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**INTERNATIONAL DEVELOPMENT ASSOCIATION**

**COUNTRY ASSISTANCE STRATEGY**

**FOR**

**THE REPUBLIC OF DJIBOUTI**

**March 1, 2005**

**Djibouti Country Management Unit  
Middle East and North Africa Region**

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The date of the last Country Assistance Strategy was December 19, 2000

### CURRENCY AND EQUIVALENTS

Unit of Currency = Djibouti Francs (DF)  
US\$1 = 177.7 DF (Exchange Rate Fixed as of February 28, 2005)

### FISCAL YEAR

January 1 – December 31

### ABBREVIATIONS AND ACRONYMS

AAA	Analytical and Advisory Activity	HIV	Human Immune-Deficiency Virus
ADETIP	Social Fund and Public Works Project	IMF	International Monetary Fund
AFD	French Development Agency	JSA	Joint Staff Assessment
AfDB	African Development Bank	MDG	Millennium Development Goal
AIDS	Acquired Immune-Deficiency Syndrome	M & E	Monitoring and Evaluation
ACP	African, Caribbean and Pacific countries	MTEF	Medium-Term Expenditure Framework
AU	African Union (previously the Organization of African Unity- OAU)	OED	Operations Evaluation Department
BDMO	Banque de Djibouti et du Moyen Orient	ONED	Office National des Eaux de Djibouti
CAE	Country Assistance Evaluation	PER	Public Expenditure Review
CAS	Country Assistance Strategy	PESW	Programmatic Economic and Sector Work
CFAA	Country Financial Accountability Assessment	PIP	Public Investment Program
CPAR	Country Procurement Assessment Review	PPI	Private Participation in Infrastructure
CPPR	Country Portfolio Performance Review	PPIAF	Public-Private Infrastructure Advisory Facility
EC	European Commission	PSD	Private Sector Development
EDD	Djibouti Electricity Authority	PAID	Port Autonome International de Djibouti
EU	European Union	PRGF	Poverty Reduction and Growth Facility
FCC	Fiscal Consolidation Credit	PRSP	Poverty Reduction Strategy Paper
FDI	Foreign Direct Investment	QAG	Quality Assurance Group
FGM	Female Genital Mutilation	REER	Real effective exchange rate
GEF	Global Environment Facility	ROSC	Report on the Observance of Standards & Codes
GER	Gross enrolment ratio	SNIFD	National Strategy for the Integration of Women in Development
GoD	Government of Djibouti	WBI	World Bank Institute

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## **MAP OF DJIBOUTI (#29358)**

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## EXECUTIVE SUMMARY

- i. *During the late 1980s and most of the 1990s, domestic and regional military strife led to deep macroeconomic imbalances and weakened economic activity in Djibouti.* A prolonged civil war disrupted vital economic sectors and imposed a heavy cost on the budget. War in neighboring countries led to a large influx of refugees, putting an extra burden on already stretched public services. Fiscal mismanagement and waning donor support compounded the impact of these shocks leading to a build-up of Government arrears of some 30 percent of GDP by 2000. The Currency Board Arrangement limited the possibility of the use of monetary instruments in macroeconomic management. GDP growth averaged less than one percent during this period, compared with an average population growth rate of 2.8 percent per annum further deepening poverty.
- ii. *During the past four years—the period of the last CAS—good progress was made in addressing many of these problems.* Supported by an IDA Fiscal Consolidation Credit (FCC), and an IMF Poverty Reduction and Growth Facility (PRGF), fiscal and structural reform measures succeeded in halting the deteriorating macroeconomic situation and reversing the build up of domestic arrears. These measures included civil service downsizing, a far-reaching pension reform that placed the system on a much stronger footing, improved management of the port and airport facilities by entrusting it to a private international investor, and strengthening of public expenditure institutions.
- iii. *However, this improved macro economic stability, while critical, is not sufficient to deal with the deep structural problems of poverty and income distribution and take the country out of the trap of low social and economic equilibrium.* Despite its high per capita income (US\$920 in 2004) that places it in the ranks of low middle-income countries, Djibouti has an extremely high incidence of poverty (42 percent absolute and 75 percent relative poverty rates), and a very low level of human development as indicated, among others, by one of the lowest school enrollment and highest mortality rates in the world. At the same time, high wage rates in the formal sector create serious problems of non-competitiveness and skewed income distribution. All these factors have contributed to low growth and employment creation and would, in the future, continue to limit the possibility for Djiboutians to benefit from employment opportunities that would be generated from the envisaged extension of the port and the development of an associated free trade zone.
- iv. *Djibouti's Poverty Reduction Strategy Paper (PRSP), presented to the Board on June 8, 2004, identifies an ambitious four-pronged strategy.* The strategy aims at: (i) strengthening competitiveness for higher and sustainable growth by persevering with overall macroeconomic stability, while accelerating structural reforms to create a better investment climate for private investment; (ii) accelerating human development through improved school enrollment and quality of education, strengthening the health care system, broadening the social safety net; and implementing the national gender strategy; (iii) promoting regional and local development to reach out to poor urban neighborhoods, nomads, and isolated rural communities; and (iv) improving governance and public sector management through greater transparency and accountability.
- v. *The planned CAS for the period FY06-08 is broadly aligned with the main pillars of the PRSP, building on the achievements of the previous CAS, which has also focused on the same areas.* Solid performance has been achieved under the previous CAS, marking a clear departure from the past: all programs were, or are expected to be, completed on or ahead of time;

portfolio performance improved dramatically meeting all portfolio performance targets; and every project is expected to meet its developmental objectives. The planned IDA program would support the pillars of PRSP through lending and non-lending services. The competitiveness pillar will be supported through: (i) a power and water sector project to lower utilities' cost and extend service delivery to the poor, and (ii) a partial risk guarantee to the concession of the rail link to Ethiopia in support of the port to complement the previous road corridor project. Support to the human development pillar will consist of: (i) a second education project (APL), following on a first successful project; (ii) a skills development and employment creation project, and (iii) an emergency floods rehabilitation project. Support to the governance pillar focuses on providing assistance through IDF grants to the implementation of the action program and recommendations of the Country Financial Accountability Assessment (CFAA) and Country Procurement Assessment Review (CPAR).

vi. *This CAS argues for a more active income/rent distribution policy (more so than the PRSP) as a critical policy reform area to reduce poverty, because Djibouti's skewed income distribution impedes the trickle down of the benefits of growth to the poor, and because, in the case of a rent-based economy like Djibouti, it will continue to act as a major constraint to growth itself.* Djibouti is essentially a rent-based economy, with rents deriving from its geographical and geopolitical position contributing a much larger share of GDP than agriculture and industry. At present, most of the rent (revenues from the port, rent of military bases, and grants and assistance), essentially channeled through the budget, is captured by the civil service in the form of high public wages (the average public wage is 9-10 times GDP per capita). This deprives the majority of the population from benefiting from public services, such as education and health, because the excessive size of the public wage bill (50 percent of the budget) leaves no room for improving service delivery beyond its very low level. In addition to crowding out social expenditures and investment in human capital, the oversized wage bill crowds out investment in physical infrastructure that further drives up the cost of doing business. The fixed exchange rate policy emanating from the Currency Board Arrangements, keeps real wages high as it shelters it from any adjustment through general price increase. Taken together, these factors impede growth and employment and, in turn, hurt the poor.

vii. *With rents associated with the port and the military bases, and foreign aid expected to continue to be the major drivers of Government revenues and GDP, the only policy option available to the Government in the short run to improve poverty and income distribution is to find ways to reduce public sector wage expenditures and redistribute these towards social and infrastructure expenditures.* This can be achieved through the combination of an adjustment in the exchange rate, an explicit reduction in wages, and a restructuring of the size and composition of the civil service. The CAS proposes to intensify the policy dialogue with the authorities to delineate the most appropriate and feasible reform policy venue to address wage level misalignment. It reserves financial support to this reform under a high-case scenario which would be triggered by the Government's willingness to undertake this reform.

viii. *The planned assistance strategy entails risks.* Sustained macroeconomic stability depends heavily on the steady flow of Government revenues from the port and military bases rental, and more critically, on the implementation of an adjustment of the wage bill and exchange rate to address Djibouti's skewed income distribution and competitiveness problems. The first is linked to unpredictable development in the regional security situation, and the second on the political will of the authorities to move ahead with reforms. While the new foreign direct investment in the port extension and the renewed rental of military bases may mitigate the first

risk, the difficult political economy of implementing an exchange rate and wage bill adjustment sheds uncertainty around an effective way out of the low equilibrium situation. Risks related to the implementation capacity also exist, but experience from the last CAS shows that well-focused projects with simple design and close and proactive supervision from the Sana'a Office will help minimize significantly this risk.

ix. ***The following issues are suggested for Board consideration:***

- Alignment of the CAS program to the PRSP and focus of the CAS program given the limited IDA envelope.
- Emphasis on income distribution and appropriateness of the CAS proposed policy instruments to address it.



## I. COUNTRY CONTEXT

### A. GENERAL CONTEXT

1.1 ***Djibouti is a small and poorly endowed country with a service-based economy.*** It has an estimated population of 660,000, two-thirds of whom live in the capital city Djibouti-Ville. Most of the remaining population lives in a handful of secondary towns. The natural rate of population growth is estimated at 2.4 percent per annum. Djibouti is poorly endowed in natural resources (limited arable land, rainfall and underground water). However, the country benefits mainly from its strategic military and international shipping location on the Red Sea's southern entrance.

1.2 ***Djibouti's economy is mainly a rent economy.*** It is based on revenues and rents generated directly and indirectly from the activities of the port (managed by Dubai Ports International since 2001) as well as related business. It also relies on the rental of military bases to France since independence in 1977, and most recently to the US and Germany, including services associated to these bases. External support by Djibouti's partners through grants and other financing facilities is also an important source. This is reflected in the large share of the service sector in the economy, which accounts for 77 percent of GDP. The primary sector accounts for only 3 percent and the secondary for 20 percent<sup>1</sup>.

#### Box 1: Historical Background

France established the port of Djibouti in 1892 as a coaling station for ships traveling to its possessions in the Indian Ocean and Far East. Four years later, Djibouti became a French territory. In 1977, after 80 years of colonial rule, Djibouti gained independence from France. At the time of independence, an agreement between France and Djibouti provided for a French military presence and development assistance, including sizable budgetary support.

1.3 ***With a per capita income of US\$920, Djibouti is classified as a low middle-income country. Yet, it has a very high level of poverty (42% absolute and 75% relative) and some of the poorest social indicators in the world.*** This paradox is explained essentially by the fact that while a large part of the economy is based on rents (derived from the port, military bases rental and donors financial support), and channeled mainly through the budget, a significant part of this rent is passed on to Government employees through high wages, leaving insufficient resources for social expenditures, social transfers and public investment. Because of the marginal contribution of the primary and secondary sectors in the process of production, Government expenditure policy is the primary instrument available for achieving income re-distribution in the short- to medium-term. Achieving a better income distribution must be at the heart of the Government's poverty reduction strategy, given the prevailing degree of poverty and low level of human capital development in Djibouti. This implies a need for difficult policy actions if the Government wishes to pursue a pro-poor agenda. The issue is discussed further in Section III.

### B. POLITICAL AND INTERNATIONAL RELATIONS CONTEXT

1.4 ***A key determinant of Djibouti's domestic political context and developments is the power balance interplay between its ethnicities.*** Djibouti's population is composed mainly of two ethnic groups, the Afars and the Issas. The Issas extend into Somalia and the Afars also extend into Ethiopia and Eritrea. Competition for power among these ethnic groups led to a very

<sup>1</sup> Of which only 2.5 percent is manufacturing and the rest is for construction and public works, and water and electricity.

damaging civil war in 1991-94. This civil war triggered huge disruptions and macroeconomic instability from which the country has yet to fully recover. The strong ethnic linkage of Djibouti to its volatile and conflict-prone neighbors—Somalia, Ethiopia and Eritrea, is a source of vulnerability and risk, e.g., leading to refugees flows, deterring foreign investment, and affecting overall internal political stability. The pressure on the country's leadership and decision-making process not to upset the precarious balance between these interests, under the current volatile regional circumstances, diminishes its ability to take critical economic and social reform decisions, precisely when they are most needed.

**1.5 Djibouti's political system remains, however, relatively open, with an elected president, a Parliament and a judiciary.** The executive reflects a sharing of power between the two major ethnic groups with higher representation of the Issas in the Government, civil service, and the ruling party. This power sharing is subject to sporadic resentments (and challenges) by the Afars. Widely acclaimed reforms toward a more meritocracy-based access to civil service and public sector jobs were undertaken by the current President. The next presidential elections are scheduled for April 2005. The opposition has limited influence and representation in Parliament as a result of the winner-take-all electoral system. The President's dominant coalition party, *Union pour la majorité présidentielle*, is expected to remain in power for the foreseeable future.

**1.6 Djibouti's international relations and partnerships strengthened in the last 3 years and are expected to deepen during the CAS period.** In addition to Djibouti's strong historical partnership with France, relations with the United States deepened following the increased U.S. military presence in the region and the establishment of a U.S. military base in Djibouti. Both have resulted in improved external flows in the form of rent (for bases) and aid. However, this also creates the risk of taking the pressure off the much-needed reforms, a possibility that the Government and the donors should guard against.

**1.7 Commercial relations with Ethiopia (currently capturing more than 60 percent of the Djibouti's port traffic) have become easier.** This followed the signature in April 2003 of an agreement with Ethiopia governing the use of the port and the transit of goods to and from Ethiopia. This lowers the risk of Ethiopia traffic going to other ports.

**1.8 Djibouti's trade system is fully open with no protective tariffs and non-tariff barriers.** Capital movement is free, which has yielded a very high level of openness. As such, Djibouti has been a regional center for trade and financial services and could build further on this and on its prospective port development to further strengthen its position.

**1.9 Djibouti has recently adopted anti-money laundering legislation but it lacks implementation capacity.** Djibouti has not undergone a Financial Sector Assessment Program or Anti-Money Laundering (AML) assessment. Djibouti's fully open trading system and free capital movement make the development of an effective AML system a necessity to prevent potential abuse that might undermine the country's openness.

## C. SOCIAL CONTEXT

**1.10 Djibouti's social indicators rank 157th among 174 countries on the UNDP's Human Development Index.** Despite recent progress in expanding access, Djibouti's education system is still not on track to meet the Millennium Development Goals (MDGs). Illiteracy is extremely high, especially for women (85 percent). *About 50 percent of children still do not attend*

***school, and more than 20 percent of those enrolled do not complete the six years of primary education.*** There are also large inequalities in access to education services: enrollment varies widely across income levels, gender, and regions. Moreover, the system is very costly due to the high unit costs for school construction and teacher salaries. Unfortunately, despite the enormous needs, the budget does not have much room for additional expenditures since education expenditure already accounts for close to 27 percent of Djibouti's large budget size of 30 percent of GDP. These constraints render the achievements of the MDGs nearly impossible (see Table 1, on cost of achieving education goals).

