

Report No: 134321-DJ

Economic Transformation in Djibouti

SYSTEMATIC COUNTRY DIAGNOSTIC

October 2018

The purpose of this Systematic Country Diagnostic (SCD) is to identify the most critical development constraints facing Djibouti and how to make growth more inclusive and sustainable while promoting shared prosperity. The findings and recommendations of the SCD are based on analytical work carried out by a World Bank Group team with expertise in macroeconomics and poverty analytics, human capital development and labor markets, infrastructure and private sector development, governance and climate change. The team also undertook consultations with the Government of Djibouti and representatives from civil society, private sector stakeholders and the donor community. The SCD provides analysis and recommendations for policies that the Government might pursue to reduce barriers to inclusive and sustainable growth and achieve its vision of becoming a modern economy and regional hub for trade and logistics, which can create jobs and raise living standards for Djiboutians.



Government Fiscal Year:
January 1 – December 31

Currency Equivalents:
Exchange Rate Effective as of May 19, 2018

Currency Unit = Djiboutian Franc (DJF)
US\$1 = 177.72 DJF

Weights and Measures:
Metric System

ABBREVIATIONS AND ACRONYMS

AFC	Africa Finance Corporation	ES	Enterprise Survey
Afreximbank	African Export-Import Bank	FCV	Fragility, Conflict and Violence
AKI	Key Indicators	FDI	Foreign Domestic Investment
CBN	Cost of Basic Needs	FRUD	Front for the Restoration of Unity and Democracy
CCD	Chamber of Commerce of Djibouti	FZ	Free Zone
CCECC	China Civil Engineering Construction Corporation	GDP	Gross Domestic Product
COMESA	Common Market for Eastern and Southern Africa	GFDRR	Global Facility for Disaster Reduction and Recovery
CPEC	<i>Caisse Populaire d'Épargne et de Crédit</i>	GNI	Gross National Income
CPI	Consumer Price Index	HDI	Human Development Index
CPIA	Country Policy and Institutional Assessment	HIS	Health Information System
CRS	Constant Return to Scale	ICT	Information and Communication Technology
CRVS	Civil Registration and Vital Statistics	IDA	International Development Association
CS	Censuses and Surveys	IGAD	Intergovernmental Authority on Development
CSOs	Civil Society Organizations	ILO	International Labor Organization
DCC	Djibouti Chamber of Commerce	IMF	International Monetary Fund
DCT	Doraleh Container Terminal	kWh	Kilowatt
DeMPA	Debt Management and Performance Assessment	LMI	Lower Middle Income
DFiD	Department for International Development	MDAs	Ministries, Departments, and Agencies
DFZ	Djibouti Free Zone	MEFI	Ministry of Economy and Finance in Charge of Industry
DISED	<i>Direction de la Statistiques et des Etudes Démographiques</i>	MENA	Middle East and North Africa
DJF	Djiboutian Franc	MICs	middle-income countries
DPW	Dubai Port World	MOH	Ministry of Health
DT	Djibouti Telecom	MSC	Methodology, Standards and Classifications
EBA	External Balance Assessment	NDC	Nationally Determined Contribution
ECHACP	European Commission for Humanitarian Aid and Civil Protection	ND-GAIN	Notre Dame Global Adaptation Index
EDAM	<i>Enquête Djiboutienne Auprès des Ménages</i>	O&M	Operation and Maintenance
EDD	<i>Énergie de Djibouti</i>	ODA	Official Development Aid
EDESIC	<i>Enquête Djiboutienne sur l'emploi, le secteur informel et la consommation des ménages</i>	ONEAD	<i>Office National de l'Eau et de l'Assainissement de Djibouti</i>
		PAID	<i>Port Autonome International de Djibouti</i>
		PAPFAM	Pan Arab Project for Family Health
		PPP	Public-Private Partnership

RER Real Exchange Rate
SMART Standardized Monitoring and
Assessment of Relief and Transitions
survey

Contents

Abbreviations and acronyms	i
Team members and acknowledgments	vii
Executive summary.....	viii
1. Djibouti's Development Experience and the Case for Economic Transformation.....	1
1.1 The current pattern of robust but debt-financed growth, with high poverty and unemployment, is unsustainable	2
1.2 Looking ahead, what will it take to transform the economy towards inclusive growth?	4
1.2.1 <i>Opportunities and challenges</i>	4
1.2.2 <i>Identifying binding constraints to economic transformation</i>	6
2. Transforming the Environment for Business and Investment: Constraints and Reform Areas	7
2.1 Preserving macroeconomic stability: Recent development, constraints, and what needs to be done	7
2.1.1 <i>Public debt as a risk to macro stability and sustainable growth in Djibouti</i>	7
2.1.2 <i>Fiscal Policy</i>	9
2.1.3 <i>External performance</i>	10
2.1.4 <i>Real exchange rate overvaluation represents a threat to macro stability</i>	13
2.1.5 <i>What needs to be done?</i>	13
2.2 Create conditions for a productive and dynamic private sector: Current situation, constraints, and what needs to be done.....	14
2.2.1 <i>Business regulations, input costs, and competition</i>	14
2.2.2 <i>Firms' access to finance</i>	22
2.2.3 <i>Djibouti's connectivity potential for diversification towards more productive exports</i>	23
2.3 Reforms for ensuring macroeconomic stability and improving the environment for business and investment	23
3. Transforming Human Capital by Investing in Nutrition, Learning and Skills: Constraints and Reform Areas 26	26
3.1 Tackling Childhood Stunting	28
3.1.1 <i>Current situation</i>	28
3.1.2 <i>What constrains child growth in Djibouti?</i>	29
3.1.3 <i>What needs to be done to tackle stunting?</i>	32
3.2 Expanding Schooling, Learning, and Skills	34
3.2.1 <i>Current situation</i>	34
3.2.2 <i>What is constraining schooling, learning and skills acquisition in Djibouti?</i>	35
3.2.3 <i>What needs to be done?</i>	38
3.3 Reforms for transforming human capital	39
4. Transforming Governance for Effective Public Service Delivery: Constraints and Reform Areas	40
4.1 Current situation	40
4.2 Improving public administration capacity, effectiveness, accountability, and transparency: What are the constraints?	41
4.3 What needs to be done? Reforms for strengthening governance effectiveness.....	43
5. Summary of Policy Actions and Priorities	44

Annex 1. Brief History of Djibouti	49
Annex 2. Growth and labor market paradox.....	49
A2.1 The empirical framework of measuring growth in TFP	49
A2.1.1 Growth-accounting assessment and results.....	49
A2.1.2 The empirical framework of measuring growth in TFP	51
A2.2 Djibouti’s labor market paradox – the low employment rate	52
Annex 3. The SCD approach	55
A3.1 Business environment analysis	56
A3.1.1 The enterprise survey diagnostic	56
A3.1.2 Competition Policy and Poverty Alleviation.....	59
A3.1.3 Djibouti’s ranking on ICT.....	61
A3.1.4 Tourism sector as a promising area for jobs creation	62
Annex 4. Djibouti’s External Sector.....	64
Annex 5. The Worldwide Governance Indicators (WGI)	69
Annex 6. Environmental Sustainability	70
Annex 7. Data Diagnostic.....	77
Annex 8. Analyzing three hypotheses about Djibouti’s development challenges	79
A8.1 Is the high-cost base economy due to small state size?	79
A8.2 Is the elasticity of employment to growth low?	82
A8.3 Has Djibouti exploited all the benefits associated with its location?.....	82
References.....	83
Endnotes.....	87

Figures

Figure ES.1 Contribution to Growth by Factor	ix
Figure ES.2 Contribution to Growth by Sector	ix
Figure ES.3 Growth Decomposition	ix
Figure ES.4 Poverty Rates (National Poverty Line).....	ix
Figure ES.5 Macroeconomic Conditions: Debt, Fiscal and Current Account Deficits	xi
Figure ES.6 Prevalence of Under-5 Stunting, 1996-2013	xii
Figure ES.7 Djibouti’s percentile rank on World Governance Indicators (0=worse, 100=best governance)	xiv
Figure 1.1 Annual GDP Growth	2
Figure 1.2 Sectoral Share of GDP.....	2
Figure 1.3 National Poverty Rates	3
Figure 1.4 Debt, Fiscal and Current Account Deficit.....	3
Figure 1.5 Annual Contribution to Growth by Factors and TFP 2005-2015	3
Figure 1.6 Net Job Creation	4
Figure 1.7 Labor Force Participation Rates by Age	4
Figure 1.8 Opportunities and Challenges	5
Figure 2.1 PPG Debt, Fiscal and Current Account balances	9
Figure 2.2 Trade balance (% of Exports).....	12
Figure 2.3 Trade and Current Account Balances (%GDP)	12

Figure 2.4	SOE Sales as a Percentage of GNI for Selected Countries (2011) versus Djibouti SOE Contribution ... to GDP (2014)	19
Figure 2.5	Operational Business Risks Related to Weak Competition Policies for Selected Countries (2015) ..	19
Figure 2.6	Minimum Capital Requirements for Accessing Free Zone Benefits, Djibouti versus UAE.....	20
Figure 3.1	Government Spending on Education	27
Figure 3.2	Public Spending on Health (% of GDP)	27
Figure 3.3	Prevalence of Under-5 Stunting, 1996-2013	28
Figure 3.4	Stunting Prevalence and GDP Per Capita in Africa	28
Figure 3.5	Regional and Income Disparities in Stunting Rates	29
Figure 3.6	What needs to be done to tackle stunting?	34
Figure 3.7	Educational Attainment Among Working-Age Population	34
Figure 3.8	School Progression	35
Figure 3.9	What Needs to be Done to Raise Children’s Schooling and Ensure They Acquire Relevant Skills? ..	38
Figure 4.1	Djibouti’s Performance on Key Governance Indicators: Score and Rank	41
Figure 4.2	Average rank on Worldwide Governance Indicator	41
Figure 4.3	Voice and Accountability	41
Figure 4.4	Framework for Improved Governance	42
Figure A2.1	Annual contribution to growth by factors and TFP 2005-2015	50
Figure A2.2	Labor Participation by Age	52
Figure A2.3	Labor productivity (GDP per employed person), 2016 estimates	53
Figure A2.4	Growth in labor productivity	53
Figure A2.5	High Wages Induced by Public Sector and Unemployment:	54
Figure A2.6	Composition of Employment, 2015	54
Figure A3.1	Inclusive growth analytics	56
Figure A3.2	Business Environment Analysis	56
Figure A3.3	Size Comparison in Manufacturing	58
Figure A3.4	Employment Share of Young Firms	59
Figure A3.5	Net Job Creation (3 years)	59
Figure A3.6	Distribution of Firms by age	59
Figure A3.7	Employment Share by Age	59
Figure A3.8	Ranking of the ICT Sector in lower-income countries from MENA and Sub-Saharan	62
Figure A3.9	Djibouti’s Ranking by Arab Regulatory Network (AREGNET) on Key ICT indicators	62
Figure A4.1	Trade Openness Relative to Income in Djibouti	64
Figure A4.2	Import versus Exports and the Trade Deficit.....	64
Figure A4.3	Export of Services vs. Goods.....	65
Figure A4.4	HHI in products.....	66
Figure A4.5	Djiboutian Export Decomposition by Number of Goods and Destination, Relative to Peers	66
Figure A4.6	Decomposition of Export along Margins of Trade.....	67
Figure A4.7	Products Birth, Survival and Death.....	68
Figure A4.8	Export Sophistication.....	68
Figure A6.1	Component Plot of Vulnerability	71

Boxes

Box 3.1	Lack of an Integrated National Water and Sanitation Sector	31
Box A3.1	Djibouti’s state monopoly in the telecommunications sector	61

Tables

Table ES.1	Policy Actions	xvii
Table 2.1	Djibouti’s Performance on Logistics Performance Index	11
Table 2.2	Costs of Getting Electricity in Djibouti Compared to Others	16
Table 2.3	Cross-country Comparisons of ICT Performance Indicators (2016)	17

Table 3.1	Drivers of Stunting in Djibouti	31
Table 4.1	What are the Constraints to Capable, Transparent, and Accountable Public Administration Needed for Effective Service Delivery?	43
Table 5.1	Policy Priorities Across Business Environment, Human Capital and Governance	46
Table A2.1	Compound Annual Growth Rates of Factors (percent)	50
Table A2.2	Contribution to growth by period (%)	51
Table A3.1	Number of Firms by Sector and Employment	58
Table A3.2	Non-exhaustive List of State-owned Enterprises in Djibouti, as at 2014	60
Table A4.1	Djibouti’s Top Export Goods in 2005 and 2016	65
Table A6.1	ND-GAIN Scores of Djibouti vs. Comparable Countries in 2016	70

TEAM MEMBERS AND ACKNOWLEDGMENTS

The Djibouti Systematic Country Diagnostic was led by Julie Lohi (Economist, IBRD), Nistha Sinha (Senior Economist, IBRD), and Adamou Labara (Country Manager, IFC) with support from Thomas Laursen and Emmanuel Pinto Moreira (Lead Economists); Tracey Lane, Gustavo Demarco, and Ashish Khanna (Program Leaders); and Praveen Kumar (Economic Advisor). The report was prepared under the overall guidance of: Asad Alam (Country Director, MNC03), Atou Seck (Country Manager, MNCDJ), Poonam Gupta (Country Program Coordinator, MNCA3), Kevin Carey (Practice Manager, GMTMN), and Benu Bidani (Practice Manager, GPV06). Peer reviewers were Paul Brenton (Lead Economist, GMTRI) and Francisco Galrao Carneiro (Practice Manager, GMTA1). Edouard Al-Dahdah (Senior Public-Sector Specialist, GGOOS) and Nabila Assaf (Practice Manager, GFCME) provided substantive inputs. Muna Salim (Senior Program Assistant, GMTMN) supported the team throughout the SCD preparation process. The report was edited by Deborah Davis (Consultant).

The SCD extended team consists of staff from across the World Bank Group’s Global Practices (GPs) and Cross-Cutting Solutions Areas (CCSAs). The extended team played an important role in providing expert input and critical review throughout the SCD process. Important contributions from Claudio Montenegro and Reyes Aterido are gratefully acknowledged.

GP, CCSA, or Unit	Team members
Climate Change	Jason James Smith
Competition Policy	Sara Nyman
Education	Simon Thacker
Energy	Emmanuel Py
Environment and Natural Resources	Charlotte De Fontaubert
Finance and Markets	Roya Vakil
Fragile, Conflict and Violence	Catalina Quintero
Governance	Robert Yungu, Abdoulaye Keita
Health, Nutrition and Population	Elizabeth Mziray
International Finance Corporation	Adamou Labara
Jobs	Dino Leonardo Merotto
Macroeconomics and Fiscal Management	Julie Lohi
Poverty and Equity	Gabriel Lara Ibarra, Vibhuti Mendiratta
Social Protection and Labor	Philippe Auffret, John Van Dyck (Social Protection)
Social, Urban, Rural and Resilience	Brahim Abdelwedoud
Trade and Competitiveness	Amadou Dem
Transport and Information and Communication Technology	Sami Ali (Transport), Xavier Decoster (Information and Communication Technology)
Water	Sally Zgheib, Mouhamed Fadel Ndaw

EXECUTIVE SUMMARY

Djibouti is a relatively young nation, having gained independence from France in 1977. The Government is headed by the president, who serves a 5-year term. Legislative power is vested in the parliament. Djibouti has adopted many modern institutions that are still maturing against a backdrop of a nomadic pastoral tradition. The country is classified as a fragile state based on its score on the World Bank's Country Policy and Institutional Assessment (CPIA).

Djibouti is a small¹ lower-middle income economy that occupies a pivotal position for trade and security in the Horn of Africa and Gulf of Aden. The country is strategically located at the crossroads of maritime trade – one of the world's busiest shipping routes with access to the Mediterranean and Indian Ocean and a key connection point between Africa, Asia and Europe. Djibouti's main physical asset is a natural deep-water port that makes it a convenient refueling and transshipment center. The country also services the trade of its fast-growing but landlocked neighbor, Ethiopia. Ethiopian trade service accounts for more than 80 percent of the Djiboutian port activities. The country also plays an important security role in the region, hosting refugees fleeing political and environmental crises from neighboring countries. In addition, Djibouti hosts several foreign military bases whose rents are an important source of government revenues.

Djibouti achieved a remarkable growth over the last decade by investing in transport and port infrastructure and making the most out of its geo-strategic asset. Yet looking ahead, there are concerns about inclusiveness and sustainability of this growth. Over 2013-2016, GDP growth averaged 8 percent (Figure ES.1) and GDP per capita growth averaged 6.3 percent over the same period, a strong performance compared to similar countries. But this growth has not been inclusive: extreme poverty continues to affect 20.8 percent of the population, unemployment is high (39 percent) and human capital outcomes are generally low. Djibouti's human capital is limited not only because of its population size, but also because of low human development outcomes, with nearly half of its working age population (ages 15-64) never having attended school and about a third of children affected by malnutrition. Poverty is particularly high outside Djibouti City, at 44.6 percent (Figure ES.4). Capital accumulation, increasingly debt financed, has been the main driver of growth, with little contribution from labor productivity or innovation by firms (Figure ES.3). Debt-financed capital accumulation raises concerns about the sustainability of growth, as it has led to a rapid rise in external public and publicly guaranteed (PPG) debt. PPG debt rose from 57.1 percent of GDP in 2014 to an estimated 89.7 percent in 2017. The repayment burden of the fast-maturing debts is expected to constrain fiscal space and could limit much-needed spending in social sectors. Moreover, the country faces the challenges posed by the arid climate, including high drinking water scarcity and vulnerability to droughts. Climate and environment-related hardship has increasingly become a concern for the pastoral population living outside of Djibouti City, whose main source of income – livestock – were affected by the recent drought.

More fundamentally, the greater role of capital accumulation in growth, along with the limited contribution of labor or productivity, points to a lack of economic transformation. When growth is underpinned by economic transformation, productivity gains are unleashed through a movement of workers and resources from low to higher-productivity activities within and across sectors. Such a

¹ With a population estimated to be 942,300 in 2016 by United Nation Population Division (UNPD).

transformation does not appear to have occurred. Djibouti has been able to grow without significant transformation because this growth has been supported by dividends from its geostrategic importance (ports and military bases), which has reduced incentives to undertake reforms. The services sector is the main engine of the economy, accounting for nearly 80 percent of growth and a significant share of employment; the agriculture sector has very limited potential given Djibouti’s arid climatic conditions (Figure ES.2). Yet, even within services, outside of the public sector, most workers are engaged in low-value informal wholesale and retail trade. Indeed, the majority of its working-age population is either unemployed, informally employed, or out of the labor force. The public sector plays a dominant role in the economy both as an employer and producer of goods and services. Poor human capital outcomes, especially low literacy rates, also contribute to a low-productivity economy. Low value addition in the domestic economy is further evidenced by limited export activity and reliance on imports.

Figure ES.1 Demand Side Contribution to Growth

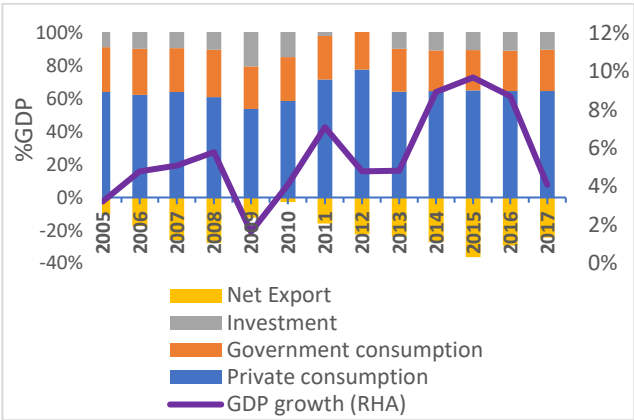
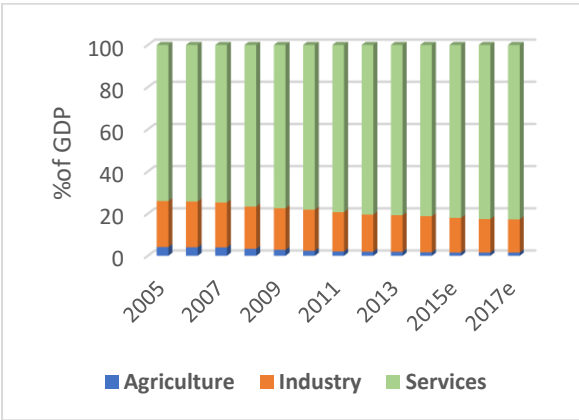
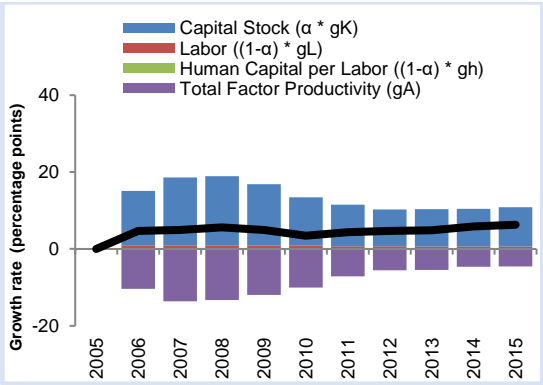


Figure ES.2 Contribution to Growth by Sector



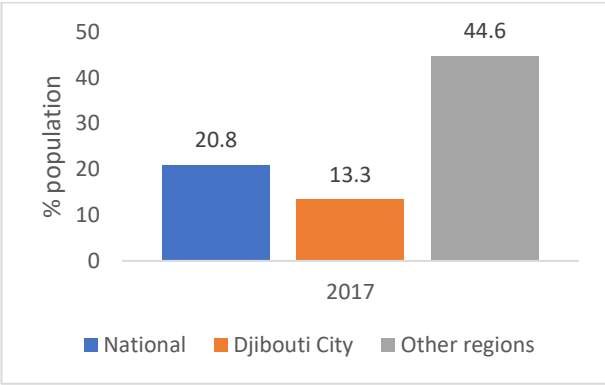
Source: World Bank staff calculations using Government data

Figure ES.3 Growth Decomposition



Source: Bank staff calculation using WDI data

Figure ES.4 Poverty Rates (National Poverty Line), 2017



Source: Poverty using national extreme poverty line for respective survey years. DISED.

The Systematic Country Diagnostic (SCD) argues that Djibouti needs economic transformation to achieve the productivity and employment growth that can, in turn, make growth inclusive and sustainable, driven by a vibrant private sector and healthier, educated and productive workers. The SCD views economic

transformation as a process that changes the production sector as well as human resources. On the production side, the transformation will shift growth from being (a) capital-accumulation driven to productivity driven; (b) state led to private sector led; (c) low to high employment- intensity production processes; (d) concentrated to diversified production sectors; and (e) import oriented to export oriented. Such a shift will also mean that the economy is resilient at the macro-fiscal level, with less reliance on rent-based revenues and more market oriented and competitive. For human resources, transformation will mean a shift to higher human capital with lower disparities in income, gender, and across regions.

Many of the features of Djibouti's lack of transformation – e.g., concentrated production sources, diseconomies of scale, and large presence of the public sector – may be the result of its small size. However, the evidence suggests that the small size of the economy is not a handicap. Djibouti can improve its economic performance despite its size, by undertaking reforms. The experience of small countries such as Mauritius suggests that it is possible to overcome some of the challenges posed by size by exploiting untapped opportunities, pursuing macro-fiscal resilience, and linking strongly to international trade. For Djibouti, underutilized opportunities consist of proximity to markets in dynamic Common Market for Eastern and Southern Africa (COMESA) ² countries, as well as the potential for developing tourism activities, light manufacturing in industrial zones around the port, industrial fishery, and potential for capitalizing on its ICT capability, given its regional comparative advantage as the landing site of undersea fiber optic ICT cables.

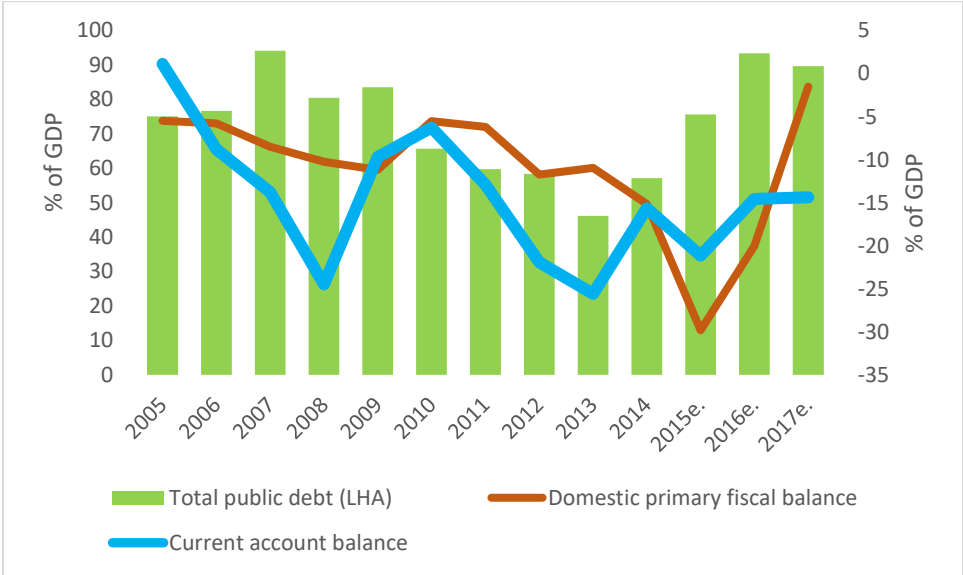
The analysis undertaken for the SCD shows that setting economic transformation into motion would require tackling constraints in three inter-related areas: (a) the enabling environment for business and investment; (b) human capital and workforce skills; and (c) governance effectiveness with capacity of enforcing the rule of law. Examining constraints in the enabling environment for business and investment and human capital is important for understanding the obstacles to shifting of resources and workers to more productive activities and sectors. Governance effectiveness is a cross-cutting area for achieving productivity and employment growth because it affects the efficiency and equity of delivery of services used by businesses and households. Ability to monitor development progress through timely data is an essential component of governance effectiveness. However, data availability is limited which also affected the analysis of the SCD. Either data are absent (such as on refugee population), outdated (government spending on social sectors), not consistently available and comparable over time (such as poverty estimates, labor market indicators, enterprise performance, national accounts), or inconsistent with international data sources (such as school enrollment rates, employment indicators).

Enabling environment for business and investment: The SCD examines two sets of constraints in this area. The first set of constraints relates to the country's **debt level**, the **tax system**, and **factors that hamper export performance**, all of which could potentially discourage investors and reduce growth. With the current debt level, there are fewer creditors willing to provide more external financing or invest in the country. On the tax front, the tax incentive system, which puts more tax burden on SMEs, and the low control capacity of the tax administration create economic distortions and constitute a bottleneck to the business environment and investment. As a result of the distortive tax system, the tax base has been narrow, with risks of further erosion of the base and revenue mobilization, constituting a major constraint

² COMESA currently has 19 members: Burundi, Comoros, Democratic Republic of the Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe.

to sustainably creating fiscal space. Meanwhile, export performance is low, largely due to lack of export-enhancing trade policy and limited domestic production capacity, which in turn increases current account deficit through high reliance on imports. Current account deficits have persisted and peaked at around 25 percent of GDP in 2015 due to increased capital imports for infrastructure projects (Figure ES.5). Another constraint to export performance comes from the fact that the real exchange rate is estimated to be overvalued. However, the SCD recognizes that adjustments to align the exchange rate could adversely affect the deficit and further increase the debt. A key constraint to export performance, is the low competitiveness and productivity of the private sector.

Figure ES.5 Macroeconomic Conditions: Debt, Fiscal and Current Account Deficits



Source: World Bank staff calculation using Government data.

Export performance is further constrained by the fact that despite its membership in COMESA, Djibouti has yet to operationalize the common market’s customs transit guarantee scheme, especially at the Djibouti-Ethiopia border. Djibouti so far has had limited trade with other COMESA countries. Djibouti’s high trade tariffs and non-tariff trade barriers, as reflected by the Logistics Performance Index (LPI), further limit cross-border trade and lower external performance.

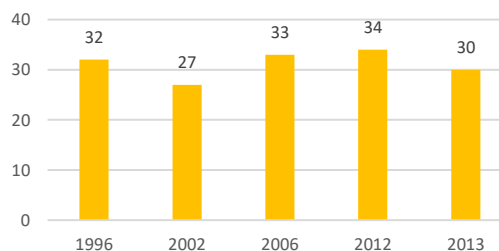
The second set of constraints to the enabling environment for business and investment relates to the **performance of the private sector**. Is the private sector small in Djibouti because of the high cost of finance or because of low perceived returns to engaging in these activities? Both sets of constraints appear to be important. There are constraints to accessing finance both on the supply and demand sides; financial market infrastructure is underdeveloped, and the use of the informal sector by businesses leads to widespread use of cash in transactions and limits the use of banking services. There are several factors that reduce the perceived returns to private sector investment. Among these, the SCD identifies (a) a tax incentive system which favors large firms and creates economic distortions; (b) business regulations, where there have been notable efforts to improve the business environment, but further reforms are needed to reduce the procedural hurdles and cost to start up and register a business; (c) lack of competition with no competition policy in place and the presence of state-owned enterprises (SOEs),

which affect private sector’s opportunity to compete on a level playing field in a number of markets usually supplied by private players.

Firms also face productivity constraints arising from high costs of hiring skilled workers and using electricity and ICT – two services provided by state-run utilities. Low human capital of the workforce and a shortage of skilled workers create a disconnect between labor productivity and labor costs and reduce firms’ incentives to use labor-intensive technologies. The public sector, a large employer in the labor market, competes with the private sector for skilled workers; high public-sector wages further bid up the private sector’s cost of hiring skilled labor. In the last enterprise survey conducted in 2013, 47 percent of firms (in services and manufacturing) reported electricity to be a constraint. Electricity tariffs paid by businesses are among the highest in the Middle East and North Africa (MENA) region due to the generation mix, which consists of cheap power purchased from Ethiopia and aging and costly generation capacity within Djibouti. High technical and non-technical losses, operation and maintenance costs of aging power plants and the grid, salaries, and taxes paid on imported power from Ethiopia further add to the high cost of electricity provision. With regard to ICT, Djibouti’s potential is widely known. Yet, the country is ranked consistently among the most expensive in MENA by the Arab Regulators Network for two main products essential for business operation – business broadband providing satisfactory quality of service, and leased lines providing digital connections among a company’s various physical sites.

Human capital and workforce skills: Raising human capital is crucial for improving the employability of workers. Is human capital low because of low demand from households (especially the poor) to invest in human capital or because the supply of services (mostly by the public sector) is of low quality? The SCD reviewed constraints to human capital development on both the demand and supply sides by focusing on two key areas that have implications for future productivity growth: the prevalence of childhood stunting, and poor education and skills outcomes. The most recently available data on nutritional status (Figure ES.6) show that 30 percent of the children under 5 years of age are stunted, a result of chronic undernutrition. While school enrollments have improved over time (there are some discrepancies between nationally and internationally reported enrollment rates), progression from primary to secondary and tertiary is low. Girls’ school progression lags that of boys. After OTI in 5th Grade, girls are less likely to continue their studies. Looking across the constraints in this area, there are a whole range of obstacles on both the supply and demand sides.

Figure ES.6 Prevalence of Under-5 Stunting, 1996-2013



Source: UNICEF/WHO/WB 2017; SMART Survey 2013.

