PROJECT INFORMATION DOCUMENT (PID)
CONCEPT STAGE

Report No.: PIDC1256

Project Name	Djibouti: Governance for Private Sector Development Project (P146250)
Region	MIDDLE EAST AND NORTH AFRICA
Country	Djibouti
Sector(s)	General industry and trade sector (50%), Agro-industry, marketing, and trade (20%), SME Finance (15%), Public administration- Indust ry and trade (15%)
Theme(s)	Other Private Sector Development (50%), Corporate governance (50%)
Lending Instrument	Investment Project Financing
Project ID	P146250
Borrower(s)	Ministry of Economy and Finance, in charge of Industry and Planning
Implementing Agency	The World Bank
Environmental Category	C-Not Required
Date PID Prepared/ Updated	29-Jan-2014
Date PID Approved/ Disclosed	29-Jan-2014
Estimated Date of Appraisal Completion	20-Feb-2014
Estimated Date of Board Approval	29-Apr-2014
Concept Review Decision	Track I - The review did authorize the preparation to continue

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I. Introduction and Context

Country Context

1. Economic growth in Djibouti has accelerated in recent years, reaching 4.6 percent on average between 2005 and 2010. The acceleration of growth in the 2000s comes after a decade of significant output decline, following the political turmoil that erupted in the country over that period. However, GDP per capita in 2010 is still lower than it was in 1990. Moreover, Djibouti's recent growth is tightly linked to substantial inflows of foreign investment, which financed the construction of new port and hotel infrastructures.
2. The government has long played a preponderant role in Djibouti's economy. However, in a context marked by significant fiscal constraints, developing the private sector remains the only way to sustain and promote growth, provide job opportunities for the young, and reduce poverty. Despite the recent increase in growth, Djibouti's private sector remains embryonic and poorly organized. The country has only about 100 businesses that are managed in accordance with modern principles

as most businesses in Djibouti are microenterprises, operating in the services sector.

3. Despite this growth, the job situation in Djibouti is dire. Unemployment hovers between 50 to 60 percent and more than 70 percent for young people (under the age of 30). The recent economic growth has failed to generate enough job opportunities to reduce unemployment, while the medium- and long-term prospects are troubling as demographic pressures will intensify in the coming years, with the arrival in the labor market of a young and increasingly well-educated population.

4. Djibouti’s economic potential remains fundamentally untapped. Djibouti has natural assets, which, if exploited, could serve as the basis for a new growth model. A recent Bank study on Djibouti’s growth model focused on four growth sectors in Djibouti in order to evaluate that potential: tourism, fisheries, transport/logistics and telecommunications

5. The tourism sector is certainly one of the most promising in terms of job creation. Djibouti currently welcomes about 50,000 tourists a year, most of whom are business travelers visiting the country because of the presence of foreign military bases. Tourist lodging capacity is small (1,200 beds), reflecting a dearth of investment in the sector. Djibouti is endowed with extraordinary natural assets for the development of tourism, including marine life of great beauty, unique geological landscapes, and a rich cultural and archeological heritage. Many of these sites would likely be eligible for UNESCO classification. Moreover, tourism demand focused on the Red Sea is especially dynamic, as evidenced by the increasing popularity of dive tourism in Sharm el-Sheikh and Hurghada. Djibouti could therefore position itself as a first-class tourist destination in the region. According to Bank projections, Djibouti could attract up to 500,000 tourists each year by 2030 and SME in the tourisms sector can benefit from this growth, provided they have the capacity and know how to be goods and services providers in the tourism industry.

6. The proposed development model is based on three components: a capital city component (business and recreational tourism); a seaside component (swimming and dive complexes located on priority development sites); and an eco-conscious component (discovery tourism at archeological and prehistoric sites). According to Bank projections, Djibouti could attract up to 500,000 tourists each year by 2030 and SME in the tourisms sector can benefit from this growth, provide they have the capacity and know how to be good and services providers in the tourism industry.