1.11 ***The health situation is also very difficult.*** Life expectancy, as an overall health indicator, is estimated at 49 years, one of the shortest in the world. Infant mortality is at 103 per 1,000. The immunization rate is only 45 percent, and malnutrition is a serious problem, with indications that 14 percent of children under the age of five suffer from acute malnutrition, and 31 percent from chronic malnutrition. Diarrheic illnesses and acute respiratory infections are the most common causes of infant mortality. Maternal mortality rate is high at about 7 per 1,000 live births and for extremely poor women this rate is as high as 9 percent.

1.12 ***Wide gender gap and Female Genital Mutilation (FGM) are major social developmental challenges.*** Women represent a very vulnerable segment of the population. The disadvantaged status of women is reflected in the gender gap indicators in all social areas as indicated above. High female mortality rates can be attributed to high fertility rates, anemia caused by malnutrition, which are in turn exacerbated by the widespread practice of female circumcision. Ninety-five percent of young girls between 6 and 9 years of age have undergone FGM. Infibulations, the most severe and harmful form of FGM, are the most widely practiced. They are known to cause serious lifelong negative physical and psychological impacts. This also increases their vulnerability to HIV/AIDS infection.

1.13 ***A law prohibiting the practice of FGM was adopted in 1995, but has proved difficult to enforce because of the private nature of the procedure.*** The National Strategy for the Integration of Women in Development (SNIFD), adopted by the new Ministry of Women Affairs in 2002, includes the fight against this practice as one of its pillars. There have also been several recently organized workshops and awareness campaigns involving religious leaders, local and international NGOs, UN agencies, and Government officials to help stop the practice.

1.14 ***The Qat Problem is not adequately addressed.*** Considerable time and resources are devoted to chewing *qat*, an amphetamine-based stimulant grown mainly in Ethiopia and Yemen. Most adult males in Djibouti chew *Qat* at all-male social gatherings for up to 5-6 hours a day, taking time from work and family life, diverting the limited incomes of poor people from basic needs spending, and adversely affecting their labor productivity and struggle for improving their well being. While precise figures are not available, it is estimated that *Qat* absorbs up to 30 percent of family budgets. Even the poorest families spend a considerable share of their budget on *Qat*. Official import figures show that about 4,000 tons of *Qat*, valued at DF3.00 billion (\$12 million), were imported yearly, making it the highest value of all import items. Long-term use of *Qat* has been shown in other countries to be associated with mouth cancer and other health problems, including child malnutrition and mortality. While the issue was debated during the PRSP preparation process, it was ultimately not reflected in the actual PRSP. Unfortunately, there seems to be neither the consensus nor the commitment from the leadership to recognize and deal with this issue.

## II. POVERTY AND INCOME DISTRIBUTION—THE PARADOX OF HIGH INCOME PER CAPITA AND HIGH AND INCREASING POVERTY

2.1 ***Recent data<sup>2</sup> show that poverty in Djibouti is both extremely high and on the rise.*** In 2002, about three-fourths (74.4 percent) of the population lived under relative poverty line and 42.2 percent under extreme poverty, as compared to 64.9 percent and 34.5 percent, respectively, in 1996. Surveys show that the most dramatic poverty incidence is in rural areas, where 83 percent lives in extreme poverty. However, Djibouti-Ville shelters the largest number of poor people and contributes by itself—65 percent and 57 percent—to relative and extreme poverty, respectively. The EDAM IS study indicates that the incidence of relative and extreme poverty is the strongest among households whose heads are unemployed. Unemployment, which is estimated at 60 percent, contributes about 65 percent to extreme poverty. What explains the apparent paradox of a relatively high GNI per capita of about US\$920, which places Djibouti at close to middle income countries, and its high and increasing poverty rate that places it among the poorest? *The main explanation of such a paradox lies in the sensitivity of poverty to income distribution and on Djibouti's budget structure which is biased against the poor.*

2.2 ***One of the strongest results of the two poverty studies is the sensitive linkage between poverty incidence and income distribution.*** The 20 percent upper income household has an average expenditure eight times higher than the lower quintile. For low poverty lines, the studies note that *poverty is more sensitive to changes in expenditure inequality than to changes in mean expenditures.* If the Gini Index of expenditure distribution increases by 1 percent, *ceteris paribus*, the extreme poverty index is estimated to increase between 1 to 4.2 percent<sup>3</sup>. *The poor are more affected by changes in expenditure inequality than by changes in mean expenditure.* This implies that an economic growth that is accompanied by increased inequality has the potential to be an “immiserating” growth. This highlights the critical importance of an active income redistribution policy that *should accompany, if not even precede* growth, in order for Djibouti’s poverty reduction strategy to be effective. To reduce extreme poverty to the PRSP goal of 19.3 percent in 2015, the PRSP itself underlines the need for “an annual real growth rate of GDP per capita of 2.5 percent in 2005-10 and of 3.5 percent in 2010-15, [combined with] a regular reduction of inequalities of 2 percent per year.” Given the uncertain growth prospects that are heavily dependent of external factors, re-distribution must be an important part of short-term agenda of poverty reduction.

2.3 ***Labor market distortion, high public sector and civil service wages, and the size of the Government’s wage bill explain a great deal of the poverty and income distribution problem in Djibouti.*** Poverty is strongly related to unemployment in Djibouti. Unemployment has reached 60 percent up from 44 percent in 1996, and has a high incidence among the poor (66 percent), and the extremely poor (72 percent). Djibouti has a dual labor market with about 70 percent of the employed in the formal sector. Fifty-five percent of those employed in the formal sector are civil servants. While unemployment is at 60 percent, the average wage in the formal sector in Djibouti remains very high. The persistence of this paradox is largely explained by the high

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<sup>2</sup> The knowledge base on poverty stems primarily from EDAM IS studies of 1996 and its 2002. Poverty information and the statistical system in general suffer from severe shortcoming, the least of which is the absence of a recent and reliable population census on to which surveys can be anchored.

<sup>3</sup> One percent as estimated by the 2002 survey and 4.2 percent was the estimate of the 1996 survey.

wage level of civil service and public enterprises, which averages about \$8,000, or 9 times the GNI per capita.

**2.4 High Government wages impact negatively on the poor by expanding the size of the public wage bill and crowding out other Government spending on basic services and direct transfers to the poor.** Djibouti has, indeed, one of the largest wage bills among its comparators, in particular when considering the low service delivery level. It constitutes about 15 percent of GDP, 60 percent of total fiscal revenues, and half of budget expenditures<sup>4</sup>. Considering the very low base in education and health service coverage and the increasing population, reaching the MDGs will require intensive hiring of teachers and nurses. There are few options to meet this new hiring—through wage cuts under the same relative size of the wage bill, being direct cuts in nominal wages; or through devaluation of the exchange rate<sup>5</sup>, or through a combination of a civil service reform involving reduction in other categories of civil service employees and wage level reduction. As an example, Table 1 illustrates, for the education sector, the adjustment needed in average wages in the sector to make up for the financing gap implied by a scenario of full school enrollment required by MDGs. The financing gap corresponds to a reduction of the wage level by about half, which could be an indication of the overall overvaluation of the wage level and prices in general.

**Table 1: Primary Completion Rate Target: Financing Gap under Alternative Scenarios**

	Quality Measures			Efficiency Measures	Financing Measures			Annual Financing Gap c/ (DF million)
	Student Teacher Ratio	Non-teacher Salary Spending a/	Average Teacher Salary (in per capita GDP unit)		Repetition Rate	Government Budget % For Education	Primary Education Recurrent Spending b/	
Baseline (full access)	30%	15.7%	8.2	11.8%	26.6%	37.6%	15	2411
Wage Change required for full access, everything else being equal.	--	--	3.7	--	--	--	--	0

a/ As a percentage of total recurrent spending on primary education.

b/ As a percentage of total recurrent education spending.

c/ Refers to the difference between total cost of service delivery and the resources domestically mobilized.

Source: Bank Staff calculation.

**2.5 The political economy of such a reform is obviously difficult as it runs against the immediate interest of the public sector elite itself.** But inaction also has a high cost that Djibouti policy makers need to consider seriously.

<sup>4</sup> The high level and structure of civil pay has been inherited from the French colonial administration and has little changed since. By virtue of Djibouti's Currency Board system (the nominal exchange rate has not changed since 1971, inflation is only about 2 percent, which does little to adjust down the real wages as in other developing countries).

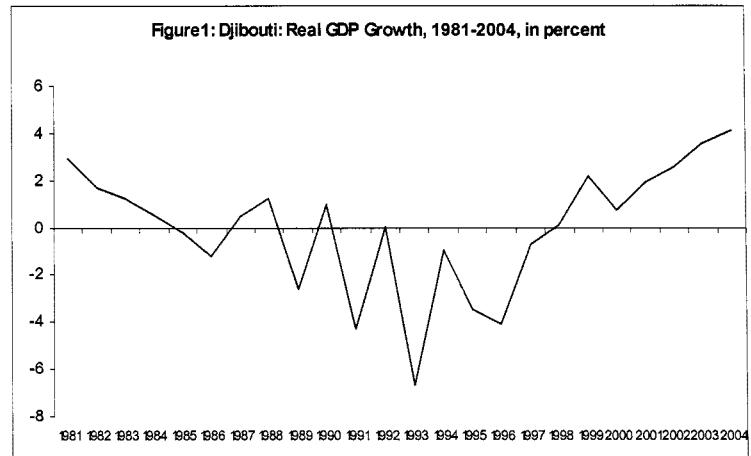
<sup>5</sup> Since most of the Government revenues are in dollars or indexed to it and, a part from wages, most of other expenditures are essentially imported are in foreign currency, a devaluation would reduce the relative size of the wage bill in the budget opening space for more hiring of needed education and health specialists and other social spending.

2.6 In addition to crowding out social expenditures, *the oversized wage bill crowds out investment in infrastructure that could directly and indirectly benefit the poor through employment and growth.* High public wages and salaries also *negatively affect the overall competitiveness of the economy and hinder growth.* Redistribution in Djibouti needs to go hand in hand, if not precede, growth.

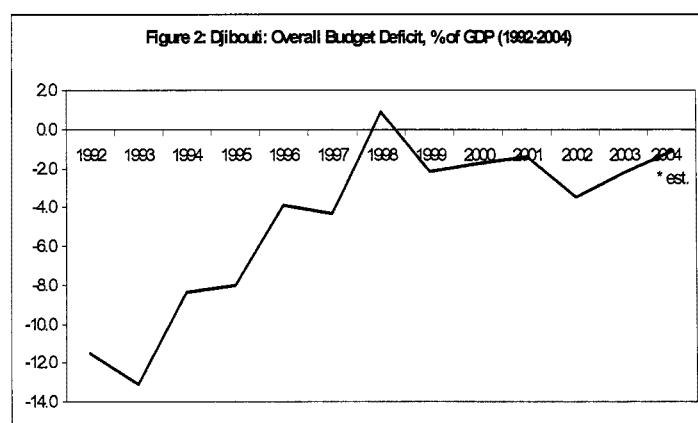
2.7 *In the past, the inflexibility of wages and attendant wage bill have led to major structural fiscal imbalances, and the continuous avoidance of addressing the problem upfront has only shifted its effects to increase in other prices and further accumulation of arrears.* A growing population and higher needs for public service have exacerbated the fiscal situation over the years. Given Djibouti's currency board system, which excludes money creation to finance budget deficit, financing these deficits was generally accommodated through accumulation of arrears, and/or an increase in taxes and surtaxes, reflected in higher prices, especially on services and service inputs, such as electricity, water, and petroleum products (surtaxes have, for example, reached about 30 percent of the price of electricity), further hindering the country's competitiveness (see Box 4 on Competitiveness Indicators).

### III. MACROECONOMIC DEVELOPMENTS AND STRUCTURAL POLICIES

3.1 *Djibouti's economy is slowly recovering from a deep recession and persistent macro instability that characterized the late 1980s and most of the 1990s, a long period marred by severe internal and external shocks, mismanagement of public finances, and distrust from the donor community.* These shocks included a civil war involving large recruitment into the regular army, whose size jumped from 4,000 to 16,000 in 1992 alone; large inflow of refugees from Somalia and other, neighboring countries in conflict estimated at 120,000 in 1996 (about 20 percent of the population at the time) increasing strain on public service delivery; and sharp decline in external assistance.



3.2 *Since Djibouti gained independence in 1977, it maintained a large Government sector financed by the rents from the port, the rent for France's military base and donors' assistance.* Civil servants continued to be paid high real wages, because the high nominal wages inherited from the French administration were protected from inflation by Djibouti's Currency Board Arrangement (CBA). There was good economic growth period



between 1978 and 1984 (with an average 4.2 percent growth per annum). This was boosted by large public investments financed by generous external grants. But it was not sustainable for long and the economy subsequently entered into a long recession with less than one percent annual GDP growth in the face of an average population growth of 2.8 percent per annum. The fiscal situation deteriorated markedly during the civil war, and the ensuing large recruitment of military personnel which further increased the size of the wage bill by some 6 percent of GDP to reach 24 percent of GDP by 1993. As a result, the overall fiscal deficit increased to 8.1 percent of GDP in 1994. This increased number of civil servants under high public wages is the most challenging developmental problem that Djibouti has to solve before progress can materialize.

**3.3 Because of the currency Board limitations on financing the large deficits through monetary creation, fiscal deficits were ultimately “financed” by the accumulation of domestic arrears on payments of wages, pension funds contribution, and to private sector and public entities.** This, in turn, led to a loss of credibility of the state and an escalation in the use of ad hoc procedures, such as uncontrolled advanced payments, that often circumvented the normal accounting and control system. Moreover, such procedures reduced transparency and accountability, contributing to further overruns and distrust from Djibouti’s development partners with decrease in grants and external financing.

**3.4 To address the destabilized and deteriorating economic situation, the Government started an adjustment program in 1996,** supported, first, by an IMF Stand-By Arrangement (SBA) during 1996-1998. A temporary restoration of fiscal balances was achieved through large cuts in public expenditures and a first wave of military demobilization. But this was not sustained as the budget position deteriorated again in 1999, and domestic arrears increased again to reach more than 27 percent of GDP. Growth rate was also slow at 1.5 percent in spite of the diversion of all Ethiopian transit trade from Eritrea ports to the port of Djibouti.

**3.5 To enhance the stabilization effort, only partially successful under the SBA, the Government initiated a medium-term structural adjustment program (1999-2002)** supported by an IMF Poverty Reduction and Growth Facility (PRGF). The Government requested IDA’s support to its adjustment program. This was provided through the Fiscal Consolidation Credit in 2001 with satisfactory results.

**3.6 The Fiscal Consolidation Credit focused on a core of interrelated fiscal consolidation actions to restore financial and budgetary discipline; contain and reduce the wage bill; improve expenditure management systems; and strengthen financial management of the key public enterprises, and initiate a process leading to the liberalization and privatization of selected infrastructure sectors.** Notwithstanding limitations of this fiscal consolidation program, in particular the deliberate delay in sequencing the core issue of high wage level and wage bill, tangible progress was achieved. This included:

- Halting the build-up of domestic payment arrears, and beginning an orderly process for clearing them. An audit was carried out that enabled the Government to validate an overall stock of domestic arrears payments of DF29 billion or 27 percent of GDP. A ten-year prioritized settlement plan was defined and adopted by the Government and is being implemented on an accelerated basis for wages and on a timely basis for the rest.