Failure to grow adequately, or childhood stunting, generally manifests within the first 1000 days of life (from a woman’s pregnancy up to 2 years of age) and can cumulatively lead to older children being excessively short for their age. Following the framework used by the World Bank,³ the SCD examines the country’s performance in addressing five underlying drivers of stunting: (a) adequate food security at the

³ World Bank 2017b.

household level; (b) access to adequate care; (c) access to healthy environment through water, sanitation and hygiene services (WASH); (d) adequate health care services; and (d) household income, poverty status, and location. Poor and rural children fare worse across all these drivers – not only in access to food and health care services, but also in access to basic WASH services provided by the state-run utility, Office National de l’Eau et de l’Assainissement de Djibouti (ONEAD). Drinking water, an essential element of WASH services, is scarce in Djibouti due to its geography and climate. Only 65 percent of the rural population has access to improved water sources. While almost all urban households have access to improved water sources, only 50 percent of the population of Djibouti City is connected to the public water supply through individual connections, the other half having to draw water from connected neighbors or from public standpipes. Access to sanitation, another component of WASH services, is limited only to the capital city. Rural children’s access to health services is also likely constrained by lack of electricity; most of the grid connections managed by the electricity utility (*Electricité de Djibouti* - EDD), are in Djibouti City.

The country’s pastoralists face elevated risks of food insecurity because they rely on dryland livestock raising. It is also difficult to reach them with health services. Since 2010, drought conditions have affected pastoralists through both reduced herd sizes and lower earnings from milk sales. Pastoralists are particularly vulnerable to the growing climate variability. On the Notre Dame Global Adaptation Index (ND-GAIN), Djibouti is ranked 159 out of 181 with respect to its vulnerability⁴ to climate change and its lack of readiness⁵ to address and adapt to these vulnerabilities.

Schooling, learning, and skills acquisition are affected by child and household characteristics and the quality and availability of the education system. There is no systematic study of which of these factors plays a more important role in constraining education and skills in Djibouti. However, it is apparent that teaching-related factors play a role in student learning, and the use of French language instruction or the poor use of pedagogical strategies can affect learning outcomes. Since Djibouti does not participate in international learning assessments, there is no data to evaluate quality of education.

Children from poor households and in rural areas are significantly less likely than better off and urban children to be enrolled at any level of school. To what extent these patterns reflect low demand for schooling for girls or in rural areas is unclear. Available evidence suggests that cost or distance to school are not common concerns, but responsibility for household chores could be a factor in discouraging schooling for girls. Schools’ lack of basic infrastructure and double shifting could be additional reasons for low enrollment. Those who progress through basic education and reach the tertiary level face challenges such as insufficient academic preparation; an under-developed tertiary education sector (single university and several small institutes under various ministries/authorities); the French system of open admission to the university, which can result in rapid crowding of most existing programs; and lack of external quality assurance mechanisms. For the sizeable population who have already left the education system or have never attended school, training opportunities and entrepreneurship appear to be limited. But according to the government, youth training programs in entrepreneurship are underway. The Center for

⁴ ND-GAIN Vulnerability measures a country’s exposure, sensitivity and capacity to adapt to the negative effects of climate change. ND-GAIN measures overall vulnerability by considering six life-supporting sectors: food, water, health, ecosystem service, human habitat and infrastructure.

⁵ ND-GAIN Readiness measures a country’s ability to leverage investments and convert them to adaptation actions. It measures overall readiness by considering three components: economic readiness, governance readiness and social readiness.

Entrepreneurship and Leadership is expected to soon begin its operations that could have significant impacts.

Governance effectiveness: As in most small states, the public sector plays a large role in Djibouti's economy, making it imperative that governance-based constraints are addressed. The *World Development Report 2017, Governance and the Law*, points to the improvement of governance as an important factor in restoring confidence in institutions and thus unlocking the potential of the private sector and people's ability to invest in human capital. Despite

Figure ES.7 Djibouti's percentile rank on World Governance Indicators (0=worse, 100=best governance)



Source: Worldwide Governance Indicators

improvements in recent years, Djibouti faces complex governance challenges and fragility. Djibouti scores low on Worldwide Governance Indicators (WGI) and is ranked among countries with low governance performance. In particular, voice and accountability, which are critical for citizens' engagement in the development process, remain low in the country (Figure ES.7). On a different measure, the country ranks 36th out of 54 on the Ibrahim Index of African Governance. The lack of government effectiveness in Djibouti is further evidenced by the country's performance on the World Bank's Country Policy and Institutional Assessment (CPIA). The CPIA assesses the capacity of a country's policy and institutional framework to foster sustainable growth, poverty reduction, and the effective use of development assistance.⁶ Djibouti's performance on the CPIA has been low and has further deteriorated in recent years. The country is classified as a fragile state based on its CPIA scores.

Other evidence demonstrates the limitations in the capacity and effectiveness of public administration and management. For example, in the delivery of health and nutrition services, sectoral capacity for planning, budget management and information, and monitoring and evaluation is low, leading to low budget execution. The availability of skilled human resources is also low: while 22.8 skilled health workers are needed per 10,000 people, only 10 skilled health workers per 10,000 people are available. This ratio is among the lowest in the MENA region.

Both capacity constraints and the limited use of ICT-enabled technology appear to be affecting the ability of the public administration to transparently and effectively monitor the performance of public services delivery. Djibouti performs worse than comparators on the World Bank's Statistical Capacity Indicator. Lack of reliable and timely data on national accounts, enterprise performance, labor markets, and lack of comparable poverty series over time, all affect the ability of the state to monitor development progress and adapt policies accordingly. Reliability and timeliness of administrative data is also a concern. For example, the Health Information System (HIS) is affected by poor data collection and processing techniques; a lack of interconnectivity among different data platforms; a limited ability to identify the

⁶ The CPIA consists of 16 criteria grouped into four equally weighted clusters: "economic management," "structural policies," "policies for social inclusion and equity," and "public sector management and institutions." The 16 criteria capture key factors that foster pro-poor growth and poverty alleviation. The rating of each of the criteria reflect a variety of indicators, observations, and judgments, focusing on the quality of the country's current policies and institutions.

specific information required to monitor equity, coverage, quality and efficiency; as well as general organization and management problems.

The SCD articulates the policy actions needed to tackle the constraints in the three inter-related areas of the enabling environment for business and investment, human capital and workforce skills, and governance effectiveness (Table ES.1). Given Djibouti's small economy and macroeconomic context, addressing these constraints can have a long-lasting development impact. Several of these constraints and associated reforms also have important complementarities for other actions and reforms. The constraints and associated policy actions can be grouped as follows:

- a. To tackle high production costs for firms stemming from cost of electricity and ICT inputs, to alleviate the adverse impact on child stunting arising from lack of clean water and sanitation, and to ensure rural primary health centers have access to electricity (grid or off-grid, renewable), Djibouti must undertake **policy and institutional reforms and investments in basic infrastructure services** such as ICT; water, sanitation, and hygiene (WASH); and electricity. It is also necessary to strengthen the operation and financial viability of the associated state run-utilities: Djibouti Telecom, ONEAD, and EDD respectively. For Djibouti Telecom, this could mean redefining its strategic positioning by developing the national fixed and mobile broadband market through sector liberalization, following the example of countries such as Cabo Verde, Bahrein, and Brunei. For WASH, there is need for a holistic, clear, and updated sector strategy as well as the evolution of the institutional structures and regulatory regime. In the case of ONEAD, in charge of WASH services provision, a priority is to improve its financial viability and reduce losses from non-revenue water provision. To improve electricity cost and access, important measures include regulatory reform; increasing generation capacity, especially considering renewables; regional integration of the Djiboutian transmission grid; and expansion of transmission and distribution of electricity.

- b. To ensure that children and youth have adequate access to quality health, nutrition, and education services, **reforms in public services delivery** are needed. For health and nutrition services, there is a need to strengthen service delivery, particularly outside the capital city, and expand the availability of trained skilled health workers. Developing quality training programs that meet the needs of employers are needed to help today's young graduates find jobs. Early Childhood Development (ECD) programs are important for tackling both childhood malnutrition and preparation for school. ECD programs can offset the adverse effects on cognitive ability among older children who are already stunted. Spending on ECD programs has been found to be among the most cost-effective investments made by governments. Introducing standardized testing for students in primary and secondary education will greatly enhance the monitoring of the quality of education services. Greater tertiary enrollment is needed to supply the labor market with higher-skilled workers. Several steps can be taken to develop tertiary education, including: (a) development of selective, professionally oriented programs within the University, following the successful model of the faculty of engineering and bachelor in business administration; and (b) preparation of a national-level vision system and strategic planning for the future expansion and consolidation of the tertiary education system.

- c. To enhance the returns to starting a business and support macro-fiscal stability, a set of **private-sector enabling and fiscal policies** are needed. Expanding domestic sources of revenue from tax reform could reduce the need for external borrowing thus creating conditions that are favorable to attracting investments. For the private sector to grow and create jobs, a key policy action is to improve access to finance. This is because as the Government makes noteworthy progress in improving the environment for doing business, demand for finance by new and existing firms will likely grow. Leveraging COMESA to access foreign markets will help reduce costs for exporting firms. Adopting a competition policy will facilitate the entry of new firms.

- d. Since poor households and those residing in rural areas are particularly worse off in human capital outcomes, developing equitable and efficient **transfer programs for poor and pastoralist households** will support these households' investment in their children's human capital, especially that of girls. For social safety net programs (cash transfers or in-kind) for the poor, it will be important to ensure adequate spending and implementation of the new social protection strategy. Promoting inter-sectoral coordination can help social safety net programs (especially conditional cash transfers) incentivize poor households to invest in children's nutrition, health, and education. Supporting pastoralists' capacity to adapt to climate variability is important as it will reduce their reliance on emergency humanitarian assistance and instead develop their resilience to shocks. Adaptation efforts could be complemented with weather index insurance and cash transfers to help pastoralist household cope with the effect of droughts.

- e. **Cross-cutting governance effectiveness reforms** could help address the lack of access to services by both businesses and households by increasing transparency and accountability. Two key actions include (a) investing in development data systems to monitor progress and make informed and transparent policy choices, and (b) enhancing the capacity of public administration. Greater use of ICT has the potential to enhance the efficiency of service delivery by supporting the improvement of information services; the strengthening of public service delivery systems; the collection of citizens' feedback on service quality; and the improvement of collaboration across and beyond government.

Table ES.1 Policy Actions

Policy and institutional reforms and investments in Infrastructure to improve access and costs	Public services delivery reform	Create enabling conditions for a productive and dynamic private sector	Transfer programs for poor and pastoralist households
1. Electricity	1. Training for employment and entrepreneurship 2. Health and nutrition systems reform	1. Tax system reform	1. Social safety nets; cash or in-kind transfers with incentives for girls' education
2. ICT		2. Access to finance	2. Measures to manage food security
3. Water, Sanitation, and Hygiene	3. Comprehensive education system reform (ECD to tertiary)	3. Competition policy 4. Greater regional integration (COMESA)	3. Measures to promote adaptation to climate change among pastoralists and consider other measures to support income generation among this group
Governance Effectiveness (Cross-Cutting)			
1. Transparency/ accountability through data and citizen's engagement 2. Public administration capacity and efficiency			

Because of Djibouti's climatic conditions and water scarcity, certain policy actions (such as expanding water access and supporting pastoralists livelihoods) will have to adopt environmentally sustainable measures in both urban and rural areas. With poor urban planning and spatially concentrated growth, slums and unplanned areas have little to no access to basic services.⁷

These five areas for policy action not only have potentially large and lasting impact, but they also share strong complementarities. For example, global experience suggests that tackling stunting is a complex development challenge. A nationally championed multi-sectoral approach would consist of nutrition-specific measures to directly impact children's growth, as well as nutrition-sensitive WASH investments that indirectly affect children's ability to stay healthy and grow. The experiences of countries such as Peru and Rwanda demonstrate the feasibility of a coordinated government push to reduce childhood stunting. Such a coordinated approach calls for an improvement in governance and service delivery. Similarly, improving access to and cost of electricity, ICT connectivity and WASH services could have a cascading effect on the private sector's ability to diversify and create jobs, support improvements in education and health, and help the public sector become more transparent and effective in delivering services. Health

⁷ According to ECHACP (2017), close to 400,000 people, about 40 percent of the country's population, live in slums on the edges of Djibouti City with minimal services.

system reforms and access to ECD create the foundations for a healthy and productive workforce by tackling malnutrition among children today and preparing children for learning.

Recognizing the complementarities across several of these reforms, the policy actions can be further sorted into the following priorities.⁸ Given their strong development impact and complementarities across businesses, human capital, and governance, investing in policy and institutional reforms and investments in the basic infrastructure services of electricity, ICT, and WASH are a top priority for policy action. The next three priorities are reforming public service delivery of health and nutrition, education, and training; creating conditions for a productive and dynamic private sector; and supporting poor and pastoralist households through efficient and targeted transfer programs. Enhancing governance effectiveness is a cross-cutting policy action needed to make other reforms effective. In particular, better data collection systems, gender-disaggregated where feasible, to monitor and track key economic and social indicators will go a long way toward closing knowledge gaps and designing evidence-based policy interventions.

⁸ When putting together a list of priorities, a question that commonly arises is the feasibility of recommended reforms. Such an assessment is outside the scope of the SCD; however, the *World Development Report 2017* suggests that in the face of obstacles, reform priorities that follow the path of least resistance could be more effective.

1. Djibouti's Development Experience and the Case for Economic Transformation

Djibouti is a relatively young lower middle-income country in the Horn of Africa. It is a small country of about 942,300 inhabitants, with more than 80 percent of the population residing in the capital city. The country's productive potential is high, as 64 percent of the population is of working age (15-64). The working-age population is estimated to be growing at 1.65 percent per year (adding between 8,000-9,000 people of working age per year). Djibouti's location makes agricultural development a challenge; it has an arid desert climate; year-round high temperatures; prolonged droughts; and limited rainfall,⁹ arable land, and ground water. Unlike many of its comparators,¹⁰ the country's agriculture sector is almost nonexistent, accounting only for about 1.5 percent of GDP and 2 percent of employment in 2015. The country thus relies heavily on food imports as well as imports of manufactured goods and energy products. Population growth has been spatially concentrated in the capital, Djibouti City, resulting in an expansion of slums and unplanned settlements – a phenomenon common to many developing countries.

The country is located at the gateway to Africa and at the crossroads of the world's busiest shipping routes, with access to the Red Sea and Indian Ocean. This strategic location and a natural deep-water port makes Djibouti a refueling center and a trade and transshipment center. The country plays an important regional role in hosting refugees who are fleeing political and environmental crises from neighboring countries. Djibouti also hosts many foreign military bases.

Djibouti's location in the arid climate zone poses high risks to its environmental sustainability. Djibouti is vulnerable to extreme events such as droughts, floods, and volcanoes. Moreover, Djibouti is at risk of sea level rise. Meanwhile more than 80 percent of its population lives in the capital city near the coast. The frequency of climatic disturbances continues to affect the population, exposing them to food insecurity, scarcity of drinking water supply and irrigation, concerns for public health, more needs for environmental management, and changes in lifestyle. The environment hardship has increasingly become a concern for the rural population, mostly nomads, whose main source of income – livestock are often wiped out by prolonged droughts.

Djibouti has made remarkable economic progress since 2000 because of trade and investments. After a civil war in the 1990s,¹¹ a peace agreement with a power-sharing arrangement was reached in early 2000 and continues to be maintained. The stable domestic political environment has allowed Djibouti to take advantage of its strategic location to attract investors and boost growth. The most important investments to date include ports development and construction of an electric railway that connects the country to Ethiopia, Africa's second most populous country and fastest growing economy, whose imports and exports account for more than 80 percent of Djibouti's port activities.

⁹ Average rainfall of only 200 mm per year.

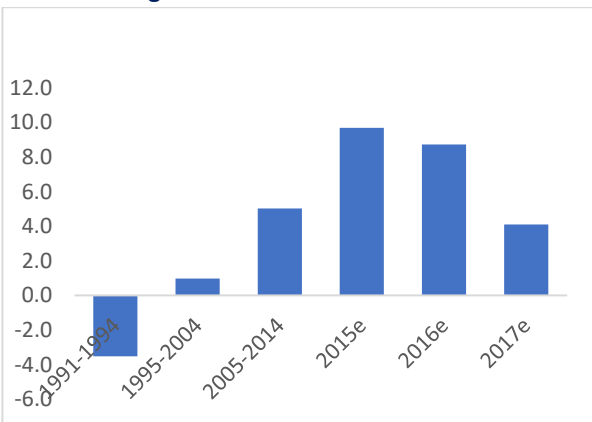
¹⁰ The SCD uses the following comparator countries: Lower-middle income countries, MENA region, and countries identified using World Development Indicators Find-My-Friends tool: Cabo Verde, Comoros, Sao Tome and Principe.

¹¹ Annex 1 presents a brief history of Djibouti.

1.1 The current pattern of robust but debt-financed growth, with high poverty and unemployment, is unsustainable

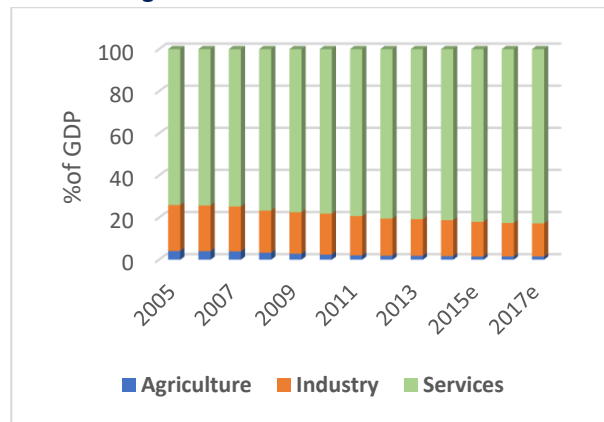
Recent investments in port and transport infrastructure have fueled economic growth and generated a predominantly capital-intensive, services-based economy with a very low export orientation. Close to 80 percent of GDP comes from the services sector. Average per capita GDP growth increased from -4 percent in 1991-1999 to 2.6 percent in 2000-2014, and is estimated at 5.8 percent in 2015-2017; GDP growth reached an estimated average of 9.1 percent in 2014-2016, before plunging to an estimated 4.1 percent in 2017, with ending of the investment projects. These infrastructure development projects that invigorated growth in recent years, were debt financed and led to a rapid rise in external public and publicly guaranteed (PPG) debt. PPG debt grew from 57.1 percent of GDP in 2014 to nearly 90 percent in 2017. Moreover, growth has not been inclusive. Results from the national household survey conducted in 2017 show that 20.8 percent of the population lives in extreme poverty. Measured using the World Bank’s international poverty line of US\$1.90, Djibouti’s poverty rate of 22.5 percent is worse than the average poverty rate of 16.4 percent for lower middle-income countries.¹² According to the employment survey conducted in 2015 (*Enquête Djiboutienne sur l’emploi, le secteur informel et la consommation des ménages or EDESIC*), the unemployment rate is 39 percent, and only 25 percent of the working age population (15-64) is employed. Formal employment is concentrated in the public sector and most employment in the private sector is informal.¹³ The poor are mostly engaged in informal work.

Figure 1.1 Annual GDP Growth



Source: World Bank staff calculations using Government data.

Figure 1.2 Sectoral Share of GDP

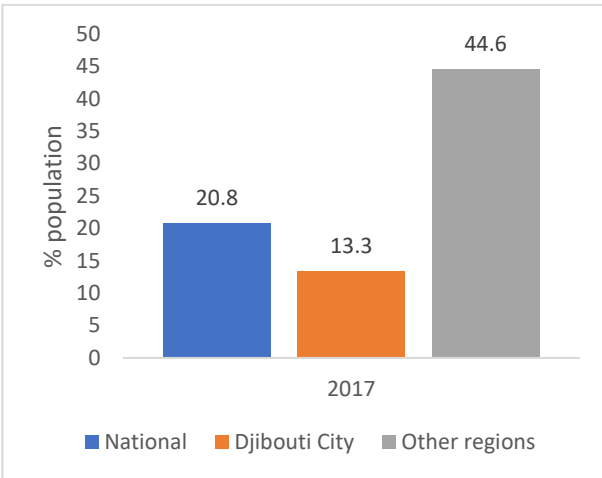


Source: World Bank staff calculations using Government data.

¹² Djibouti performs better than neighboring Ethiopia and comparators such as Sao Tome, but worse than Panama and Cabo Verde.

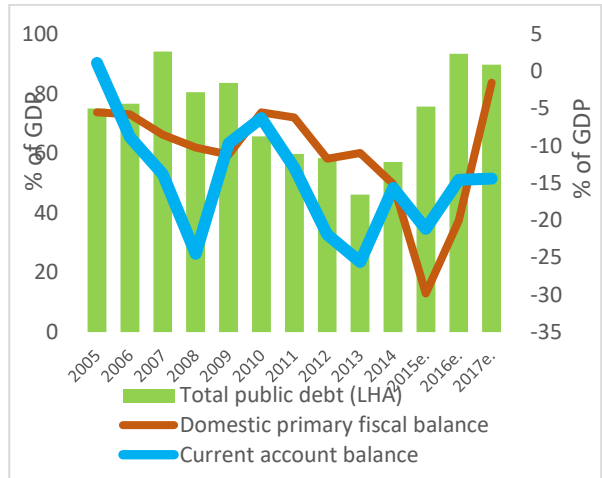
¹³ Employment composition is as follows: 59 percent public sector, 10 percent private formal, 31 percent private informal.

Figure 1.3 National Poverty Rates, 2017



Source: Bureau of Statistics (DISED). Poverty calculated using national extreme poverty line for respective survey years.

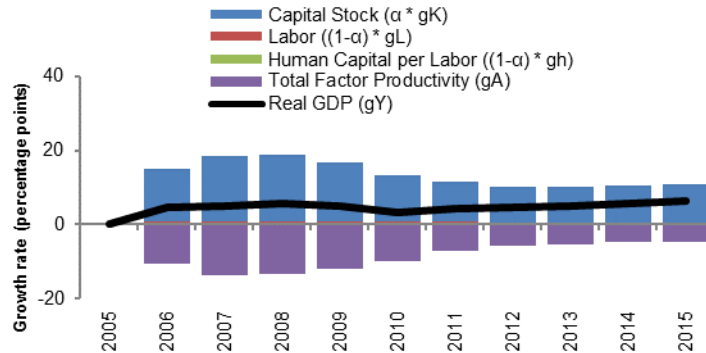
Figure 1.4 Debt, Fiscal and Current Account Deficit



Source: World Bank staff calculations using Government data.

Decomposition of growth into factors of production and productivity (see Annex 2) shows that economic growth has been dominated by capital accumulation, with little contribution from labor. Capital grew on average by more than 21 percent (2005-2015) and contributed 12 percentage points to growth. At the same time, labor grew by only 2 percent and contributed less than 1 percentage point to growth. Total factor productivity (TFP) growth was negative and thus reduced growth.

Figure 1.5 Annual Contribution to Growth by Factors and TFP 2005-2015

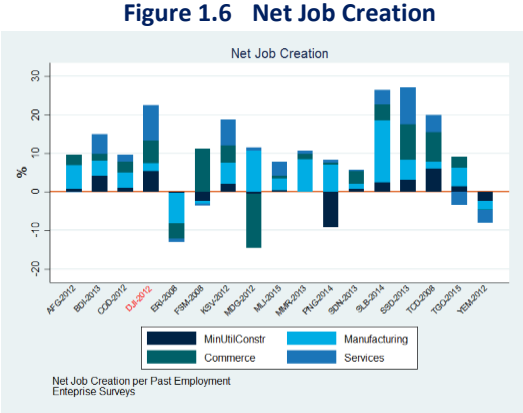


Source: World Bank staff calculations. See Annex 2 for details.

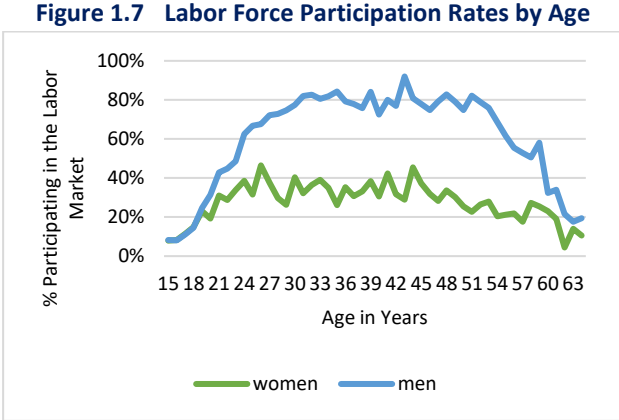
Capital accumulation from large-scale infrastructure and logistics investments has low potential to create employment and mainly raised demand for skilled labor. The job creation potential of ports, transport and logistics sectors is becoming more limited as port services are increasingly automated and rely less on unskilled labor.¹⁴ Outside of ports and logistics, the private sector is a small employer and dominated by services. The public sector is the leading employer, with higher average wages than in the private sector and the main source of formal paid work. Formal Djiboutian firms participating in the 2013 enterprise survey reported net job creation rates comparable to some of the strong-performing countries. Most of this addition to jobs took place in services, commerce, and construction firms. Ninety percent of formal

¹⁴ World Bank 2012, on Transport and logistics in Djibouti.

firms are small and medium size firms (SMEs) and only 25 percent are young firms (1-5 years). On the labor supply side, women are less likely than men to participate in the labor market. Public sector wages contribute to the high unemployment rate of 39 percent. Low labor market-relevant skills are an additional factor. Almost 50 percent of the working age population have never attended school. Consistent with the low average schooling in the country, the labor market returns to schooling, estimated to be 11.5 percent in 2012, is high; this rate of returns to schooling exceeds that for the MENA region.



Source: World Bank staff analysis of 2013 Enterprise Survey data.



Source: World Bank staff analysis of 2015 EDESIC (Employment Survey) data.

1.2 Looking ahead, what will it take to transform the economy towards inclusive growth?

Continued capital accumulation without labor productivity and innovation could bring more growth, but this approach is unsustainable and will not increase employment or reduce poverty. Global experience suggests¹⁵ that sustainable and inclusive growth can be achieved through productivity gains arising from economic transformation, provided the right institutions and policies are in place. For Djibouti, economic transformation would mean that the country achieves growth that is private sector led and employment intensive and is rooted in diversified sectors of production, with greater regional integration and export orientation.

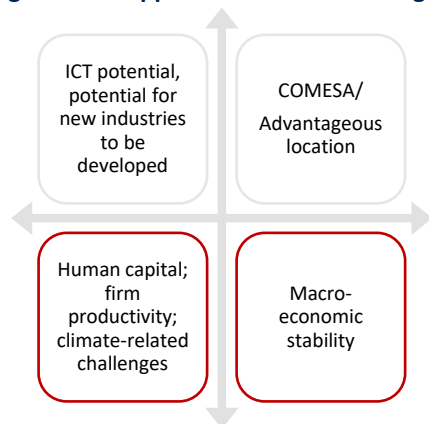
1.2.1 Opportunities and challenges

In seeking to make this shift, the country faces a favorable set of conditions because of its strategic location as a key connection point between Africa, Asia and Europe, which favors regional and global trade linkages (Figure 1.8). The recent infrastructure investments (in ports and railway) in Djibouti have the potential to transform the economy and enable it to achieve its long-term development goal of becoming a multimodal regional hub for trade and logistics. In addition to infrastructure, Djibouti has a regional comparative advantage as the landing site of undersea fiber optic ICT cables, which has the potential to exponentially increase access to mobile broadband and spur growth through manufacturing, fishery,

¹⁵ IMF 2014; MCMillan et al. 2016.

tourism,¹⁶ financial services, healthcare and other industries, with important spillover effects on supply chains and employment. A member of the World Trade Organization (WTO), unlike its biggest trade partner Ethiopia, Djibouti is a member of the COMESA free trade area, with substantial potential for gains from greater regional integration. Given its location, Djibouti can also benefit from China’s proposed Belt and Road Initiative (BRI), aimed at strengthening infrastructure, trade, and investment links between China and countries along the land and maritime Silk Road.

Figure 1.8 Opportunities and Challenges



Source: Authors’ elaboration using multiple sources of analysis.

Yet, there are some fundamental challenges that would need to be tackled. Macro stability is impacted by the growing public debt servicing obligation and current account deficit. The free trade zones that could bring Djibouti into global value chains (GVC) have created few jobs. Human capital outcomes are among the lowest in the world, and the private sector outside of ports and free trade zones is nascent and limited in its capacity to create jobs. Given Djibouti’s lack of natural resources endowment and arid climate, growth sectors are likely to be services and light manufacturing requiring higher skills than the agriculture sector (other than livestock), which in other countries has been a source of job creation and poverty reduction.

In its Nationally Defined Contribution (NDC), submitted to the United Nations Framework Convention on Climate Change (UNFCCC) in August 2015, Djibouti states that it has a “green economy strategy, the aims of which are to encourage the use of low carbon technologies that are resilient to climate change, and to promote green jobs”¹⁷. Djibouti has significant renewable energy resources, particularly solar, wind, and geothermal, relative to the size of its population and scale of its economy¹⁸. Renewable energy can play a central and multi-dimensional role in economic growth. By investing in renewable energy, Djibouti can reduce the burden on its budget and on consumers. It is also widely recognized that the renewable energy sector employs more people on a megawatt-hour (MWh) basis than the conventional energy sector.¹⁹ Reliable access to power, will help in the development of Djibouti’s ICT sector and assist the country in taking advantage of the fact that Djibouti is the landing site for two major underwater fiber optic cable.

¹⁶ Annex 3, Box 3.2 provides a case study on the tourism sector.

¹⁷ http://www4.unfccc.int/ndcregistry/PublishedDocuments/Djibouti%20First/INDC-Djibouti_ENG.pdf

¹⁸ The International Renewable Energy Agency’s (IRENA) Renewable Energy Readiness Assessment for Djibouti, http://www.irena.org/DocumentDownloads/Publications/IRENA_RRA_Djibout_2015_EN.pdf

¹⁹ Ibid

Djibouti also has the opportunity to position itself as a transcontinental transmission hub between the power pools in Africa and the Arabian Peninsula. By also becoming a source for clean energy, Djibouti can create better energy security conditions for itself and play a part in decarbonizing the power sector in Yemen and beyond.

1.2.2 Identifying binding constraints to economic transformation

Rather than continued capital accumulation, Djibouti would need to shift its policy focus to growing employment through a vibrant private sector and healthier, educated and productive workers. Raising the productivity of the private sector and enhancing the employability of workers are two inter-linked avenues for facilitating economic transformation. The report asks what constrains the private sector: is it the demand side (returns to economic activity) or the supply side (cost of accessing finance)? Similarly, the report examines what constrains improvements in employability: is it the demand for human capital by households or the supply and availability of services (public or private)? Using available data to answer these questions is important for identifying some key policy actions that Djibouti could undertake. The methodology of inclusive growth diagnostic is described in Annex 3.

In the section that follows, the report discusses the constraints to and implied reforms for transforming: (a) the environment for business and investment (Chapter 2); and (b) human capital (Chapter 3). Governance effectiveness emerges as an important set of constraints for both private sector development and human capital investments (Chapter 4). The report concludes with recommendations for policy action (Chapter 5).

2. Transforming the Environment for Business and Investment: Constraints and Reform Areas

To create jobs for shared prosperity and achieve the country's vision of becoming the regional hub for trade and logistics, the Government will need to set consistent macroeconomic goals and policy framework to keep macroeconomic fundamentals on a sustainable path. Djibouti also needs to create conditions for a dynamic private sector to create jobs in the economy's areas of comparative advantage, while ensuring that investments are aligned with the country's development goals.

