Central France</p> <p>FDED, Central Bank, development (AFD, etc.)</p> <p>Central Bank, bilateral cooperation NGOs</p> <p>SDF, Central Bank, bilateral international NGOs</p> |
|---|---|--|

Table summarizing priority actions by major areas of reform

Activities to be implemented as soon as possible are underlined and in bold

| Sector | Priority actions | Implications of reforms | | | |
|-----------------------------------|---|---|---|---|--|
| | | Integration | Competitiveness | Growth | Poverty reduction |
| Customs reform | <u>Reform Committee</u> | Facilitation of regional trade | Efficiency of des procedures and attractiveness of the port | Increase trade flows | Job creation |
| | Computerization | | | | |
| Budgetary policy | Audit of public expenditure | | -Reduce labour costs by improving potential productivity (education, health) -Enhance the functioning of the system of justice and lower transactional costs -Development of infrastructure | New activities | Ease of integration in the labour market Labour-intensive programme |
| | <u>Study of the impact of the CET and the VAT</u> | Regional agreement | Advantages of forming a customs union | Evaluation of the risks and opportunities for international trade | Redistribution implications of the CET and the VAT on consumption |
| | Elimination of arrears | | Lower additional costs and prices | Macroeconomic stability and private sector development | Impact on wages and social redistribution |
| Commercial public services | <u>Study of institutional modalities of privatization of the electric and telecommunications companies</u> | Opportunity for linkage with Ethiopia (electricity) Prospects for a telecommunications "hub" in Djibouti | Lower energy costs by expanding sources of supply Quality of service Market transparency as a factor in cost reduction | Investment and expansion of the range of profitable goods | Reduce cost and facilitate access to services |
| Institutions | <u>Support for capacity-building in MCIA (foreign trade and handicrafts departments)</u> | Better understanding of the regional environment for movements of national goods | -Advising and information concerning the productive system -Improvement of coordination with CCD | Identification of foreign market outlets | Development of employment in the services and handicrafts sectors |

| Sector | Priority actions | Implications of reforms | | | |
|---|---|---|--|--|--|
| | | Integration | Competitiveness | Growth | Poverty reduction |
| Institutions <i>(continued)</i> | <u>Incentives for creation of enterprises</u> | | Reduce transaction costs | Expand the range of marketable goods produced | Effects of the creation of new activities |
| | Simplification of free zone regimes | Harmonization of free zone regimes | | | |
| | Make ANPI operational Finalization of new Labour Code | | Single window for formalities Contract and wage flexibility | | |
| Transport and port activities | <u>Study of prospects for the Doraleh project</u> | Evaluation of regional and multilateral trade integration | Conditions for success: cost and factor availability | Investment in infrastructure and expansion of production | Skilled and unskilled jobs |
| | Establishment of an office to regulate multimodal transport (Ministry of Transport) | Regional trade flows Development of a regional transport hub | Reduce costs by improving coordination of transport modes | Development of road transport through synergy with other modes | Jobs requiring different levels of training |
| Salt | <u>Conditions for the development of salt and export prospects</u> | Creation of integration and regional export flows | -Product quality -Health standards -Factor costs | International trade and land use planning | Poverty reduction through employment in the handicrafts sector |
| Livestock | <u>Livestock intake capacity and improvement of veterinary services</u> | Creation of integration and regional export flows | -Product quality -Health standards -Factor costs | Resumption of transit activities | Creation of direct and indirect employment |
| Fisheries | <u>Analysis of fisheries potential</u> | Export flows to Asia and COMESA countries | Influence of resource prices and distribution logistics (location et export) | Sustainable development on the basis of new activities | Employment and improvement of the diet of poor people |
| Tourism | <u>Tourism development strategy</u> | Prospects for integrated regional tourism | Identification of solutions to problems of factor costs and limited hotel capacity | Evaluation of the demand for recreational and business tourism | Development of direct and indirect employment (local artisans) |

| | | | | | |
|----------------|--|--|---|---|--|
| Finance | Evaluation of involvement of various economic financing mechanisms | Development of trade with neighbouring countries | Lower capital costs by reducing transaction costs | Stimulate activities within the country | Expansion of process for participation in local activities |
|----------------|--|--|---|---|--|