- On pension system reform, implementing a strong parametric reform to improve the viability of the existing pay-as-you-go (PAYG) pension system bringing it much closer to sustainability (Box 2).
- On civil service, close to 800 civil service employees eligible for retirement were removed from the payroll and Government contributions to the pension funds have been paid on a regular basis. In preparation for addressing the wage bill and better managing the civil service, the authorities implemented an action plan to merge the civil service and payroll databases on the basis of a census of employees, ministry by ministry.

- On the reform of the public enterprises, management of the Port and Airport was entrusted through a long-term management contract to an international investor (Dubai Port International). Independent financial and organizational audits were completed in 2003 for all public companies. On the basis of these financial and organizational audits, the Government has undertaken the restructuring of Djibouti. Telecom and a national strategy and action plan for the regulation and liberalization of the information and communication sectors were adopted by the Parliament.
- There has also been progress in implementing other institutional reforms to strengthen public finance institutions and reduce the scope for mismanagement. The recently completed Country Financial Accountability Assessment (CFAA) and Country Procurement Assessment Review (CPAR) highlighted the improvement in the legal framework and the achievement of satisfactory level of external control by the newly created Chamber of Accounts. There has been improvement in the debt management system, supported by an Institutional Development Fund (IDF) grant. Achievements in institutional management of public finances build on good progress under the IMF PRGF which included: (i) strengthening budget execution procedures; (ii) updating budgetary and treasury nomenclatures; (iii) reorganizing the Ministry of Finance to provide an improved institutional framework for effective budget preparation and execution; (iv) reforming the legal framework governing public spending; and (v) rigorous implementation of a treasury cash management plan which enforced discipline and brought Government spending in line with available resources.

**3.7 Over the past 4 years there has been progress in stabilizing the budget, partly in response to the fiscal consolidation efforts and higher port activities, and partly owing to the windfall from the regional security situation and the establishment of new foreign military bases.** Such progress in stabilization centers on a low equilibrium with an unacceptably high poverty level. Moving to a new higher equilibrium with lower poverty rates hinges on sustaining the ongoing macroeconomic reforms, as well as addressing the more challenging central

#### Box 2: Djibouti's Pension System Reform

Under the FCC and with technical assistance from the World Bank, the Government undertook a comprehensive reform of the pension system. The reform included a range of corrective measures covering the parametric, financial and institutional aspects of the pension system. The parametric reform comprised: (i) unifying and extending the vesting period to 25 years to be eligible for a full retirement pension; (ii) extending the minimum age of retirement from 50 to 55 years; (iii) changing the calculation mode of future pension to using an average of salaries earned over the last 10 years of work, compounded by a percentage of all contributions; (iv) changing the rules for cumulative pensions (civil servants, Parliamentarians, and cabinet Ministers); (v) introducing a tax on pensions of 15 percent; and (vi) ensuring a minimal yearly pension of DF 170,000 to guarantee a social safety net to pensioners. Part of the outstanding stock of Government arrears to the pension funds were covered by the FCC and since then, the Government resumed its regular contribution and effective payments to pension funds. The institutional part of the reform included the merging into one single institution of the different pension funds, but due to design problems it didn't progress as expected. Completing the merger of the pension funds and expanding coverage are reminding challenges for the Government.

structural problem of the oversized wage bill and high wage levels. This would open the way to more poor people sharing the public resources, rents, and donors' grants and support.

#### **IV. DJIBOUTI POVERTY REDUCTION STRATEGY (PRSP)**

##### **A. VISION, OBJECTIVES AND STRATEGY**

**4.1 The Country Vision.** As stated in its recent PRSP, Djibouti's poverty reduction strategy aims to foster economic growth by improving the country's overall competitiveness and building human capital to achieve a substantial reduction in income poverty and unemployment, and improve living conditions for all citizens. The PRSP is structured around a long-term vision that builds on the country's strengths: its geographic location, and its port. The targeted reduction in poverty is predicated on enhancing the conditions for stronger, more equitable and sustainable growth.

**4.2 The Objectives.** The PRSP objectives are as follows: (i) to reduce the incidence of extreme poverty from 42.2 percent in 2002 to 36.1 percent in 2006, to 27.9 percent in 2010, and to 19.2 percent in 2015; (ii) to increase the average real GDP growth to 4.6 percent in 2004-06, to 5.5 percent in 2006-10, and to 6.5 percent in 2010-15, while simultaneously reducing the inequalities in income distribution by an average 2 percent per annum during 2003-15; (iii) to increase gross primary school enrollment from 42.7 percent in 2001/02 to 73 percent in 2005/06, and to achieve universal enrollment by 2015; (iv) to reduce the infant mortality rate from 103.1 per thousand in 2002, to 75 per thousand in 2006, and to 50 per thousand in 2015; (v) to reduce the infant-juvenile mortality rate from 124.5 per thousand in 2002, to 85 per thousand in 2006, and to 70 per thousand in 2015; (vi) to reduce the maternal mortality rate from 690 per 100,000 live births in 2002, to 570 in 2006, and to 400 in 2015; and (vii) to stabilize the rate of prevalence of HIV at approximately 3 percent by 2015.

**4.3 The Strategy.** The PRSP rests on four main pillars. The *first pillar* seeks to strengthen the country's competitiveness and to create conditions conducive to a strong and sustainable economic growth through (i) the pursuit of fiscal prudence and overall macroeconomic stability; (ii) the implementation of structural reforms to attract private investment, including the revision of the legal and judicial framework (an investment climate assessment is planned for FY08); (iii) the promotion of Djibouti as a competitive economic and financial hub; and (iv) the reduction in the costs of production factors through improved efficiency of investments in the infrastructure sectors (water, power, transport). The *second pillar* aims to accelerate the development of human resources through the implementation of social programs aimed at reducing poverty and gender disparities. In particular, the aim is to: (i) improve the coverage and quality of health care and education; (ii) reduce unemployment through the development of labor-intensive activities, micro-finance provision, and job training, (iii) set up social safety nets for the most vulnerable segments of the population; and (iv) implement the national gender strategy. The *third pillar* focuses on regional and local development through investments in water and basic services in poor neighborhoods located in rural and urban areas of the country. The *fourth pillar* seeks to improve governance and public sector management. The priority will be to strengthen the transparency and accountability of public expenditure management to improve its distributional and efficiency impact on the poor.

## B. MEDIUM-TERM MACROECONOMIC PROSPECTS UNDER THE CAS PERIOD (2005-08)

**4.4 In the base case medium-term scenario, Djibouti would witness a relatively improved growth rate owing to the higher investment in the port and the pursuit of reforms aiming to improve the efficiency of investments.** A surge in private investment due to the construction of the new modern port in Doraleh and a higher public investment in support of the Government's PRSP are expected to boost growth during the period 2005-08 to an average rate of 4 percent a year, at a higher pace than in the past, but less than the 4.6 percent per annum on average anticipated in the PRSP. Inflation is expected to remain at its current average of 2 percent as long as the currency board is maintained.

**4.5 Fiscal consolidation would be pursued to offset pressures on public finances stemming from the PRSP implementation.** The pursuit of the budgetary consolidation effort (barring an expected slippage during the first half of 2005 which corresponds to the Presidential electoral period) should result in achieving a surplus in the primary budget close to 4 percent of GDP on average per annum. Such a surplus is also needed to ensure a continued implementation of the Government plan for clearing domestic arrears. Fiscal consolidation will be achieved through efforts on both expenditure and revenue sides. **On the revenue side,** additional external disbursements of military bases rental linked to new military agreements with the United States and France (representing about 3 percentage points of GDP on average per annum), will materialize over the projected period, and tax revenues are projected to remain stable before the new VAT is introduced and implemented. **On the expenditure side,** total expenditures level will remain overall stable. A shift in the structure of expenditures toward higher capital spending linked to PRSP implementation will be partially balanced by lower current expenditures through the pursuit of retirement programs and military demobilization and the rationalization of other non-wage current expenditures.

**4.6 Current account pressures would intensify financing needs, but the external debt-to-GDP ratio will remain stable over the period 2005-2008.** Total financing needs are expected to increase from US\$135 million in 2003 to US\$164 million by 2006, and decline thereafter to reach US\$ 129 million by 2008. Higher current account deficits during the PRSP implementation period (2004-06) will be financed through additional external assistance, mostly in the form of official grants. Additional new lending is expected to be negotiated on concessional terms. Fiscal consolidation efforts and prudent borrowing should help maintain Government debt-to-GDP to sustainable levels (with external debt averaging 68 percent of GDP during the projected period). The base case scenario also envisages a steady inflow of foreign direct investment, although the pace will critically depend upon maintaining the investors' confidence in the Government commitment to enhance competitiveness, rule of law and economic and social stability.

**Table 2**  
**Djibouti - Selected Indicators Table**  
(In percent of GDP, unless otherwise indicated)

*Base-case (most likely) projection*

	<i>Actual</i>					<i>Estimate</i>		<i>Projection</i>		
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
<b>Part A: Main Macro Aggregates</b>										
GDP (millions of US\$)	536.1	552.9	573.6	592.0	625.0	663.0	708.1	759.2	807.7	858.4
GDP (millions of DF)	95,272.7	98,266.6	101,932.3	105,210.2	111,070.4	117,834.2	125,852.8	134,924.0	143,540.3	152,560.3
<b>Real Growth Rates (%)</b>										
GDP (mp) per capita	-0.5	-1.5	-0.2	0.6	1.8	1.6	3.2	3.9	3.3	3.2
Total consumption per capita	10.9	-0.3	-2.5	-0.7	2.0	-0.2	10.1	-2.4	4.6	4.7
GDP at market prices	2.2	0.7	1.9	2.6	3.5	3.2	4.2	4.9	4.3	4.2
Total consumption	13.8	1.9	-0.4	1.2	3.8	1.3	11.1	-1.5	5.6	5.7
Private consumption	11.0	-2.6	-9.9	6.3	3.5	3.0	13.1	-2.8	6.3	6.0
Gross domestic investment (GDI)	-13.0	40.0	-31.2	35.5	47.4	21.9	25.0	48.9	-1.8	-5.6
Exports (GNFS)	-0.7	-5.2	4.6	0.9	2.9	0.8	5.4	5.1	5.4	5.4
of which Goods	2.7	13.3	7.2	6.3	6.5	-1.6	1.7	5.8	6.6	6.8
Imports (GNFS)	-3.2	3.9	-6.8	3.6	11.9	3.0	21.4	8.4	4.3	3.2
of which Goods	5.0	8.9	-3.7	7.9	0.0	3.1	22.6	7.9	1.5	-0.2
<b>Savings-investment balances, as % of GDP</b>										
Gross Domestic investment	8.8	12.2	8.3	10.9	15.5	19.0	21.8	30.2	28.0	25.0
of which Government investment	3.1	2.7	2.5	4.5	6.7	6.1	10.0	11.0	10.0	9.0
Gross domestic savings	-5.7	-7.4	-5.2	-4.5	-5.6	-5.4	-11.3	-3.8	-4.6	-5.7
Gross national savings	8.4	5.1	2.7	4.2	8.0	10.2	5.4	11.8	11.3	13.1
<b>Other</b>										
GDP inflation (% growth rate)	2.0	2.4	1.8	0.6	2.0	2.8	2.5	2.2	2.0	2.0
Annual average exchange rate (LCU/US\$)	177.72	177.72	177.72	177.72	177.72	177.72	177.72	177.72	177.72	177.72
Money (% growth rate)	5.2	1.1	7.5	15.7	17.8	6.1	6.8	7.2	6.4	6.3
<b>Part B: Government Finance Indicators</b>										
<b>Percentage of GDP (%)</b>										
Total revenues & grants, of which	30.9	31.0	28.2	29.4	34.2	34.6	34.7	33.9	34.3	33.4
Tax revenues	21.6	21.5	20.5	21.1	22.7	21.9	21.4	21.3	21.3	20.9
Total expenditures, of which	33.1	32.8	29.6	32.9	36.4	35.7	38.1	38.1	36.4	35.3
Consumption	26.1	25.8	23.4	24.7	21.9	20.4	20.0	19.8	19.4	19.3
Overall Balance - commitment basis, incl. grants	-2.2	-1.8	-1.4	-3.5	-2.3	-1.1	-3.5	-4.2	-2.1	-1.9
Domestic Fiscal Balance, excl. grants	-2.6	-1.6	-0.3	-0.2	0.8	0.8	3.5	3.7	6.4	6.4
<b>Part C: Debt &amp; Liquidity Indicators</b>										
<b>Total DOD and TDS</b>										
DOD (US\$ millions)	274.6	262.2	262.7	335.3	396	408	464	519	563	572
DOD / GDPmp ratio (%)	51.2	47.4	45.8	56.6	63.4	61.5	65.5	68.3	69.7	66.6
TDS (US\$ millions)	10	14	11	12	16	24	28	30	32	35
TDS / exports (XGS) ratio (%)	4.0	5.5	4.0	4.4	4.6	6.6	7.0	7.4	7.4	7.3
Total gross reserves (months' imports GNFS)	2.6	2.3	2.5	2.5	2.2	2.2	2.2	2.2	2.2	2.1
<b>Part D: External Financing Plan</b>										
<b>(US\$, millions)</b>										
Private investment (net)	4.2	3.3	2.2	5.0	21.4	51.7	75.4	90.1	94.8	96.5
Net Long term borrowing excl IMF	-5.5	27.4	7.9	29.9	19.9	25.1	52.4	51.3	42.0	9.7
Adjustments to scheduled debt service	7.9	0.0	16.3	-3.2	0.0	0.0	0.0	0.0	0.0	0.0
All other capital flows	11.0	-12.3	53.2	58.2	83.8	-11.7	0.0	0.0	0.0	0.0
Financing Requirements (incl IMF)	7.9	-21.3	31.4	53.0	135.6	84.4	149.2	164.1	159.5	129.9
of which current account deficit (including grants)	1.9	39.7	31.9	40.0	47.4	58.5	115.8	139.6	134.9	102.1

## V. THE LAST CAS ACHIEVEMENTS AND LESSONS

**5.1 *The strategic focus of the last CAS (2001-2004) was to support the Government effort to reduce poverty in two main ways:***

- Interventions to enhance human capital development, giving priority to reversing one of the worst rates of school enrollment in the world, addressing the deteriorated health situation, in particular in the critical area of HIV/AIDS, and promoting a more direct support program to the poor through an active public works and community service program.
- Restoring growth by: (i) consolidating fiscal stability and improving economic competitiveness necessary to jumpstart growth; and (ii) rehabilitation of infrastructure and services related to the port as the main source of growth in Djibouti.

### A. OUTCOMES IN HUMAN RESOURCE DEVELOPMENT

**5.2 *There was impressive progress made in human resource development, with very tangible accomplishments in education.*** Early results from the ***School Access and Improvement Program***, still under implementation, show an impressive 12.5 percent increase in the rate of enrollment over the first three years of the project implementation. This first project of a three-phase Education APL focused essentially on filling the huge gap in the supply side: building and rehabilitation and management of schools, providing textbooks and supplies, training teachers and developing curriculum. The effectiveness and satisfactory implementation of the project triggered interest from other donors and discussions are underway for a donor wide education-for-all initiative.