2.1 Preserving macroeconomic stability: Recent development, constraints, and what needs to be done

Djibouti managed to achieve impressive growth, averaging 8 percent in 2013-2016, through public and private investments in port and transport infrastructure. While the inward-investment economic strategy has worked well in boosting growth, it triggered large public borrowing and expenditure. Public debt grew rapidly and the fiscal balance significantly deteriorated, putting macro stability and hence the sustainability of the growth at risk. Public debt rose from 57.1 percent of GDP in 2014 to an estimated 89.7 percent in 2017. The fiscal stance deteriorated in the face of large capital expenditures while revenues remained subdued. The current account deficit also deepened, reflecting a weak (non-transit) export performance. The export performance has been hampered by high costs of production input factors (e.g., electricity, ICT, labor costs and quality; discussed below) and the composition of activity makes the country import-dependent. The competitiveness challenge for the production sector and export in goods is exacerbated by the overvaluation of the real exchange rate, which further increases the costs of inputs for domestic production.

Yet, macroeconomic adjustment is underway. The Government has taken an important step by shifting its policy towards reducing capital spending, which has significantly improved the fiscal balance. The fiscal balance is expected to be in a small surplus in 2018. But the pressure from the debt repayment burden remains. In addition, revenues are stagnating and external performance remains low, posing downside risks to the fiscal space and growth. The growth literature emphasizes that long-term growth requires strong institutions and incentives that enable more capital, productive labor,²⁰ and a better use of the factors.²¹ A stable macroeconomic framework with healthy fiscal space is necessary to increase and maintain physical capital, invest in human capital, and improve the efficiency of factors through innovative technologies. Sustainability of growth is intrinsically linked to sustainability of the public finances.²²

2.1.1 *Public debt as a risk to macro stability and sustainable growth in Djibouti*

Public and publicly guaranteed debt grew rapidly over the past 3 years, rising from 57.1 percent of GDP (56 percent external and 1 percent domestic) in 2014 to an estimated 89.7 percent of GDP (87.8 percent external and 1.9 percent domestic) in 2017 (Figure 2.1). The debt accumulation has essentially resulted

²⁰ Field 2008; Blackman and Baumol 2008; Romer 2008.

²¹ Romer 1990; Becker 2008.

²² IMF 2015c.

from two non-concessional loans that the government contracted with China's Exim Bank in 2013 for the water project and for railway construction to link Djibouti to Ethiopia, its main trading partner whose trade accounts for more than 80 percent of Djibouti's port activities. With these non-concessional loans, the portfolio composition has also changed with more external debt on variable rate, which exposes the portfolio to higher interest rate risk. Based on the 2018 medium term debt sustainability analysis conducted jointly by the authorities and the World Bank, as of end-December 2017, 25.6 percent of Djibouti's debt portfolio is on variable interest rate (linked to the LIBOR²³) and 28 percent of the portfolio is exposed to the variation of interest rate in the next year. This can potentially increase debt servicing, given that the LIBOR (which is the reference rate on the Chinese loans) is expected to rise. It is estimated that a 1 percentage point increase in LIBOR would increase interest payments by US\$ 4.6 million. Exchange rate risk remains minor as a larger share of the external debt is denominated in US Dollar, to which the Djiboutian currency is pegged at DJF 177.72 / US\$1 since 1974.

More than two-third of external debt is on-lent to public enterprises; including the port, the railway and water companies. While sufficient revenues are eventually expected from the public enterprises, only the port is currently meeting its loan servicing requirements (consisting so far in interest payments). The Government continues to service the loans for the railway and water companies, as these companies are not yet at full operation. The railway started operating in January 2018, while the water pipe work is just being completed. Meanwhile, the debt servicing is projected to peak at 9 percent of GDP by 2024.

The foremost vulnerability for macroeconomic stability, going forward, is the risk of debt distress. Djibouti's economy is dependent on trade with Ethiopia, which accounts for more than 80 percent of Djibouti's port activities; these activities are the back-bone of the country's growth. As such, Djibouti is vulnerable to external shocks. Any adverse economic event and/or strategic trade route reorientation of Ethiopia would jeopardize Djibouti's ability to service its debt. Adverse climate events, given the country's high vulnerability to climate change, is another risk to growth. Adaptation to and mitigation of climate change would require public expenditures for strategic intervention, which in turn could limit fiscal space and the Government's ability to repay its debt. The debt repayment burden could reduce fiscal space over the coming decade and limit social investment, especially in public services delivery for human capital development, unless the Government shifts its policy towards further fiscal consolidation. In addition, the high external debt means that creditors are less willing to provide more external financing. China remains the key economic player, financing the railway between Djibouti and Ethiopia's capital, Addis Ababa, and constructing a new free trade zone. The railway project has an overall cost of US\$4 billion, of which Djibouti's cost share²⁴ is US\$491.8 million. But the relative slowdown in China's economy means that, going forward, Chinese investment flows to Djibouti might not be as strong as in previous years, and this could reduce the growth and debt servicing potential of the country.

The persisting overvaluation of the real exchange rate (estimated between 24 and 29 percent in 2016²⁵) exacerbates the country's production and export competitiveness challenge. So far, the country has been able to maintain enough foreign reserves, for about 4 months of imports, and sufficient net foreign assets

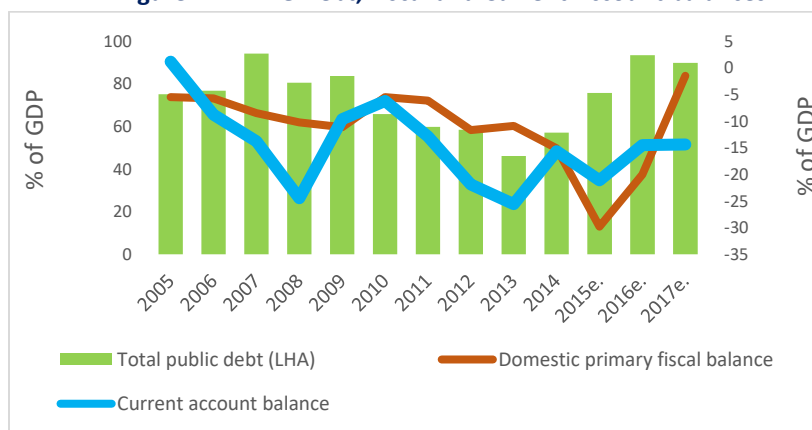
²³ The LIBOR is the London Interbank Offered Rate. The LIBOR is currently rising, meaning the cost of debt servicing for Djibouti will rise accordingly.

²⁴ The loan was contracted with China at a rate of Libor+3 with a maturity of 15 years, including 5 years grace period. The first principal payment is due in July 2021.

²⁵ IMF 2016, Article IV Consultation.

for broad money and currency board coverage. More broadly, Djibouti's debt level and the downside risks to the economy represent significant challenges for macroeconomic stability and growth sustainability. Adequate institutional reforms are required to improve management of public enterprises, mobilize domestic resources, enhance competitiveness for buoyant production and exports, and strengthen the capacity for debt management.

Figure 2.1 PPG Debt, Fiscal and Current Account balances



Sources: Djibouti authorities and World Bank staff projections.

2.1.2 Fiscal Policy

Fiscal policy is an important instrument for ensuring adequate internal and external balances to support both short and long-run growth. In the short run, fiscal policy can help offset the adverse effects of macroeconomic shocks that create large gaps between aggregate demand and potential output; as well as reduce cyclical unemployment and inflationary pressure. In the long run, fiscal policy can help ensure that fiscal balances and debts are maintained on a sustainable path so that public finances themselves do not become the source of macroeconomic instability and jeopardize growth. Fiscal policy should also enable resource allocation objectives by empowering the government to (a) improve economic performance through tax policies and expenditure; and (b) enhance allocative and technical efficiency and long-term growth by addressing damaging market failures.²⁶ Macroeconomics goals complement development goals such as poverty reduction, social inclusion, reducing inequality, and social protection against shocks and vulnerability – development objectives that market outcomes cannot always address effectively. The achievement of both macroeconomic stability and these development goals requires fiscal space.

The Government recently started a fiscal consolidation policy through reduction of capital expenditure, which combined with the end of the infrastructure projects are improving the fiscal balance. Yet, Djibouti needs to implement an efficient tax system for domestic resources mobilization that would accompany the recent shift in expenditure policy. Currently, fiscal revenue mobilization is challenged by the limited control capacity of the tax administration and the tax incentive system that tends to exempt large corporations from major taxes and puts a high tax burden on SMEs. Given the tax evasion and fraud as more taxpayers try to escape the high tax burden or benefit from the incentive system, this has led to a

²⁶ IMF 2015, 2015a.

narrowing of the tax base and tax revenues²⁷. Tax revenues as percentage of GDP declined or at best remained stagnant over the past decade. Contributions to GDP from other sources of revenue might at best stagnate in the medium term. For instance, Djibouti receives significant rent revenues from hosting foreign military bases. However, although rent revenues have increased in recent years,²⁸ they remain fixed under bilateral agreements in nominal terms and should decline as a percentage of GDP over time. Additional revenues from grants, especially from Gulf countries, are expected to remain low as the countries face relatively low oil prices; and grants from multilaterals might decline as Djibouti's income per capita rises. Hence, Djibouti needs to accelerate the tax system reform to secure domestic resource mobilization that will support debt servicing and investments for macroeconomic stability.

2.1.3 External performance

In the context of Djibouti's unfavorable climate for agriculture and its lack of natural resources, the main lever for inclusive development appears to be international trade, especially given the country's favorable location. Considering the small economic size of Djibouti, international trade is an important lever for firms to enlarge their markets and acquire economies of scale and productivity growth. Djibouti has made significant efforts to use the trade lever through its port services and rail connection to its main regional trade partner, Ethiopia. However, many trade indicators show that Djibouti has not yet established the conditions to fully utilize the cross-border trade lever for productivity growth. In addition, Djibouti has no effective export-enhancing trade policy and structural constraints to domestic production remain.

The government of Djibouti and Dubai Ports have been engaged in a legal dispute and arbitration proceedings following the government takeover of the Doraleh Container Terminal in February 2018. Djibouti is currently outperforming both Eritrea and Somalia in terms of logistics management, as measured by the World Bank's Logistics Performance Index (LPI)^{29 30} (table 2.1). However, Djibouti's port and logistics sector will likely face additional competition from neighboring countries (Eritrea and Somalia) in the coming decade. To maintain its lead position, Djibouti should deepen reforms. To that end, the country needs to: (i) establish a strong and modern governance structure and administration for ports (ii) modernize its port community information system to fasten port and custom clearances; and (iii) improve the efficiency of the free zone service providers for faster and safer entry and exist to the storage zones.

²⁷ World Bank, 2017

²⁸ Rent revenues have grown significantly with the signing in 2014 of a 10-year lease extension agreement for the US military base, Camp Lemonier, under which Djibouti receives US\$63 million per year, up from US\$38 million per year under the previous lease agreement. A new Chinese naval base was opened in 2017 and constitutes an additional source of rent revenue.

²⁹ LPI is an interactive benchmarking tool created to help countries identify the challenges and opportunities they face in their performance on trade logistics and what they can do to improve their performance (<https://lpi.worldbank.org/>). The LPI reflects a country's extent of trade facilitation in six key dimensions: infrastructure, customs, logistics competence, international shipment, tracing and tracking, and timeliness of shipment

³⁰ "Infrastructure" measures a country's trade and transport related infrastructure quality, including ports, railroads, inland roads, and information technology; "customs" measures the efficiency of the clearance process in terms of speed, simplicity and predictability of formalities by customs and border control agencies; "logistics competence" reflects the competence and quality of logistics services (including transport operators, customs brokers); "international shipment" measures the ease of shipments arrangement and shipment price competitiveness; "tracing and tracking" measures the ability to track consignments on trade within the country; and "timeliness of shipment" reflects how well a shipment reaches its destination within the scheduled or expected delivery time.

Table 2.1 Djibouti's Performance on Logistics Performance Index

Country	Overall LPI Rank/160	Overall LPI Score	Rank on LPI dimensions/ 160 economies in 2018					
			Customs	Infrastructure	International shipments	Logistics competence	Tracking & tracing	Timeliness
Djibouti	90	2.63	113	60	118	135	72	85
Eritrea	155	2.09	137	152	154	146	145	159
Somalia	144	2.21	145	157	100	121	140	157

Source: World Bank Logistics Performance Index 2018.

A relatively high trade tariff is another barrier to Djibouti's cross-border trade. The World Bank's World Integrated Trade System (WITS) shows that the weighted average applied tariff in Djibouti was almost twice that of Ethiopia in 2016 (1.68 percent in Djibouti compared to 0.98 in Ethiopia). The non-tariff barriers to trade revealed by the LPI and the level of tariffs, in addition to other constraints to domestic production (discussed in section 2.2, below), may explain the country's export competitiveness challenge and lower external performance in Djibouti.

The limited and uncompetitive domestic production base is a major constraint to export performance. Several structural and natural barriers limit Djibouti's production capacity. Djibouti's location in an arid desert climate, high temperatures all year round, prolonged droughts, limited rainfall,³¹ limited arable land, and a scarcity of groundwater, make the development of important subsets of agriculture such as breeding and crop growing nearly impossible. Agriculture is almost nonexistent, accounted only for about 1.5 percent of GDP and 2 percent of employment in 2015. The production sector is further constrained by high costs of factors of production (e.g., labor, energy and ICT), compounded by limited access to credit. Section 2.2 below discusses business environment constraints and annex 4 analyses the export sector and its outcomes.

Historically, Djibouti has had a trade deficit, which, given its constrained production and export sector, has widened over time. The trade deficit deteriorated from 27 percent of exports in the 1990s to 32 percent in the 2000s and then to 48 percent in 2010-2013, before reaching its deepest level of 104 percent in 2014-2016, with intensified capital imports for infrastructure projects (Figure 2.2). The country also runs a current account deficit, which has been at two-digit in recent years - a level that was exacerbated by increased capital imports for the infrastructure (port, railway) development projects (Figure 2.3). The current account deficit is expected to improve, with the end of the infrastructure projects, but will remain at a high single digit in the medium term as traditional imports for livelihood and capital imports related to construction (including the new free zone) will remain significant. The bulk of the deficit has been historically financed by FDI and the trend of FDI financing is expected to continue.

A vibrant production sector can stimulate export performance and catalyze economic take-off and make growth more inclusive, as demonstrated by East Asian countries. Djibouti's location and membership in COMESA are important assets that the country could exploit to achieve such export-oriented economic transformation through increased productivity and cross-border trade with regional peers. Bolstering regional trade would allow Djiboutian firms to overcome the constraints of its small domestic market and

³¹ Average rainfall is only 200 mm per year. Temperatures ranging from 30 ° to 45 ° Celsius.

acquire economies of scale. So far, despite having joined COMESA, Djibouti has yet to operationalize the customs transit guaranteed scheme, especially at the Djibouti-Ethiopia border. As a result, Djibouti has had limited trade with other COMESA countries so far, except for Ethiopia, its main trading partner.

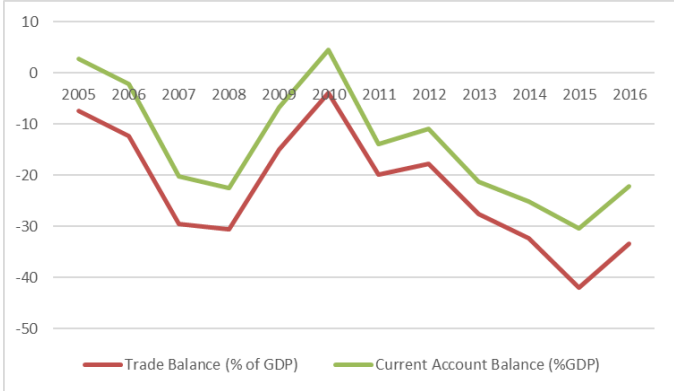
Adopting competitive domestic production and trade facilitation policies remains one of the challenges that Djibouti needs to overcome to fully exploit its export potential towards all COMESA countries, secure a niche in global value chains and improve its external performance. Currently, Djibouti suffers from low competitiveness in production, lack of diversified export goods and markets, exposing the country to volatility from terms of trade shocks.

A delay in addressing the constraints to domestic production could limit the country in taking full advantage of the opportunity to add value to the large amount of Ethiopian raw material that transits through the port due to the relatively high costs of production in Djibouti (cost of electricity, telecommunication, labor). The concentration of the economy around Ethiopian trade (which account for more than 80 percent of Djiboutian port activities) makes Djibouti vulnerable to any adverse economic event in Ethiopia and any slowdown in Ethiopia’s trade with its European and Chinese partners. More importantly, the port has so far enjoyed being the preferred maritime trade route for virtually all of Ethiopia’s imports and exports. However, the Government of Ethiopia is pursuing a policy to diversify its international trade routes. Ethiopia is engaged in discussions with Somaliland to expand trade through Berbera port and has been investing,³² along with Dubai Port World (DPW) and the Government of Somaliland, in the development of Berbera port infrastructure. The infrastructure upgrade of Berbera port is expected to include marine services (towage, linesmen and pilotage – now under a new concession; cargo handling services, with operation of a specialized container terminal for transshipments). Although Djibouti has a comparative advantage in many aspects (more security, improved transport infrastructure to connect to Ethiopia, the newly developed railway, location on China’s One Belt One Road – OBOR, a new free zone), Berbera port could capture some market share in the long run from Djibouti’s Doraleh Container Terminal (DCT). Thus, competition from Berbera port, whose development is planned, could affect port activities in Djibouti and undermine growth.

Figure 2.2 Trade balance (% of Exports)



Figure 2.3 Trade and Current Account Balances (%GDP)



Source: Government of Djibouti and World Bank staff calculations.

³² For Ethiopia, the port of Berbera in Somaliland offers a potential to diversify trade routes. DP World has 65 percent of the deal and has offered 19 percent to the government of Ethiopia. Somaliland has the remaining 35 percent.

2.1.4 Real exchange rate overvaluation represents a threat to macro stability

Djibouti has the world's oldest currency board (CB) arrangement, under which its currency - the Djibouti Franc (DJF) - has been pegged at DJF 177.72 / US\$ 1 since 1974 in nominal terms. Foreign exchange reserves were estimated at US\$ 419 million in 2017, sufficient for coverage of 5 months of imports, and projected to remain strong. Net foreign assets, currently estimated at 70 percent of GDP, are sufficient for coverage of broad money and currency board requirements. The currency board arrangement has played an important role in ensuring economic stability by enhancing the predictability of trade costs, especially important since Djibouti is heavily dependent on international trade.

However, while the CB has long secured economic certainty and the country does not present signs of foreign reserve shortages, the real exchange rate has been overvalued,³³ which tends to further weaken competitiveness and external performance. The recent real exchange rate (RER) assessment by the IMF, which builds on the current account and the external sustainability approaches using the new External Balance Assessment (EBA-lite) methodology, shows an overvaluation of the RER. Under the current account approach, which considers the temporality of the investment boom, RER overvaluation was estimated at 24 percent in 2015. The sizes of the overvaluation reflect the adjustment in RER needed to maintain the current account deficit at a norm, where economic fundamentals and desirable policies are aligned. Thus, a 29 percent adjustment in the RER (under the external sustainability approach, ES) would be required to maintain the external position (net external liability) at -80 percent of GDP over the next 5 years, or 43 percent adjustment in RER to maintain external position at -60 percent of GDP over the next 10 years.

The size of RER overvaluation sheds light on the high risk of debt distress the country faces. Such large adjustment would significantly increase debt stocks and would negatively affect the country's peg, which in turn would affect investments and growth, and further hamper macroeconomic stability. Given that the country is heavily external exposed (net importer of food, energy, and equipment) with an already high external debt stock, an abrupt RER adjustment could have serious welfare consequences yet take a long time to achieve current account rebalancing given inelastic import demand. Addressing key structural constraints to productivity would be the safer option to improve competitiveness and ensure macroeconomic stability.

2.1.5 What needs to be done?

Clearly, ensuring macroeconomic stability to make Djibouti attractive for investment and support long-run growth requires targeted reforms and institutional capacity building. Suggested reforms include:

- a. *Measures to bring public debt to a sustainable path.* This would require building up public finance management capacity; better debt management with a focus on regulations for on-lending, coordination, accountability, transparency, and clearly defined responsibility among government entities involved in the debt management; and creation of fiscal space by enhancing the capacity for domestic resources mobilization through an efficient and broad-based tax system, while

³³ International Monetary Fund 2016b.

rationalizing spending. A comprehensive reform of the tax system, including the tax administration and tax policy, is necessary.

- b. *Export development based on latent comparative advantage to reduce export concentration and deepen spillovers from existing openness.* Currently, the high dominance of imports over exports contributes to significant trade deficits and a large current account deficit. Djibouti's dependence on imports of essential goods, including food and fuel, means that it is highly vulnerable to external shocks.
- c. *Close monitoring of the exchange rate regime.* The country's structural reliance on imports means that a devaluation of the nominal exchange rate would take time to correct the current account. In the short and medium term, rather than exchange rate adjustments, addressing the country's competitiveness challenges would require structural reforms that would reduce production costs, especially those arising in the non-tradable sector, to promote a productive and job-creating private sector.

2.2 Create conditions for a productive and dynamic private sector: Current situation, constraints, and what needs to be done

This section analyzes the constraints to inclusive growth in Djibouti.³⁴ The approach considers the long-term perspective of growth by focusing on productive employment to sustain growth, and on pro-poor growth as a means of increasing the income of the poor in absolute terms. These analyses reflect, respectively, the demand (jobs creation) and supply (productive labor force) sides of the labor market. The synergy and dynamism of these two sides of the market are what can generate inclusive growth.³⁵ Annex 3 provides the diagnostic framework for analyzing the constraints to businesses and employability.

The business environment analysis in the lens of inclusive growth analytics reveals a number of constraints that need to be addressed to ease the transformation of the Djiboutian economy towards a private sector led growth where greater export potential can be leveraged by creating conditions for a dynamic private sector, attracting investments and creating jobs. Policy changes to enhance private productive capacity would include:

2.2.1 Business regulations, input costs, and competition

Djibouti has the vision of becoming a regional logistic and trade hub. In this context, Djibouti has made notable efforts in recent years towards improving port and transport logistics, and the business environment. Recent changes in the business environment include making it easier to start a business, simplifying registration formalities, and eliminating the minimum capital requirement for limited liability companies. In addition, Djibouti adopted a new Commercial Code, which broadens the range of movable

³⁴ The analysis follows the frameworks laid out in Hausmann et al. 2005 and Ianchovichina 2009.

³⁵ See Annex A for a detailed explanation of the inclusive analytics framework and its application to Djibouti.

assets that can be used as collateral to obtain credit. Other reforms in the business environment are reflected in the 2018 Doing Business report, which ranks Djibouti 154th out of 190 countries, compared to 171th in 2017. Key areas of recent reforms include easing business registration, barriers to obtaining construction permits, registering a property, and adoption of a new Credit Information Law. While these reforms represent tremendous progress towards a business-friendly environment, more efforts are needed to enhance development of a competitive private sector in Djibouti. Key measures for improvement include: lowering the cost of production factors, namely electricity, ICT, as well as labor costs, to raise competitiveness; further easing access to finance; leveling the playing field to enhance competition; and reforming the tax system to make it more equitable across firms.

Electricity

Electricity is a crucial input for businesses. Exploiting Djibouti's potential in fisheries, for example, requires readily available and reliable electricity due to the need for refrigeration. Likewise, the development of tourism, which is one of Djibouti's unexploited potential growth sectors, also requires available, reliable, and affordable electricity. Beyond business development, accessible and reliable electricity at reasonable cost is also crucial for quality and efficient public services delivery.

The energy sector in Djibouti is progressively becoming a more modern and attractive sector for investors; however, tariffs remain high for businesses. Since 2012, Djibouti's electricity sector has evolved from being dependent on imported petroleum products to an interconnected one with access to affordable foreign (hydro) and future domestic (geothermal) baseload resources. A few years ago, the national electric utility, *Énergie de Djibouti* (EDD) used 100 percent fuel oil to produce electricity and was the country's main national heavy fuel oil (HFO) consumer. Owing to the interconnection with Ethiopia, this fuel consumption has been significantly reduced. Total consumption of petroleum products in Djibouti is now about 360,000 tons/year. An interconnection with Ethiopia has been developed (with funding from the African Development Bank, AfDB) and covers 70 percent of the supply at a very low Power Purchase Agreement (PPA) tariff (US\$ 0.06-0.07 / kWh³⁶).

Despite the introduction of lower-cost hydro-based power from Ethiopia since 2012, electricity tariffs remain high and are identified by businesses as an important constraint. The electricity tariff in Djibouti stands at 23.4 US cents per kWh in 2017, up from 22.8 in 2016, compared to, for instance 4.7 and 4.4 US cents/kwh in Ethiopia in 2016 and 2017 (Table 2.2). Electricity tariffs are high due to (a) the generation mix (power purchased from Ethiopia is cheap but varies by wet/dry season; (b) aging and inefficient generation facilities and distribution lines, with high operation and maintenance costs; (c) high technical and non-technical losses; (d) taxes paid on imported power from Ethiopia; and (e) workers' salaries. The company exhibits losses of electricity estimated at 12 percent, of which about 6 percent is due to unstable wire connections between the hydropower source and Djibouti, and 6 percent due to aging infrastructure.

EDD is Djibouti's only electricity provider. However, in 2015, an Independent Producer Law³⁷ opened the market for generation, with EDD remaining the single buyer and distributor. Every year EDD connects

³⁶ The PPA tariff is a two-tiered tariff:

-US\$ 60 / MWh for wet season off peak hours, and

-US\$ 70 / MWh for dry season off peak hours and wet season peak hours.

³⁷ Loi n°88-AN-15-7^{ème} « portant réglementation des activités des producteurs indépendants d'électricité ».

between 1,500 and 2,000 additional clients to the grid. EDD has 18 generating units running on expensive³⁸ heavy fuel oil in Boulaos and 6 diesel units in Marabout. EDD also faces low grid expansion due to the lack of sufficient investment. The company has limited operational capacity and funds to invest in overhauling/extending the medium voltage lines. EDD's effective generation capacity is limited to 67 MW, which might lead to severe shortages, especially with the 5 to 6 percent demand growth rate each year. Total annual generation, including imports, is only 400 GWh (2015). There are two small off-grid solar panel systems, each 100 kWp, in Ali Addeh and Adailou, which are operated by *Agence Djiboutienne de Développement Social* (ADDS). Although reliability of supply has improved in recent years, many commercial and industrial companies have their own generators either to backup EDD's supply in case of load shedding during peak loads or to provide the power they need to operate daily. As an example, the free port of Djibouti finances its own power supply (but is not entitled to sell its surplus energy). There is potential for diversifying energy sources toward renewables to reduce energy prices. Djibouti will also need a regulator to fairly and effectively regulate electricity prices. Currently, the tariffs are defined by the government and there is no regulation mechanism in place.

Table 2.2 Costs of Getting Electricity in Djibouti Compared to Others

Country/Region	Getting Electricity - Cost (% of income per capita)		Getting Electricity - Price (US cents per kWh)	
	2016	2017	2016	2017
MENA	787.9	771.8	11.3	11.4
Ethiopia	1414.9	1238.8	4.7	4.4
Sub-Saharan Africa	3894.4	3799.1	20.3	19.1
Djibouti	6579.4	6386.8	22.8	23.4

Source: Doing Business 2017.

Information and communication technology (ICT)

Like electricity, ICT is of cross-cutting importance for businesses development. ICT is needed for businesses to connect with customers and improve their services delivery and feedback. Readily available and reliable ICT services open doors for private entrepreneurship, job creation and growth. The literature emphasizes that a 10 percent increase in broadband penetration can lead to between a 0.24 and 1.5 percent increase in GDP.³⁹ Djibouti has a regional comparative advantage as the landing site of the undersea fiber optic ICT cables. However, the ICT sector remain uncompetitive, with high prices and low coverage due to state monopoly; only Djibouti Telecom (DT) – provides both fixed and mobile services. DT's strategy is oriented to international markets and has not been conducive to expanding broadband access and use in the domestic market, where more capacity could be allocated at a reduced price. DT sells much of its capacity on the international market, mainly to Ethiopia, leaving the domestic market in shortage. The operator has banked on the country's geostrategic position between the Middle East and Africa to offer connectivity between the two regions for global communications carriers. However, little of this cheap bandwidth is offered to consumers and businesses locally.

³⁸ Because of the relatively small quantities which are ordered.

³⁹ World Development Report 2016.

Djibouti has one of the highest proportions of urban population among the Lower Middle Income (LMI) countries in MENA and sub-Saharan Africa (SSA), with around 80 percent of the population living in capital city and suburb. However, it has one of the lowest mobile broadband coverage rates in the region. Mobile subscription penetration represented only 38 percent of the total population in 2016. Djibouti lags far behind the East Africa region, whose average mobile subscription penetration was 54 percent in 2016. The coverage of mobile broadband (3G) in Djibouti is among the lowest, with just over half the population covered by 3G. The 4G system – which is now widespread in the world and enables ultra-fast broadband for mobile services – is still in the pilot stage in Djibouti. The penetration rate for internet use is only 12 percent of the population, half the rate of SSA (Table 2.3). The international telecommunications organizations rank Djibouti close to last place among LMI countries on ICT development. This rank has crumbled during the last six years, from 130th out of 190 countries in 2010 to 161st out of 190 countries in 2016.

Businesses would greatly benefit if the ICT had a better performance. Two main products are essential for the operation of businesses, namely business broadband (which provides satisfactory quality of service level) and leased lines (which provides digital connections between various physical sites of a company). For both products, Djibouti has been ranked consistently among the most expensive countries in the MENA region by the Arab Regulators Network (AREGNET)⁴⁰ (Annex 3.1.3). The low performance combined with high ICT service prices slow firms’ operations and limit their expansion and jobs creation.

With an adequate ICT policy, the digital sector could generate as many as 5,000 jobs in the next three years, almost four times the number of jobs today (around 1,300). Djibouti’s banking sector has expanded rapidly during the last 10 years, and Djibouti could become a financial hub for the region by exploiting the opportunities offered by electronic and mobile banking. The Government could also explore the potential for the integration of banking services with port and trade-related financial services, such as insurance and trade credit.

Table 2.3 Cross-country Comparisons of ICT Performance Indicators (2016)

Country	Pop.	GNI per cap.	ITU ranking	Mobile penetration (2G/3G/4G)	Mobile 3G coverage	Mobile BB penetration (3G/4G)	Fixed BB penetration (all)	Fixed BB penetration (DSL)	Fixed BB penetration (Fibre)	Internet penetration	
	(Unit)	(m)	(US\$)	Rank	% pop.	% pop.	% HH.	% HH.	% HH.	% pop.	
Djibouti	0.9		161	38%	58%	8%	16%	14%	0%	12%	Djibouti
Cabo Verde	0.5	3 280	97	129%	64%	67%	14%	13%	0%	43%	Cabo Verde
Sao Tome and P	0.2	1 760		107%	54%	25%	3%	0%	0%	26%	STP
Armenia	3.0	3 880	71	122%	99%	56%	63%	32%	24%	58%	Armenia
Comoros	0.8	780		41%	60%	0%	1%	1%	0%	7%	Comoros
Morocco	34.4	3 030	96	119%	90%	48%	19%	19%	0%	57%	Morocco
Mauritius	1.3	9 780	73	136%	90%	73%	58%	35%	20%	50%	Mauritius
Panama	3.9	11 880	93	138%	93%	58%	38%	13%	0%	51%	Panama
Mauritania	4.1		151	112%	42%	47%	2%	0%	0%	15%	Mauritania

Source WDI 2015; GSMA Intelligence

Cost of hiring workers

Several factors create a disconnect between labor productivity and labor costs and hence reduce firms’ incentives to use labor-intensive technologies. Average labor productivity is low in Djibouti because of low

⁴⁰ One of the most comprehensive ICT pricing benchmark for the MENA region is issued by the Telecom Regulatory Authority of the Kingdom of Bahrain, which commissions and coordinates a yearly study on behalf of AREGNET, based on the cost of purchasing “baskets” of telecommunications services. The latest study was published in 2016, and allows MENA countries to compare their price levels.

human capital, including educational achievement and skills training (see employability section). The shortage of skilled workers bids up the wages offered to skilled labor. This is compounded by high public-sector wages. The public wages raise wages in the formal private sector, which must compete for skilled workers. Wage levels in Djibouti are estimated to be about 2 to 3 times higher than in Ethiopia. For instance, based on a World Bank assessment of transport and logistics in 2012,⁴¹ wages of Djiboutians in the transport sector are between US\$ 300 and 500, compared to US\$70 in Ethiopia. Wages of low-skilled workers in Djibouti are estimated to be about US\$ 250 (50,000 DJF) per month.