7. Djibouti’s artisanal fishing sector plays a minor role in the economy. The fisheries sector employs about 2,600 people, including 600 seamen. The number of boats reported is 157, not counting boats used for clandestine fishing, which seem to be practiced intensely. The volume of catches is relatively small (1,800 tons), with most of the yield sold in the domestic market. However, Djibouti has major maritime resources that are largely underutilized. The authorized exploitable potential is estimated at more than 30,000 tons. Some fishing grounds, such as small pelagic zones, which seem to have great potential, are not exploited at all. Market demand is strong and diversified, and fish consumption on the domestic market is growing steadily, in tandem with the development of tourism and changing eating habits.

8. The transport and logistics sector is the backbone of Djibouti’s economy. The country has a remarkable deep-water port complex, located on one of the busiest maritime routes in the world. The Emirate of Dubai played a major role in financing the development of the port, and in helping Djibouti implement proven methods for effective port management. The Port of Djibouti is also the main point of access to the sea for Ethiopia, a landlocked country with a population of close to 90 million. Nearly 85 percent of the traffic in the port of Djibouti is related to Ethiopian transit shipping. As a result of the recent port and road improvements, the Djibouti-Addis corridor is more attractive to Ethiopian merchants than the Berbera and Port Sudan corridors. The Djibouti-Ethiopian railroad shut down completely in 2009. The Djibouti port complex contributes substantially to the national economy, accounting for nearly 20 percent of GDP and generating 15,000 direct and indirect jobs, or 10 percent of the actively employed population.

9. Djibouti is one of the last three African countries (along with Ethiopia and Eritrea) to have a monopoly in the telecommunications sector. Despite a trend toward improvement, access to telecommunications services remains extremely limited compared to other African countries. Mobile telephone and Internet services are expensive and of poor quality. The deficiencies in the telecommunications sector are a major obstacle to Djibouti's competitiveness as high quality services are necessary to solidify its position as a regional hub, attract foreign investors, and promote the emergence of new sectors of activity. Paradoxically, Djibouti has a powerful but largely underutilized infrastructure of undersea cables. Although Djibouti Télécom manages several undersea cables, it sells the capacity to foreign countries, particularly in the sub-region. In addition to generating substantial, growing income for the national operator, this capacity could be used to spur national development and job creation. Accordingly, the vision proposed for the sector is based on two pillars. The first consists of modernizing the telecommunications sector by opening up the market in order to reduce costs and improve service quality. Such an opening would also have the effect of repositioning Djibouti Télécom in its field of expertise and opening up other market segments to private investors. The second development pillar consists of using the existing telecommunications infrastructure to promote the development of offshoring activities, especially call centers, which could provide employment for young graduates with a good command of languages. To make this ambition a reality, Djibouti has a development strategy for the telecommunications sector and has updated its regulatory framework. The country is working with the Bank on a reform program to help address the issues related to the telecom sector and tape into its potential for growth and job creation.
10. Djibouti's economic and social situation is quite troubling. Many success stories have occurred in small countries such as Cape Verde and Mauritius, whose populations are as small as Djibouti's. The strategic questions for Djibouti today are: "How did those countries, which are similar to Djibouti, manage to develop so quickly?" and "Why has Djibouti failed to develop its economic potential, particularly in the fields of tourism, fishing, and telecommunications?"

Sectoral and Institutional Context

1. To realize its potential, Djibouti must improve its governance and its business environment. Djibouti's main challenges in the years to come are to leverage the expected scaling-up of investment in transport logistics and diversify its economy by developing selected value chains to accelerate growth. In particular, the challenges facing the Government are to (i) improve the investment climate to create the incentive for the private sector to invest in the high value clusters/ value chains; (ii) make strategic choices and the required investment to tap into the potential offered by the Ethiopian market and more generally its strategic position as logistic hub; (iii) maximize the contribution of these investment in the tourism sector, in infrastructures and possibly fisheries to its economy.
2. The decisive factor in economic development is the quality of governance. Both Cape Verde and Mauritius have favorable governance indicators with respect to the rule of law, legal security, combating corruption, and the effectiveness of public policies. Djibouti, on the other hand, suffers from a major governance deficit in all the dimensions mentioned, and is scored rather poorly on those international indicators that cover it. For example, the Bank's World Governance Indicators score Djibouti poorly on voice and accountability, effectiveness of government and rule of law. Corruption remains problematic. Consultations with the Bank on reforming the overall governance environment have focused on: (i) improving legislative frameworks, in particular in relation to private sector activities; (ii) budget transparency and national accounts; (iii) monitoring and evaluating reforms with participation of civil society; (iv) training and capacity-building for public sector officials and institutions; and (vi) strengthening the role of the courts.