**5.3 *In the other sectors, the two health projects, HIV/AIDS Malaria and TB Control, and Health Sector Development project have had a good implementation start. The Social Development and Public Works project helped extend economic and social infrastructure to poor communities,*** including road, drainage and water supply network improvement, rehabilitation of health and social services, marketplaces, and preparation and implementation of participatory community development plans. The project also helped promote small construction and service contractors' capacity building, which prepares local SMEs to take advantage of other business and work opportunities offered by military bases and new developments. The expected employment creation impact was, however, more modest than expected.

### B. OUTCOMES IN THE AREAS OF FISCAL CONSOLIDATION, COMPETITIVENESS AND GROWTH RESUMPTION

**5.4 *In the second area of strategic focus of the CAS i.e., restoring economic growth through improvement of the port-linked infrastructure and structural adjustment and fiscal consolidation, macro stability was re-established and GDP per capita re-commenced its growth, but the impact on poverty reduction was rather disappointing.*** The IDA-financed ***Emergency Road Corridor Rehabilitation project*** and a supplemental credit to this project, were instrumental to the timely removal of a binding constraint to port activities. The project responded to the reorientation of Ethiopia's foreign trade route to the port of Djibouti following the Ethiopian-Eritrea war in 1998. Total port traffic rose to 6.0 million tons in 2003, compared to solely 1.7 million in 1997.

**5.5 In the area of structural reforms, IDA-financed Fiscal Consolidated Credit supported the most critical policy reforms over the past four years,** in particular in the area of pension system reform, arrears management and clearing, and public enterprises reform (section III). Djibouti's fiscal situation has been brought closer to stability, with improved—though still far from satisfactory—public finance management. Since 2002, Djibouti's GDP per capita growth has reverted to a positive trajectory after a long period of decline. However, the impact on poverty has been disappointing with the dramatic worsening of poverty indicators between 1996 and 2002 (section II). With no indication that this tendency has been reversed during the CAS period, the pressing need to confront upfront and actively the income distribution problem in Djibouti is underscored.

### C. PORTFOLIO MANAGEMENT

**5.6 Portfolio management over the past CAS period improved dramatically.** The project portfolio showed a dramatic turn around with all portfolio indicators turning from highly unsatisfactory to satisfactory or highly satisfactory. Ratings for development objective and implementation progress of all projects in the portfolio are currently satisfactory. The disbursement ratio has progressively increased to reach 28 percent in FY04, compared to only 6 percent in FY00 and to the target of 18 percent set in the CAS. Disbursement lags have been reduced significantly, and project implementation time and efficiency have also improved. In particular, the Education project will be closing a year ahead of schedule leading the way to an earlier than expected start of the second phase of the Education APL. The implementation of both the International Corridor project and the Social Development and Public Works project progressed much better and much faster than planned; and the Board approved two supplemental credits on June 5, 2003 and June 26, 2003 respectively for these projects.

**Table 3: Portfolio Status and Performance under the last CAS**

Project	Comm Amt (\$M)	Total Disb. (\$M)	% Disb. #	DO Rating	IP Rating	Date Approval	Date Effect.	Date Closing
Ex-Combatants Reintegration Project	2.7	2.2	81.5	-	-	12/07/98	08/05/99	06/30/02
Fiscal Consolidation Credit	10.0	10.5	105.3	-	-	12/20/01	03/01/02	10/31/03
Tech. Assistance (PATARE)	6.5	5.5	84.6	-	-	01/23/97	08/22/97	12/31/03
Intl. Road Corridor Rehab Project (original cr.)	15.0	15.2	101.4	S	S	06/22/00	12/28/00	12/31/04
Intl. Road Corridor Rehab Project (suppl credit)	6.0	5.2	86.7	S	S	06/05/03	03/10/03	12/31/04
School Access & Improv. Program	10.0	10.3	103.0	S	S	12/19/00	04/20/01	06/30/05
Social Dev. & Public Works (original credit)	14.8	13.5	91.2	S	S	05/25/99	03/09/00	06/30/06
Social Dev. & Public Works (supplemental cr.)	5.0	0.0	0.0	S	S	26/6/03	03/12/03	06/30/06
Health Sector Development Project	15.0	4.1	27.3	S	S	06/04/02	11/11/02	06/30/08
HIV/AIDS, Malaria and TB Control	12.0	3.3	27.5	S	S	05/29/03	12/02/03	09/30/08
Total:	97.0	69.8	72.0					

Indicators	Actual Performance (Base Line)	Projected Targets (FY01 CAS)			Actual Annual Performance			
		FY01	FY02	FY03	FY01	FY02	FY03	FY04
Disbursement Ratio (%)	FY00 6.0	FY01 10.0	FY02 15.0	FY03 18.0	FY01 15	FY02 27	FY03 42	FY04 28
Disbursement Lag: Org. (%)	Disbursement Lag: Org. (%) 48.0	-	-	-	51	39	19	-3
Projects At Risk (%)	75.0	50.0	20.0	20.0	40	33	29	0
Problem Projects (%)	50.0	20.0	10.0	10.0	40	0	14	0
Proactivity Index	100.0	85.0	85.0	85.0	100	100	100	100

\*/ Disbursed Amount may be over 100% due to exchange rate gains

**5.7 Factors that have contributed to the improvement in the quality and speed of implementation include:** (i) focused, and simpler design of the projects adapted to local implementation capacity; (ii) a more intensive supervision of the portfolio with a problem-solving approach, supported by closer involvement of the Country Management Unit and an excellent dialogue with the Government; and (iii) a more proactive and professional External Financing Coordination Unit within the Ministry of that helped quickly address the problems as they arose.

## VI. BANK GROUP ASSISTANCE STRATEGY

### A. CHOICE OF FOCUS OF THE NEW CAS

**6.1 During the consultation process, the Bank team and the authorities discussed two options as to how to focus the CAS program** to bring about higher effectiveness given the large demand for IDA support and the limited available IDA allocation.

**6.2 The first option was to target the CAS program to one of the four pillars of the PRSP** that the Government and IDA considered the most important (e.g. social development), to bring about a critical difference in this particular area.

**6.3 The second option was to cover more areas of the PRSP, at the cost of spreading resources more thinly, using small but strategic interventions of mixed lending and ESW in each of the important areas.** The objective would be to bring Bank good practices and knowledge to bear in more than one area of the PRSP, and **to unlock higher mobilization of donor partner resources and assistance in these sectors.** Several donors have experienced slow implementation of their programs due to difficulties in dialogue on critical sectoral policy and institutional reform areas. Some donors have expressed interest in IDA's involvement in their area of involvement/support because of: (i) IDA's comparatively good quality sector work (on education, water and sewerage, energy, transport and the port, public enterprise reform, the pension system, CFAA and CPAR); (ii) IDA's relatively good dialogue on critical structural issues advanced under the FCC process; and (iii) the good momentum and excellent collaborative spirit and trust prevailing between the Government and the Bank.

**6.4 The second option is favored.** It will allow the Bank to build on the previous CAS program, which was essentially in line with the PRSP priorities, thereby allowing, to a certain limit, for the needed critical mass to attain the developmental objectives of the program and create the desired changes and improvements.

### B. ALIGNMENT TO THE PRSP PILLAR OF IMPROVING COMPETITIVENESS, GROWTH AND INCOME DISTRIBUTION

**6.5 The envisaged CAS program in support of the PRSP pillar of growth and competitiveness involves several interconnected actions, building on the investment and structural adjustment programs started under the previous CAS.** Specifically, it involves: (i) moving a step further in addressing fiscal consolidation, improving competitiveness, and income distribution--this would be carried out through a combination of further wage bill adjustments to create more fiscal room to expand priority public services and transfers to the poor, and through the restructuring of utility sectors (power and water) to reduce the costs of doing business and

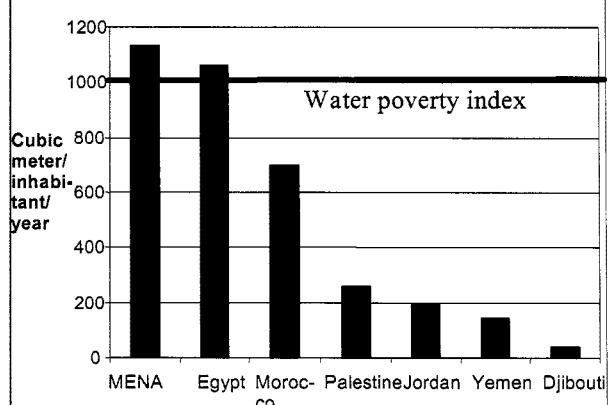
improve access of the poor to these essential public services; (ii) sustaining development and improved management of the Ethiopia Djibouti transport infrastructure in support of port activities, the economic backbone for growth and employment; and (iii) vocational training to enable local work force take advantage of spillover activities related to the expansion of the port.

**6.6 B.1 Assistance in support of wage bill reduction and expenditure restructuring reform:** As highlighted above (Section II), the relative size of the public wage bill in the budget is too high, mostly driven by an average high wage of about 9 times the GDP per capita. This limits severely the fiscal room to hire more teachers and health professionals and to provide transfers and assistance to the poorest to meet the PRSP and Millennium Development Goals. There are really no other options than to tradeoff high wages to higher recruitment. This is possible through the combination of restructuring (less of administrative and security personnel and more of public service professionals) lower real wage levels through any politically feasible combination of direct nominal wage cuts, and adjustment of the exchange rate. In addition to the direct effects of this reform, these actions could also reduce business costs, enhancing growth through improving competitiveness, and provide fiscal space also for raising investment and maintenance expenditures in the physical infrastructure base, thereby reaching and benefiting the poor both directly and indirectly.

**6.7 Planned IDA assistance.** On the analytical and technical side, IDA assistance would consist of economic and sector work and technical support covering the critical aspects of the wage bill restructuring reform. This includes a CEM based on a series of focused analytical policy notes covering the different components of the reform and assessing their economic and social impact, their phasing, and the alleviation of their impact on the poor; and finalizing the Public Expenditure Review with emphasis on restructuring expenditure in key sectors. On the lending side, IDA assistance would consist, under a high case scenario, of a second fiscal consolidation credit, supporting the second phase of reforms undertaken under the FCC, focusing on wage bill and public expenditure restructuring.

**6.8 B2. Restructuring the utilities sector as a means of enhancing competitiveness and improving access to services to the poor:** The utility sectors, mainly power and water, have been identified in the PRSP as key bottlenecks to improving the overall economic competitiveness. The issue is the very high cost of utilities, which also constitutes an access barrier to the poor. Tariffs for electricity and water services are the highest in the MENA region, at an average of US\$0.20/kWh for electricity, and US\$1.10m<sup>3</sup> for water (as compared to MENA average of US\$0.07 for electricity and US\$0.28 for water). The reasons for the high prices are several, but notably: the higher cost of electricity production due to a reliance on imported diesel fuel for power generation; large inefficiencies in the form of network losses; high administrative overhead costs due to overstaffing; inordinately high wages (*see Box 4*); and high levels of taxation (33 percent taxes on all petroleum products and about 20 percent more of

**Box 3: Renewable water resources (2000)**



surtaxes<sup>6</sup>). IDA has played a leading role in assisting the Government in assessing the financial performance of the power and water companies through the FCC. The two sector strategy notes on power and water and PRSP work have identified an action plan for both sectors focusing on the following key objectives: (i) improving the efficiency and financial performance of the utilities through restructuring and promotion of private sector participation; (ii) addressing key service-delivery constraints through rehabilitation of networks and protection of resources; and (iii) exploring new resources for water supply (e.g., desalination) and power generation (e.g., renewable energy and interconnection possibilities).

#### **Box 4: Competitiveness Indicators In Djibouti**

**High wages and high wage bill.** An IMF survey was conducted to compare wage and price levels in Djibouti, Addis Ababa (Ethiopia) and Sana'a (Yemen). The survey revealed that Djibouti's wages are much higher than those of neighboring countries. At 1999 exchange rates, wages in Djibouti were 3 to 6 ½ times the level of those in Ethiopia and Yemen. The differentials were generally higher for skilled and semi-skilled employees (public servants, and hotel and restaurant staff) than for unskilled workers (manual laborers and domestic servants). The apparent insensitivity of wage rates to the high level of unemployment may reflect the benchmark established by the dominant public sector, which accounts for approximately half of the total reported wage earner population (or almost three-quarters when public enterprises are included in the public sector). In 1998, the average wage rate in Djibouti's civil service was indeed about 45 percent above the average wage rate of workers in the private sector and public enterprises. Estimated average salaries for public sector employees were more than five times the level in Ethiopia and about four times the level of comparable employees in Yemen.

**High utilities prices.** Djibouti faces high production costs associated with utility prices. In particular, the price of the kW/hour for industries was about 26 cents in 2000, and the cost of telephone calls abroad ranged from more than US\$1 per minute to neighboring countries to almost US\$3 per minute to Europe, and US\$ 4 to the United States. Utilities are expensive primarily because of high wages, a large tax burden, and poor management practices. When looking at public enterprise accounts, it appears that wages and salaries of public enterprises range from 31 percent of value added for Djibouti-Telecom, to 77 percent for the airport. The wage bill of the electricity company was 51 percent in 2000. Poor collection rates and fraud are other problems faced by some public enterprises, including the electricity and water company.

**High service prices.** Higher prices of transport contribute to the fact that road traffic between Djibouti and Ethiopia is mostly handled by Ethiopian companies, which pay lower wages to their drivers than those paid to Djibouti drivers. Other prices of services (recreational, tailoring, shoe repairing, apartment rents) are much more expensive in Djibouti. As a result, the ratio of non-tradable prices to tradable prices is higher in Djibouti than in its two neighboring countries.

**High Real exchange rate (REER).** Following the depreciation of the US dollar in effective terms, Djibouti's real effective exchange rate depreciated between 2002 and 2004 by about 30 percent. Despite this depreciation the REER remained overvalued compared to the early 1990s (over 20 percent). Such an overvalued exchange rate continues to undermine the country's overall competitiveness.

6.9 **Planned IDA assistance** would consist of a dual power and water project. The IDA contribution towards this project is expected to be about US\$7 million. In addition, a GEF grant towards renewable and energy efficiency improvement is being pursued and would be in the range of US\$2.5 to US\$3.5 million. The power sector-related components would include a small investment in the distribution network in Djibouti-Ville to rehabilitate and extend the network to un-served residential consumers, as well as to the commercial district; and the construction of a small wind farm to serve an interior town. The water sector component will focus on initiating protective measures of the aquifer that serves 70 percent of Djibouti's population. However, although the Bank's contribution to the critical needs of the water sector are limited due to the constraints of the IDA envelope, the Bank will work closely with the EU who is preparing a large water sector investment project (US\$20 million) and has requested that its project be linked

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<sup>6</sup> The abnormally high level of taxes and surtaxes were inherited from the stabilization period. They need to be revised within a potential new fiscal consolidation follow up operation.

to the Bank's activities in terms of overall development objectives (see below under the institutional component). Another component will focus on the institutional restructuring of the power and water utilities and the associated regulatory frameworks. IDA involvement in the sectors' institutional restructuring builds on the work undertaken under the FCC. In addition, the EU, the largest donor in the water sector, has requested Bank leadership in sectoral reform, and is conditioning the release of its investment funds on the implementation of reforms in the sector.