High wage levels and other costs of production increase costs to businesses and limit job creation. For instance, the Djibouti Free Zone (DFZ) was created in 2004 to support industrial development and job creation. The DFZ was established in partnership with JAFZA and designed in the spirit of the Dubai's Jebel Ali Free Zone and Morocco's Tanger Med to serve as a "virtuous circle" of a regional multi-modal hub that would create an integrated logistical platform through the development of new employment-generating activities, particularly in the processing industries. However, since its creation, DFZ has had only a limited impact on employment, with only 1,000 jobs created. The majority of DFZ businesses use the zone mainly for storage purposes. Only two industrial packaging companies are currently operating in DFZ. The zone has not been successful in attracting manufacturing firms likely due to the high costs of inputs.

Competition policy

In Djibouti, direct government participation extends to a number of markets that are normally supplied by private players.⁴² The significant presence of SOEs in Djibouti may affect opportunities for the private sector to compete on a level playing field and increases the need for principles of competitive neutrality to guide government actions in markets where state actors operate. Sales by SOEs constitute between 60 to 70 percent of GDP⁴³ (Figure 2.4). Although this high share may result from the relatively small size of the Djiboutian economy, it is very high compared to countries that are considered to have intense state participation in the economy. As of 2014, there were at least 21 SOEs in operation across 13 sectors, with at least one SOE that is fully controlled by the Government of Djibouti⁴⁴ in those sectors. Several SOEs participate across several markets within a sector, including those that play a role in food security and that control the prices of staple goods. Market players perceive this as creating a relatively high risk of distortions (Figure 2.5).

Putting in place a competition policy would facilitate the cascading of private sector participation. Almost 30 percent of all manufacturing markets in Djibouti are monopolies, duopolies or oligopolies. Among its comparator group, only Morocco has a greater proportion of monopolies in its economy. Although for some product markets, inherent market characteristics naturally result in relatively more concentrated market structures regardless of the level of competition, in other cases concentrated markets arise from government interventions that restrict entry or facilitate dominance, or that create an unlevel playing field.

⁴¹ World Bank 2012.

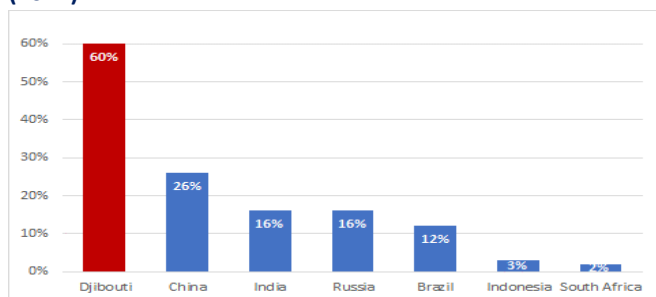
⁴² Such as container terminal operation, cement production, and ownership and management of real estate.

⁴³ World Bank 2016a.

⁴⁴ World Trade Organization 2014.

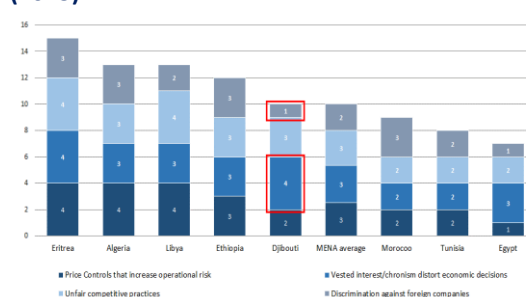
Djibouti lacks an effective Competition Law and institutions to enforce a competition framework. This has led to the extension of state monopolies and control of prices in markets, such as postal services and telecommunications wholesale services, which should typically be open to competition. The competition analysis⁴⁵ shows that in markets where SOEs compete with the private sector, state actors have benefited from advantageous financing terms through government guarantees on public enterprise debt or on-lending to SOEs. Such advantages significantly distort the playing field competition and reduce returns to private operators. An effective competition policy is key to promoting greater productivity, economic diversification and growth, while directly contributing to poverty alleviation. Principles of competitive neutrality among all firms are key to promoting well-functioning market dynamics, including through tax neutrality, regulatory neutrality, debt neutrality and subsidy schemes that do not discriminate among competitors.

Figure 2.4 SOE Sales as a Percentage of GNI for Selected Countries (2011) versus Djibouti SOE Contribution to GDP (2014)



Source: Przemyslaw et al. 2013; World Bank 2016a.

Figure 2.5 Operational Business Risks Related to Weak Competition Policies for Selected Countries (2015)



Source: Elaborated by the authors based on data from the Economic Intelligence Unit and on World Bank 2016a.

Tax system as a constraint to small business development

An efficient system of domestic revenue mobilization will be instrumental for Djibouti to sustain investment and growth while servicing the debt. However, the current tax system presents some constraints that prevent it from playing such an instrumental role. The major constraint is the incentive system. Two tax regimes coexist in Djibouti through the incentive system: disclaimer and derogations from the Free Zone, where investment incentives are granted through the Investment Code, the Free Zone Law, and some discretionary exemptions by the Government. Other mechanisms include the Common Law - “Code Général des Impôts”, externally financed development operations, and diplomatic privileges.⁴⁶ The incentive system tends to exempt large corporations from major taxes and puts a high tax burden on SMEs, which creates strong internal distortions. The “Regime A” under the Investment Code exempts consumption tax and import taxes on capital inputs for firms with a turnover of DJF 5-50 million. The “Regime B” waives industrial and commercial income tax and land tax⁴⁷ over 10 years for firms with

⁴⁵ World Bank 2016a.

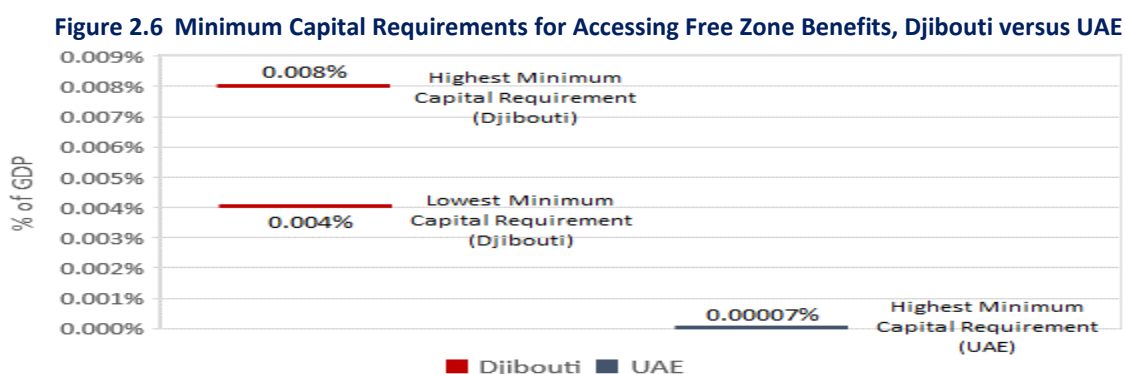
⁴⁶ IMF 2016a; World Bank 2017. Other mechanisms include the Common Law (CGI); externally financed development operations, and diplomatic privileges.

⁴⁷ See articles 16, 17 and 18, Law N°58/AN/94/3rd L amending the Law N°88/ AN/84.

turnover exceeding DJF 50 million. Since 2008, 38 investors have received approval under regime A and 98 under regime B. The Free Zone Code grants exemptions for a period of up to 50 years on all direct and indirect taxes, except for taxes on salaries and wages and value-added tax (VAT). The tax exemptions in Djibouti was equivalent to 26 percent of GDP in 2014. This is a large. Thus, the way the Government allocates such privileges among competitors might significantly distort market dynamics. The minimum requirements for both regimes are high compared, for example, to the UAE (Figure 2.6). Such requirements systematically exclude smaller, more labor-intensive enterprises from gaining these exemptions. Mainly foreign firms with large investments benefit from the exemption while the tax burden falls on SMEs. As such the incentive system limits the growth of SMEs and maintains job creation below potential. Meanwhile, large foreign firms operate in capital-intensive sectors and have limited job creation potential for low-skilled Djiboutians.

Djibouti’s income tax on salaries (ITS) is also high. Employers deduct the ITS directly from workers’ wages and remit the funds to the tax administration. Revenues from ITS account for about 6 to 7 percent of GDP, a relatively higher level than that of SSA countries (4.5 percent of GDP in 2010s). The high contribution of the payroll tax is due in part to its mode of collection, its high concentration in Djibouti City, and the fact that employees working in the free zone are subject to the ITS. The ITS scale is complex; it comprises six tranches, starting at zero rate for monthly incomes below 50,000 DJF. The marginal rate is 2 percent for monthly salaries between 50,000 and 79,999 DJF; 15 percent for the bracket between 80,000 and 99,000 DJF; 18 percent for 100,000 to 199 000 DJF; 20 percent for 200,000 to 649,999 DJF, and 30 percent for 650,000 DJF and above. To stimulate labor participation in the formal economy, it would be important to reduce the number of brackets and increase the threshold for taxable wages so that modest wages are not taxed. This would have the effect of bringing the minimum wage in Djibouti in line with best practice.

Although the introduction of VAT in 2009 was consistent with good practice, in application the VAT is not economically neutral and can potential create economic distortions. The legal restrictions to the reimbursement of VAT credits, the average reimbursement time of nine months, and the irregularities of these repayments all work against its economic neutrality.



Source: Elaborated by authors based on (a) World Bank data for GDP, (b) capital requirements stated by Djibouti’s Investment Code (Act No: 103/AN/05/5eme L) and (c) EAU government website available at <https://government.ae/en/information-and-services/business/starting-a-business-in-a-free-zone>.

Note: The lowest requirement in Djibouti is DJF 12.500.000 (US\$70.000); the highest is US\$140.000 or equivalent in DJF (the table uses the same exchange rate to convert the highest value into francs). The highest value required in EAU is AED 1.000.000 for a General Trading License in DMCC; lowest value is zero. Considering World Bank Data for 2015 GDP (LCU), Djibouti requirement is around 0.004 percent of the country’s GDP of DJF 307 billion; this figure is around 0.00007 percent in EAU, considering its GDP of AED 1.345 trillion.

Suggested reforms include:

- a. *Business regulations:* Djibouti should consider (a) further reducing procedures, time required, and costs to start up and register a business; (b) facilitating access to finance to boost entrepreneurship; (c) taking measures to reduce the cost of and access to electricity while enhancing reliability; (d) putting in place measures to increase mobile broadband and internet penetration; and (e) enforcing contracts and protecting investors.
- b. *Electricity tariffs:* Djibouti needs to diversify its energy sources and raise generation capacity, with special consideration given to renewables. The country should also pursue regional integration of the transmission grid and expand the transmission and distribution of electricity. In parallel, the Government should prepare for medium-term options based on geothermal, wind and solar energy. Variable renewable energy sources may be used to reduce the cost of fuel for thermal generation. Reducing electricity tariffs would also require that Djibouti put in place a regulator. Currently, the tariffs are defined by the government and there are no regulatory mechanisms in place.
- c. *ICT policy:* It is crucial to redefine the strategic positioning of Djibouti Telecom by developing the national fixed and mobile broadband market. This will require liberalization of the sector to reduce costs while enhancing competitiveness in services provision. Djibouti can draw inspiration from the example of other countries that have developed their digital sector. For example, Cabo Verde, Bahrain, and Brunei have a comparable population and have been able to develop a controlled sector by introducing a second mobile operator alongside the incumbent.
- d. *Labor costs:* Continue efforts to contain the public-sector wage bill and invest in schooling and workforce skills.
- e. *Competition:* Adopt a holistic competition policy framework resting on three pillars: fostering pro-competition sectoral regulations and government interventions; putting in place measures to guarantee competitive neutrality between state and private players; and ensuring effective economy-wide enforcement of the Competition Law.
- f. *Tax system:* Djibouti should consider (a) revising the incentive system (Investment Code, free zone regime, regime of foreign military bases) to enlarge the tax base while making the tax system more equitable; (b) eliminating the internal consumption tax (TIC), which represents a trade tariff, and adjust it to the VAT while ensuring the economic neutrality of the VAT refund; (c) modernizing the tax administration (moving from paper to electronic declaration will reduce interaction between the tax administration and taxpayers, and reduce tax fraud and corruption) and enhancing the control system; and (d) revising the Tax Law and simplifying the ITS to make taxes on wages more rational and fair, especially for low-wage workers.

- g. *Trade policy*: A more export-enhancing trade policy will make it easier for firms to compete in external markets, which will, in turn, help them to gain know-how and improve production methods while reaching economies of scale.

2.2.2 *Firms' access to finance*

Firms, especially SMEs, have difficulty accessing finance in the domestic market. Recent data show that about only 5 percent of formal SMEs have access to bank loans, with loans to SMEs representing only 12 percent of total bank loans to enterprises. Access to credit is limited for SMEs in Djibouti due not only to the lack of financial intermediation and high requirements, but also to lack of financial information. Djibouti ranks 183rd out of 190 economies on the getting credit indicator,⁴⁸ which reflects credit information and secured transaction regimes. This situation is reflected in the requirement for land guarantees for more than 90 percent of loans. The interest spread is also substantial, standing at 10 percent (between the average lending rate of 13 percent and average deposit rate of 3 percent). The high requirements and large interest spread tend to exclude a large portion of SMEs, young entrepreneurs and women entrepreneurs from accessing finance.

In general, the financial market remains underdeveloped and lacks modern financial instruments to stimulate entrepreneurship. Both supply side and demand side constraints explain the low extent of financial intermediation in Djibouti. On the supply side, the lack of competition, lack of financial market infrastructure, and limited economies of scale discourage credit institutions from lending to the private sector. Two major challenges continue to undermine the demand side of the financial market: the lack of affordability and the regulatory and institutional environment itself. Due to low competition, the small market and risky environment, loans are expensive in Djibouti. The regulatory and institutional environment of the financial market does not facilitate the development of the sector. A well-established credit guarantee fund and a national payment system are two critical infrastructures that would ease access to financing and enhance financial inclusion. However, their implementation continues to be delayed.

Suggested reforms in this area include closing the financial intermediation gap and raising the intermediation capacity of the financial sector, accompanied by an improved business regulatory framework. Specifically, to this end, Djibouti would need to design and put in place key financial market infrastructure, such as an efficient credit information system through the expansion of the public credit registry and/or the creation of a private credit bureau; and a credit guarantee scheme. This infrastructure would primarily mitigate the credit risks, both in terms of probability of default, and of loss in the case of default. In addition, regulatory reforms are needed to increase the competition among the market players. While financial infrastructure and fair competition are important, successful financial intermediation would simultaneously necessitate a deep reform of the regulatory and institutional framework that currently hinders the emergence of a vibrant private sector.

With regard to financial market development, the following reforms are needed: (a) reduce the collateral requirements and interest on loans; (b) introduce new financial instruments that are appropriate for the domestic market; and (c) introduce mortgage loans to enhance financing and financial inclusion. These

⁴⁸ Doing Business 2018.

reforms would entail accelerating the establishment of the credit guarantee fund and the national payment system, the reform of the *Caisses Populaires d'Epargne and Credit (CPEC)*, and the restructuring of the Djibouti Economic Development Fund (FDED).

2.2.3 Djibouti's connectivity potential for diversification towards more productive exports

Djibouti could capitalize on its strategic location and connectivity potential to develop a productive export base while enhancing regional integration to enlarge markets available to its firms, allowing economies of scale. Djibouti's geostrategic location at a maritime crossroads, near dynamic COMESA markets (with large amounts of raw and unfinished materials flowing through Djibouti's port), and its additional comparative advantage as the landing site of undersea fiber optic ICT cables, represent significant opportunities. With these advantages, Djibouti is in a good position to develop both high value-added services (e.g., storage, packaging, hotels and restaurants) and light manufacturing in industrial zones around the port (e.g., agro-processing, finishing and re-export of clothing, leather goods and electronics) for a buoyant export sector.

Diversifying from the existing expertise that Djiboutian firms have built in relation to the transport infrastructure investment in the country, and moving towards more productive exports, would require an export-enhancing trade policy, learning about new targeted markets and standards, as well as access to inexpensive inputs for production. COMESA greatly reduces the costs of learning about neighboring markets (i.e., it supports cost discovery) because of the absence of trade barriers and standardization and harmonization of competition rules within the common market. Even with these advantages, however, Djiboutian firms will need access to finance, skills, and cheaper and more reliable energy supplies to be able to innovate and compete successfully.

2.3 Reforms for ensuring macroeconomic stability and improving the environment for business and investment

This section summarizes the constraints to macroeconomic stability and the business environment and provides rationale for selected reform priorities. The first concern for macroeconomic stability is the debt level, which pose substantial risks to macro-stability. Despite the concerning debt level, debt management is not considered a first priority in this SCD because debt is an outcome of the fiscal-growth policy mix and should be placed in that broader context. Furthermore, the country is already acting on debt management issues, and is currently receiving technical support from the World Bank to build its debt management capacity. The Bank conducted a debt management performance assessment (DeMPA)⁴⁹ in 2017 under a programmatic technical assistance, which provided the necessary analysis to the Government. Based on the findings and recommendations of the DeMPA, the Government has not made any new borrowing since 2017. A Bank mission was in Djibouti in March 2018 to support the Government in developing a debt management reform plan, with a focus on the legal framework and institutional arrangements. The mission also provided technical training to build capacity of the debt management units in basic cost and risk analysis and develop a medium-term debt management strategy (MTDS). The MTDS will identify the

⁴⁹ World Bank 2017a.

desirable debt portfolio composition, while minimizing costs at acceptable levels of risk. This ongoing support is expected to help the country contain the debt and improve its management.

The second concern for macroeconomic stability is the overvaluation of the real exchange rate, because it directly affects the size of the traded sector through relative production costs, making exports and potential import-competing sectors uncompetitive. Like other countries with apparent overvaluation, policymakers may rationalize the level of the exchange rate in terms of structural import dependence, especially for capital goods, therefore warranting tilting relative prices in favor of imported capital goods. However, this policy mix in fact contributes to current account deficits because of the adverse impact on exports and bias towards all imports (not just capital goods), with implications for foreign reserves. As such, an overvalued RER can induce more borrowing, because of the import financing need in the face of low export performance. Nonetheless, for a net importer like Djibouti, abruptly adjusting the RER to align macroeconomic fundamentals and desirable policies can have adverse effect on the economy by increasing the amount of currency needed to cover imports and debt servicing. In addition, given the small production sector, real exchange rate adjustment may not boost exports enough to offset the negative effects on debt and imports. Thus, while the RER needs to be closely monitored, instead of real exchange rate adjustment, the SCD recommends reforms that will make the regulatory framework more business friendly; enhance productivity and competitiveness of the private sector by lowering the cost of basic infrastructure; enhance human capital quality for higher productivity; as well as reform the tax, competition and trade policies. These reform needs were discussed in section 2.2.1, and are covered in the priority action matrix. The suggested reforms and policy improvements are also expected to improve the competitiveness of the production sector and enhance exports for better external performance.

The business environment analysis reveals a number of constraints that have thwarted the development of the private sector, making the government the main job creator, with growth led by the public sector. The constraints to private sector growth include (a) a burdensome business regulatory framework; (b) limited access to and high cost of basic infrastructure for production (electricity and ICT); (c) the high cost and low quality of labor; (d) an inequitable tax policy; (e) the high prevalence of state-owned enterprises and lack of competition; (f) limited financial intermediaries and access to credit; and (g) lack of an export-enhancing trade policy to enable firms to take greater advantage of the geo-strategic location through diversification towards more productive exports.

Recognizing ongoing reform efforts such as containing public sector wages and easing some dimensions of doing business, a selected set of priorities stand out from the long list of constraints identified. In the short and medium term, economic transformation towards private sector-led growth will require the authorities to prioritize improvements in electricity and ICT connectivity, and greater leveraging of the export potential offered by COMESA. A potential quick win would be to strengthen domestic resources mobilization through tax reform. If well implemented and accompanied by an adequate expenditure policy, tax reform could have cross-cutting effects by creating fiscal space for investment and stimulate SMEs, which in turn would create jobs and increase production. Increased productivity could reduce the country's reliance on imports of basic goods, boost exports, and improve external performance. A strong and equitable system of domestic resources mobilization could be a strong lever to reduce borrowing and contain the growth of debt. Thus, tax reform for domestic resources mobilization is critical to sustaining investment and preserving macro stability. Tackling reforms that make it easier to start a business and register property, as well as enhancing access to finance, would be important as well. Finally, Djibouti

should consider ways to enhance competition. One pathway would be to reform SOEs in certain sectors better suited to private sector participation.

3. Transforming Human Capital by Investing in Nutrition, Learning and Skills: Constraints and Reform Areas

With only 25 percent of the working age population employed in formal or informal work, expanding productive employment is essential for Djibouti to achieve inclusive growth. Global experience shows that low human capital constrains growth because it is difficult for an economy to innovate, lift productivity, and benefit from new investments if talent and skilled human resources are scarce.^{50,51} One study estimates that if African and South Asian countries had eliminated stunting among today's workers, their economies could have grown by around 9-10 percent of GDP per capita.⁵² Along with its importance for productivity, investing in human capital is of intrinsic value as it improves people's wellbeing. Picking up from the preceding chapter, which examined bottlenecks to employment creation by businesses, this chapter examines the human side of the process and asks what constrains employability and progress in human capital in the country.

Djibouti ranks 172nd out of 188 countries and territories on the Human Development Index (HDI), making it one of the lowest ranking nations in the world. Despite recent improvements in key health indicators, Djibouti lags behind similar and neighboring countries. For example, although life expectancy has improved over the last 20 years, gains have been slow in comparison to countries with similar economies such as Cabo Verde and Belize. Moreover, with a current life expectancy at birth of 62 years, Djibouti's average is more than ten years lower than that of the Middle East and North Africa region.⁵³ While the fertility rate has steadily decreased to 3.1, infant and maternal mortality ratios not only remain higher than that of economically comparable nations, but are higher than those countries within Djibouti's geographic region.⁵⁴ Only 23 percent of women receive four or more antenatal care visits, and only 54 percent receive any form of postnatal care.⁵⁵ Maternal mortality, although decreasing (from 517 per 100,000 live births in 1990 to 229 in 2016), is still markedly higher than target of 129 of the Millennium Development Goals (MDG⁵⁶) that was set for 2015. These indicators show the challenges that remain in improving access to and quality of obstetric and neonatal care. Between 2002 and 2013 there has been virtually no improvement in the percentage of children aged 0-59 months who are underweight (30 percent). During the same period, the proportion of children under five who were acutely malnourished

⁵⁰ India is one example – the internationally known and skills-intensive IT sector is unable to absorb the large majority of the workforce because of low education. Ahsan and Mitra 2016.

⁵¹ One indicator to assess if human capital is a constraint is to look at returns to schooling. High rates of return to schooling would suggest that education constrains growth in Djibouti. This is indeed the case. In 2012, the average returns to years of schooling was estimated to be 11.5 percent. This return to schooling for Djibouti is high compared to the returns estimated for other small states (with population levels like or lower than Djibouti) and Middle East and North Africa countries. For the small share of the educated who have completed schooling beyond secondary, the returns in wages are higher than the average of 11.5 percent. In 1996, when educational attainment was much lower than today, the returns to years schooling was estimated to be 15.5 percent.

⁵² Galasso and Wagstaff 2016.

⁵³ World Bank Group, World Development Indicators.

⁵⁴ Ibid.

⁵⁵ Ministère De La Sante Djibouti, Direction De La Statistique Et Des Etudes Démographiques, and Pan Arab Project for Family Health, "DEUXIEME ENQUETE DJIBOUTIENNE SUR LA SANTE DE LA FAMILLE EDSF//PAPFAM 2 -- 2012 : Rapport Final."

⁵⁶ The Millennium Development Goals' "Target 5.A" was to reduce by three quarters, between 1990 and 2015, the maternal mortality ratio.

fell slightly from 19.4 to 17.8 percent, and 5.7 percent of children under five suffer from severe acute malnutrition (SAM).

Change in two dimensions – child nutrition, specifically child growth, and learning and skills – is essential for transforming human capital in Djibouti. Stunting or a shortfall in growth in childhood has been found to be adversely linked to productivity and cognitive ability in adulthood. Djibouti’s education system must also train future workers to deal with expanding automation and the rising digital content of jobs. Tackling stunting among young children and boosting the education system will raise employability today and in the future.

Transforming human capital in Djibouti calls for reform in public services delivery (health, nutrition, and education); investment in social safety nets for the poor; and addressing essential elements of environmental sustainability, including water, sanitation and hygiene (WASH) and climate change adaptation, which especially affects pastoralists and those living outside the capital city. Available data show that Djibouti’s spending on education and health (as a percentage of GDP) is comparable to or exceeds that by small states as a group (Figure 3.1 and Figure 3.2). The fact that human development outcomes do not align with public spending suggests that sectoral inefficiencies are present. Within the MENA region, Djibouti, along with Morocco, has the lowest efficiency score on public spending on education, which Bahrain, Kuwait, and Qatar have the highest efficiency scores.⁵⁷

Figure 3.1 Government Spending on Education (% of GDP)

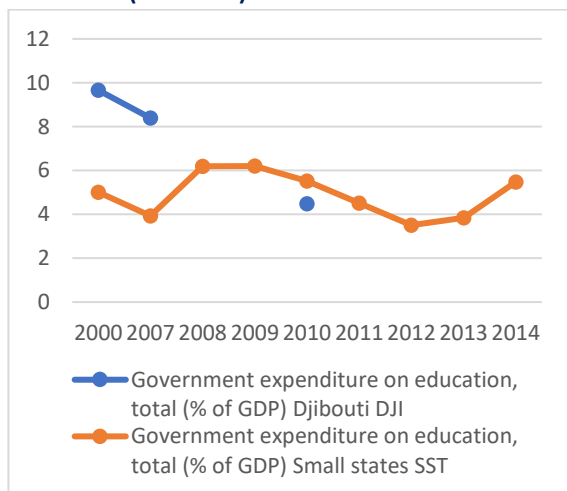
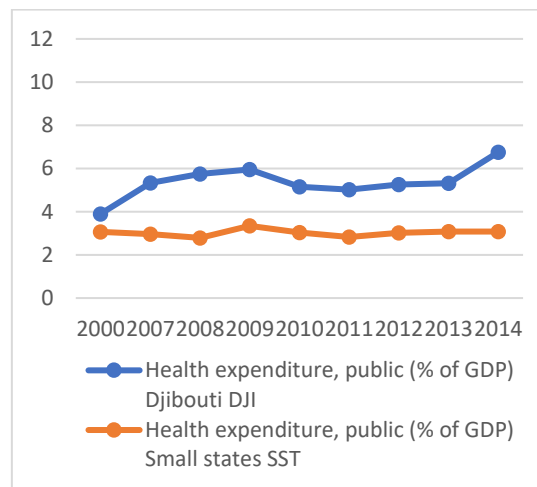


Figure 3.2 Public Spending on Health (% of GDP)



Source: Authors’ calculation using WDI data

⁵⁷ Finding cited in Brixi et al. 2015.

3.1 Tackling Childhood Stunting

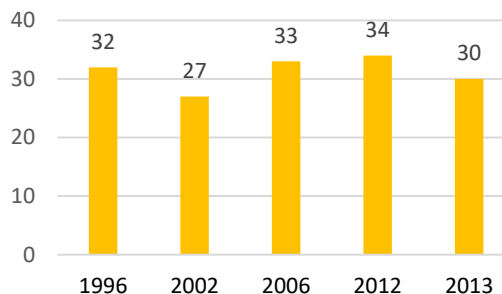
3.1.1 Current situation

Childhood stunting,⁵⁸ which reflects chronic undernutrition, affects an estimated 33,000 children per year in Djibouti. In 2013, 30 percent of children 0-5 years were estimated to be stunted, with no difference in incidence between girls and boys (Figure 3.3). The World Health Organization (WHO) considers this prevalence of stunting to be a very severe public health problem. Over the past two decades, stunting rates in Djibouti have remained relatively unchanged.

Between 2002 and 2013, the rate increased by 3 percentage points, from 27 percent to 30 percent. The age group most affected by stunting are children 12-23 months, with approximately 41.5 percent of this age group excessively short for their age.

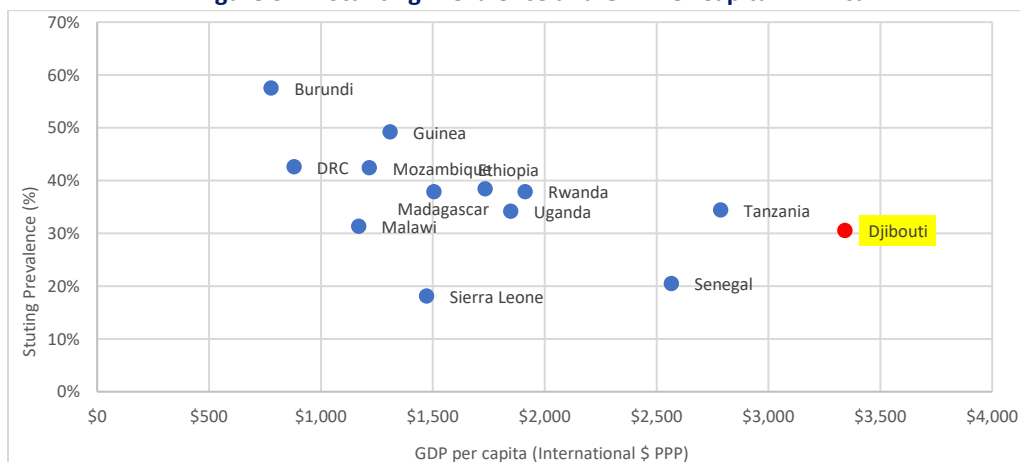
Although the prevalence of stunting is lower than in neighboring countries (Tanzania: 34.4 percent; Ethiopia: 38.4 percent), Djibouti is still among the 37 high-burden countries that account for 85 percent of global stunting prevalence. Its rate of stunting is nearly double the level of countries like Senegal (18.7 percent), which have introduced large-scale programs to tackle child undernutrition. Also, countries like Sierra Leone and Senegal have achieved lower rates of child stunting despite having lower GDP per capita than Djibouti (Figure 3.4).

Figure 3.3 Prevalence of Under-5 Stunting, 1996-2013



Source: UNICEF/World Health Organization/World Bank 2017; SMART Survey 2013.

Figure 3.4 Stunting Prevalence and GDP Per Capita in Africa



Source: World Development Indicators

⁵⁸ Refers to a condition where a child is excessively short for their age. This is measured using children's height-for-age z-score. If a child's height-for-age z score is less than 2 standard deviations below the median of a healthy reference population (WHO 2006 reference population) then she is considered to be stunted.