3. Djibouti lacks legal security and has a weak judiciary system. In Djibouti the judicial system is beset with numerous problems, such as insufficient resources, no judicial training, lack of independence and impartiality, and the slowness with which judgments are executed. In these circumstances, both the domestic and the international business communities express serious reservations about the ability of the Djiboutian justice system to guarantee the protection of their rights and to resolve disputes fairly. Less than 10 cases are handled each year by the commerce chamber of the court.

4. Recognizing the weaknesses within the judicial sector, the GoD launched a reform strategy in 2011 (Une Justice Efficace, Efficiente, Respectueuse des Droits de l'Homme et au Service du Développement), to be implemented over the period 2012-2016. This reform strategy covers: (i) building human resource capacity; (ii) improving court infrastructure in Djibouti Ville and outside regions; (iii) enhancing access to justice (including the execution of court decisions); (iv) modernizing the civil and criminal codes and procedural codes; (v) addressing gaps in the criminal justice framework; (vi) and improving human rights. To supplement the strategy the GoD has established a special system of commercial courts to address the gaps in services to support private sector development.

5. While the strategy is a positive step forward in terms of planning reform, it is currently not backed by financial and personnel resources from the government, nor are activities related to building capacity of the commercial courts or providing services to the poor and vulnerable. To assist with the implementation of the strategy, the Ministry of Justice (MoJ) requested technical assistance from the Bank, on the following topics: capacity-building to the commercial courts; improving service delivery to the poor and other vulnerable persons; case management and automation; and judicial training. After consultations with the MoJ, it was agreed to focus on support to the commercial courts as a matter of priority given the Bank's comparative advantages and the likely available resources for this proposed Project.

6. Djibouti presents weaknesses in public policy planning and execution conducive to private investments. Indeed, none of the sectors mentioned above has strategic and operational planning instruments elucidating the government's vision for the sector and providing an action plan to guide the work of the departments concerned. Without clear public policies, certain decisions involving important choices are taken without any real coordination or prior reflection. Consequently, instead of offering investors a comprehensible framework, the policy on attracting investments to Djibouti is limited to welcoming project developers and signing memoranda of understanding that rarely yield tangible results. This is especially true of infrastructure projects: the decision-making process is so opaque and disconnected from any strategic planning that obtaining reliable information about such projects is extremely difficult, even within the ministries involved. This governance context discourages serious investors who are interested in developing long-term projects in Djibouti, and who are key to realizing the potential of the growth sectors (especially tourism and telecommunications).

7. To exploit its economic potential to the fullest, Djibouti needs to radically change its governance arrangements. The Government of Djibouti wishes to enhance the use of Public Private Partnerships (PPPs) as a mechanism for procuring and financing infrastructure projects and services in the public sector. A number of PPP projects are either on-going or at various stages of project development. The success of these PPPs will depend, to a large extent on the establishment of a strategic framework comprising a clear guiding policy; appropriate legal provisions and institutional set up capable of efficient implementation of PPP projects; standard procedural guidelines for the process; and adequate transaction, technical, contract management and project monitoring expertise.

8. The General business environment is not conducive to private sector development. The cost and time for starting a business in Djibouti remain high, compared to similar countries despite some

progress since 2012 with the transfer of the Commerce Registry to ODPIC. High tax rates and cumbersome tax regulations and administration were identified as key constraints in the 2013 DB.

9. Access to finance for MSME is limited in Djibouti. A Djibouti FSAP was conducted in 2009. An FSAP follow up was conducted in 2010 focusing on policies to improve access to finance. These studies all concluded concluded that SMEs access finance is limited and made recommendation in that respect. They found that only about 5% of registered firms having a loan. While the amount of credit to the private sector has increased over the past few years, it has been directed towards a small select group of firms and only few SMEs. The FSAP recommendations included (i) the establishment of a guarantee fund to support SME access to financing to alleviate collateral requirement; (ii) help to the CBD to develop a reliable and more comprehensive credit registry (from its several and fragmented existing banking supervision database, monetary statistics, credit registry, checks history files etc.), with an open and transparent consultation mechanism to help reduce information asymmetry in the credit market; and (iii) the modernization of the payment systems.