**Box 5: Utilities' Unit Performance Compared to MNA's Good Practice**

The price for electricity and water in Djibouti is much higher than in other countries in the region, and also when compared to good general industry practice more generally. Average electricity tariffs in the region range from US¢9/kWh to industry and US¢6/kWh to households in Yemen; US¢6/kWh to industry and households in Jordan and US¢6.9/kWh to industry and US¢9.5/kWh to households in Morocco. In Djibouti, the average selling price is US¢20/kWh, but commercial customers including small enterprises pay as much as US¢32/kWh and the Office National des Eaux de Djibouti (ONED) pays US.41/kWh. The same applies to the water sector, where the lowest tariff to households reaches US¢35/m<sup>3</sup>, compared to US¢25/m<sup>3</sup> in Yemen; US¢22/m<sup>3</sup> in Jordan, and US¢20/m<sup>3</sup> in Morocco. Good practice in electricity is an average tariff of between US¢10-15/kWh. It is more difficult to have a benchmark for water since it varies greatly with the source and amount of water resources.

The sectors also suffer from overstaffing, which is of serious concern, given the high cost of labor in Djibouti. Measured in relationship to number of connections, the Djibouti Electricity Authority (EDD) has 31 connections per employees whereas good practice is 70-100. Measured slightly differently for the water sector, ONED has 21 employees per active 1,000 connections, while good practice is in the range of 4 to 6.

**6.10 B3. Development and rehabilitation of the transport infrastructure in support of the Port of Djibouti as the engine of economic growth and employment:** Djibouti has put the development of the port and the transport sectors at the heart of its poverty reduction strategy. The potential of the port as an engine of growth looks clearer today than in the mid-1990s when the port was losing most of its transshipment traffic to other competing ports in the region. The situation is much improved today because of the sharp increase in port traffic following the Ethiopian-Eritrea war in 1998, combined with the rehabilitation of the road link to Ethiopia, which was supported by IDA's emergency Road Corridor Rehabilitation Project and a supplemental credit, as well as the Government's decision to transfer the port management to a private operator. This stimulated considerably port activity (traffic increased by 165 percent between 1997 and 2002), and more than compensated for the drop in transshipment.

6.11 The first challenge for Djibouti is to preserve the Ethiopian transit traffic by improving the attractiveness and competitiveness of the port, as well as its transportation logistical links with its hinterland. The second challenge is to maximize the port's significant growth and employment potential by regaining and expanding its share in transshipment and diversifying related business, including a potential free trade zone (FTZ).

6.12 Improvement in both physical infrastructure and the institutional setting are needed for the port of Djibouti to play its role as the gateway to and from its hinterland, especially vis-à-vis Ethiopia. Regarding the port, a new oil terminal is being built at the Dorale site with private financing to alleviate the operational constraints posed by the old oil facilities in the current port site.

6.13 A long-term plan to develop the Djibouti-Addis Ababa Corridor started with the IDA-supported rehabilitation of the Djibouti-Galafi road, encompassing also the development of the rail link between Djibouti and Addis. The European Union is also financing a future improved

road link between Djibouti and Addis Ababa, in addition to its financing of emergency repairs to the rail link to bring it up to an acceptable level for efficient and safe operations.

6.14 On the institutional side, Djibouti's decision to have a partnership with the private sector in port and airport management has been successful thus far, and lays the ground for more such partnerships. Preparation is underway for a concession scheme for the rail link between Djibouti and Addis Ababa through the privatization of "*Chemin de Fer Djibouto-Ethiopian*", a joint-national company operating the 800-kilometer rail link between Djibouti and Addis. Governments in both countries now sponsor this scheme.

#### **Box 6: Development of the Port of Djibouti**

Djibouti has put the development of the port and the transport sector at the heart of its poverty reduction strategy. The potential of the port as an engine of growth looks clearer today than in the mid 1990s when the port was losing most of its transshipment traffic to other competing ports in the region. The sharp increase in port traffic following the Ethiopian-Eritrea war in 1998, combined with the rehabilitation of the road link to Ethiopia, which was supported by IDA's emergency Road Corridor Rehabilitation Project and a supplemental credit, as well as the Government's decision to transfer the port management to a private operator stimulated considerably port activity. Total port traffic rose to 5.97 million tons in 2003, compared to 4.55 million tons in 2002 and solely 1.7 million in 1997, which more than compensated for the drop in transshipment. The challenge for Djibouti is to first preserve Ethiopian transit traffic by improving the attractiveness and the competitiveness of the port and its logistics links with its hinterland, and then to seek to diversify the port's business.

***Strengthening the competitiveness of the port of Djibouti and logistics links with its hinterland.*** Improvement of both physical infrastructure and institutional settings is needed for the port of Djibouti to play its role as the gate to and from its hinterland, and mainly Ethiopia. On the port side, a new oil terminal is being built at Dorale site with private financing to alleviate the current operational constraints posed by the old oil facilities in the current port site. A long-term plan to develop the Djibouti-Addis Corridor started with the IDA's supported rehabilitation of the Djibouti-Galafi road and it also encompasses development of the rail link between Djibouti and Addis. The European Union is financing a future improved road link between Djibouti and Addis Ababa along the same route as the existing rail link via Ali-Sabieh in Djibouti and Dire-Dawa in Ethiopia. The EU is also financing emergency repairs to the rail link to bring it up to an acceptable level for efficient and safe operations. On the institutional side, Djibouti's decision to have a partnership with the private sector in port management was so far successful and it lays the ground for more such partnerships. Preparation is underway of a concession scheme for the rail link between Djibouti and Addis through the privatization of "*Chemin de Fer Djibouto-Ethiopian (CFDE)*", a joint-national company operating the 800-kilometer rail link between Djibouti and Addis. This scheme is now sponsored by Governments in both countries. A national road strategy aimed at improving the institutional arrangements of the road sector including road management and financing of road maintenance is being carried out under the emergency road corridor rehabilitation project. This CAS proposes support in this area through a Partial Risk Guarantee in support of the concession to the privatization of the CFDE, and a transport strategy study.

***Diversifying the port's business and related activities.*** The Government and the private operator of the port have set as a strategic goal to increase Djibouti's share in the very competitive regional transshipment traffic. The construction with private participation of a new deepwater container terminal at Dorale site along with an industrial and commercial free zone is on their agenda. While the activities of this proposed port are rather capital than labor intensive, a successful free zone should be a significant source of employment. If this ambitious project did materialize, for it to benefit the economic and social development of the country, special attention should be focused to train a qualified labor force on one hand, and to reduce the extremely high cost of labor in Djibouti on the other hand. This CAS supports address the first area through the proposed Partial Risk Guarantee.

6.15 ***Planned IDA assistance*** would consist of an IDA partial risk guarantee, which could be matched by the same amount from Ethiopia with which coordination is under way, to the concession being considered to mitigate the risks associated with such a complex bi-national project. IDA is also carrying out a Transport Sector Review aimed at improving the institutional arrangements of the road sector, including road management and financing of road maintenance. IDA will support the Government in adopting and implementing the recommendations of this Review.

### C. ALIGNMENT TO THE PRSP PILLAR OF HUMAN RESOURCE DEVELOPMENT AND POVERTY ALLEVIATION

6.16 The focus of the previous CAS on human development was also aligned with what subsequently became the second pillar of the PRSP. This CAS continues IDA support in the same area covered in the previous CAS with additional lending except in health, where two operations (Health Sector Development; and HIV/AIDS) have just started and their implementation should cover the required IDA support in this sector over the next four years.

**6.17 C1. Continuing support for an accelerated school access and improvement agenda:** The first phase of Djibouti's School Access and Improvement Adaptable Program Lending (APL), the first IDA project in education, is being completed one year ahead of schedule with significant and encouraging results in several areas: (i) increased enrollment with a primary gross enrollment ratio (GER) of 52 percent compared to 39.5 percent at the start of the project in 2000; (ii) decreased grade repeater rates from 10 percent to 7 percent; (iii) increased availability of textbook at a ratio of 1:1; (iv) increased teacher training; (v) revised curriculum; and (vi) achievement of all the triggers agreed upon to move the second Phase of the APL.

6.18 *Planned IDA assistance* would consist of a *second accelerated school access and improvement project for the second phase of the education APL*. The objectives of this project are to expand coverage of quality basic education through targeted activities which contribute to increased access and retention rates of the system, and to further reduce repetition and drop-out rates. The specific objective of this phase is to increase the enrollment to 70 percent by 2008, with special emphasis on girls education, in line with the PRSP targets. IDA will work closely with other donors to mobilize additional financial resources for reaching this target. An Education Sector Strategy Assessment will be prepared in FY07.

**6.19 C2. Continuing support for employment generation and direct support to the poor:** With respect to employment generation and social development, the last CAS program consisted of the consolidation and expansion of a Social Development and Public Works Program. The program contributed to poverty reduction through: (i) construction and rehabilitation of social and economic infrastructure in the poorest neighborhoods with a direct impact on the living conditions of the poor (such as street works, drainage, water and sanitation systems, local markets, schools, and health care facilities), while at the same time, offering employment opportunities; (ii) supporting community development through social mobilization programs and investment grants for the creation of community facilities; and (iii) institutional capacity building by developing the capability of small local private contractors to enable them to benefit from opportunities offered by the port development, the military bases and other activities; and also improving the institutional capacity of the Government, communities and NGOs to design and implement poverty reduction interventions.

6.20 One of the main factors characterizing the unemployment situation in Djibouti is the lack of basic skilled labor and the lack of training to address this problem. Addressing this impediment to employment would enable labor force to better take advantage of existing and potential service activities developments, in particular that of construction and other services related to the military bases, and transport related to the port, as well as to the potential demand from its ongoing expansion and possible free zone development.

6.21 ***Planned IDA assistance*** would consist of a credit focused on employment creation with two components: (i) rehabilitation of basic services (in particular water and sewerage system) in one of the poorest districts (the Cartier Dariba); and (ii) financing of a small focused Vocational Training project to enable unemployed young people to take advantage of expected employment opportunities linked to the development of the port. IDA support will continue in the area of pension system reform (under the Planned second Fiscal Consolidation Credit) and an employment strategy note (CEM).

6.22 **C3. Providing support to poor victims of the flood:** The PRSP highlights the vulnerability of Djibouti to various natural disaster dangers and emphasizes need for developing prevention and management capacity. An Emergency Floods Rehabilitation project for \$6.4 million was approved in September 2004 to assist the Government of Djibouti in helping people hurt by the floods that devastated the region in April 2004, that impacted about 15 percent of the population, or about 100,000 people. Most of the affected population lives in the poorest areas. Support will be given to rehabilitate social and economic infrastructure (e.g., housing, schools, medical centers) that was damaged. The project also includes technical assistance to support short and long-term disaster prevention management plans.

6.23 **C4. Providing support in other key problematic social areas:** As identified above (paras. 1.10-1.14), women in Djibouti bear additional disadvantages and burden that the PRSP recognize as key hurdles in the way of uplifting the well being of the whole society. The PRSP, however, does not deal adequately with the Qat issue, because there is less internal consensus about the problem. IDA assistance under the CAS program will, nevertheless, address both issues.

6.24 ***Planned IDA assistance to furthering the gender agenda:*** The UNDP and UNFPA are providing assistance to the Ministry of Gender, mainly in capacity building. The IDA-financed Social Development and Public Works project provided credit to micro-enterprises, many of which are run by women. The Planned new Social Development and Public Works II credit would follow step. The first School Access and Improvement project under the previous CAS has met its explicit targets for reducing the gender gap in schooling. The second School Access project, under this CAS will further aid in this effort with still greater emphasis on girls schooling. The Health project, currently under implementation, also aims at reducing the high rates of infant and maternal mortality. A coordinated effort will be made with donors to support NGOs in the on-going public awareness and education campaign for the elimination of FGM practice.

6.25 ***Planned IDA assistance to address the Qat problem:*** IDA efforts will aim at building consensus in the country on the importance of this issue in terms of its serious social and economic consequences. An assessment of the social and economic implications of Qat import and consumption at the household and macro levels will be made within the framework of the programmed work on poverty assessment. IDA will raise the issue more prominently in its policy dialogue with the authorities. IDA will join other donors in the effort of raising awareness about the harmful effects of Qat consumption and provide support to national initiatives to address this problem.

#### D. ALIGNMENT TO THE PRSP PILLAR OF PROMOTING GOOD GOVERNANCE

6.26 The PRSP emphasizes governance improvement as one of the main pillars of development and poverty reduction. In this agenda, governance improvement is defined broadly as furthering the promotion of good political, local, economic and financial governance, strengthening the capacity for planning and administrative management and modernizing it. Priority in this agenda is given to ensuring transparent and efficient management of public expenditure, and to improving equity and effectiveness in order to transform governance into “a true instrument for combating poverty.”

6.27 *Two key IDA fiduciary activities, a CFAA and a CPAR, have been finalized in addition to a Public Expenditure Review.* These constitute a strong basis for identifying improvement areas and a concrete program of actions that the authorities are willing to undertake to move forward on their governance agenda

6.28 In the area of public financial management, the CFAA noted a relatively good quality of the legal framework, a satisfactory level of the external control carried on by the newly created Chamber of Accounts, and a relative improvement in the system of payments and accounting. On the other hand, it pointed to major weaknesses undermining the management and transparency of public spending. The three areas of weaknesses identified and examined by the CFAA concern budget formulation, execution, and internal control.

6.29 The CPAR collaborative exercise also pointed to several weaknesses in public procurement which diminish the absorptive capacity, and deprive the country from fully benefiting from available donor financing. Absorptive capacity remains hampered by several procurement weaknesses at different levels, including an incomplete and complex procurement code; an unclear legislative and regulatory framework; lengthy and inefficient procurement procedures; loss of private sector confidence due to large Government arrears leading to exaggerated risk premiums; and weaknesses in the customs’ institutions at both the institutional and human resource levels.

6.30 ***The planned IDA assistance*** would consist of support in implementing the detailed and phased program of actions in the areas of financial management and public procurement, which have been identified and discussed collaboratively with the authorities, the private sector, and the donor community during a workshop organized by the Government. IDA would support this PRSP Governance improvement pillar with two IDFs (to implement the CPAR and CFAA policy recommendations), which would also be complemented by technical assistance from other donors.

**Table 4: Planned World Bank Group Program FY 05-08 (Base Case: US\$ 30 mil.)**

FY05		FY06		FY07		FY08	
Operations	(US\$ m)	Operations	(US\$ m)	Operations	(US\$ m)	Operations	(US\$ m)
Emergency Floods Rehabilitation	6.4 <sup>7</sup>	School Access and Improvement (Phase II)	10	Djibouti-Ethiopia Rail Road Partial Risk Guarantee	3	Social Dev./ Public Works II	5
Power and Water Project	7						
<b>Total</b>	<b>13.4</b>		<b>10</b>		<b>3</b>		<b>5</b>
<b>Non-Lending (AAA: New and ongoing*) and TA</b>							
Economic Monitoring (PRSP and MDGs)		Economic/PRSP Monitoring		Economic/PRSP Monitoring		Economic/PRSP Monitoring	
Transport Sector Review		Poverty Assessment				Public Expenditure Review Update	
Public Expenditure Review		CPPR		CPPR		CPPR	
Economic and Social Impact of Public Wage Bill reform*		* CEM: Medium- term reform framework for growth with distribution					
CG Meeting				PRSP Assessment			
Energy, Poverty and Social Impact Analysis		Two IDF grants for Improved Economic Governance to implement the CPAR and CFAA policy recommendations		TBD		TBD	

\* This policy note is part of the CEM.