3.1.2 What constrains child growth in Djibouti?

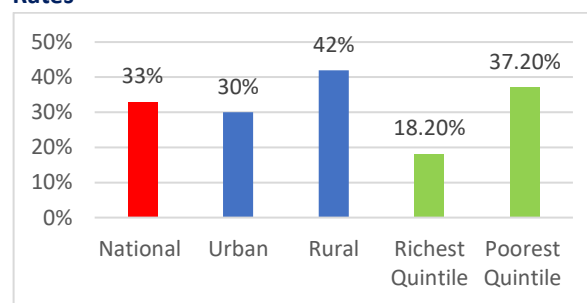
An infant will not gain height as she grows older if her food intake (breastmilk, complementary solid foods) is inadequate and/or if she repeatedly experiences infectious diseases. Failure to grow adequately generally manifests within the first 1000 days of life and can cumulatively lead to older children being excessively short for their age. Reasons for a child's inadequate food intake and disease exposure can range from her mother's level of knowledge, behavior and poor income to broader systemic and public service delivery issues such as weak health services for infants, poor water and sanitation facilities, and food insecurity. Following the framework used in a recent World Bank analysis,⁵⁹ this SCD examines the country's performance in five underlying drivers of stunting: (a) adequate food security at the household level; (b) access to adequate care; (c) access to healthy environment; (d) adequate health care; and (e) household income, poverty status, and location.

Table 3.1 summarizes the key constraints with regards to each driver of stunting. Statistics suggest that Djibouti faces constraints across all areas. However, there has been no systematic study to identify which of the drivers of stunting are the most salient. Looking across the indicators for the five drivers of stunting, three patterns stand out.

First, household income and poverty status affect stunting rates. As per the 2013 Standardized Monitoring and Assessment of Relief and Transitions (SMART) survey, 37 percent of children in the poorest quintile were stunted as compared to 18 percent among the richest (Figure 3.5). A confluence of factors elevates the risk of stunting among poor children. Aside from low access to basic services, the poor face high levels of food insecurity, which in turn affects pregnant women and their babies' nutritional status. Since Djibouti imports most of its food, the domestic market price of food items is affected by volatility in international food prices – it is estimated that more than 40 percent of any rise in international food prices is passed through to domestic food prices in Djibouti. Although current domestic food prices are forecast to be stable due to predicted low and stable international food prices,⁶⁰ the poor remain exposed to future volatility in food prices and hence to the risk of malnutrition. It is important to note that stunting also affects almost a fifth of all children among the richest quintile, which suggests that other factors such as care practices and behaviors play an important role as well.

Second, both urban and rural children face constraints in key drivers of nutrition, although some indicators are decidedly worse in rural areas. While urban children have stunting rate of 30 percent, rural children have a stunting rate of 42.3 percent. The Obock, Dikhil and Tadjourah regions have the highest stunting rates, at 45.9, 44.2 and 40.8 percent, respectively. Indeed, indicators for almost all drivers of stunting are worse for rural than urban residents. Reaching rural residents living in low-density settlements far from

Figure 3.5 Regional and Income Disparities in Stunting Rates



Source: UNICEF/World Health Organization/World Bank 2017; SMART Survey 2013.

⁵⁹ World Bank 2017b.

⁶⁰ FAO 2017.

the capital city can be expensive and stretch the available human resources needed to deliver services. In particular:

- a. Even with support from several donors to the Expanded Program on Immunization (EPI), the share of children fully immunized by their first birthday ranges from 70-80 percent in urban areas and from 40-50 percent in rural areas. According to the Ministry of Health,⁶¹ as of June 2017, 75 percent of primary health care facilities did not provide immunizations due to the lack of a functional cold chain (because of the unavailability of refrigerators and/or lack of electricity or batteries for solar-powered systems).
- b. There is also a shortage of health workers at the primary health care level and outside of Djibouti City. Djibouti only has 10 skilled health workers per 10,000 people, much below the WHO recommended ratio of 23 skilled health workers per 10,000 people.
- c. Drinking water, an essential element of WASH services, is scarce in Djibouti due to its geography and climate. Only 65 percent of the rural population has access to improved water sources. While almost all urban households have access to improved water, only 50 percent of the population of Djibouti City is connected to the public water supply through individual connections, the other half having to draw water from connected neighbors or from public standpipes.⁶² The national water utility ONEAD (Office National de l'Eau et de l'Assainissement de Djibouti) a state-owned enterprise (SOE) is the only agency in water and sanitation and operates the only existing wastewater treatment plant in the country. Djibouti faces significant challenges in term of institutional capacity of ONEAD. Its weak performance has been partly due to insufficient human capacity at both managerial and technical levels, especially with regards to the practical aspects of modernizing and improving the performance of a water utility.
- d. Access to sanitation, another component of WASH services, is limited to the capital city, with only one wastewater treatment plant (3,700m³/day) operational since 2014 and 6 pumping stations. Studies from contexts such as India and sub-Saharan Africa⁶³ have found children's lack of WASH access to be significantly associated with the incidence of stunting. Djibouti does not have an integrated water and sanitation strategy to effectively manage its limited resources and deliver services to the public (Box 3.1).

Third, the country's pastoralists, who rely on dryland livestock raising, are vulnerable to variable rainfall levels and climate change; reaching them with services is also difficult. Since 2010, drought conditions have affected pastoralists. Despite average to above-average rainfall during the March to June rainy season in 2017, which restored pasture and water resources, the Famine Early Warning Systems Network (FEWSNET) estimated that poor pastoralists in the Southeast Pastoral Border livelihood zone will likely

⁶¹ Ministry of Health 2017

⁶² For water supply in capital city, pipe-borne water was used by 94.1% of households (41.4% in households, 39.8% in courtyards and 12.9% from a public standpipe) compared to rural areas, where pipe-borne water is used by only 27.4% of households (3.6% in households, 4.4% in courtyards and 19.4% from a public standpipe).

⁶³ See World Bank 2017b and Galasso and Wagstaff 2016.

face limited food availability during June to September 2017 lean season due to small herd sizes and consequently lower earnings from milk sales. According to the Ministry of Health, the mobile health clinics that are intended to serve these populations are not fully functional for a variety of reasons, including poor management and coordination and lack of skilled health professionals.

Box 3.1 Lack of an Integrated National Water and Sanitation Sector

Djibouti lacks an integrated national water and sanitation sector strategy. The high salinization of aquifers in Djibouti is due to limited water planning and the excessive exploitation of groundwater resources. There is a need for a holistic, clear, and updated sector strategy for water and sanitation provision, covering all sub-sectors and use (water resource management, water supply, sanitation, water quality and conservation), infrastructure development (wastewater treatment stations, distribution systems, production and transfer systems), as well as the evolution of the institutional structures, and regulatory regime. In addition, needs of strategic reflection remain, as physical conditions make inter-basin transfers or development of deep aquifers to balance supply and demand very costly (requiring special O&M provisions) and there are large ecological obstacles (uncertainties regarding the sustainability of the new sources).

Source: See Annex 6

Table 3.1 Drivers of Stunting in Djibouti

Underlying driver of Stunting	Evidence of constraints to addressing these drivers in Djibouti	Particular groups affected
Adequate food security at the household level. Consists of four broad dimensions: availability, access, utilization and stability (over time)	<ul style="list-style-type: none"> All food items imported, fluctuations in international food prices directly affect Djibouti's poor who spend up to three-quarters of their income on food. Price passthrough Severe and prolonged droughts affected food security of about 20 percent of the capital's population and three-quarters of rural households Pastoralists were particularly affected by the drought 	<ul style="list-style-type: none"> Poor households Rural population Pastoralists
Access to adequate care. Covers mothers' knowledge, practices and beliefs, health and nutritional status, autonomy and control of resources, workload and time constraints	<ul style="list-style-type: none"> Exclusive breastfeeding lowest rates in the world – 1.3%, compared to a global average of 38%. 	
Access to a healthy environment, via Water, Sanitation and Hygiene	<ul style="list-style-type: none"> 65% of rural population with improved water sources. Universal in urban areas. Access to improved sanitation facilities: 60% in urban areas to just 5% in rural areas 	<ul style="list-style-type: none"> Poor households Rural population

services and conditions (or WASH)	<ul style="list-style-type: none"> • Access to improved water sources higher among the richest quintiles relative to the poorest ones 	
Adequate healthcare. child's access to skilled medical care to minimize the effects of illness and preventively address health issues, such as diarrheal diseases	<ul style="list-style-type: none"> • Fully immunized 1 year old: 70% to 80% (urban); 40% to 50% (rural) • 75% of primary health care facilities did not provide immunization due to absence of functional cold chain due to unavailability of refrigerators, issues with electricity or batteries (for solar-powered systems) 	<ul style="list-style-type: none"> • Rural population
Child's household's income and poverty status and location	<ul style="list-style-type: none"> • Stunting is significantly high among poor children, children living in rural areas, and those living in refugee camps. 	<ul style="list-style-type: none"> • Refugee camps; rural areas • Pastoralists

Source: Authors' elaboration using multiple sources of analysis.

3.1.3 What needs to be done to tackle stunting?

Global experience suggests that tackling stunting is a complex development challenge. A multi-sectoral approach, summarized in Figure 3.6 below, consists of measures that directly impact children's growth (nutrition specific) as well as measures such as water and sanitation investments that indirectly affect children's ability to stay healthy and grow (nutrition sensitive). While the list of measures appears long, the experience of countries such as Peru and Rwanda demonstrate the feasibility of a coordinated government push to successfully reduce childhood stunting. Such a coordinated approach calls for an improvement in governance and service delivery (discussed in chapter 4).

Efforts must be focused on preventing stunting as well as ameliorating the negative effects of stunting among the 33,000 children who are already affected. Reinforcing the capacity of the National Nutrition Program to deliver nutritional services could be a good starting point. Global evidence suggests that nutrition-specific health services focused on the critical 1000-day window from a woman's pregnancy to her child's second birthday, combined with a concerted effort to expand WASH services,⁶⁴ especially to poor and rural families, can be effective in preventing childhood stunting. For health and nutrition services, there is a need to strengthen service delivery, particularly outside the capital city. Efforts to improve the functioning of primary health care facilities will require better access to electricity (through reliable non-grid solutions) and increased availability of skilled health workers. Complementing these measures with ICT-enabled remote diagnostics and telemedicine can help offset the challenges posed by limited human resources.

Additional nutrition-sensitive interventions include measures to improve food security⁶⁵ and in-kind or cash transfer programs (safety nets) for poor households, where women are often the main recipients of

⁶⁴ See Annex 6.

⁶⁵ The Government's food security strategy is aimed at: (a) developing agriculture in neighboring countries, particularly Ethiopia and Sudan, to create a buffer stock of food; and (b) developing arable land within the country through irrigation systems and mobilization of surface water. However, the 3-years long drought that hit the country in 2008-2011 has impacted this sector

the transfers. Such safety net programs aimed at the poor and vulnerable households can smooth children's and pregnant mothers' food intake in times of shocks. When complemented with nutrition interventions, these programs can have a significant impact on reducing stunting. In Togo, cash transfers complemented with nutrition interventions aimed at young children were found to reduce the incidence of stunting by 20 percent.⁶⁶

Expanding WASH access to improve access to potable water and sewerage services in urban and rural areas involves (i) increasing the number of households with access to drinking water supply; (ii) increasing the number of households connected to sanitation network; (iii) rehabilitation of sanitation network; (iv) building new wastewater treatment plant as to increase the connection rate to the public sanitation network; (v) improving the quality of services in poor areas; (vi) rehabilitating the existing water supply infrastructure. Achieving these improvements would require an integrated water and sanitation strategy as well as institutional strengthening and efficiency improvements in ONEAD. These improvements are especially needed to reduce water loss and improve financial viability of ONEAD (particularly to cover costs of new investments in the system).

Pastoralists who rely on livestock raising are particularly vulnerable to the growing climate variability. Djibouti is ranked 159th out of 181 with respect to its vulnerability⁶⁷ to climate change and its lack of readiness⁶⁸ to address these vulnerabilities. Based on the Notre Dame Global Adaptation Index (ND-GAIN), Djibouti is the most vulnerable to climate change among comparable countries and the least prepared to address this vulnerability. In its Nationally Determined Contribution (NDC), submitted to the United Nations Framework Convention on Climate Change (UNFCCC) in August 2015, Djibouti has emphasized the urgent need to address adaptation to the effects of climate change. Supporting pastoralists' capacity to adapt to climate variability is critical to build their resilience and reduce reliance on humanitarian aid. Adaptation efforts could be complemented with weather index insurance and cash transfers to help pastoralist households cope with the effects of drought.

Finally, early childhood development (ECD) programs can help offset the adverse effects on cognitive ability among older children who are already excessively short for their age. Spending on ECD programs has been found to be among the most cost-effective investments made by governments. They offer psychosocial stimulation and other interventions aimed at promoting cognitive, language and socio-emotional development for children older than 2 years of age. Evidence suggests that such interventions may help prevent stunted children from falling ever further behind their peers and may even allow them to catch up.⁶⁹

dramatically, which will necessitate mitigation measures such as scaling up innovative approaches for water harvesting and management, and strengthening rural income-generating activities (fisheries and handicrafts are possibilities). In addition, there is a need for soil and water conservation activities to protect water structures, water sources, and enhance vegetation regeneration around these structures.

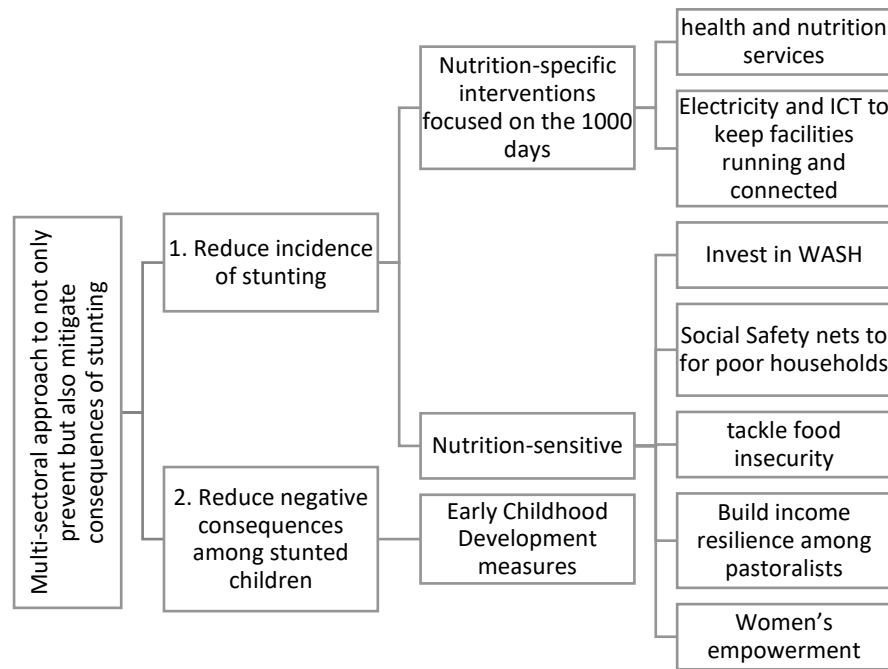
⁶⁶ Briaux et al, 2017.

⁶⁷ ND-GAIN Vulnerability measures a country's exposure, sensitivity and capacity to adapt to the negative effects of climate change. Vulnerability is considered in six life-supporting sectors: food, water, health, ecosystem service, human habitat, and infrastructure.

⁶⁸ ND-GAIN Readiness measures a country's ability to leverage investments and convert them to adaptation actions. Readiness is considered in three components: economic readiness, governance readiness and social readiness.

⁶⁹ Galasso and Wagstaff 2016; Kogali and Kraft 2015.

Figure 3.6 What needs to be done to tackle stunting?



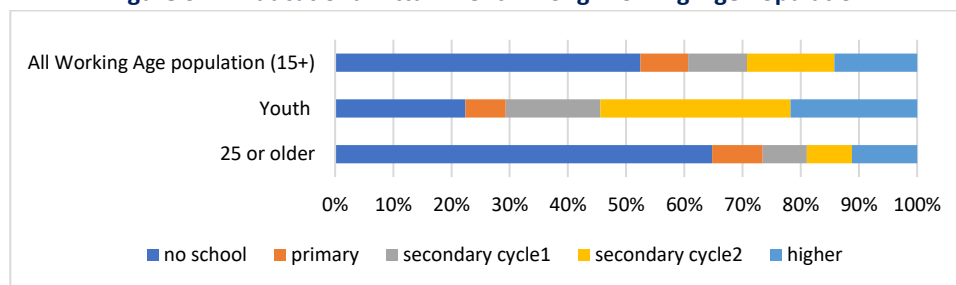
Source: Authors' elaboration using multiple sources of analysis

3.2 Expanding Schooling, Learning, and Skills

3.2.1 Current situation

Employability of the working age population is significantly affected by the fact that 52.5 percent of today's working age population has no schooling. Literacy rates are correspondingly low.⁷⁰ These figures are the outcome of past low schooling in Djibouti. Since 2000, as more schools have been constructed and more textbooks have been provided, gross enrollment rates also more than doubled at the primary, secondary, and tertiary levels. This has resulted in much more schooling among young people (15-24) compared to the older population: only 22 percent of youth have no schooling as compared to 65 percent of those aged 25-64 years (Figure 3.7).

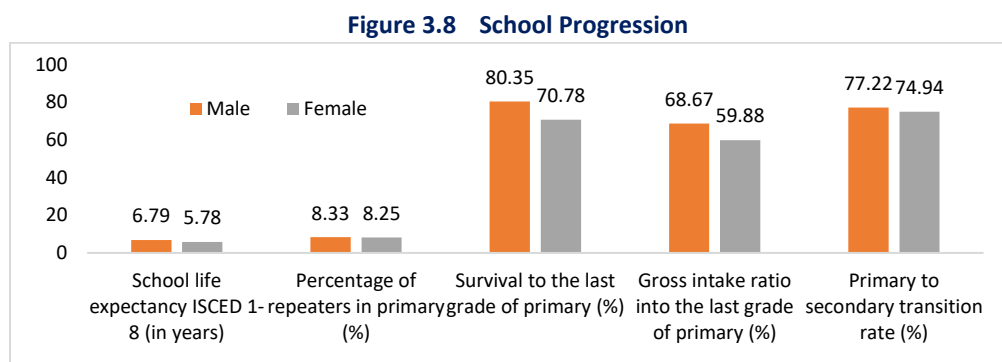
Figure 3.7 Educational Attainment Among Working-Age Population



Source : World Bank staff calculations using *Enquête Djiboutienne sur l'emploi, le secteur informel et la consommation des ménages* (EDESIC) 2015.

⁷⁰ Results from the 2012 Household Survey (*Enquête Djiboutienne Auprès des Ménages*, EDAM) survey show that only about 50 percent of the over 15 population is literate.

Despite these improvements, however, enrollment rates are still low: gross enrollment rates are 64 percent for primary, 48.3 percent for secondary, and 5 percent for tertiary.⁷¹ There are inconsistencies between Government and UNESCO UIS figures reported in World Development Indicators database. This discrepancy is due to the different population estimates used: Ministry of Education (MENFOP) bases its calculations on population figures from the national statistical agency while UNESCO UIS uses UN population projections. When the new census is carried out, UNESCO UIS and DISED/MENFOP figures should be harmonized. Enrollment in early childhood education (ECE) is very low. For those who do enroll in primary, progression to higher levels is a concern. Only 80 percent of enrolled boys and 71 percent of girls reach the last grade of primary. Primary to secondary transition rate is similarly low, at 77 percent for boys and 75 percent for girls (Figure 3.8). Dropout rates are not readily available but are estimated to have climbed from 3.7 percent in 2013 to 7 percent in 2015.⁷² Additionally, out of school figures remain high and have climbed marginally between 2014 and 2015.⁷³



Source: Authors' elaboration using ISCED/EUROSTAT data

Schools are expected to teach basic competencies that enable students to acquire the skills valued by employers and are useful for self-employment. Djibouti has not participated in internationally benchmarked learning assessments such as PASEC – the international assessment of learning for francophone African countries – making it difficult to assess the quality of learning. A recent Early Grade Mathematics Assessment⁷⁴ shows that mathematical learning in year 2 is low.

3.2.2 What is constraining schooling, learning and skills acquisition in Djibouti?

Factors related to both child and household characteristics and the education system drive schooling, learning, and skills acquisition. There is no systematic study of which of these factors are most important. As the *2018 World Development Report on Learning to Realize Education's Promise*⁷⁵ discusses, teaching-related factors play a role in student learning, therefore, language of instruction (French or mother tongue) and the use of pedagogical strategies are important factors. Since Djibouti does not participate in

⁷¹ World Development Indicators, latest figures.

⁷² *Plan d'Action de l'Education 2017-19*.

⁷³ Out-of-school boys and girls (thousands): 14.73 and 18.734 (2014) and 18.9 and 21.5 (2015), respectively.

⁷⁴ 2017 assessment carried out under World Bank PAEQ project.

⁷⁵ World Bank 2018.

international learning assessments, there is no data to evaluate quality of education. Table 3.2 summarizes the available evidence on the drivers of education and learning. A few patterns stand out.

First, a child's gender, household income and location appear to matter, but concerns about cost or distance to school may not be important factors. Girls are much less likely than boys to continue beyond primary school. After OTI in 5th Grade, girls are less likely to continue their studies. Rural girls' enrollment and primary completion rates are even lower. Children from poor households and rural areas are significantly less likely than better-off and urban children to be enrolled at any level of school. To what extent these patterns reflect low demand for schooling for girls or in rural areas is unclear. The 2015 EDESIC survey respondents who had never attended or dropped out of school listed several reasons for doing so. Among 15 to 24-year-old boys not in school, the most common answer was that they were not interested in school or that school was not useful. However, estimates of returns to schooling suggest large returns to attending primary or higher education, so it is difficult to understand why school was not considered to be useful. Among out-of-school girls, household responsibilities were also frequently cited. Cost or distance to school were not common concerns.

Schools' lack of basic infrastructure and double shifting could be reasons for low enrollment. Twenty percent of rural primary schools do not have water supply and 55 percent do not have electricity. Despite school expansion, high student-teacher ratios and the practice of double shifting continues.⁷⁶ In urban primary schools, the student-teacher ratio is high at 34 students per teacher. In rural primary schools, while student-teacher ratios are low, a larger share of classrooms (24 percent as compared to 7 percent in urban schools) are run on double shifts. Double-shifting of classrooms, a way to increase the supply of schooling, shortens teaching hours, and second-shift students contend with uncomfortable classroom temperatures. Between 2014 and 2016, the Government opened 127 new classrooms with the objective of reducing class size to 45 students, but the need for access continues to outstrip supply.

Second, tertiary education is affected by insufficient academic preparation of incoming secondary school students; the under-development of the sector (a single university and several small institutes under various ministries/authorities); the French system of open admission to the university, which can result in overcrowding of available programs; and lack of an external quality assurance mechanism.

Third, for the sizeable population who have left the education system or never attended school, training opportunities and entrepreneurship appear to be limited. In 2016, 2249 students, mostly male, were enrolled in public or private professional training programs. The Ministry of Education⁷⁷ has noted that: (a) the training system does not provide graduates with practical knowledge; (b) enterprises are not consulted in the design of work internships; (c) theoretical courses are out of date; and (d) youth lack the necessary skills to understand how companies are organized and managed.

⁷⁶ MENFOP 2016-17.

⁷⁷ Ministry of Education 2007.

Table 3.1: What Constrains Schooling, Learning, and Acquisition of Skills?

Underlying drivers	Evidence on these drivers in Djibouti	Particular groups affected
Child's gender, location, household income and poverty status	<ul style="list-style-type: none"> • Gross primary enrollment rate: 60 percent for girls and 68 percent for boys. Girls less likely to progress to higher levels <ul style="list-style-type: none"> - Primary completion rates for rural girls is less than 8 percent, for all girls, 35 percent - Rural-urban school enrollment gap widened between 1996 and 2012. • Among 15-24-year-old boys not in school the most common reason was that they were not interested in school or that school was not useful. Among out-of-school girls, household responsibilities were also frequently cited. Cost or distance to school were not common concerns. (2015 EDESIC Labor Force Survey) • Poor children have lower school participation including in pre-school --an important component of ECD. Lower electricity access among poor households can be an additional contributing factor. 	<ul style="list-style-type: none"> • Girls • Rural children • Children from poor households
School system and policy (public schools) for primary, secondary, tertiary and TVET --Learning environment/Infrastructure	<ul style="list-style-type: none"> • School with electricity: 55 percent of rural primary and 74 percent of urban primary schools • High student-to-teacher ratio of 31.7. Large class sizes especially in urban primary schools. • 12 percent of public primary classrooms operate on a double-shift schedule (MENFOP Annuaire Statistique 2016-17) • Few national assessments of learning or sources of poor learning is available. • Teacher training and textbooks are not constraints. Pedagogy and accountability and teacher incentive systems could play a role. • Tertiary education level: constrained by low quality of lower schooling levels, under-developed tertiary education sector, French system of open admission to the university with risk of rapid crowding of most existing programs, no external quality assurance, incipient research • Technical and vocational education and training (TVET): 2007 Study by the Ministry of Education found a number of gaps in labor market relevance of training. • For those outside of the school system, there limited training and ecosystem support opportunities. 	<ul style="list-style-type: none"> • Rural schools • Youth transitioning to the labor market

Source: Authors' elaboration using multiple sources of analysis

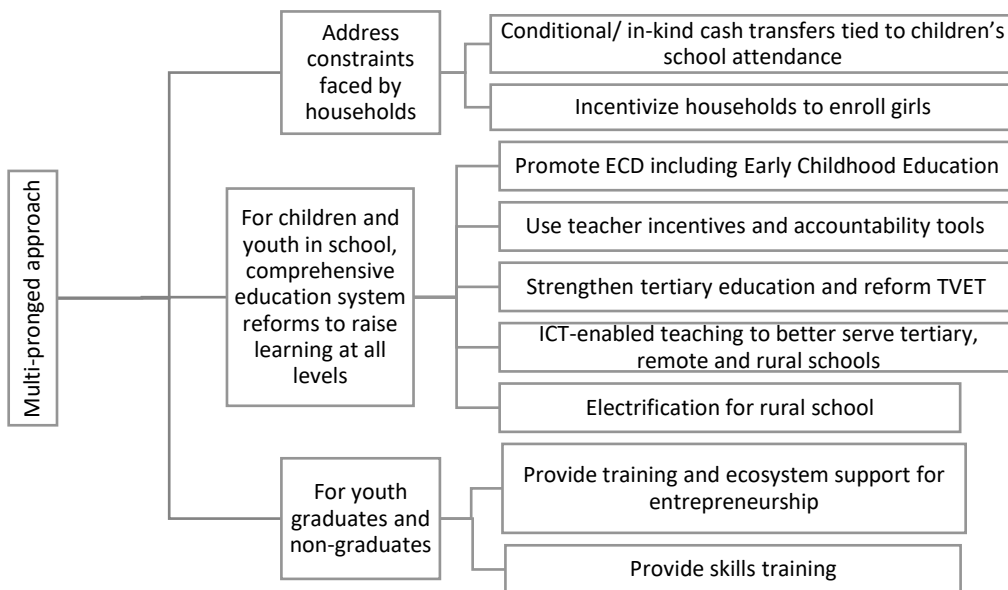
3.2.3 What needs to be done?

Djibouti has been successful in raising education enrollment rates over the past decade. Yet statistics suggest that more needs to be done to make basic schooling universal and ensure that all youth have access to learning and skills training that prepares them for the job market. Figure 3.9 summarizes the areas where actions could be taken. Along with sector reforms, expanding school electrification and leveraging ICT services could improve schooling outcomes, especially for students in rural areas.

Two programs – ECD and social safety nets – could have high payoffs in schooling and learning, given the high rates of stunting (discussed in the previous section) and the low schooling outcomes. In Argentina, Colombia and the United States, participation in ECD programs has been found to significantly raise schooling outcomes. Countries such as Algeria have been successful in expanding early childhood education. Social safety net programs, such as cash and in-kind transfers linked to school attendance, have been found to be successful in raising enrollment and completion rates, especially for girls. Female school stipend programs have been effective in raising girls’ school participation in Bangladesh and Pakistan.

Greater tertiary enrollment is needed to supply the labor market with high skills. Several steps could be taken to develop tertiary education, including: (a) development of selective, professionally oriented programs within the university, following the successful model of the faculty of engineering and the school of business administration; (b) preparing a national-level vision and strategic plan for the expansion and consolidation of the tertiary education system; and (c) consolidation of existing institutions under the umbrella of the Ministry of Higher Education, and integration of the national research center (*Le Centre d'étude et de recherche de Djibouti*, CERD) into the university. Regarding item (b), preparing a strategic plan for tertiary education, it will be important to identify potential areas of growth linked to Djibouti’s development priorities; as well as measures to manage the growing number of students through. Some options are more short-duration programs, increased reliance on good quality online/ICT-enabled education, and more quality private institutions.

Figure 3.9 What Needs to be Done to Raise Children’s Schooling and Ensure They Acquire Relevant Skills?



Source: Authors’ elaboration using multiple sources of analysis

3.3 Reforms for transforming human capital

Investing in and boosting human capital is central to transforming the Djiboutian economy. As the preceding discussion shows, there are a number of constraints to improving child nutrition, learning, and skills. These constraints are summarized in tables 3.1 and 3.2. Looking at the constraints, three areas for reforms can be identified:

- a. Public services delivery: expansion of health and nutrition services, reform of the education system from primary through tertiary, ECD, training and entrepreneurship promotion.
- b. Basic infrastructure: policy and institutional reforms and investments in ONEAD to improve WASH services. Reforms to improve electricity and ICT access discussed in chapter 2 will also be beneficial to improving delivery of health services and schooling especially outside Djibouti City.
- c. Programs for poor and pastoralist households: expansion of social safety nets, cash or in-kind transfers with incentives for girls' education, can help improve poor children's human capital outcomes. For pastoralists, income and welfare are dependent on the environment. Promotion of climate change adaption will help these households build resilience to droughts.

4. Transforming Governance for Effective Public Service Delivery: Constraints and Reform Areas

As in most small states, the public sector in Djibouti plays a large role in the economy, making it imperative that governance-based constraints are addressed. The *2017 World Development Report, Governance and the Law*, points to improved governance as an important factor in restoring confidence in institutions and thus unlocking the potential of the private sector and human capital development. Addressing governance-based constraints in Djibouti would require investing in three interconnected areas – public administration capacity, effectiveness of public services delivery, and accountability and transparency to ensure a well-functioning business environment.

4.1 Current situation

Djibouti scores low on Worldwide Governance Indicators (see Annex 5) and is among the lowest-performing countries on governance. It lags relative to peers on the indicator for voice and accountability (figures 4.1, Figure 4.2, and Figure 4.3); In 2016, Djibouti ranked 38th out of 54 countries in the Ibrahim Index of Governance in Africa. There are shortcomings in governance in various dimensions, sometimes associated with insufficient capacity, as illustrated by the country's performance on the CPIA, which assesses the quality of a country's policy and institutional framework to foster sustainable growth, poverty reduction, and the effective use of development assistance.⁷⁸ Djibouti's performance on the CPIA has been low and has further deteriorated in recent years. The country is classified as a fragile state based on its CPIA scores.⁷⁹

Good governance and strong institutions play an important role in countries' socio-economic development. Governance in the context of socio-economic development encompasses several institutional dimensions: state capacity, regulation of economic institutions, and political institutions of a society. The regulation of economic institutions reflects the market-enhancing aspect of good governance where transaction costs to firms are reduced and policies for efficient market functioning are implemented.⁸⁰ State capacity reflects the ability to efficiently deliver public goods that affect, for example, citizens' ability to invest in human capital. The efficient delivery of public services requires citizens' engagement, and voice and accountability through collective decision making.