10. Djibouti SME sector lack skill, know-how and competitiveness. In general, the Djibouti SME sector does not have international exposure and experience on modern management methods and standards. As a result, the level of technical and managerial capability and skills in the business community is low and constitutes an obstacle to new technology adoption, worker productivity improvement and new product development. This has exacerbated market failures that cause SMEs to invest less in modernization and technology acquisition than is economically optimal. The Government should help SMEs make the needed investments to become more competitive because (i) the costs of local expertise are high (consultants, technical experts, trainers and training institutions) and SMEs are unable to afford the services, particularly in light of their deteriorating financial situation. The project could help alleviate the market failure by providing adequate incentives and resources to SMEs to improve their competitiveness.

11. The proposed project will help the Government in its efforts to improve the business environment, enhance its capacity to attract private investors in key promising sectors and strengthen the capacity of local SMEs to be able to respond to demand and market needs.

Relationship to CAS

By requesting support in the form of a first PSD investment loan in Djibouti, the government has signaled its commitment to private sector development and a break from the past. The project Concept Note is in line with key priorities outlined by the Government in its development strategy “Djibouti Vision 2020 Vision” and the new Country Partnership Strategy, which also reflects an ongoing dialogue with the authorities following the completion of the “New growth Model” report. Over FY13, the team has imitated several rounds of consultation with stakeholders and government institutions in order to confirm/inform the content and scope of the proposed project activity so that the Project Concept Note reflects government needs in the areas of Finance and Private Sector Development. Also, as most World Bank financed projects and programs, this proposed project has a capacity building component (under Component 2 and component 3) to provide support to key Government entities involved in its implementation.

II. Proposed Development Objective(s)

Proposed Development Objective(s) (From PCN)

The Project Development Objective is to help improve selected aspects of Djibouti’s business environment and support enterprises in selected sector/industries. The PDO’s related performance indicators are (i) the improvement in the investment climate as measured by the reduction in time required to create a company; and the reduction in time to pay taxes; (ii) the decrease in the average number of days to settle commercial dispute; (iii) the improvement of the performance of SMEs supported by the project as measured by the increase in their sales/turnover compared to a control group. The ultimate beneficiaries would be SMEs, Government and private sector institutions in charge of PPD and investment climate reform.

Key Results (From PCN)

The proposed project will help the Government in its efforts to improve the business environment, enhance its capacity to attract private investors in key promising sectors and strengthen the capacity of local SMEs to be able to respond to demand and market needs.

III. Preliminary Description

Concept Description

The project would have the following two components:
Component 1: Governance and Investment Climate Reform (US$2.5million of which IDA US $1million for the commercial court; US$1million (TBC) through the IFC for Investment Climate Reforms in particular the support for the creation of a one stop for improve business registration, TA to streamline tax and customs regimes, and TF US$0.5million from the First initiative for the access to finance TA); and,
Component 2: Investment Promotion and enterprises development (US$1.5million of which US $1million from IDA for the matching grant, US$0.5million from PPIAF for the PPP framework, and US$0.5million from the FPD Competitive Industries Program for the ANPI and PPD).

IV. Safeguard Policies that might apply

Safeguard Policies Triggered by the Project	Yes	No	TBD
Environmental Assessment OP/BP 4.01		✗	
Natural Habitats OP/BP 4.04		✗	
Forests OP/BP 4.36		✗	
Pest Management OP 4.09		✗	
Physical Cultural Resources OP/BP 4.11		✗	
Indigenous Peoples OP/BP 4.10		✗	
Involuntary Resettlement OP/BP 4.12		✗	
Safety of Dams OP/BP 4.37		✗	
Projects on International Waterways OP/BP 7.50		✗	
Projects in Disputed Areas OP/BP 7.60		✗	

V. Financing (in USD Million)

Total Project Cost:	4.00	Total Bank Financing:	4.00
Financing Gap:	0.00		

Financing Source	Amount
BORROWER/RECIPIENT	0.00
International Development Association (IDA)	4.00
Total	4.00

VI. Contact point

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