## E. LENDING SCENARIOS AND TRIGGERS

**6.31 The base-case lending program of about US\$31 million will fully utilize Djibouti's IDA indicative allocation for the next four years<sup>8</sup>.** The base case is predicated on continued satisfactory macroeconomic management and good portfolio performance. The CAS does not envisage a **low case scenario** because of: i) negligible probability of base case triggers not being met; (ii) the small size of IDA allocation in the base case; and (iii) the remaining lending program beyond FY05 is essentially in education and poverty alleviation. The alternative lending case scenario is thus limited to a high case scenario.

**6.32 The high case lending scenario would provide for US\$9 million above the base case.** It would consist of a poverty reduction credit in support of scaling up the fiscal consolidation agenda started during the last CAS with a Fiscal Consolidation Credit (FCC). The second FCC will focus on public expenditure restructuring with emphasis on the wage bill (structure of civil service and wage level adjustment) with the objectives, as highlighted above of: (i) creating needed fiscal room for higher public service spending, (ii) improving income distribution and direct transfers to the poor; and (iii) enhancing overall competitiveness of the economy. The triggers for the high case scenario would consist of: satisfactory IDA portfolio performance with no more than two problem projects in the portfolio; satisfactory progress in implementation of

<sup>7</sup> Out of the project cost of US\$6.4 million, \$3.2 million is in the form of a grant, and an equal amount is in the form of an IDA credit.

<sup>8</sup> This envelope will be finalized subsequently along IDA14 rules and IDA14 funds availability.

the economic governance and transparency agenda; and Government's readiness to undertake a credible and sustainable reform program of wage bill restructuring and enhancing competitiveness.

**Table 5: Lending Scenarios and Triggers**

<b>Trigger areas</b>	<b>To move to the high case</b>	<b>Means of verification</b>
Poverty Reduction	<ul style="list-style-type: none"> <li>Satisfactory progress in overall implementation of the PRSP</li> </ul>	Annual PRSP progress report and associated Joint Staff Assessment (JSA)
Portfolio performance	<ul style="list-style-type: none"> <li>Satisfactory IDA portfolio performance with no more than 2 problem projects in the portfolio.</li> </ul>	Bank project supervision reports; bi-monthly portfolio review; CPPR.
Macroeconomic management and Structural Reforms	<ul style="list-style-type: none"> <li>Government preparedness to undertake meaningful public wage bill reduction and restructuring reform.</li> </ul>	IMF and WB staff review and reporting.
Improved Governance and Transparency	<ul style="list-style-type: none"> <li>Good progress in implementation of agreed upon action program in procurement and public financial management (CFAA/CPAR program).</li> </ul>	Regular Bank progress reviews.

#### F. IDA LENDING TERMS AND DJIBOUTI'S INFLATED GNI PER CAPITA

6.33 *Djibouti GNI per capita of US\$920 has became higher than the operational cutoff for eligibility for 40-year IDA funding of US\$895 over the past three years.* This high level of GNI per capita in dollar terms is to a large extent artificially inflated by the overvalued exchange rate. It does not reflect the extent of prevailing poverty in Djibouti as highlighted above. Unless the Government addresses the underlining factors of its inflated GNI per capita, it will deprive Djibouti from the needed IDA softer terms. This is in addition to the beneficial implication that such policy reform could have in correcting the income distribution bias against the poor as discussed in section II.

#### G. COORDINATION WITH DEVELOPMENT PARTNERS

6.34 *Quite in contrast with the improvement in IDA portfolio performance and dialogue with the Government, many partners express frustration about difficult policy dialogue and slow project implementation.* Several large and critical projects have been in the pipeline for a long time without materializing. Portfolio performance is also un-even across partners. This underscores the need to assess donors' collective experience with Djibouti and share lessons of what has worked well and what did not as the donors community prepares to pledge its future assistance to Djibouti's PRSP during the Consultative Group (CG) meetings to be organized this summer.

6.35 *The PRSP preparation and consultation process, in which donors were associated, offered a good opportunity for a shared understanding of the Government strategy and priorities.* Through its PRSP, Djibouti has its first comprehensive and consistent vision and strategy of development and poverty reduction since independence. The PRSP processes led donors to start refocusing their assistance on a more informed basis along the Government priorities. The process has also forced the start of a more active coordination among the donor community which should intensify at the Consultative Group meeting that would be chaired by the World Bank. IDA would work with donor agencies to ensure that: (i) policy or institutional

advise is mutually consistent; (ii) investment programs addressing the priorities of the PRSP are consistent and do not overlap; (iii) donors share sectoral and economic analysis and information; and (iv) IDA and donors operational procedures (e.g., for procurement, accounting, and audit) are as standardized as possible to ease project implementation.

**6.36 This CAS, prepared in close collaboration with the donor community, is designed to complement and support other donors' effort.** (see section VI-A). It specifically arranged some of the lending and non-lending operations to address problems that constrain other donors support (as is the case with the water and power project for example) and use any comparative advantage IDA might have to help in this regard. As shown in the CAS results matrix (Annex B9) there are already many synergies between IDA assistance and other donors' proposed interventions. These will be further clarified as donors' consultation on defining respective assistance to the PRSP investment program progress.

**6.37** More specifically, the World Bank will continue its strong collaboration with the IMF and will ensure that a consistent message is conveyed on the macroeconomic, public finance management and other structural reforms. The planned second Fiscal Consolidation Credit (FCC) would reinforce and complement the IMF's potential PRGF program as it was the case with the first FCC. On other areas, such as in the water, power, and transport sectors, IDA's assistance both in lending and in analytical (AAA) work is being prepared in close collaboration with the EU and complements its investment and assistance in sector reforms as well as the AfDB's intervention in the energy sector. The Bank is also supporting in-country aid coordination led by other donors through sector-level technical assistance (e.g., Djibouti education local donor group led by France). There is also close collaboration with the UN, the *Caisse Francaise de Developpement* and other donors in improving Governance.

## VII. MANAGING THE RISKS

**7.1 The realization of Djibouti's poverty reduction strategy, and the effectiveness of this CAS which is aligned to it, are subject to several external and internal risks.** The PRSP recognized upfront most of these risks.

**7.2 Djibouti's exposure to external risk is high because its economy depends mainly on the port and its development; the rental of military bases; and grants and soft financing from donors—all of which are subject to high geo-political uncertainties.** Regarding the port, the surge in growth since the mid-1990s of port activities with Ethiopia was attributable to the Ethiopia/Eritrea war, and subsequent reliance of Ethiopia on the Djibouti port for most of its imports and exports. To limit the risk of the reversibility of the increase in its share in Ethiopia trade traffic, Djibouti needs to improve the overall competitiveness of the port by reducing costs, and improving infrastructure links (road and railways) to Ethiopia. In this respect, the on-going effort to expand transport infrastructure with direct financial participation of the Ethiopian side raises the stakes of the latter in maintaining continuous business and limits this risk. As for the prospective development and expansion of port as a transshipment hub, it is still awaiting the conclusion of a deal with a foreign private investor. The rental of the newest military bases (the US and Germany bases) which constitutes an important additional source of revenue to the Government and influences the development of many service activities, is also subject to unpredictability, even though more in the longer term than in the near term, given the continuing regional instability in the Middle East.

*7.3 The financing of the PRSP investment program hinges on important contributions from donors in the form of grants, which, if not forthcoming in the amounts envisaged, could jeopardize fiscal sustainability and/or the PRSP investment program.* This risk and its effects will be hopefully adequately addressed by Djibouti's partners during the planned Consultative Group Meeting in support of the PRSP. Djibouti would mitigate this risk significantly by addressing its structural adjustment reform to boost confidence of its partners in the effectiveness of their support and foreign investors on the competitiveness and long term economic, social and political stability of the country.

*7.4 CAS implementation is also subject to two major internal risks. First, there is the risk that the Government may move too slowly or not at all with respect to the next phase of fiscal consolidation and restructuring.* Failing to take these decisions and implementing such reforms would shed more uncertainty on the attainment of the PRSP objectives in terms of basic service delivery and better income and rent distribution. It would also delay the necessary adjustments needed to improve competitiveness and thus deter potential FDI, and diminish donor support. The envisaged high-case scenario lending (FCC II) would provide, along with expected larger support from Djibouti's other partners, both technical and financial assistance to help witter down the social costs of this reform, and enhance its social and political feasibility.

*7.5 The other source of internal risk is related to the capacity to implement and monitor Djibouti's poverty reduction strategy, which implies a large increase in the public investment program in a situation of relatively low skill levels and limited administrative and management capacity.* The risk is not significant with regard to the implementation of the CAS program (section V). However, the institutional capacity constraints can potentially limit the Government's ability to utilize fully and effectively increased support from other donors. IDA will keep this broader issue under review.

# Djibouti at a glance

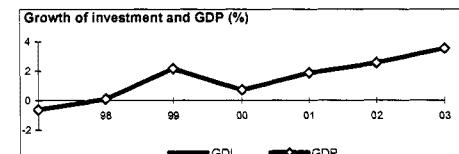
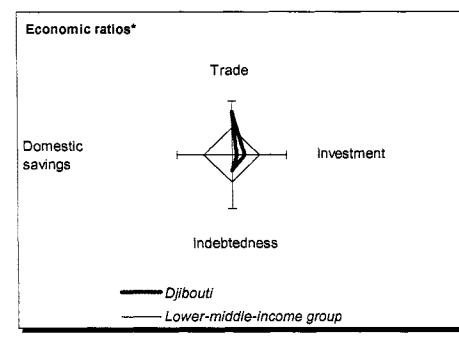
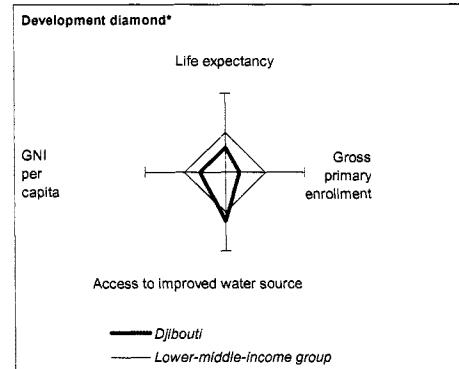
CAS Annex A2

		M. East & North Africa	Lower- middle- income		
		Djibouti			
<b>2003</b>					
Population, mid-year (millions)		0.71	312	2,655	
GNI per capita ( <i>Atlas method, US\$</i> )		910	2,210	1,480	
GNI ( <i>Atlas method, US\$ billions</i> )		0.64	689	3,934	
<b>Average annual growth, 1997-03</b>					
Population (%)		2.2	1.9	0.9	
Labor force (%)		..	2.9	1.2	
<b>Most recent estimate (latest year available, 1997-03)</b>					
Poverty (% of population below national poverty line)		..	..	..	
Urban population (% of total population)		84	58	50	
Life expectancy at birth (years)		44	69	69	
Infant mortality (per 1,000 live births)		100	44	32	
Child malnutrition (% of children under 5)		..	..	11	
Access to an improved water source (% of population)		100	88	81	
Illiteracy (% of population age 15+)		..	31	10	
Gross primary enrolment (% of school-age population)		40	96	112	
Male		46	100	113	
Female		35	92	111	
<b>KEY ECONOMIC RATIOS and LONG-TERM TRENDS</b>					
	1983	1993	2002	2003	
GDP (US\$ billions)	..	0.47	0.59	0.62	
Gross domestic investment/GDP	..	..	..	..	
Exports of goods and services/GDP	..	..	..	..	
Gross domestic savings/GDP	..	..	..	..	
Gross national savings/GDP	..	..	..	..	
Current account balance/GDP	..	..	..	..	
Interest payments/GDP	..	0.4	0.4	0.5	
Total debt/GDP	..	56.1	56.6	63.4	
Total debt service/exports	..	..	..	..	
Present value of debt/GDP	..	..	37.2	..	
Present value of debt/exports	..	..	..	..	
	1983-93	1993-03	2002	2003	2003-07
(average annual growth)					
GDP	-0.9	0.2	2.6	3.5	..
GDP per capita	-6.5	-2.4	0.6	1.8	..
Exports of goods and services	..	..	..	..	..
<b>STRUCTURE of the ECONOMY</b>					
	1983	1993	2002	2003	
(% of GDP)					
Agriculture	..	3.1	..	..	
Industry	..	20.5	..	..	
Manufacturing	..	5.3	..	..	
Services	..	76.4	..	..	
Private consumption	..	..	..	..	
General government consumption	..	..	..	..	
Imports of goods and services	..	..	..	..	
	1983-93	1993-03	2002	2003	
(average annual growth)					
Agriculture	..	2.2	..	..	
Industry	..	-5.7	..	..	
Manufacturing	..	-9.9	..	..	
Services	..	0.3	..	..	
Private consumption	..	..	..	..	
General government consumption	..	..	..	..	
Gross domestic investment	..	..	..	..	
Imports of goods and services	..	..	..	..	

Note: 2003 data are preliminary estimates.

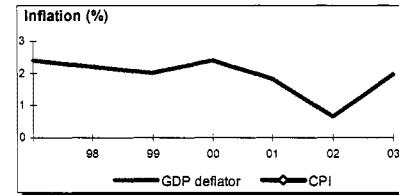
This table was produced from the Development Economics central database.

\* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

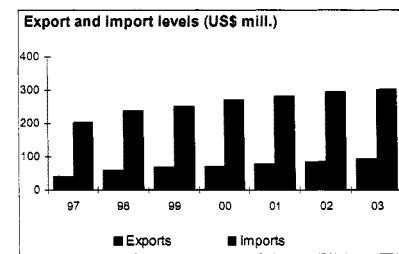


*Djibouti***PRICES and GOVERNMENT FINANCE**

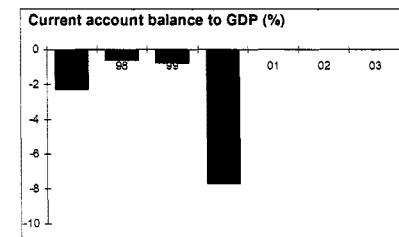
	1983	1993	2002	2003
<b>Domestic prices</b>				
(% change)				
Consumer prices	..	..	..	..
Implicit GDP deflator	..	4.4	0.6	2.0
<b>Government finance</b>				
(% of GDP, includes current grants)				
Current revenue	..	37.2	31.6	31.0
Current budget balance	..	-4.8	3.3	3.7
Overall surplus/deficit	..	-13.0	-0.7	-0.5

**TRADE**

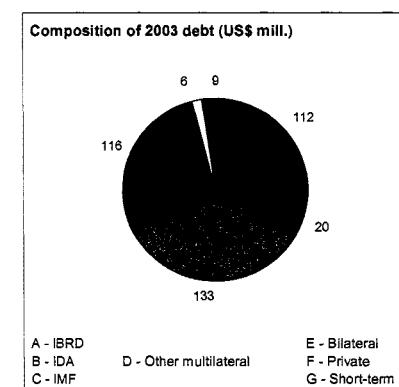
	1983	1993	2002	2003
(US\$ millions)				
Total exports (fob)				
Food and live animals	..	71	86	94
Coffee and derivatives	..	..	7	8
Manufactures	..	..	55	60
Total imports (cif)	..	..	295	303
Food	..	..	65	87
Fuel and energy	..	..	13	13
Capital goods	..	..	103	106
Export price index (1995=100)	..	..	..	..
Import price index (1995=100)	..	..	..	..
Terms of trade (1995=100)	..	..	..	..