Djibouti's current performance on governance, given its limitations in voice and accountability, public sector management and institutions, social inclusion, government effectiveness in public services delivery and enforcing the rule of law, constitutes a significant barrier for socio-economic development and

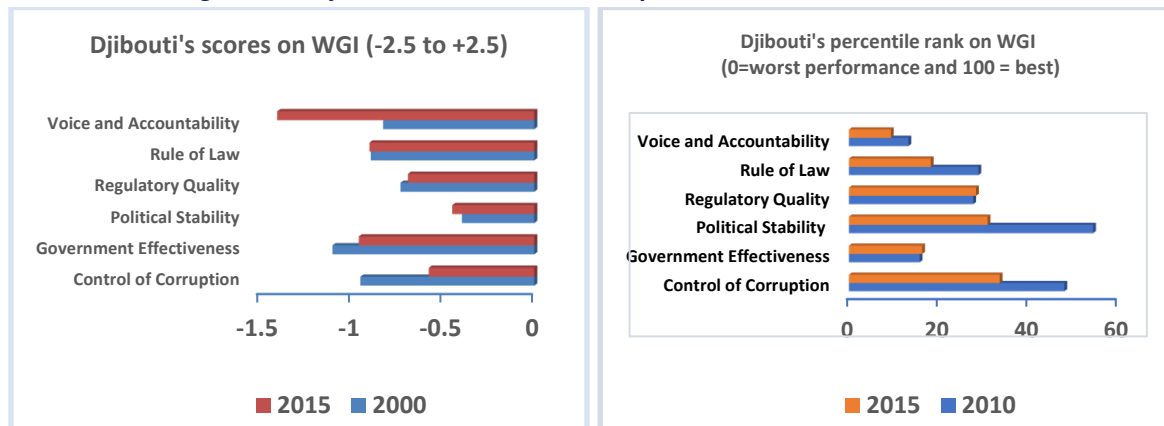
⁷⁸ The CPIA consists of 16 criteria grouped into four equally weighted clusters: "economic management," "structural policies," "policies for social inclusion and equity," and "public sector management and institutions." The 16 criteria capture key factors that foster pro-poor growth and poverty alleviation. The rating of each of the criteria reflect a variety of indicators, observations, and judgments, focusing on the quality of the country's current policies and institutions.

⁷⁹ The scale of the CPIA score is from 1 (weak performance) to 6 (highest performers), where countries with score below 3.2 are classified as fragile. Djibouti's overall CPIA score has been on a declining path, dropping from 3.18 in 2011 to 3.05 in 2014 and to 3.0 in 2016. The lowest CPIA scores are on the cluster for "public sector management and institutions," with a score of 2.5 in 2016, and the cluster for "policies for social inclusion and equity," with a score of 2.5 in 2016.

⁸⁰ Khan 2007.

inclusive growth. Thus, governance and institutional reforms are necessary to support sustainable and inclusive growth.

Figure 4.1 Djibouti's Performance on Key Governance Indicators: Score and Rank



Source: Worldwide Governance Indicators.

Figure 4.2 Average rank on Worldwide Governance Indicator

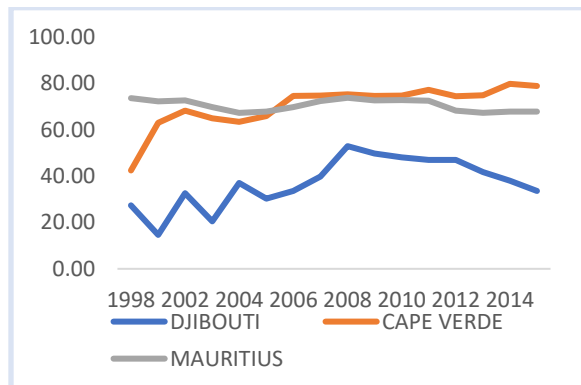
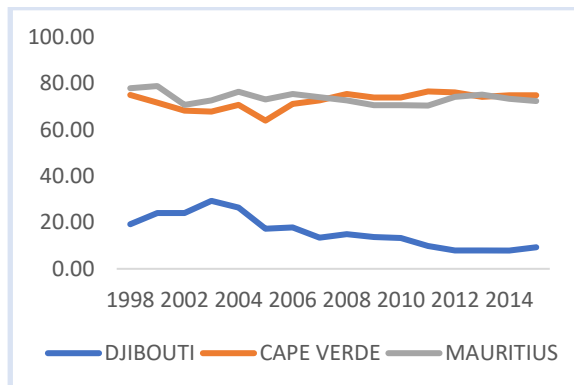


Figure 4.3 Voice and Accountability



Source: Worldwide Governance Indicators.

4.2 Improving public administration capacity, effectiveness, accountability, and transparency: What are the constraints?

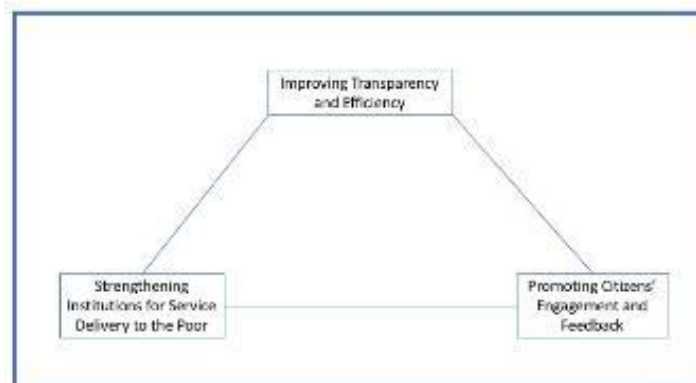
The recent fragility assessment by the World Bank⁸¹ shows that the prevalence of non-merit-based hiring and/or promotion at the institutional level and lack of results-based management have affected the performance of the civil services in Djibouti. The capacity of civil servants is assessed to be low. Lack of transparency further limits public sector accountability and efficiency.

⁸¹ World Bank 2017, Risk and Resilience Assessment.

As the 2017 WDR emphasizes, improved governance is an important factor in restoring confidence in institutions and enhancing institutional performance in public services delivery.

As described in Figure 4.4, this would require investment in three interconnected areas: (a) transparency and efficiency to enhance state accountability, through improved data collection for monitoring and evaluation, budget transparency, fiscal management, and public administration reforms; (b) institutions for service delivery, especially for the poor, and a spatial strategy that balances serving the large population in Djibouti City with areas outside the capital city; and (c) citizens' engagement and feedback, through broader consultation mechanisms in the design and delivery of projects, as well as through a focused policy dialogue that can support the government in developing platforms of expression, particularly for young Djiboutians.

Figure 4.4 Framework for Improved Governance



Source: Cited in 2017 Risk and Resilience Assessment.

Table 4.1 summarizes the constraints related to governance/public administration on public services delivery.

The health and education sectors illustrate some of the public administration capacity constraints. There is limited sector capacity for planning, budget management, health information, and monitoring and evaluation. The sector also lacks strategic management, particularly with respect to human resources and regulation of the pharmaceutical industry. As noted in chapter 3, the availability of skilled human resources is also a constraint with only 10 skilled health workers per 10,000 people. There are similar administrative constraints affecting the delivery of nutrition services. Poor managerial capacity for coordination and human resource constraints have limited the Ministry of Health's capacity to deliver nutritional services under the National Nutrition Program. In the area of education, the Government is committed to education policy reforms; however, improved capacity to implement these reforms is needed.

While more analysis is needed regarding options for civil service reform, an important vehicle for improving transparency is the timely collection, dissemination and use of data and statistics. During the preparation of the of SCD, a common constraint was the issue of limited data and evidence. For example, though the country is making progress on data production, national account data, whether aggregate or disaggregate, are still in preparation and preliminary. While the country has made recent investments in improving poverty measurement, there remain challenges of data comparability across time and coverage of populations such as refugees and pastoralists. The country last prepared a National Strategy for Development of Statistics in 2011 but it was only partially implemented. There are also issues of comparability between national and international data, making it difficult to monitor development progress in the Djibouti. Reflecting these challenges, Djibouti scores low on the World Bank's Statistical Capacity Indicator. The country performs worse than the majority of its comparators by income and fragile state status. A diagnostic of data availability is presented in Annex 7.

Reliability and timeliness of administrative data are also a concern. For example, the data on immunization coverage vary depending on the data source, and in most cases, are based on estimates. The Health Information System is affected by poor data collection and processing techniques; the lack of interconnectivity among different data platforms; limited ability to identify the specific information required at different levels to monitor equity, coverage, quality and efficiency; and general organization and management problems, including the absence of a comprehensive information strategy. The most recent health data, which primarily comes from the PAPFAM and SMART surveys, provides health statistics from 2012 and 2013, respectively.

Table 4.1 What are the Constraints to Capable, Transparent, and Accountable Public Administration Needed for Effective Service Delivery?

Area	Evidence of constraints
Capacity, effectiveness of public administration and management	<ul style="list-style-type: none"> • Djibouti's performance is ranked low by World Governance Indicators (WGI) and the Ibrahim Index of African Governance (IIAG) • For health and nutrition services, sectoral capacity for planning, budget management and information, monitoring and evaluation is low leading to low budget execution <ul style="list-style-type: none"> --availability of skilled human resources is low. While 22.8 skilled health workers are needed per 10,000 people only 10 skilled health workers per 10,000 people are available (lowest in MENA region)
Transparency and accountability of public administration --Monitoring performance of public services and promoting accountability and transparency through data --citizen's participation and engagement	<ul style="list-style-type: none"> • Timely collection, dissemination and use of data and statistics important but Djibouti suffers on this front <ul style="list-style-type: none"> --Djibouti performs worse than comparators on the World Bank's recently developed Statistical Performance Index (SPI) -- No reliable national accounts. • Reliability and timeliness of administrative data is a concern. • Governance indicators also show that Djibouti's performance on engaging citizens is low

Source: Authors' elaboration using multiple sources of analysis

4.3 What needs to be done? Reforms for strengthening governance effectiveness

Two key governance reforms include investing in development data systems to monitor progress and enable informed and transparent policy choices, and enhancing public administration capacity. The greater use of ICT could help to improve administrative effectiveness by supporting the improvement of information services; the strengthening of public service delivery systems; regular user feedback on service quality; and the improvement of collaboration across and beyond government.

5. Summary of Policy Actions and Priorities

Drawing together the constraints and areas for policy action in the three inter-related areas of the enabling environment for business and investment (Chapter 2), human capital and workforce skills (Chapter 3), and governance effectiveness (Chapter 4), this chapter reviews the policy actions needed to set economic transformation in motion. These policy actions tackle those constraints that can have long-lasting development impact, given Djibouti's small economy and macroeconomic context. Several of these constraints and associated reforms also have important complementarities for other actions and reforms. The policy actions are summarized in Table 5.1 and can be grouped as follows:

- a. To reduce the production costs for firms and improve children's health and nutritional status, Djibouti must undertake **policy and institutional reforms and investments in basic infrastructure services** such as ICT; water, sanitation, and hygiene (WASH); and electricity. This calls for also strengthening the operation and financial viability of the associated state-run utilities – Djibouti Telecom, ONEAD and EDD, respectively. For Djibouti Telecom, this could mean redefining its strategic position by developing the national fixed and mobile broadband market through sector liberalization, following the example of countries such as Cabo Verde, Bahrein, and Brunei. For WASH, there is a need for a holistic, clear and updated sector strategy, as well as the evolution of the institutional structures and regulatory regime. In the case of ONEAD, in charge of WASH services provision, a priority is to improve its financial viability and reduce losses. For improving electricity cost and access, important reforms include regulatory reform; increasing generation capacity, especially considering renewables; regional integration of the Djiboutian transmission grid; and expansion of transmission and distribution of electricity.
- b. Boosting children's and youth's human capital development and employment prospects requires **reforms in public services delivery** of health and nutrition services, education and training. For health and nutrition services, there is a need to strengthen service delivery, particularly outside the capital city, and expand the availability of trained skilled health workers. Early childhood development programs are important for tackling both childhood malnutrition and preparation for school. ECD programs can offset the adverse effects on cognitive ability among older children who are already excessively short for their age. Spending on ECD programs has been found to be among the most cost-effective investments made by governments. Introducing standardized testing for students in primary and secondary education will greatly enhance monitoring of the quality of education services. Greater tertiary enrollment is needed to supply the labor market with high skills. Several steps can be taken to develop tertiary education, including: (i) development of selective, professionally oriented programs within the university, following the successful model of the faculty of engineering and school of business administration; and (ii) preparing a national vision and strategic plan for the expansion and consolidation of the tertiary education system.
- c. To support job creation, a set of **private sector-enabling policies** are needed that tackle not only access to finance, competition, and access to export markets, but also macro-fiscal stability through tax system reform. For the private sector to grow and create jobs, a key policy action is

to improve access to finance. This is because as the Government makes noteworthy progress in improving the environment for doing business, demand for finance by new and existing firms will likely grow. Expanding domestic sources of revenue through tax reform could reduce the need for external borrowing. Adopting competition policy will facilitate the entry of new firms. Leveraging COMESA to access foreign markets will help reduce borrowing costs and search costs for exporting firms.

- d. Developing equitable and efficient **transfer programs for poor and pastoralist households** will support these households' investment in their children's human capital, especially that of girls. For social safety net programs (cash transfers or in-kind) for the poor, it would be important to ensure adequate spending and implementation of the new social protection strategy. Promoting inter-sectoral coordination can help social safety net programs (especially conditional cash transfers) incentivize poor households to invest in children's nutrition, health and education. Supporting pastoralists' capacity to adapt to climate variability is critical, as it will help move them away from humanitarian assistance to a focus on development. Adaption efforts could be complemented with weather index insurance and cash transfers to help pastoralist households cope with the effect of drought.
- e. **Cross-cutting governance effectiveness reforms** through greater transparency and accountability could help improve access to services for both businesses and households. Two key actions include investing in development data systems to monitor progress and make informed and transparent policy choices, and enhancing public administration capacity. Greater use of ICT has the potential to enhance the efficiency of administrative services delivered to citizens by supporting the improvement of information services; the strengthening of public service delivery systems; regular user feedback on service quality; and improved collaboration across and beyond government.

Because of Djibouti's climatic conditions and water scarcity, environmentally sustainable policies will need to be put in place in both urban and rural areas. With poor urban planning and spatially concentrated growth, slums or unplanned areas have increased in Djibouti City, with little to no access to basic services.⁸²

These 5 areas for policy action not only have potentially large and lasting impact, but they also share strong complementarities. For example, global experience suggests that tackling stunting is a complex development challenge. A nationally championed multi-sectoral approach would consist of measures to directly impact child's growth (nutrition-specific) as well as WASH investments that indirectly affect children's ability to stay healthy and grow (nutrition-sensitive). The experience of countries like Peru and Rwanda demonstrates the feasibility of a coordinated government push to successfully reduce childhood stunting. Such a coordinated approach does call for an improvement in governance and service delivery. Similarly, improving access to and cost of electricity, ICT connectivity and WASH services could have a cascading effect on the private sector's ability to diversify and create jobs, support improvements in

⁸² According to ECHACP 2017, close to 400,000 people – almost 40 percent of the country's population – live in slums on the edges of Djibouti City with minimal services.

education and health, and help the public sector become more transparent and more effective at delivering services. Health system reforms and access to ECD create the foundations for a healthy and productive workforce by tackling malnutrition among children today and prepare children for learning.

Recognizing the complementarities across several of these reforms, the policy actions can be further sorted into the following priorities (Table 5.1).⁸³ Given their strong development impact and complementarities across businesses, human capital and governance, the top two priorities for policy action are (a) investing in policy and institutional reforms; and (b) investing in basic infrastructure services – electricity, ICT and WASH. The next three priorities are (a) reforming public service delivery of health and nutrition, education and training; (b) creating conditions for a productive and dynamic private sector; and (c) supporting poor and pastoralist households through efficient and targeted transfer programs. Governance effectiveness, which aims to tackle the country’s low institutional capacity, is a cross-cutting policy action.

Table 5.1 Policy Priorities Across Business Environment, Human Capital and Governance

Policy and institutional reforms and investments in Infrastructure to improve access and costs	Public services delivery reform	Create enabling conditions for a productive and dynamic private sector	Transfer programs for poor and pastoralist households
1. Electricity	1. Training for employment and entrepreneurship 2. Health and nutrition systems reform	1. Tax system reform	1. Social safety nets; cash or in-kind transfers with incentives for girls' education
2. ICT		2. Access to finance	2. Measures to manage food security
3. Water, Sanitation, and Hygiene	3. Comprehensive education system reform (ECD to tertiary)	3. Competition policy 4. Greater regional integration (COMESA)	3. Measures to promote adaptation to climate change among pastoralists and consider other measures to support income generation among this group
Governance Effectiveness (Cross-Cutting)			
1. Transparency/ accountability through data and citizen’s engagement 2. Public administration capacity and efficiency			

Source: Authors’ elaboration using multiple sources of analysis

⁸³ When putting together a list of reform priorities, a question that commonly arises is the feasibility of their implementation. Such an assessment is outside the scope of the SCD; however, the *World Development Report 2017* suggests that in the face of obstacles, reform priorities that follow the path of least resistance could be more effective.

Identifying specific measures or actions under each of the priority areas would require closing data and knowledge gaps (Annex 7 presents a diagnostic of data availability). The lack of statistics for monitoring and evaluation remains one of the major constraints to development in Djibouti. The Government has put forward a national development strategy (Vision 2035). However, the lack of a national strategy for statistics development and reliable national accounts hamper monitoring, evaluation, and necessary macroeconomic analysis of this development strategy. Closing these data gaps, gender-disaggregated where feasible, would be critical to designing informed policies.

The gaps in macroeconomic data include: (a) lack of coherent and consistent real sector data (real sector data are not up to date and in some cases the data is not coherent between the central bank and the National Statistics Office; and (b) lack of high-frequency macro data (monthly, quarterly, semi-annual). Several surveys are conducted by the National Statistical Office; notably, the household survey of consumption and income was successfully conducted in 2017 and provides the most recent evidence on welfare, especially within the capital city. But recent survey data are lacking on labor markets, demographic and health indicators, and enterprises, both formal and informal. The only labor force survey in the country was conducted in 2015. Regular labor force surveys are critical for monitoring unemployment and a range of other labor market statistics. The most recent health and nutrition data, which primarily come from the PAPFAM and SMART surveys, are from 2012 and 2013, respectively. The last population census was conducted in 2009. The next population census, due to be carried out in 2019, will be important for informed policymaking and planning.

Closing knowledge gaps will be important for designing effective multi-sector policies. These include: (a) analysis of the most important drivers of child stunting in Djibouti to guide design of multi-sectoral policies; (b) analysis of most important drivers of children's enrollment in ECD, primary, secondary and tertiary education; (c) reasons for girls' low participation in education and skills training; (d) a detailed jobs diagnostic; (e) assessment of skills needs and drivers of participation in and returns to skills training, workforce development, and entrepreneurship programs; (f) the most important constraints to women's participation in the labor market, as both employees and entrepreneurs; and (g) identifying binding constraints to the development of a national statistics system

ANNEXES

Annex 1. Brief History of Djibouti

The current territory of the Republic of Djibouti became the French territory under the name of “*Territoire Français des Afars et des Issas* (i.e. French territory of Afars and Issas⁸⁴)” on May 20, 1896, following an 1862 treaty⁸⁵ with the Afar Sultan of Tadjourah to surrender to France the territory of Obock, and the subsequent 1884 treaty of *Khor Ambado* with the Issa chiefs. Additional treaties to draw the border with Somaliland and Eritrea were then signed with the English colony of Somaliland and Italian colony of Eritrea, respectively, in 1888 and 1891. Despite being a French territory, Djibouti was claimed by the neighboring powers in the name of ethnic presence and particularly given its geostrategic location on the Straits of Bab-el-Mandeb at the west coast of the Red Sea in the Horn of Africa. President Siad Barre of Somalia put forward the pan-Somalist doctrine for the Somalian-origin people in the country, while Ethiopia and Eritrea claimed the presence of Afars in the region. However, in two referendums for independence in 1958 and 1967, the country voted to remain under the French leadership.

Djibouti acquired its independence from France on June 27, 1977. The country is a presidential republic. The Government is headed by a president, who exercises executive power. The legislative power is vested in the parliament.

Annex 2. Growth and labor market paradox

A2.1 The empirical framework of measuring growth in TFP

The SCD’s growth-accounting exercise aims to shed light on how factors of production, namely capital and labor, have evolved over the past decade and how total factor productivity (TFP) has contributed to the growth in Djibouti.

A2.1.1 Growth-accounting assessment and results

The growth-accounting exercise assesses the contribution to growth from factors of production (human and physical capitals) and total factor productivity (TFP). This assessment uses the World Bank tool for TFP, with a methodology that builds on Ghosh and Kraay (2000). The model assumes that GDP can be expressed as a function of physical capital and human capital. The TFP calculation considers labor participation rate, return to schooling, average years of schooling, and share of the population that is in working age. Thus, it comprehensively assesses human capital. Whether the Cobb-Douglas (CD) production function or a Constant Elasticity of Substitution (CES) between labor and capital is considered, the results show negative TFP in Djibouti over the past decade. Though negative, the TFP is improving (Figure A2.1). The negative TFP is consistent across the different assumptions on the return to scale (decreasing return to scale, DRS; constant return to scale, CRS; and increasing return to scale, IRS).

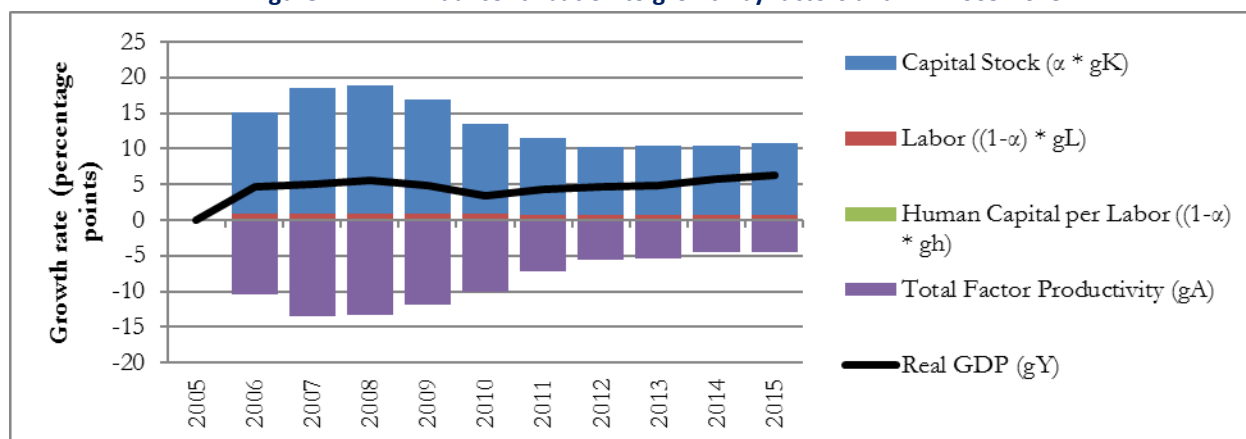
⁸⁴ Brisset, Quentin and Chauderge, Etienne, 2016, « *La guerre civile à Djibouti (1991-1994) Patrimonialisation et personnification des relations de pouvoir dans la Corne de l’Afrique* », SciencesPo, Rennes.

⁸⁵ <http://djibouti.frontafrique.org/?toDo=docs&ID=4&posID=4&cherche>.

Furthermore, the growth-accounting exercise shows that capital accumulation has been the driver of growth. Capital stock grew by 21.4 percent on average during 2005-2015, with a contribution to growth of 12.8 percentage points over the same period (considering initial capital-output ratio of 1.2). At the same time, labor grew only by 2 percent, with a contribution of only 0.8 percentage point to growth. Total factor productivity remained negative, with an average growth of -8.6 percent in 2005-2015, and thus reduced overall growth by 8.6 percentage point over the period (Figure A2.1 and Tables A.2.1 and A2.2).

The results of this growth-accounting exercise shed light on why growth has had a limited impact on poverty. A key reason is that physical capital accumulation has not been accompanied by gains in human capital. Therefore, the productivity of the physical capital was not anchored by a mass domestic human capital, which has hampered the transmission of growth to poverty reduction. These results imply that relying on capital accumulation alone to lift growth is not a sustainable strategy. They also suggest that investing in human capital would enhance growth through total factor productivity and make growth more inclusive.

Figure A2.1 Annual contribution to growth by factors and TFP 2005-2015



Source: Author's calculation using WDI data

Table A2.1 Compound Annual Growth Rates of Factors (percent)

		2005-2015	2005-2007	2007-2010	2010-2012	2012-2015
Capital Stock	gK	21.4	26.4	25.9	17.0	16.5
Labor	gL	2.0	2.4	2.2	1.7	1.6
Human Capital per Labor	gh (N/A)	.	.	.	.	.
Total Factor Productivity	gA	-8.6	-12.0	-11.8	-6.3	-4.9
Real GDP	gY	5.4	4.4	4.1	5.3	7

Source: Author's calculation using Government data and WDI

Table A2.2 Contribution to growth by period (%)

		2005-2015	2005-2007	2007-2010	2010-2012	2012-2015
Capital Stock	gK	12.8	15.9	15.5	10.2	9.9
Labor	gL	0.8	1.0	0.9	0.7	0.6
Human Capital per Labor	gh (N/A)	.	.	.	.	.
Total Factor Productivity	gA	-8.6	-12.0	-11.8	-6.3	-4.9
Real GDP	gY	5.4	4.4	4.1	5.3	7

Source: Author’s calculation using Government data and WDI

Note: † Growth rates are weighted according to the income share of capital (%) = 60%.

A2.1.2 The empirical framework of measuring growth in TFP

Box A2.1 The empirical framework of measuring growth in TFP

The model assumes GDP can be expressed as a function of physical capital and human capital (see Ghosh and Kraay, 2000) as follows:

$$Y = AF(K, H),$$

where:

Y is gross domestic product (GDP data from the Government of Djibouti)

A is an index of total factor productivity (TFP)

K is gross domestic capital stock (calculation is described below)

H is human-capital-adjusted labor input, defined as:

$$H = L \times D \times P \times \exp(\text{phi} \times S),$$

where:

L is population (retrieved from the WDI)

D is share of population age 15-64 (retrieved from the WDI)

P is labor force participation rate (data from UNPD, available at <http://hdr.undp.org/en/data#>)

S is number of years of education per worker (data from HDI at UNDP, <http://hdr.undp.org/en/data#>)

“phi” is a parameter that measures the returns to education (computed to be 11 percent for Djibouti)

Two types of production functions are considered.

- The first is a Cobb-Douglas production function with possibly non-constant returns to scale, where $F(K, H) = [K^\alpha \times H^{(1-\alpha)}]^\gamma$

where alpha (α) is a parameter between 0 and 1 that measures the relative importance of capital, and gamma (γ) is a parameter that measures the extent of returns to scale. Reasonable values of alpha range from 0.3 to 0.5. If gamma=1 (gamma > 1) (gamma < 1) there are constant (increasing) (decreasing) returns to scale. A decreasing return to scale is a condition when increasing factors of production (physical capital and human capital by X%, output increases by less than X%. Under a constant return to scale, an increase of factors by X% leads to increase in output by X%. If the production process exhibits an increasing return to scale, then an increase of the factors by X% generates an increase in output by more than X%. Reasonable values of gamma range from 0.8 to 1.2. In general, $\gamma = 0.8$, for a decreasing return to scale; $\gamma = 1$, for a constant return to scale; and $\gamma = 1.2$, for an increasing return to scale assumption.

- The second production function is a constant return to scale constant elasticity of substitution between physical and

$$\text{human capital: } F(K, H) = [\alpha K^\rho + (1 - \alpha)H^{(1-\alpha)}]^{(\frac{1}{\rho})}$$

where rho (ρ) = (sigma-1)/sigma is the elasticity of substitution between K and H. When sigma = 1 this reduces to the Cobb-Douglas case above with gamma = 1. Reasonable values of sigma range from 0.8 to 1.2. To obtain the limiting Cobb-Douglas case use a value of sigma = 0.9999 because values of sigma=1 will result in error messages (division by 0).

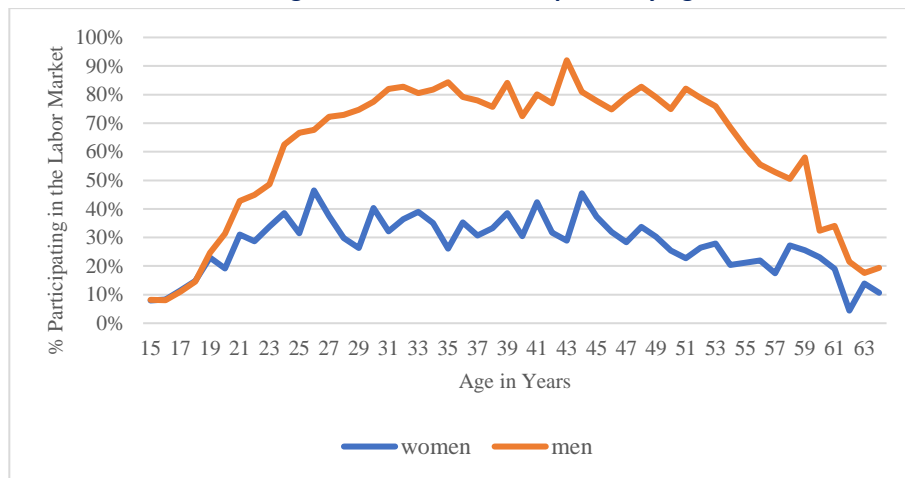
K: Capital stocks are constructed using the perpetual inventory method. The calculation requires information on the initial capital-output ratio in 2005 (ky0), depreciation rates (delta), and gross domestic investment. For most developing countries, reasonable values range between ky0=1 and ky0=2. The model assumes ky0=1.2. Reasonable values for the depreciation rate range from delta = 0.04 to 0.08. capital depreciation rate is in the calculation for Djibouti is set at 6 percent, a rate used widely for most countries. After calculating the initial capital stock (in 2005), capital stock for subsequent years is obtained using the following formula:

$$K(t) = (1 - \text{delta}) K(t - 1) + I(t)$$

A2.2 Djibouti's labor market paradox – the low employment rate

Djibouti employs just about a quarter of its working age population (15 and older); this low employment rate is due to low labor force participation, especially by women (Figure A2.2). The low rate of labor participation in turn may be due to mismatch between labor market and labor skill. Participation in the labor market – whether working or searching for job – is higher among men than women aged 30-50 years. In 2015, 25.4 percent of the working age population was employed, while 39 percent of economically active workers were unemployed. These statistics mask notable variations by sex and age. Among women, the employment-to-population ratio is only 14 percent compared to 38 percent for men. The majority of young people (15-24) are enrolled in school and only 25 percent participate in the labor market. Among those who do participate, 68 percent are unemployed, compared to 33 percent of those aged 25 and older. About 20 percent of young people, mostly girls, are not in employment, education or training (NEET). Young people who are neither in employment nor in education or training are at risk of becoming socially excluded.

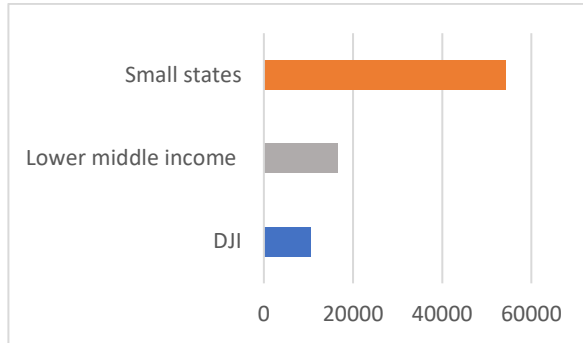
Figure A2.2 Labor Participation by Age



Source: World Bank staff calculations using 2015 EDESIC. Participation consists of workers who are employed or searching for a job.

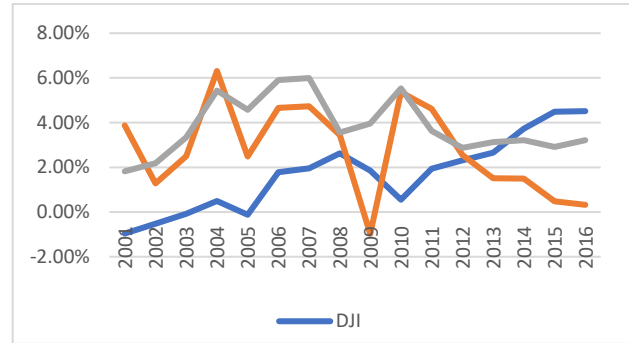
Labor productivity is also low. Consistent with the low human capital of the population, as described in Chapter 1, labor productivity is low even when compared to small states and lower middle-income countries. However, the year-on-year growth of labor productivity appears to have picked up in recent years likely because of the expansion in schooling. Encouragingly, unlike some small states and lower middle-income countries, Djibouti has experienced growing labor productivity in the recent years, although from a lower base (Figures A2.3 and A2.4)

Figure A2.3 Labor productivity (GDP per employed person), 2016 estimates



Source: WDI and ILO.

Figure A2.4 Growth in labor productivity

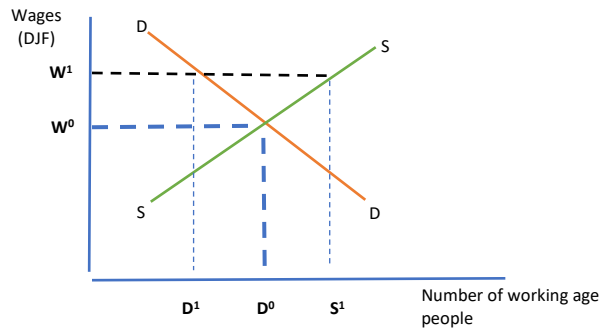


Source: calculated using WDI data. Y-on-Y growth.

Unemployment and related outcomes are a result of the interplay between supply- and demand-side dynamics of the labor market, and are also affected by the presence of the public sector. At the economy-wide level, the number of workers available to work (supply) is affected by population growth, while the demand for workers comes from formal private firms. At the “market clearing” wage W^0 , demand for workers matches the number of workers willing to work at that level of remuneration and there is zero unemployment (only frictional unemployment). In Djibouti, the public sector is a large employer of workers and pays wages that are not set by market forces or workers’ productivity. The wages offered are higher than what would be offered in a comparable private sector job. Since the private sector competes with the public sector for workers, private firms also offer high wages (W^1) (Figure A2.5). However, at this high wage, the demand for workers (D^1) is far below the available supply (S^1), leading to unemployment. This case illustrates Djibouti’s situation, where the unemployment rate is 39 percent. According to the country’s first labor force survey, the 2015 EDESIC⁸⁶, most of the unemployed are seeking paid (73.1 percent), permanent (72.6 percent), formal (67.0 percent), and public-sector jobs (57 percent). The unemployed also report the minimum acceptable wage to be DJF 126,000, which above the average earnings of public sector and formal private sector workers (about DJF 90,000).

⁸⁶ Enquête djiboutienne sur l’emploi, le secteur informel et la consommation (2015), DISED.

**Figure A2.5 High Wages Induced by Public Sector and Unemployment:
A Conceptual Framework for Labor Markets**

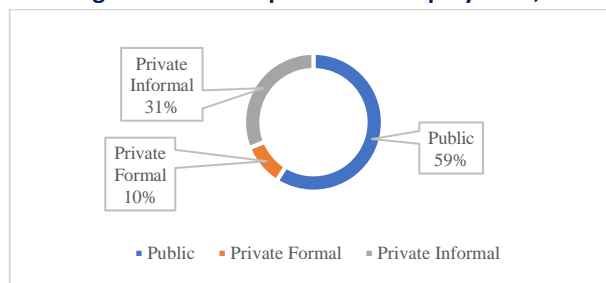


Source: Authors' elaboration using multiple sources of analyses

Notes: Line SS depicts the number of people willing to work at each wage. Line DD depicts the number of workers, private formal firms demand at each wage. W^0 is the wage at which supply meets demand. W^1 is the wage at which supply of workers exceeds demand.

Although employment has grown over time, the quantity and quality of jobs remain limited. Using ILO's model-based estimates of employment, between 2000 and 2015 employment in Djibouti grew cumulatively by 52 percent, leading to a GDP per capita elasticity of 1.08. Nevertheless, the level of employment (quantity) is low. Djibouti's employment to population ratio (ILO estimates) is lower than the average for small states. Only a few national sources of employment data are available, but they offer a more disaggregated view than ILO estimates of the type or quality of jobs available in the economy. For example, the 2015 EDESIC estimated the employment-to-population ratio to be only 25.4 percent, which implies that the country's 9.7 percent growth rate is based on only a quarter of its working age population engaged in economic activity. What is even more concerning being that most of this employment is either in the public sector (public administration or state-owned enterprises) or in informal private sector activities, mainly construction, wholesale and retail trade, transport, household services and other services (Figure A2.6). Agriculture, globally a source of subsistence jobs, is not a significant employer of workers in Djibouti. Interestingly, transport, which is an important sector for Djibouti's economy, employs only 7.6 percent of formal private sector workers and 5.3 percent of informal workers.

Figure A2.6 Composition of Employment, 2015



Source: Calculations based on EDESIC 2015.

Annex 3. The SCD approach

This SCD builds on existing analytical work in Djibouti and new assessments across sectors to identify the country's main development constraints. It follows the inclusive growth analytics framework of Hausmann, Rodrik and Velasco (2005), as presented in Ianchovichina and Lundstrom (2009), to identify the major constraints to inclusiveness in Djibouti.

There is a broad recognition across the growth literature that inclusive growth requires both productivity growth and an enlargement of employment opportunities to include a larger share of the labor force. Both require enhanced labor skills (employability) and a conducive structural condition to diversify economic activities and create jobs. As Ianchovichina and Lundstrom (2009) framed it, both the pace and pattern of growth are crucial for its inclusiveness. While a rapid pace of growth is necessary for sustainable poverty reduction,⁸⁷ it needs to be broad-based across sectors and inclusive of a larger share of the labor force through productive employment.

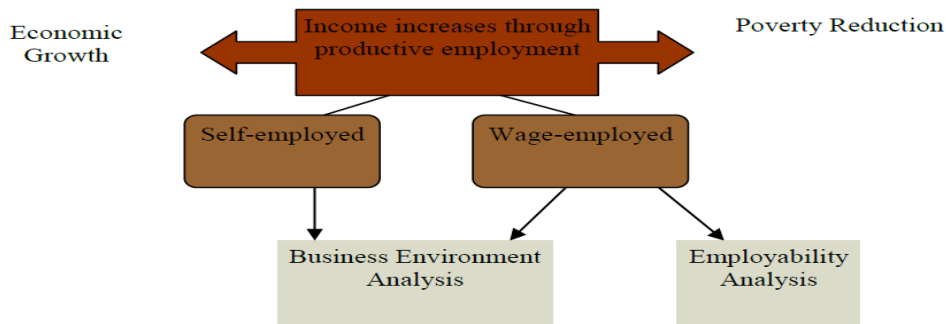
The World Economic Forum (2017) defines inclusive growth as a necessary strategy to translate top-line economic performance (growth) into bottom-line sustained living standards through wages and non-wage income, economic opportunities, safety and the quality of life. While growth can occur without meeting these expectations, if the determinants of inclusiveness are not in place, such a growth strategy will not be successful in the long run. To be sustainable, growth needs to encompass, as core elements, inclusiveness, equal labor market access opportunity, and protection for all (DFID, 2004; Commission on Growth and Development, 2008; OECD, 2008; WEF, 2017). Inclusiveness of growth requires a direct link between its macro and micro determinants, where micro determinants reflect the structural environment for economic diversification and enhancing the country's economic competitiveness. The direct linkage between the two dimensions reveals their interdependence in achieving inclusive growth.

The inclusive growth approach takes a long-term perspective, focusing on productive employment to sustain growth, and on pro-poor growth as a means of increasing the incomes of the poor in absolute terms. Beyond the redistribution of existing resources, inclusive growth requires an enlargement of the economy and an increase in employment and productivity across sectors.

The inclusive growth analytics require two main components: the business environment analysis and the employability analysis (Figure A3.1), the latter including both the demand (job creation) and supply (productive labor force) sides of the labor market. The synergy and dynamism of these two sides of the market are what can generate inclusive growth.

⁸⁷ An extended body of literature finds that high growth pace over a long period is crucial in poverty reduction (see Dollar and Kraay, 2002; Lin, 2003; Rodrik, 2007; DFID, 2008)

Figure A3.1 Inclusive growth analytics

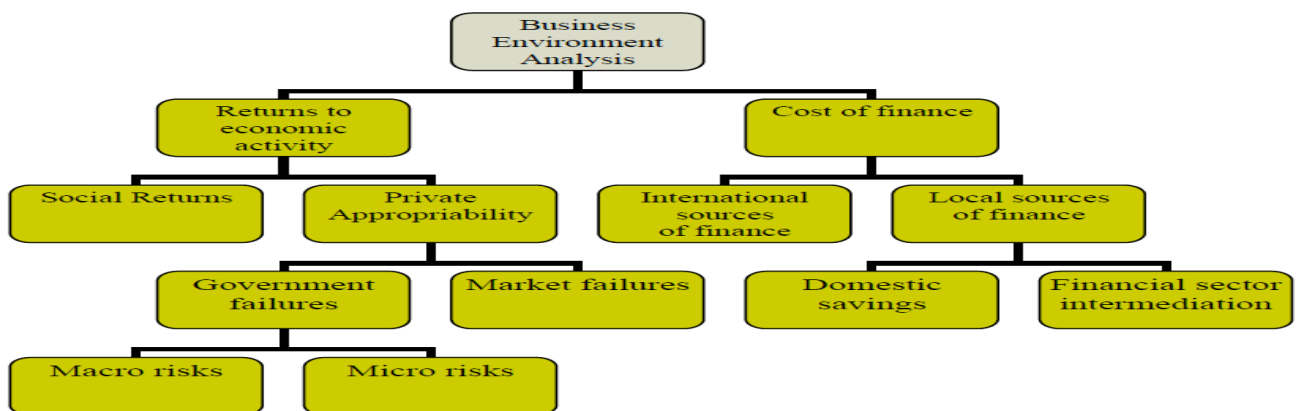


Source: Adopted from Ianchovichina and Lundstrom (2009)

A3.1 Business environment analysis

The business environment analysis framework encompasses (a) factors that reduce returns to economic activities, and (b) the cost of business financing (Figure A3.2). For factor (a), the SCD examines the structure of the private sector (firms age, size, jobs creation) using the diagnostic of the enterprise survey (see section A3.2 below). It then assesses key policy to derive their implication for costs and returns to economic activities, and for private sector development and jobs creation. These key areas include: competition policies (whether there is a level playing field to enable private sector development); management of electricity and ICT (access to and costs of utilities for production); doing business outcomes; tax policy; and the public-sector wage bill. The constraints for factor (b) are analyzed through the lens of financial market conditions, since most Djiboutian firms are SMEs that rely on domestic financing.

Figure A3.2 Business Environment Analysis



Source: Adopted from Ianchovichina and Lundstrom (2009)

A3.1.1 The enterprise survey diagnostic

To assess cost factors for businesses in Djibouti, the SCD team first undertook a diagnostic of the 2013 enterprise survey (the most recent) to understand the structure of the country's formal private firms. The survey covers only Djibouti City and includes roughly 90 percent of firms with more than five⁸⁸ employees. However, given that Djibouti City accounts for about 80 percent of the country's total population and most of its economic activities, the survey provides useful insights about the country's business environment.

The diagnostic reveals that most Djiboutian private firms are small and medium size (about 90 percent of total firms), but in contrary to SME literatures, Djiboutian SMEs have limited job creation capacity. The private sector jobs are concentrated in services and retail commerce.

Based on the survey, there were 14,900 private sector full-time jobs in 2013 (Table A3.1 and Figure A3.6), representing only 10 percent of formal jobs. About 80.2 percent of these jobs were created in retail commerce (40 percent) and services (40.2 percent). Manufacturing firms are relatively small and created a smaller share of employment (Figure A3.3). The performance of young firms operating in manufacturing in Djibouti is one of the lowest among fragile countries (Figure A3.4). In addition, young manufacturing firms in Djibouti have lower net jobs creation (Figure A3.5). Manufacturing jobs accounted for 9.5 percent and construction for 10.3 percent. Manufacturing firms have, on average, about 15.6 full time workers, compared to 54.7 for construction, 40.7 for commerce and 38.2 for services. Disaggregating firms by size shows that most formal private firms in Djibouti are small (less than 20 workers) and medium (20 to 99 workers). Large firms (with 100 or more workers) represent 6.6 percent of total formal private firms, but account for more than half of the full-time jobs. Small firms represent about 64 percent of total formal private firms and medium firms account for 27 percent. Thus, SMEs together account for more than 90 percent of formal private firms.

The diagnostic also shows that young Djiboutian firms create fewer jobs. This is in contrast to the findings of the literature. For instance, a cross-country analysis using SMEs firm-level data in 17 OECD countries and Brazil, finds that younger SMEs are net jobs creators, even during periods of crisis (Criscuolo et al. 2014). Djiboutian young SMEs would therefore be expected to create more jobs in normal circumstances. In Djibouti, however, more matured firms (20+) created a higher share of jobs than young and medium-age firms relative to their numbers (Figure A3.6). This may indicate that the ability of young firms to create jobs depends on the business environment and enabling national policies.

The diagnostic reflects not only the concentration of the economy around services, but also some challenges facing the production sectors, which potentially prevent their expansion to take full advantage of regional opportunities. In fact, Djibouti's geostrategic location at a maritime crossroads near dynamic COMESA markets and Ethiopia (with its large amount of raw and unfinished materials flowing through Djibouti's port), as well as Djibouti's additional comparative advantage as the landing site of the undersea fiber optic ICT cables, represent significant opportunities for developing higher value-added activities. These could include storage, packaging, hotels and restaurants; and, in industrial zones around the port, light manufacturing such as agro-food processing and packaging, and finishing and re-export of clothing, leather goods and electronics. Djibouti also hosts many foreign military bases, and the presence of foreigners with strong purchasing power is an additional source of domestic demand for goods and

⁸⁸ The survey includes firms with 5 or more total employees. The analysis uses full-time employees as default; firms can have fewer than 5 permanent employees.

services. Taking advantage of such demand would require a competitive domestic production sector. But instead, Djibouti presents a paradox of more transit trade with a smaller traded sector, reflecting the existence of potential structural constraints that limit the development of the private sector and its potential for creating jobs, especially in the industrial sector.

Job creation has been limited

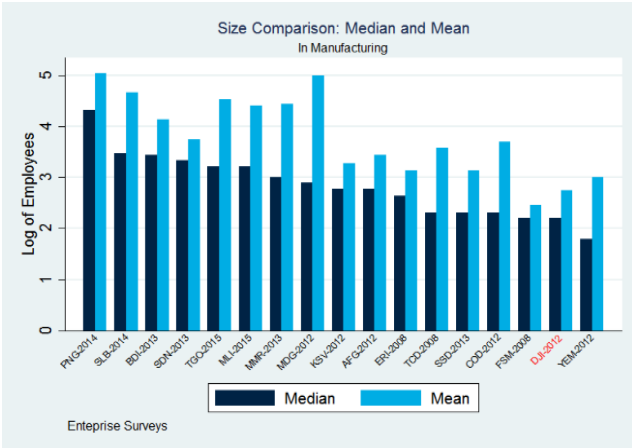
Although employment has grown over time, the quantity and quality of jobs remain limited (see enterprise survey below). Using ILO’s model-based estimates, employment grew cumulatively by 52 percent between 2000 and 2015, leading to a GDP per capita elasticity of 1.08. Nevertheless, Djibouti’s employment-to-population ratio (ILO estimate) is lower than the average for small states. The few national sources of employment data offer a more disaggregated view than ILO estimates of the type or quality of jobs available in the Djiboutian economy. For example, the 2015 EDESIC estimated the employment-to-population ratio to be only 25.4 percent which, implies that the country’s 4 percent growth rate is based on only a quarter of its working-age population being engaged in economic activity. Even more concerning, most of this employment is either in the public sector (public administration or state-owned enterprises) or in informal private sector activities consisting of mainly of construction, wholesale and retail trade, transport, household services and other services (Figure 2.4). Incidentally, transport which is an important sector for the Djiboutian economy employs only 7.6 percent of formal private sector workers and 5.3 percent of informal workers. This could mean that the sector is capital and skill intensive. Thus, promoting jobs in sector could require targeted training programs to match the skills requirement.

Table A3.1 Number of Firms by Sector and Employment

Sector	# of Firms	Full-time Employment
Construction	28	1,533
Manufacture	91	1,421
Commerce	146	5,952
Services	157	5,994
Total	422	14,900

Source: World Bank, Job Diagnostic 2017, based on Djibouti 2013 Enterprise Survey

Figure A3.3 Size Comparison in Manufacturing



Source: World Bank, Job Diagnostic 2017, based on Djibouti 2013 Enterprise Survey

Figure A3.4 Employment Share of Young Firms



Source: World Bank, Job Diagnostic 2017, based on Djibouti 2013 Enterprise Survey

Figure A3.5 Net Job Creation (3 years)

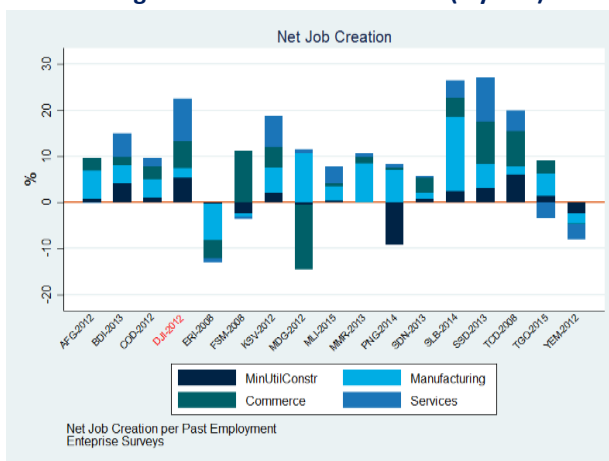


Figure A3.6 Distribution of Firms by age

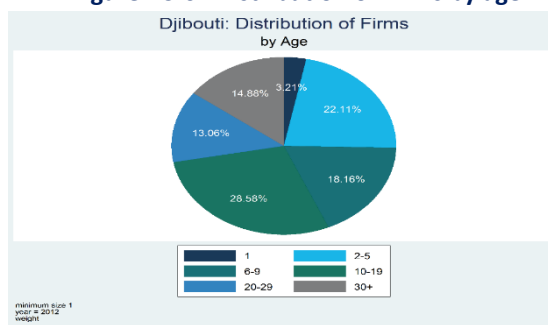
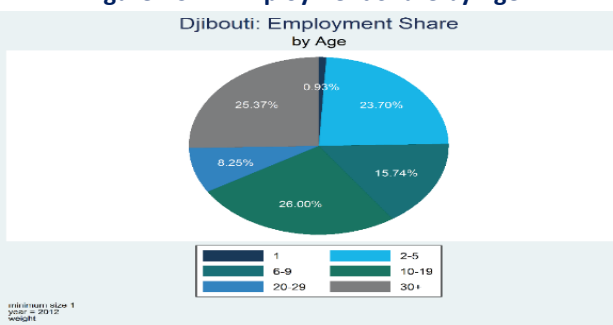


Figure A3.7 Employment Share by Age



Source: World Bank, Job Diagnostic 2017, based on Djibouti 2013 Enterprise Survey

A3.1.2 Competition Policy and Poverty Alleviation

Boosting competition can be most effective in reducing poverty and increasing shared prosperity when it occurs in sectors that are most relevant for less well-off households. Competition in sectors that make up a high proportion of the consumption basket of less well-off households can have direct impacts on poverty alleviation. Where these sectors are relatively more important for the consumption basket of the less well-off compared to richer households, such interventions also have a positive distributional effect.

In the case of fuel, implicit subsidies and price controls in the oil sector are thought to lead to distortions that disproportionately benefit rich households (IMF 2016)⁸⁹. A less distortionary mechanism would allow for a pricing mechanism with full pass-through of international prices, coupled with safety nets targeted at the poor.

⁸⁹ The current pricing mechanism for kerosene, diesel, and gasoline adds several taxes to CIF prices. The implicit subsidies take the form of a discretionary negative tax adjustment that reduces the applicable taxes on these products. IMF (2016). Djibouti. Selected Issues. IMF Country Report No. 16/249, p.12. For diesel and gasoline, top income quintile households have traditionally received 12 times more in subsidies than the two poorest quintiles combined. Recently, the authorities have kept domestic prices of oil fuels largely unchanged while international oil prices have dropped by more than 50 percent since the end of 2014.

Food products and nonalcoholic beverages are by far the most important category of consumption for the poorest households; therefore, lowering prices through competition in these goods can be particularly welfare enhancing for the poor. Out of 13 countries in Africa and Latin America for which household consumption data were available for the IMF 2016 study, in 10 countries food and nonalcoholic beverages made up 40 percent or more of the consumption basket of the lowest income decile.⁹⁰

Reducing prices by 10 percent through pro-competition interventions in certain staple foods markets in Kenya, South Africa and Zambia, would yield greater gains among the poor than the rich, with the greatest impact achieved for the bottom 10 percent in South Africa (which would gain 15 times more than the top 10 percent), followed by Kenya (6 times more) and then Zambia (3 times more). Furthermore, the average income of Kenyans, South African and Zambians would be expected to rise by 1.05, 0.89, and 0.87 percent, respectively. This equivalent increase in disposable income of more than US\$700 million (2015 dollars) a year would lift people approximately 270,000 in Kenya, 200,000 in South Africa, and 20,000 in Zambia above the poverty line.⁹¹ In Senegal, reducing the price of seven food products would lead to a 1.16 percentage point fall in the poverty rate, equivalent to 158,139 people moving out of poverty.⁹²

Table A3.2 Non-exhaustive List of State-owned Enterprises in Djibouti, as at 2014⁹³

Sector	Company
Water and Sanitation	L'Office National des Eaux et de l'Assainissement de Djibouti (ONEAD)
Electricity	L'Electricité de Djibouti (EDD)
Oil and Gas	La Société Internationale des Hydrocarbures de Djibouti
Postal Services	L'Office des Postes et des Télécommunications (OPT)
Financial	La Banque de Développement de Djibouti (BDD)
	Le Fond de Développement Économique (FDED)
Transport and Logistics	Airport - L'Aéroport International de Djibouti (AID)
	Maritime port – Le Port Autonome International de Djibouti (PAID)
	Chemin de fer Djibouti-Éthiopie (Rail transport; JV with Ethiopian government)
	Doraleh Conteneur Terminal
Telecommunication	Radio-Télévision de Djibouti (Audiovisual)
	Djibouti Télécom (DT)
Food and Food-related	Laboratoire d'Analyse Alimentaire
	la Société Djiboutienne de Sécurité Alimentaire
Cement	Cimenterie d'Ali-Sabieh (Cement)

⁹⁰ World Bank. 2017. A Step Ahead: Competition Policy for Shared Prosperity and Inclusive Growth. Washington, DC, p. 11.

⁹¹ The World Bank Group. 2016. Breaking Down Barriers: Unlocking Africa's Potential through Vigorous Competition Policy. Washington, DC: World Bank Group, p. 7.

⁹² World Bank Group (2017)

⁹³ Even though Djibouti has developed a privatization program during the 1990's focused on developing a market economy based on greater participation of the private sector, its implementation has been slow. Law No. 130/AN/96/3ème L10 lays down the terms and conditions for privatization of holdings, enterprises, assets or activities belonging to the public sector, and privatization programs are implemented by a National Privatization Committee, under the supervision of the Minister responsible for finance. See official website from the Ministry at <http://www.ministere-finances.dj/refProjets/LOI130PrivatisationDOC/index.html>; WTO (2014). Trade Policy Review. WT/TPR/S/305 17 September 2014, p. 33. Available at https://www.wto.org/english/tratop_e/tp_r_e/s305_e.pdf.

Printing	Imprimerie Nationale de Djibouti (Printing)
Trade / Commerce / Retail	Centrale d'achat des Médicaments et Matériels Essentiels (CAMME)
	Compagnie Nationale du Commerce (CNC)
Ceramics	Compagnie Nouvelle de Commerce (CNC)
Real Estate	La Société Immobilière de Djibouti (SID)
	L'Agence de Réhabilitation Urbaine et du Logement Social

Source: Elaborated by authors based on information available at (i) WB (2016). Djibouti Governance Capacity Building State-Owned Enterprise Governance Reform. Report No: ACS19010, pp. 5-6; (ii) WTO (2014). Trade Policy Review. WT/TPR/S/305 17 September 2014, p. 33.

A3.1.3 Djibouti's ranking on ICT

Box A3.1 Djibouti's state monopoly in the telecommunications sector

Djibouti is one of only six countries in the world with a state-owned monopoly in the telecommunications sector (one of three in Africa). Djibouti Telecom has a monopoly in all telecommunications markets, including those that are typically open to competition such as mobile and data services. It represents a significant portion of the economy, with revenues accounting for up to 7 percent of GDP.

A lack of competition to drive service delivery, productivity and innovation could be one reason for the poor performance in the sector. In 2016, Djibouti ranked 160th out of 175 countries in the ICT Development Index published by the United Nations Office of Information and Communications Technology (UN OICT).⁹⁴ Mobile telephone and internet services are expensive and their penetration rates are among the lowest. Penetration rates are also low (Table 2.3). It is estimated that the price of fixed broadband in Djibouti would absorb roughly the whole income of the poorest 60 percent of the population.⁹⁵

The presence of the state monopoly does not appear to be justified by public interest objectives such as promoting universal access. In addition to high prices, some parts of the country, especially in the north, are largely underserved.⁹⁶ Penetration of 3G broadband stands at 2.22 percent nationally, while fixed broadband penetration is at 10.3 percent, lagging many MENA peers.⁹⁷

Djibouti has the capacity to roll out services to a much greater share of the population through its powerful but largely underutilized infrastructure of undersea cables. Instead, Djibouti Telecom sells its excess capacity abroad; in 2012, these sales generated US\$22 million in revenues. The World Bank has targeted IDA funds to help the Government improve its telecom legal and regulatory framework, designing the issuance of a new license to an international (facilities-based) operator. An entrant has the potential to bring healthy competition to the mobile and internet sectors, improve the quality of service, and eventually increase the mobile phone penetration rate to more than 60 percent.⁹⁸ Djibouti could, for example, take advantage of its current infrastructure to promote outsourceable activities such as call centers and back-office functions.⁹⁹

⁹⁴ See <http://www.itu.int/net4/ITU-D/idi/2016/#idi2016countrycard-tab&DJI>.

⁹⁵ Gelvanovska, Natalija; Rogy, Michel; Rossotto, Carlo Maria. 2014. Broadband Networks in the Middle East and North Africa: Accelerating High-Speed Internet Access. Directions in Development--Communication and Information Technologies; Washington, DC: World Bank.

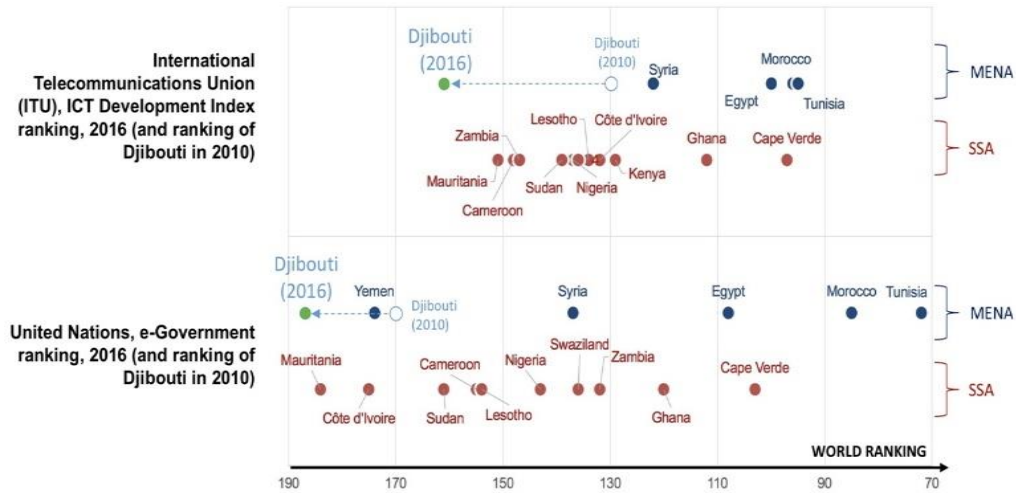
⁹⁶ WB (2014). Country Partnership Strategy for The Republic of Djibouti FY2014-2017, p 8.

⁹⁷ Gelvanovska, Rogy and Rossotto, 2014.

⁹⁸ WB (2014). Country Partnership Strategy for The Republic of Djibouti FY2014-2017.

⁹⁹ WB (2014). Country Partnership Strategy for The Republic of Djibouti FY2014-2017, p 8.

Figure A3.8 Ranking of the ICT Sector in lower-income countries from MENA and Sub-Saharan



Source: ITU and UNDESA

Figure A3.9 Djibouti's Ranking by Arab Regulatory Network (AREGNET) on Key ICT indicators

- a. Ranking for fixed broadband for businesses prices (2011-2016) b. Ranking for 2 Megabits per second (Mb/s) leased line prices (2011-2016)

	2011	2012	2013	2015	2016
Algeria	9	6	9	12	11
Bahrain	10	11	10	7	9
Comoros	-	-	-	-	-
Djibouti	12	13	14	11	14
Egypt	2	2	2	3	3
Iraq	-	-	-	-	-
Jordan	5	8	8	-	6
Kuwait	-	-	-	-	-
Lebanon	7	4	5	2	2
Libya	-	-	-	-	-
Mauritania	-	-	-	10	13
Morocco	1	1	1	1	1
Oman	3	5	6	5	7
Palestine	-	-	7	-	-
Qatar	6	10	12	9	12
Saudi Arabia	-	9	11	-	-
Somalia	-	-	-	-	-
Sudan	4	7	4	4	4
Syria	-	-	-	-	-
Tunisia	11	14	15	13	5
UAE	8	12	13	8	10
Yemen	-	3	3	6	8

Source: AREGNET (2016)

	2011	2012	2013	2015	2016
Algeria	5	5	5	5	5
Bahrain	14	14	14	13	13
Comoros	-	-	-	-	-
Djibouti	15	15	15	14	14
Egypt	2	3	3	3	3
Iraq	-	-	-	-	-
Jordan	16	16	16	16	16
Kuwait	-	-	-	-	-
Lebanon	4	2	2	2	2
Libya	3	4	4	4	4
Mauritania	-	-	-	-	-
Morocco	13	13	13	12	12
Oman	9	10	10	10	10
Palestine	7	7	6	6	6
Qatar	6	6	8	8	8
Saudi Arabia	12	12	12	11	11
Somalia	-	-	-	-	-
Sudan	-	-	17	17	17
Syria	1	1	1	1	1
Tunisia	8	8	7	7	7
UAE	11	11	11	15	15
Yemen	10	9	9	9	9

Source: AREGNET (2016)

A3.1.4 Tourism sector as a promising area for jobs creation

The tourism sector is clearly the most promising area for jobs creation. Djibouti possesses exceptional natural assets for tourism development, with beautiful marine fauna, geological landscapes unique in the world, and a rich cultural and archeological heritage. Most of these sites would be eligible for rankings on the UNESCO lists. In addition, Red Sea-destination tourism demand is especially high, shown by an increase in scuba-diving tourism in Sharm el-Sheikh and Hurghada. Djibouti could become a leading tourists' destination for the region because of this activity. In addition, the foreign military bases attract about 50,000 visitors a year.