**BALANCE of PAYMENTS**

	1983	1993	2002	2003
(US\$ millions)				
Exports of goods and services				
Imports of goods and services				
Resource balance				
Net income				
Net current transfers				
Current account balance				
Financing items (net)				
Changes in net reserves				
<b>Memo:</b>				
Reserves including gold (US\$ millions)	..	..	..	..
Conversion rate (DEC, local/US\$)	177.7	177.7	177.7	177.7

**EXTERNAL DEBT and RESOURCE FLOWS**

	1983	1993	2002	2003
(US\$ millions)				
Total debt outstanding and disbursed	46	264	335	396
IBRD	0	0	0	0
IDA	1	40	79	112
Total debt service	5	11	12	16
IBRD	0	0	0	0
IDA	0	0	1	2
Composition of net resource flows				
Official grants	24	53	26	..
Official creditors	13	19	24	20
Private creditors	0	0	0	0
Foreign direct investment	0	1	4	..
Portfolio equity	0	0	0	..
World Bank program				
Commitments	6	0	15	11
Disbursements	1	4	18	26
Principal repayments	0	0	1	1
Net flows	1	3	17	25
Interest payments	0	0	0	1
Net transfers	1	3	17	24



Note: This table was produced from the Development Economics central database.

9/15/04

**CAS Annex B2**

**CAS Annex B2 - Djibouti**  
**Selected Indicators\* of Bank Portfolio Performance and Management**  
As of February 8, 2005

Indicator	2002	2003	2004	2005
<b>Portfolio Assessment</b>				
Number of Projects Under Implementation <sup>a</sup>	6	7	5	5
Average Implementation Period (years) <sup>b</sup>	2.1	2.7	3.2	2.9
Percent of Problem Projects by Number <sup>a, c</sup>	0.0	14.3	0.0	0.0
Percent of Problem Projects by Amount <sup>a, c</sup>	0.0	10.6	0.0	0.0
Percent of Projects at Risk by Number <sup>a, d</sup>	33.3	28.6	0.0	60.0**
Percent of Projects at Risk by Amount <sup>a, d</sup>	41.8	32.9	0.0	60.5**
Disbursement Ratio (%) <sup>e</sup>	27.0	41.7	28.3	19.9
<b>Portfolio Management</b>				
CPPR during the year (yes/no)				
Supervision Resources (total US\$)	201	297	551	570
Average Supervision (US\$/project)	29	42	79	80

\*\* Djibouti's portfolio has no unsatisfactory project and no problem projects. The percentage of project at risk is driven by only one project-specific risk flag for two of the projects in the portfolio. This one risk flag triggers the qualifier problem project as it adds to the two automatic country risk flags (Country Environment and Country Records Risk Flags). The problems are being actively dealt with and shall be resolved on time.

Memorandum Item	Since FY 80	Last Five FYs
Project Evaluated by OED by Number	11	3
Project Evaluated by OED by Amt (US\$ millions)	64.2	18.5
% of OED Projects Rated U or HU by Number	54.5	66.7
% of OED Projects Rated U or HU by Amt	44.4	43.0

- a. As shown in the Annual Report on Portfolio Performance (except for current FY).
- b. Average age of projects in the Bank's country portfolio.
- c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).
- d. As defined under the Portfolio Improvement Program.
- e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: Investment projects only.

**CAS Annex B3 - IDA Program Summary – Djibouti**

As of February 8, 2005

**Planned IDA Base-Case Lending Program<sup>a</sup>**

<i>Fiscal Year</i>	<i>Project ID</i>	<i>US\$(M)</i>	<i>Strategic Rewards b (H/M/L)</i>	<i>Implementation b Risks (H/M/L)</i>
2005	Flood Emergency Rehabilitation	6.4	H	L
	Power and Water	7.0	H	M
	<b>Result</b>	<b>13.4</b>		
2006	Second School Access and Improvement	10.0	H	L
	<b>Result</b>	<b>10.0</b>		
2007	Ethiopia Rail Road Partial Risk Guarantee	3.0	H	M
	Fiscal Consolidation Credit	9.0	H	M
	<b>Result</b>	<b>12.0</b>		
2008	Second Social Development/Public Works II	5.0	H	M
	<b>Result</b>	<b>5.0</b>		
<b>Overall Result</b>		<b>40.4</b>		

- a. This table presents the planned program for the next three fiscal years.
- b. For each project, indicate whether the strategic rewards and implementation risks are expected to be high (H), moderate (M) or low (L)

**CAS Annex B4****CAS Annex B4 – Summary of Nonlending Services - Djibouti**

As of February 8, 2005

<i>Product</i>	<i>Completion FY</i>	<i>Cost (US\$000)</i>	<i>Audience<sup>a</sup></i>	<i>Objective<sup>b</sup></i>
<b>Recent completions</b>				
Environmental Mainstreaming into PRSP	2004	16.0	Govt/Donor	Knowledge Generation
Water Sector Note	2004	136.0	Government	Knowledge Generation
Country Procurement Assessment Review	2004	86.0	Government	Knowledge Generation
Country Financial Accountability Assessment	2004	126.0	Government	Knowledge Generation
Public Expenditure Review	2005	133.0	Government	Knowledge Generation
<b>Underway</b>				
Djibouti CAS	2005	55.0	Govt/Bank	Knowledge Generation
Transport Review	2005	60.0	Government	Knowledge Generation
Economic/PRSP Monitoring	2005	50.0	Government	Knowledge Generation
Energy Poverty & Social Impact Analysis	2005	80.0	Government	Knowledge Generation
Economic and Social Impact of Public Wage Bill Reforms	2005	100.0	Government	Problem Solving
<b>Planned</b>				
IDF CPAR/Governance	2006	70.0	Government	Problem Solving
IDF CFAA/Governance	2006	70.0	Government	Problem Solving
Economic/PRSP Monitoring	2006	50.0	Government	Knowledge Generation
CPPR	2006	50.0	Government	Knowledge Generation
Country Economic Memorandum	2006	170.0	Government	Knowledge Generation
Poverty Assessment	2006	100.0	Government	Knowledge Generation
CG Meetings	2006	40.0	Govt/Donors	Problem Solving
PRSP Assessment	2007	100.0	Government	Knowledge Generation
Economic/PRSP Monitoring	2007	50.0	Government	Knowledge Generation
CPPR	2007	50.0	Government	Knowledge Generation
Public Expenditure Review Update	2008	85.0	Government	Knowledge Generation
Economic/PRSP Monitoring	2008	50.0	Government	Knowledge Generation
CPPR	2008	50.0	Government	Knowledge Generation

a. Government, donor, Bank, public dissemination.

b. Knowledge generation, public debate, problem-solving.

## Djibouti Social Indicators

	Latest single year			Same region/income group	
	1970-75	1980-85	1997-03	M. East& North	Lower-middle-income
				Africa	
<b>POPULATION</b>					
Total population, mid-year ( <i>millions</i> )	0.2	0.4	0.7	311.6	2,655.2
Growth rate (% annual average for period)	6.1	3.3	2.2	1.9	0.9
Urban population (% of population)	61.6	71.1	83.6	58.0	49.7
Total fertility rate ( <i>births per woman</i> )	6.7	6.4	5.2	3.1	2.1
<b>POVERTY</b>					
(% of population)					
National headcount index	..	..	..	..	..
Urban headcount index	..	..	..	..	..
Rural headcount index	..	..	..	..	..
<b>INCOME</b>					
GNI per capita (US\$)	..	..	910	2,210	1,480
Consumer price index (1995=100)	..	54	117	..	..
Food price index (1995=100)	..	..	..	..	..
<b>INCOME/CONSUMPTION DISTRIBUTION</b>					
Gini index	..	..	..	..	..
Lowest quintile (% of income or consumption)	..	..	..	..	..
Highest quintile (% of income or consumption)	..	..	..	..	..
<b>SOCIAL INDICATORS</b>					
<b>Public expenditure</b>					
Health (% of GDP)	..	..	4.1	2.8	2.6
Education (% of GNI)	..	..	..	4.3	4.0
Social security and welfare (% of GDP)	..	..	..	..	..
<b>Net primary school enrollment rate</b>					
(% of age group)					
Total	..	31	34	83	91
Male	..	37	38	86	92
Female	..	26	30	83	91
<b>Access to an improved water source</b>					
(% of population)					
Total	..	..	100	88	81
Urban	..	..	100	96	94
Rural	..	..	100	78	70
<b>Immunization rate</b>					
(% of children ages 12-23 months)					
Measles	..	27	62	92	78
DPT	..	22	62	92	84
Child malnutrition (% under 5 years)	..	..	..	..	11
<b>Life expectancy at birth</b>					
(years)					
Total	42	46	44	69	69
Male	41	45	44	67	67
Female	44	48	44	70	71
<b>Mortality</b>					
Infant (per 1,000 live births)	160	137	100	44	32
Under 5 (per 1,000)	241	199	143	54	40
Adult (15-59)					
Male (per 1,000 population)	586	527	590	193	214
Female (per 1,000 population)	470	428	541	143	135
Maternal (per 100,000 live births)	..	..	730	..	..
Births attended by skilled health staff (%)	..	73	..	..	..

CAS Annex B5. This table was produced from the CMU LDB system.

09-Feb-05

Note: 0 or 0.0 means zero or less than half the unit shown. Net enrollment rate: break in series between 1997 and 1998 due to change from ISCED76 to ISCED97. Immunization: refers to children ages 12-23 months who received vaccinations before one year of age.

**CAS Annex B6**  
Page 1 of 2

**Djibouti - Key Economic Indicators**

Indicator	Actual					Estimate		Projected			
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	
<b>National accounts (as % of GDP)</b>											
Gross domestic product <sup>a</sup>	100	100	100	100	100	100	100	100	100	100	
Agriculture	3	4	4	4	4	4	4	4	4	4	
Industry	15	15	16	16	16	16	16	16	16	16	
Services	82	81	81	81	81	81	81	81	81	81	
Total Consumption	106	107	105	105	104	106	106	106	106	106	
Gross domestic fixed investment	9	12	8	8	11	9	9	9	9	9	
Government investment	3	3	2	2	4	3	3	3	3	3	
Private investment	6	10	6	6	4	6	6	6	6	6	
Exports (GNFS) <sup>b</sup>	47	44	46	46	46	46	46	46	46	46	
Imports (GNFS)	61	64	59	59	59	59	59	59	59	59	
Gross domestic savings	-6	-7	-5	-5	-4	-6	-5	-4	-3	-2	
Gross national savings <sup>c</sup>	8	5	3	4	4	4	4	4	4	4	
<b>Memorandum items</b>											
Gross domestic product (US\$ million at current prices)	536	553	574	592	625	663	708	759	808	858	
GNI per capita (US\$, Atlas method)	810	830	840	850	850	850	850	850	850	850	
Real annual growth rates (%)	2.2	0.7	1.9	2.6	3.5	4.2	4.2	4.3	4.3	4.3	
Gross domestic product at market prices	2.0	0.7	1.6	2.4	3.4	4.0	4.0	4.0	4.0	4.0	
Gross Domestic Income	-0.5	-1.5	-0.2	0.6	1.6	2.2	2.2	2.2	2.2	2.2	
Real annual per capita growth rates (%)	10.9	-0.3	-2.5	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	
Gross domestic product at market prices	8.1	-4.8	-11.8	4.3	1.7	2.0	2.0	2.0	2.0	2.0	
Total consumption	10.9	-0.3	-2.5	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	
Private consumption	8.1	-4.8	-11.8	4.3	1.7	2.0	2.0	2.0	2.0	2.0	
<b>Balance of Payments (US\$ millions)</b>											
Exports (GNFS) <sup>b</sup>	249	243	262	272	289	309	337	357	380	412	
Merchandise FOB	69	75	76	83	89	93	99	106	114	120	
Imports (GNFS) <sup>b</sup>	327	352	339	364	421	471	505	537	563	595	
Merchandise FOB	252	270	263	287	338	452	481	487	488	495	
Resource balance	-78	-109	-77	-91	-132	-162	-234	-258	-263	-275	
Net current transfers	64	53	33	41	44	47	47	47	47	47	
Current account balance	-2	-40	-32	-40	-58	-116	-140	-135	-102	-102	
Net private foreign direct investment	4	3	2	5	21	52	90	94	95	95	
Long-term loans (net)	-5	-1	-1	24	38	27	55	44	44	44	
Official	-3	-2	28	3	3	52	51	42	10	9	
Private	-2	-2	28	3	3	52	51	42	10	9	
Other capital (net, incl. errors & omissions)	19	-12	69	55	65	14	32	43	43	43	
Change in reserves <sup>d</sup>	-16	21	-48	50	78	-14	-3	-1	-1	-1	
<b>Memorandum items</b>											
Resource balance (% of GDP)	-14.5	-19.6	-13.5	-6.3	-15.4	-21.1	-24.4	-34.0	-32.6	-30.7	
Real annual growth rates (%)	13.8	0.8	6.3	6.7	6.5	1.7	5.8	6.6	6.8	6.8	
Merchandise exports (FOB)	13.3	3.3	-2.9	3.4	4.3	-1.6	4.9	4.3	4.2	4.2	
Primary	14.9	-2.9	5.6	6.3	6.3	-1.6	5.4	4.6	4.3	4.3	
Manufactures	2.3	4.7	1.8	1.2	0.0	3.1	22.6	7.9	1.5	-0.2	
Merchandise imports (CIF)	-	-	-	-	-	-	-	-	-	-	

(Continued)

**Djibouti - Key Economic Indicators**

(Continued)

Indicator	Actual			Estimate			Projected			
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
<b>Public finance (as % of GDP at market prices)<sup>e</sup></b>										
Current revenues					30.9	31.0	28.2	29.4	34.2	33.9
Current expenditures					30.0	30.1	27.2	28.5	29.8	27.1
Current budget balance					0.9	0.9	1.1	0.9	4.5	26.4
Capital expenditure					3.1	2.7	2.5	4.5	5.0	6.5
Foreign financing					0.4	0.4	0.4	0.4	6.7	10.0
<b>Monetary indicators</b>										
M2/GDP					54.6	53.5	55.5	62.2	69.4	69.4
Growth of M2 (%)					5.2	1.1	7.5	15.7	17.8	6.4
<b>Price indices (YR93=100)</b>										
Merchandise export price index					154.4	166.9	157.6	161.0	163.0	170.7
Merchandise import price index					158.5	162.6	155.6	167.5	197.8	216.2
Merchandise terms of trade index					97.4	102.7	101.3	96.1	82.4	80.3
<b>Real interest rates</b>										
Consumer price index (% change)					2.0	2.4	1.8	0.6	2.0	4.5
GDP deflator (% change)					2.0	2.4	1.8	0.6	2.0	2.5
										1.5
										1.4
										1.7

a. GDP at factor cost

b. "GNFS" denotes "goods and nonfactor services."

c. Includes net unrequited transfers excluding official capital grants.

d. Includes use of IMF resources.

e. Consolidated central government.

**CAS Annex B8**

**CAS Annex B8 – Djibouti**  
**Status of Bank Operations Portfolio**  
As of February 8, 2005

**Closed Projects 11**

<u>Active Projects</u>		<u>Last PSR</u>			<u>Original Amount in US\$ millions</u>					<u>Difference Between Expected and Actual Disbursements<sup>a/</sup></u>	
<u>Project ID</u>	<u>Project Name</u>	<u>DO</u>	<u>IP</u>	<u>Fiscal Year</u>	<u>IDA</u>	<u>Grant</u>	<u>Cancel</u>	<u>Undisb.</u>	<u>Orig.</u>	<u>Frm Rev'd</u>	
P089968	Flood Emergency Rehabilitation HIV/AIDS, Malaria & TB	S	S	2005	6.46			6.77	0.48		
P073603	Control	S	S	2003	12.00			9.57	-1.50		
P071062	Health Sector Development	S	S	2002	15.00			13.81	3.46		
P044584	Social Dev. and Public Works	S	S	1999	19.80			6.83	1.07	2.06	
P044585	School Access and Improvement	S	S	2001	10.00			0.20	-0.45		
<b>Total</b>					<b>63.26</b>	<b>0.0</b>	<b>0.0</b>	<b>37.19</b>	<b>3.06</b>	<b>2.06</b>	

**IDA \***

Total Disbursed (Active)	49.74
of which has been repaid	0.00
Total Disbursed (Closed)	64.16
of which has been repaid	5.22
Total Disbursed (Active + Closed)	113.90
of which has been repaid	5.22
Total Undisbursed (Active)	39.50
Total Undisbursed (Closed)	0.00
Total Undisbursed (Active + Closed)	39.50

\* Disbursement data are updated at the first week of the month

a/ Intended Disbursements to date minus actual disbursements to date as projected at appraisal

## CAS- Djibouti- FY05-FY08 CAS RESULTS MATRIX

**Strategic Objective 1: Improving growth, income distribution and the country's overall competitiveness**

Long-term development goals PRSP goals	Issues that hinder the ability to achieve PRSP goals	Outcomes influenced by the CAS Program during the 4 year period			Bank Assistance Bank and Partner interventions for each strategic objective
		CAS Outcomes that the Bank expects to influence through its interventions in 4-year period and outcome-level indicators	Intermediate outcomes to track implementation towards expected CAS outcomes	Bank Assistance	
<b>Reduced poverty through higher growth, improved competitiveness, and reduced income inequalities</b>	<ul style="list-style-type: none"> <li>Poor and non-diversified resource endowment (apart from the port) and too low human development level that could support the development of a service economy around the planned port expansion and benefit from it.</li> </ul>	<ul style="list-style-type: none"> <li>GDP growth rate increased to an average of 4.5% by 2008.</li> <li>Improved fiscal stability (fiscal deficit maintained at around 2% GDP) through improved tax system, improved expenditure efficiency and effectiveness and continuous settlement of internal arrears as scheduled.</li> </ul>	<ul style="list-style-type: none"> <li>Increased investment and mobilization of donors financing as indicated by PRSP</li> <li>AAA work carried out, assessing options, quantifying economic and social effects, and drawing implementation design for reform in the areas of competitiveness and wage bill reform, and public expenditure restructuring.</li> </ul>	<b>IDA Assistance:</b> <b>AAA</b> <b>Lending</b>	Under a high-case scenario, support of a comprehensive competitiveness enhancement reform through a second-phase Fiscal Consolidation Credit.
<b>Reduced Poverty:</b>	<ul style="list-style-type: none"> <li>Reduce incidence of extreme poverty from 42.2 percent in 2002 to 19 percent in 2015</li> </ul>			<b>IMF Assistance:</b> SMP (and depending on performance a possible PRGF) focusing on maintaining macroeconomic stability and key structural reforms.	
<b>Higher Growth:</b>	<ul style="list-style-type: none"> <li>Competitiveness problems: overvalued exchange rate; high public wage levels which drive high average wages in private sector; oversized wage bill which leaves no space for expanding public services from their low levels or permits direct distribution to the poor.</li> <li>Excessively high utility prices due to poor management of public utilities enterprises and high wages.</li> </ul>	<ul style="list-style-type: none"> <li>External debt maintained within sustainability limits.</li> </ul>	<ul style="list-style-type: none"> <li>Wage bill and competitiveness reform initiated.</li> <li>Progress in implementation of institutional reforms in water and energy public enterprises.</li> </ul>	<b>IDA Assistance:</b> <b>AAA</b> <b>Technical assistance to design and implement energy sector reform</b> <b>Lending</b>	Power and water project. GEF grant towards renewable and energy efficiency improvements
<b>Improved Macroeconomic Stability and Competitiveness:</b>	<ul style="list-style-type: none"> <li>Difficult political economy of reforms: Public wage reduction or civil service reform, or foreign exchange policy adjustment, all key to addressing the non-competitiveness of the economy, are difficult given that the short term losers are the empowered civil servants and the short term gainers are the powerless poor.</li> <li>fiscal stability, and efficient and effective public service delivery.</li> <li>Stable of external sector and financial sector. Sustainable external debt.</li> <li>Reduced costs of production factors, and improved competitiveness.</li> </ul>	<ul style="list-style-type: none"> <li>Reduce costs of factors of production by addressing high labor costs and skills shortages and issuing a new labor code, and restructure utility companies to restore their financial viability and reduce energy/water prices to lower business costs.</li> </ul>	<ul style="list-style-type: none"> <li>Reforms to improve institutional setting in the transport sector initiated. FDI to the transport sector mobilized.</li> </ul>	<b>AfDB Assistance:</b> <b>AAA</b> <b>Lending</b>	Support to the water sector reform (lending).
<b>Improved income distribution:</b>	<ul style="list-style-type: none"> <li>Income distribution inequality reduced gradually in line with poverty reduction strategy objectives.</li> </ul>			<b>EU Assistance:</b> <b>AAA</b> <b>Lending</b>	Electricity linkage with Ethiopia (TBC)
	<ul style="list-style-type: none"> <li>Achievement of PRSP Goals assumes availability of large public investment program that would need to be financed mostly through grants.</li> <li>Implementation capacity constraints and need for improvement of economic governance.</li> </ul>			<b>IDA Assistance:</b> <b>AAA</b> <b>Lending</b>	Transport Sector Review
				<b>IDA Assistance:</b> <b>AAA</b> <b>Lending</b>	IDB partial risk guarantee (matched by the same amount from Ethiopia, to the concession scheme for the rail between Djibouti and Addis Ababa
				<b>EU Assistance:</b> <b>AAA</b> <b>Lending</b>	Road link between Djibouti and Addis Ababa.

**Strategic Objective 2: Human Resource Development and Poverty Alleviation**

<b>Long-term development goals</b>	<b>Outcomes influenced by the CAS Program during the 4-year period</b>	<b>Bank Assistance</b>		
<ul style="list-style-type: none"> <li>Improve coverage, equity, quality and efficiency of education.</li> <li>Achieve universal enrollment by 2015.</li> <li>Improve students' learning achievement and retention in basic education</li> <li>Improve education sector management and efficiency.</li> </ul>	<ul style="list-style-type: none"> <li>low access of rural children, girls and children with special needs</li> <li>lack of female teachers;</li> <li>lack of schools and adequate facilities</li> <li>high unit cost for school construction and learning materials and teacher's salaries.</li> </ul>	<ul style="list-style-type: none"> <li>Increased Gross rate of enrollment to 73% per 2008</li> <li>Increased ratio of girls to total student population from 44% in 2003 to 48% in 2008</li> <li>Students 6-11 year old completing primary schooling from 55% in 2003 to 80% in 2008</li> </ul>	<ul style="list-style-type: none"> <li>Production of a school map and development of norms for schools construction and rehabilitation</li> <li>110 additional classrooms build and or rehabilitated by 2008</li> </ul>	<ul style="list-style-type: none"> <li><b>IDA Assistance Lending</b> IDA -Schools Access Improvement Program (Phase II) - \$US 10 10</li> <li><b>USAID Assistance</b> Education Quality enhancement - \$US 10</li> <li><b>France's Assistance</b> Programme d'Appui au Schéma Directeur de l'Education nationale</li> <li>African Development Bank, Saudi Development Fund and Japan</li> </ul>
<ul style="list-style-type: none"> <li>Improve coverage and quality of health care services</li> </ul>	<ul style="list-style-type: none"> <li>Reduce infant mortality rate from 103.1 per thousand in 2002 to 70 per thousand in 2015</li> <li>Reduce maternal mortality rate from 690.2 per 100,000 live births in 2002 to 400 in 2015</li> <li>Stabilize the rate of prevalence of HIV at no more than 3 percent by 2015</li> </ul>	<ul style="list-style-type: none"> <li>Reduction of infant mortality rate to 85 per 1,000 live birth 2006</li> <li>Reduction of maternal mortality rate to 570 per 100,000 live births in 2006.</li> <li>At least 80 percent of the population is aware of at least 3 measures to prevent the transmission of HIV/AIDS</li> </ul>	<ul style="list-style-type: none"> <li>Increased immunization levels from 45% in 2002 to 80% in 2008</li> <li>Increased number of health facilities that use the IMCI protocols from zero percent in 2002 to 60% in 2008</li> <li>Increased deliveries that are attended by medically trained staff from 44% in 2002 to 70% in 2008</li> <li>Increased distribution of condoms particularly among the vulnerable groups from 11,5,000 per year in 2002 to 600,000 per year in 2008.</li> </ul>	<ul style="list-style-type: none"> <li><b>IDA Assistance</b> Implementation of IDA Health Sector Development Project (\$15 m.) (started)</li> <li>Implementation of IDA HIV/AIDS, Malaria &amp; Tuberculosis Control Project (\$12 m.) (started)</li> <li>Global Fund: HIV/AIDS (\$12 m.)</li> <li><b>USAID Assistance</b> Maternal and Child Health (\$12 m.)</li> <li><b>French Assistance</b> French Cooperation: Health support (\$1 m.)</li> </ul>
<ul style="list-style-type: none"> <li>Improve employment opportunities and access to social protection by the poor</li> </ul>	<ul style="list-style-type: none"> <li>Overall uncompetitive environment;</li> <li>low demand for labor, in particular for unskilled and uneducated labor force;</li> </ul>	<ul style="list-style-type: none"> <li>Job creation through development of high-labor intensive public works and rehabilitation of basic services and community development and through targeted training.</li> </ul>	<ul style="list-style-type: none"> <li>Construction/rehabilitation of social infrastructure (water/sewerage) in the poor neighborhood of Dariba (pilot)</li> <li>Training in selected areas related to port activities to enable local people to take advantage of port development.</li> </ul>	<ul style="list-style-type: none"> <li><b>IDA Assistance Lending</b> Social Development, public works (II) AAA</li> <li>Labor market and competitiveness (CEM)</li> </ul>
<ul style="list-style-type: none"> <li>Reduce gender disparities and enhance women status in: decision making, health, education and the economy</li> </ul>	<ul style="list-style-type: none"> <li>Severe overall women disempowerment (less educated, less access to civil service employment, less represented politically, and disadvantaged culturally)</li> </ul>	<ul style="list-style-type: none"> <li>Improved access to health and education services (indicated above)</li> </ul>	<ul style="list-style-type: none"> <li>Improved access to health and education services;</li> <li>Progress in elimination of FGM practice</li> </ul>	<ul style="list-style-type: none"> <li><b>IDA Assistance Lending</b> (covered under health and education)</li> </ul>

### Strategic objective 3: Strengthening governance and public finance management

Long-term development goals		Outcomes influenced by the CAS Program during the 4 year period		Bank Assistance
PRSP goals	Issues that hinder the ability to achieve PRSP goals	CAS Outcomes that the Bank expects to influence through its interventions in 4-year period and outcome-level indicators	Intermediate outcomes to track implementation towards expected CAS outcomes	Bank and Partner interventions for each strategic objective
Consolidated democratic achievements Improved local good governance and participation Improved judicial system Well functioning, efficient and effective Administration Improved transparency and accountability of public finance management and public procurement systems.	<ul style="list-style-type: none"> <li>Low level of human development constrains political development;</li> <li>Difficult ethnic balance and its linkage to unstable neighborhood;</li> <li>Difficulty to implement administrative and civil service reform under high unemployment, extreme poverty and fragile ethnic balance;</li> <li>Control bodies lacking human, technical and financial resources to adequately monitor the efficiency of public procurement and ensure transparency.</li> <li>Customs –critically important in a port-based economy– need to be modernized.</li> </ul>	<ul style="list-style-type: none"> <li><b>Improved economic governance through efficient and transparent procurement:</b> <ul style="list-style-type: none"> <li>Updated procurement code</li> <li>Harmonized procurement procedures.</li> </ul> </li> <li>Customs: Management and staff fully trained on new customs information management tools.</li> </ul> <p><b>Improved Public Finance Management</b></p> <ul style="list-style-type: none"> <li>Improved budget preparation and execution process under management of the Budget Directorate (BD).</li> <li>Ensured realism and consistency of the budget with medium term macroeconomic framework and PRSP;</li> <li>Improved budget transparency by promoting control and audit functions as well as the parliamentary oversight as a real counterparts within the PFM system</li> <li>Improved monitoring to ensure better compliance between initial and actual budgets avoiding arrears accumulation.</li> <li>Weaknesses on budget formulation, execution and internal control need to be addressed to enhance fiscal discipline, and improve overall efficiency and transparency of public spending.</li> </ul>	<ul style="list-style-type: none"> <li>Current procurement Code first issued in 1995 is updated, and endorsed by Cabinet and Legislature.</li> <li>An efficient appeals process on public procurement introduced;</li> <li>Procedures and practices improved to reduce private sector's perception of the risks of "doing business" with the Govt of Djibouti;</li> <li>Institutional framework for public procurement reinforced through capacity building for CNM and control bodies to achieve greater transparency and efficiency.</li> <li>The NPM broadly disseminated in public sector agencies.</li> <li>Customs Directorate and Port Authority modernized and fully computerized.</li> </ul>	<ul style="list-style-type: none"> <li><b>IDA Assistance</b></li> </ul> <p><b>AAA:</b></p> <p>The 2004 CPAR has highlighted the need for updating the 1995 Procurement Code, the importance of providing technical assistance in public procurement capacity building, as well as promoting the local private sector's competitiveness.</p> <p><b>Technical Assistance:</b></p> <p>An IDB Grant (FY05-08) is approved to finance the required technical assistance to address the current legislative, institutional, and manpower weaknesses which have a negative impact on the use of budget resources, and those from donors and IFIs.</p> <ul style="list-style-type: none"> <li><b>France Cooperation Assistance</b></li> </ul> <p><b>(TBC)</b></p> <p>French Cooperation has indicated it is prepared to commit the necessary TA resources to implement the Customs modernization initiative in early 2005.</p> <ul style="list-style-type: none"> <li><b>IDA Assistance</b></li> </ul> <p><b>AAA:</b></p> <p>A CFAA was carried out in FY05, and a workshop, widely attended by the government external donors, and private sector delineated a reform and action program to improve efficiency and transparency of public finance management.</p> <p><b>Technical Assistance:</b></p> <p>An IDB Grant (FY05-08) is approved to finance the required technical assistance to implement the above program.</p>