Tourist accommodations are limited, demonstrating the low level of investment in this sector. Despite a steady increase in the number of beds over the last ten years, hotel capacity remains limited, with a total of only 1,227 beds in hotels and similar establishments. There are only two major international brand-name hotels in Djibouti: the Sheraton, built more than 30 years ago, and the Kempinski, open since 2006. The latter, built by the Emirati Nakheel group at a cost of US\$150 million (equivalent to 15 percent of GDP), is a five-star hotel with 180 rooms, mainly used by foreign military clientele. Since the construction of the Kempinski, Djibouti has not managed to attract additional significant tourism sector investments. The most recent investment was the construction of the mid-class Bavaria Hotel, with 60-room capacity, in 2010. Hotel occupancy remains highly concentrated in Djibouti City. The main tourist sites in the region have not been developed and lack appropriate infrastructure. Some campgrounds have been established but offer limited amenities and accommodations (an estimated 780 beds in 2011).

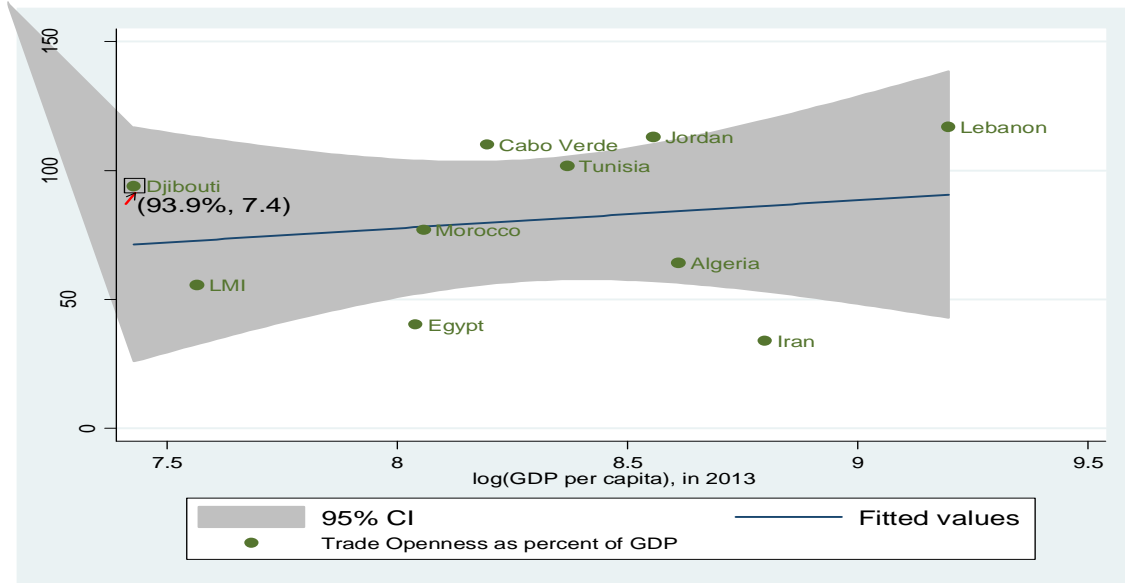
Tourism's contribution to growth and employment remains modest, with only 4,500 persons presently working in the sector, half of them in the hotel business. Official tourism revenues totaled US\$15 million in 2010, about 1.5 percent of GDP. The sector's direct and indirect contribution to GDP, including the informal economy (e.g., restaurants, handicrafts, non-market accommodations) is estimated at less than 3 percent. According to CNSS data, formal employment in the sector is estimated at less than 2,000 persons. The largest employer is the Kempinski hotel, with about 500 employees, of which 450 are Djiboutian nationals. The impact of Djibouti's tourism sector on the economy remains very low compared to other African countries. Tourism revenues amount to 22.4 percent of GDP in Cape Verde, 5.7 percent in Mauritius, and 6 percent in Egypt.

Based on simulations, the sector could accommodate as many as 500,000 tourists a year by 2030, generating 30,000 direct jobs and accounting for more than 10 percent of GDP. This momentum could also drive the growth of several other sectors of the economy, including construction, handicrafts, fisheries, and agriculture. In addition, tourism has the advantage of being a socially inclusive sector, which contributes to regional development and affords many job opportunities for women and youth. Although very ambitious, this projection is achievable provided that an appropriate strategy is implemented; Cabo Verde managed to boost tourism tenfold in less than 15 years. Achievement of Djibouti's tourism potential will require alleviating serious constraints to development of the sector, including lack of an official tourism policy and strategy, inadequate air travel connection, and issues of image and reputation.

Annex 4. Djibouti's External Sector

- Djibouti has a high trade openness relative to its income level.

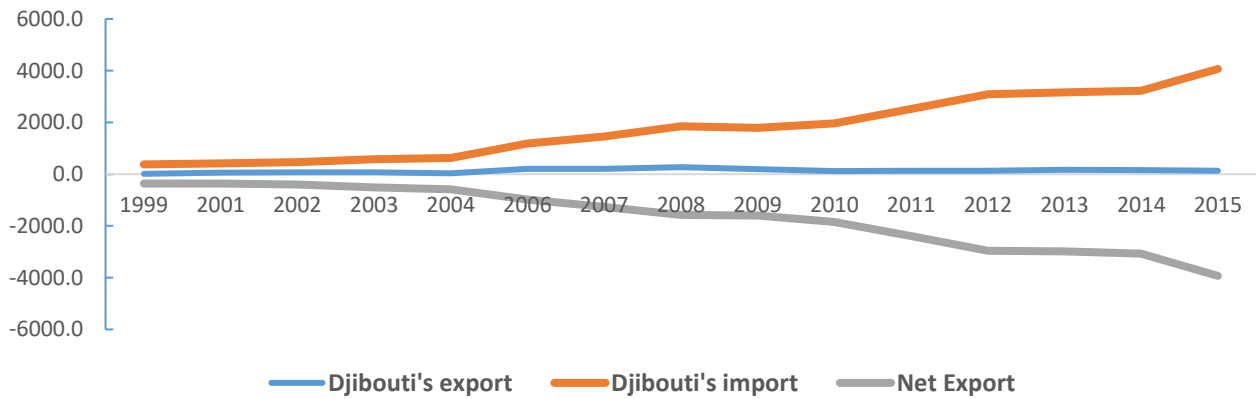
Figure A4.1 Trade Openness Relative to Income in Djibouti



Source: Author's calculation using WDI and UNCTAD data.

- However, openness in Djibouti has been driven by imports, which resulted in large trade deficits.

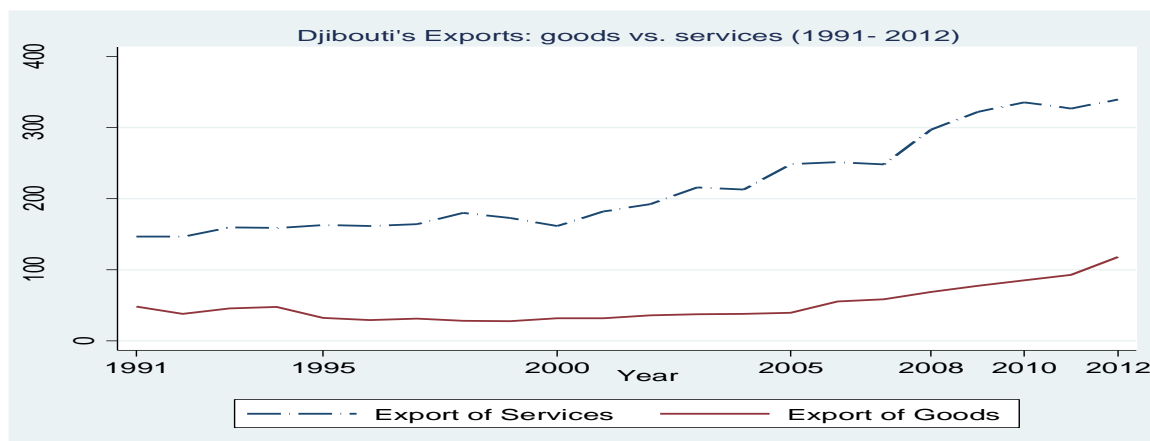
Figure A4.2 Import versus Exports and the Trade Deficit



Source: Author's calculation using WDI

- Exports have been dominated by services over goods.

Figure A4.3 Export of Services vs. Goods



Source: Author's calculation using WDI and UNCTAD data

- Djibouti has a concentrated export basket of goods. The basket seems to have further shrunk between 2005 and 2016. This may be due to lack of product competitiveness. In 2005, the top 5 export goods represented 92 percent of total export in goods. By 2016 the basket composition has changed, the country exported mainly two goods: “zinc waste and scrap” and “iron oxides and hydroxides”, and these top 2 products represented 98.7 percent of total goods export (Table A4.1). The Hirschman-Herfindahl Index (HHI),¹⁰⁰ which measures the concentration of a country's exports (at HS2 codes) has been large for Djibouti relative to comparators and increased between the two years, confirming the further concentration of the export basket (Figures A4.4a and A4.4b).

Table A4.1 Djibouti's Top Export Goods in 2005 and 2016

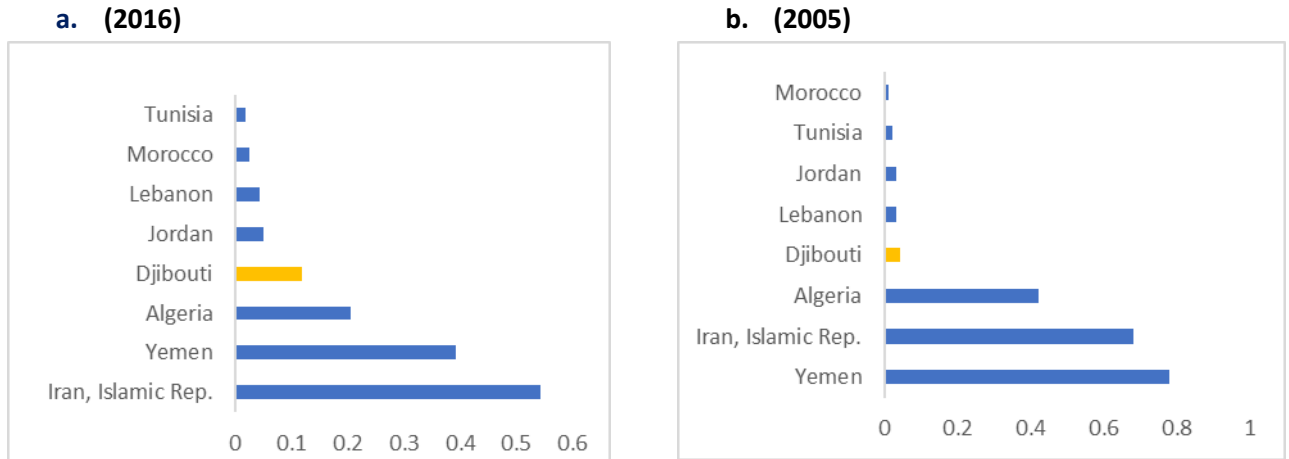
2005		2016	
product description (at 4 digits disaggregation, HS)	Share in total export (%)	Product description (at 4 digits disaggregation, HS)	Share in total export
Albumins, albuminates and other alb.	40.8	Zinc waste and scrap	77.2
Extracts and juices of meat, fish a	19.9	Iron oxides and hydroxides; earth c	21.5
Granules and powders, of pig iron, sp.	14.4		
Malt	9.4		
Carbon paper, self-copy paper, etc,	7.7		
Total share of export	92.2	Total share of export	98.7

Source: World Integrated Trade Solution (WITS), Mirror¹⁰¹ data

¹⁰⁰ The Hirschman-Herfindahl Index is computed as the sum of squared nominal shares of each sector (2-digits Harmonized System (HS) 2 digit (S codes) in total export value. A country with a perfectly diversified export portfolio will have an index close to zero, whereas a country which exports only one product will have a value of 1 (least diversified). Thus, the Lower HHI index indicates the higher level of diversification. However, when using nominal values, the index is sensitive to changes in prices.

¹⁰¹ WITS mirror data is the reported import of the rest of the world from the given country. Thus, it represents the country's export.

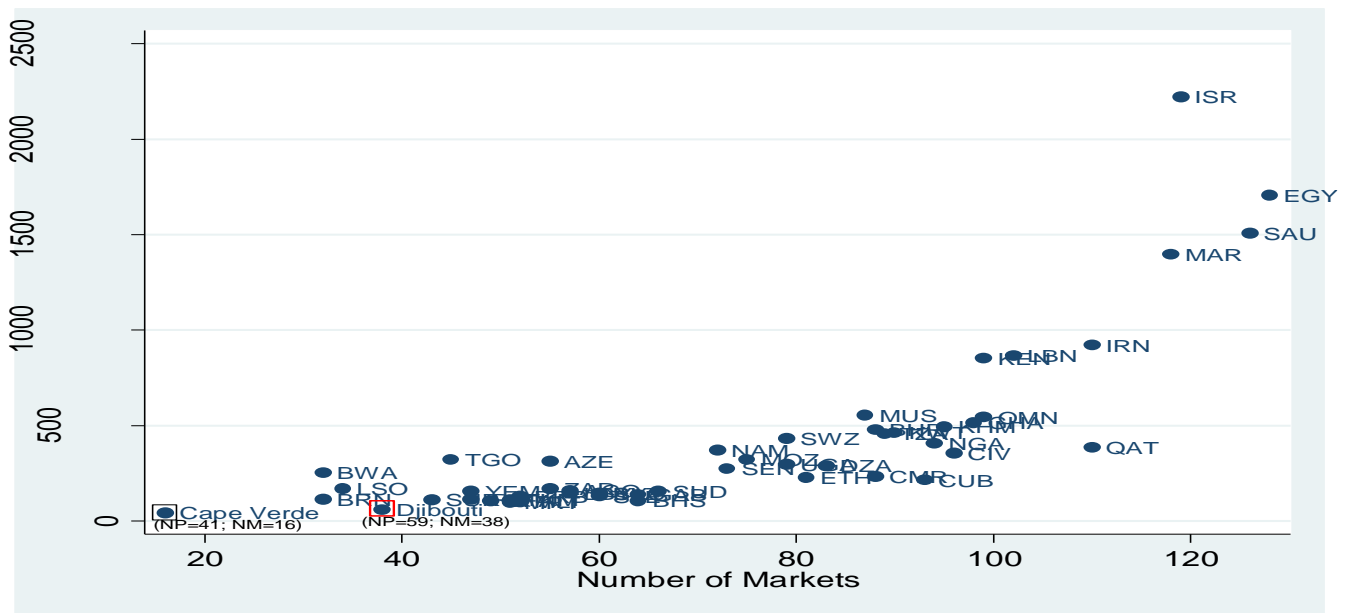
Figure A4.4 HHI in products



Source: World Bank World Integrated Trade Solution (WITS), trade outcome indicators

- In 2013, Djibouti’s export basket was composed of only 59 products for just 33 destinations.

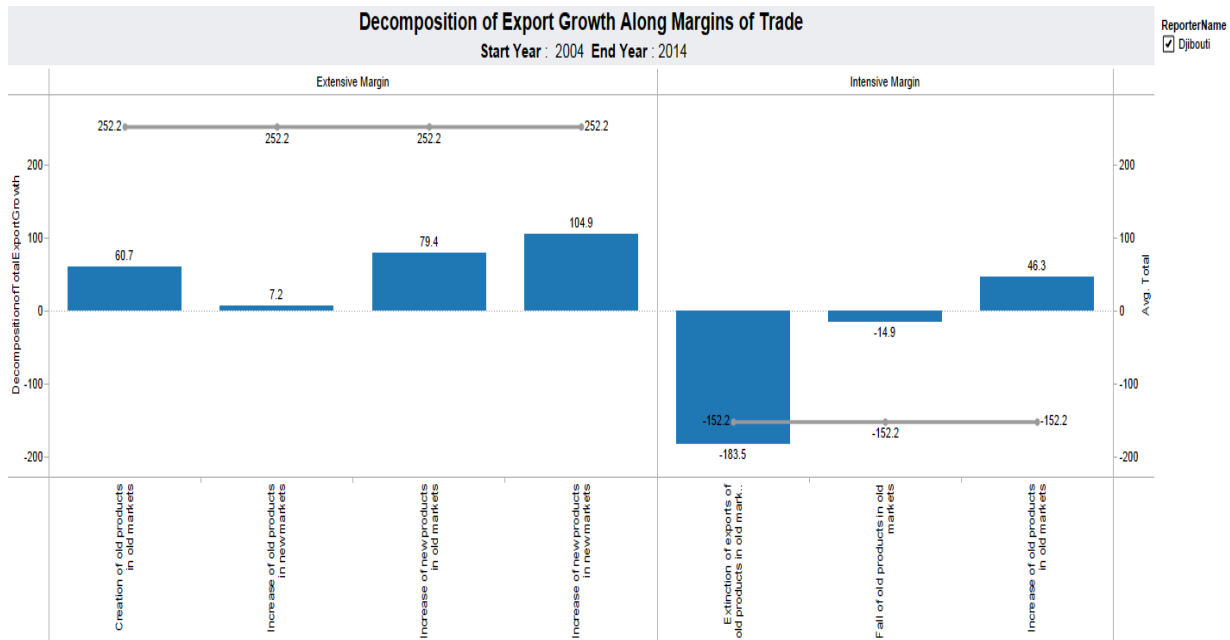
Figure A4.5 Djiboutian Export Decomposition by Number of Goods and Destination, Relative to Peers



Source: World Bank World Integrated Trade Solution (WITS), trade outcome indicators

- Figure A4.6 below shows the decomposition of goods export growth along the two margins of trade: (a) the intensive margin, reflecting the expansion of existing trade flows; and (b) the extensive margin, which is the addition of new products and new markets (destinations). The gray horizontal line in Figure A4.6 represents the net effect of each of the two margins. From this decomposition, it appears that between 2004 and 2014, there was quite a bit of increase/creation of goods, netting 252.2 percent at the extensive margin, which could reflect entries to the production market. However, Djibouti's exports significantly contracted at the intensive margin over the same period, with a net of -152.2 percent. Thus, existing trade flows did not expand to new markets, meaning that there were no new export destinations, rather the trade flows contracted from the existing markets.

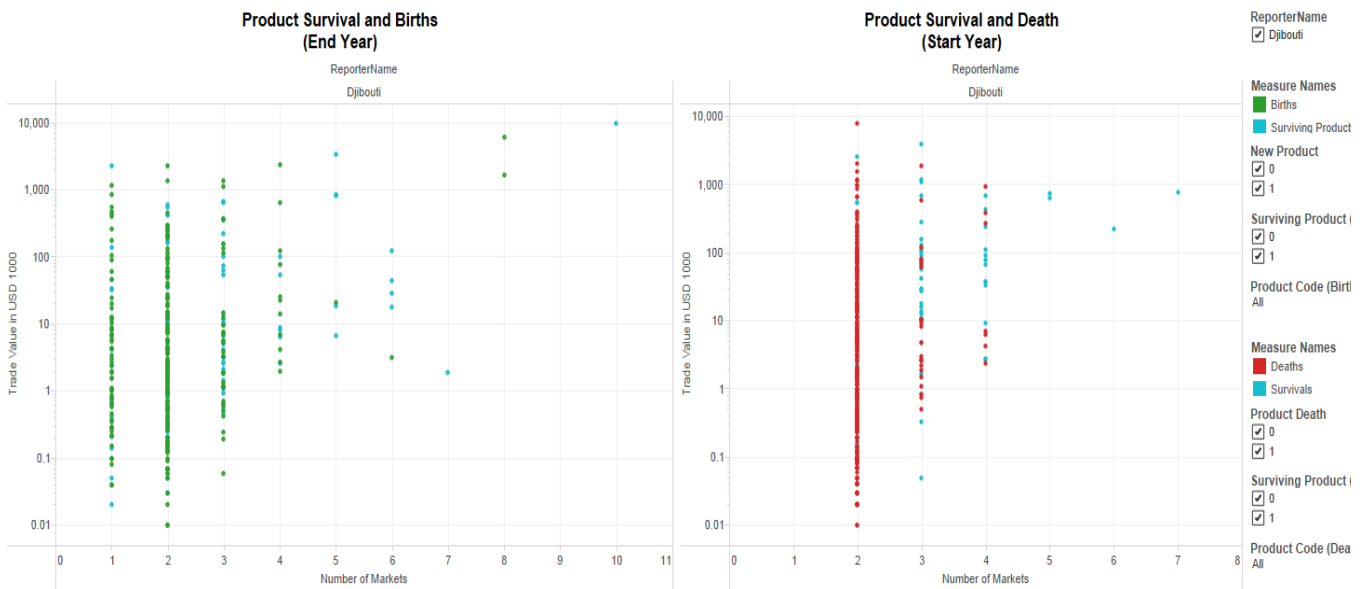
Figure A4.6 Decomposition of Export along Margins of Trade



Source: World Bank World Integrated Trade Solution (WITS), trade outcome indicators

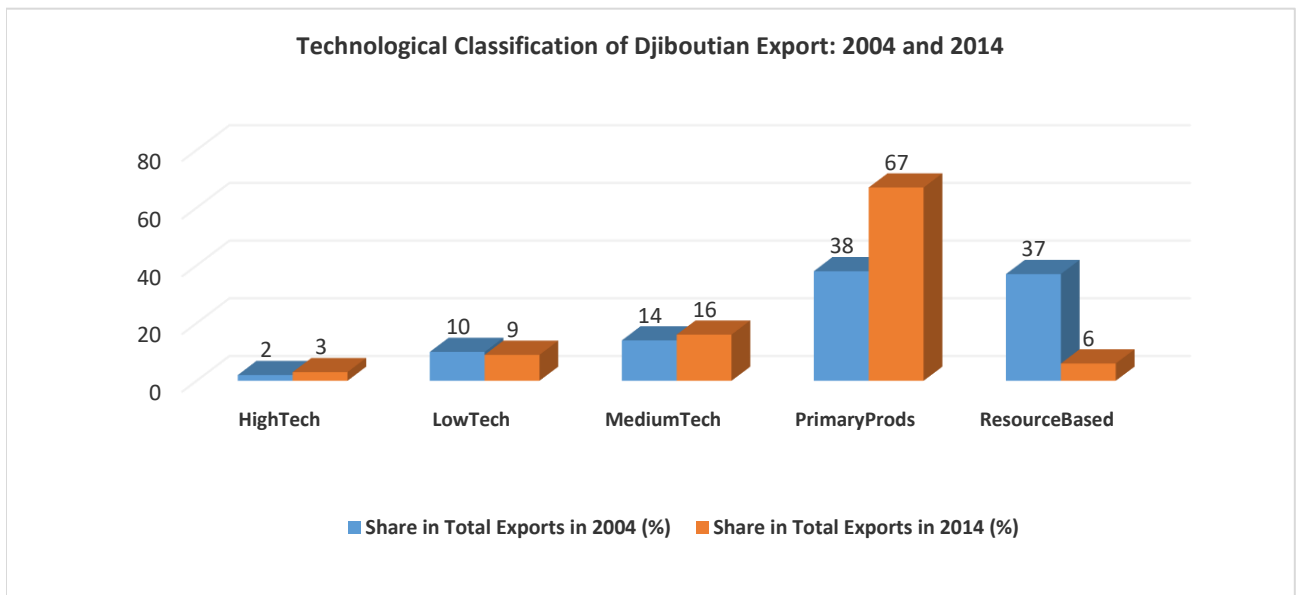
- The depiction of birth and death of products in Djibouti during the 2004-2014 (Figure A4.7) confirms entries on production markets and the creation of new goods or the increase of existing goods to some extent (shown as a large number of birth of products). However, only an insignificant amount remains over time and on very few markets. A larger number of product births (new product creation) but low survival (see blue dots versus green dots)- reflected into larger number of products death – red dots). This suggest that the products are not competitive (sophistication, quality, cost) to survive on the export markets.

Figure A4.7 Products Birth, Survival and Death



Source: World Bank World Integrated Trade Solution (WITS), trade outcome indicators

Figure A4.8 Export Sophistication



Source: World Bank World Integrated Trade Solution (WITS), trade outcome indicators.

Annex 5. The Worldwide Governance Indicators (WGI)

Box A5.1 Understanding the Worldwide Governance Indicators (WGI)

The Worldwide Governance Indicators (WGI) are a research dataset summarizing the views of a large number of enterprises, citizens and experts on the quality of governance in industrial and developing countries. These data are gathered from a number of survey institutes, think tanks, non-governmental organizations, international organizations, and private sector firms. The six aggregate indicators are based on 31 underlying data sources. Details on the underlying data sources, the aggregation method, and the interpretation of indicators can be found in World Bank Policy Research Working Paper No. 5430, available at

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1682130.

Full interactive access to the aggregate indicators and the underlying source data, is available at www.govindicators.org.

- Score estimates range from -2.5 (weak) to 2.5 (strong) governance performance
- Percentile ranks among all countries ranges from 0 (lowest) to 100 (highest).

Indicators	Definition
Voice and accountability	Reflects perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media.
Government effectiveness	Reflects perceptions of the quality of public services, the quality of the civil service and its degree of independence from political pressures, the quality of policy formulation and implementation, and the credibility of the Government's commitment to such policies.
Regulatory quality	Reflects perceptions of the Government's ability to formulate and implement sound policies and regulations that permit and promote private sector development.
Rule of law	Reflects perceptions of the extent to which citizens have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police and the courts, as well as the likelihood of crime and violence.
Political stability and absence of violence/terrorism	Reflects perceptions of the likelihood of political instability and/or politically motivated violence, including terrorism.
Control of corruption	Reflects perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as capture of the state by elites and private interests.

Annex 6. Environmental Sustainability

Djibouti's location in the arid climate zone poses high risks to its environmental sustainability. Djibouti is vulnerable to extreme events such as droughts, floods, and volcanoes. Moreover, Djibouti is at risk of sea level rise, which threatens the 80 percent of the population living in the capital city near the coast. The frequency of climatic disturbances, combined with lack of environmental management, exposes the population to food insecurity, scarcity of drinking water supply and irrigation, and dangers to public health. Environmental hardship particularly affects the rural population, mostly nomads, whose main source of income – livestock – is often wiped away by prolonged droughts.

Djibouti is ranked 131st out of 181 in 2016 with respect to vulnerability¹⁰² to climate change and lack of readiness¹⁰³ to address this vulnerability. Based on the Notre Dame Global Adaptation Index (ND-GAIN), Djibouti is the most vulnerable among comparable countries to climate change and least prepared to address this vulnerability (Table A6.1). It has both a great need for investment and innovations to improve readiness, and a great urgency for action. Djibouti is the 28th most vulnerable country and the 27th least ready country. Djibouti is the either the most or second most vulnerable in terms of food security, water, and habitat among comparator countries (Figure A6.1).

Table A6.1 ND-GAIN Scores¹⁰⁴ of Djibouti vs. Comparable Countries¹⁰⁵ in 2016

Country	Rank	ND-GAIN Score
Armenia	85	41.4
Sao Tome and Principe	120	48.0
Comoros	121	48.7
Djibouti	131	50.1

Source : Notre Dame Global Adaptation Initiative (ND-GSIN)

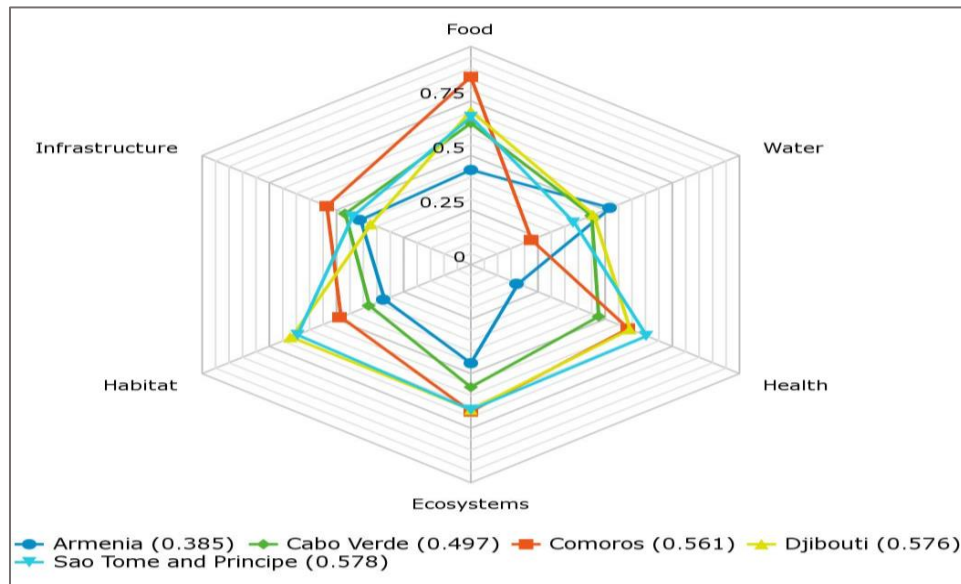
¹⁰² ND-GAIN vulnerability measures a country's exposure, sensitivity and capacity to adapt to the negative effects of climate change. ND-GAIN measures overall vulnerability by considering six life-supporting sectors: food, water, health, ecosystem service, human habitat, and infrastructure.

¹⁰³ ND-GAIN Readiness measures a country's ability to leverage investments and convert them to adaptation actions. ND-GAIN measures overall readiness by considering three components: economic readiness, governance readiness and social readiness.

¹⁰⁴ Note: scores are in percentage term. A smaller score indicates lower extent of vulnerability (the smaller the score, the better)

¹⁰⁵ <http://index.gain.org/ranking>.

Figure A6.1 Component Plot of Vulnerability



Source: Authors' calculation using Notre Dame Global Adaptation Initiative (ND-GAIN)

Djibouti's absolute maximum monthly temperatures have increased over the last three decades by between 0.5 and 1.5°C¹⁰⁶, and average temperatures are expected to increase by 0.6°C to 2.4°C by 2050. The minimum temperature recorded in Djibouti City has risen by close to 1.3°C in the space of 30 years.¹⁰⁷ Rainfall in the country is limited and its variability has increased over the past decade. Critical rainfall periods, which feed the central lowland grazing zones during the months April through August, have become significantly shorter, and are predicted to further decrease. The Hays-Dadaac or winter rains, which occur during the months of September to February, are also predicted to decrease, with marked changes expected during the growing period of September and October.

Djibouti is one of most water-scarce countries in the world, and its environmental threats have significant implications for drinking water. Djibouti has no permanent source of surface water – no rivers, streams or fresh-water lakes – and because of extreme evaporation, less than five percent of the already limited rainfall replenishes groundwater reserves. Nearly 95 percent of the water used for drinking, irrigation and economic activities comes from underground aquifers that are replenished primarily through infiltration and rainwater runoff. The excessive use of groundwater and the lack of water planning had caused the salinization of these aquifers. The low availability and mobilization of water resources limits access to drinking water and sanitation and hinders the development of agricultural and economic activities in general. The high rainfall variability expose Djibouti to water-related disasters, with more than 35 percent of the population directly vulnerable to the impacts of floods and droughts.¹⁰⁸ In 1994 and 2004, two major floods killed 100 and 300 people, respectively, and affected more than 200,000 others. The 2004

¹⁰⁶

http://sdwebx.worldbank.org/climateportal/countryprofile/home.cfm?page=country_profile&CCode=DJI&ThisTab=RiskOverview

¹⁰⁷ See Djibouti NDC (http://www4.unfccc.int/Submissions/INDC/Published%20Documents/Djibouti/1/INDC-Djibouti_ENG.pdf)

¹⁰⁸ GFDRR 2016. "Managing Drought and Sustaining Growth in Djibouti." Stories of Impact.

<https://www.gfdr.org/sites/default/files/publication/Djibouti.pdf>

floods led to US\$11.1 million in losses. According to the Ministry of Health (MOH), limited access to safe drinking water due to floods and poor sanitation and hygiene conditions led to a surge in diarrhea and cholera cases in Djibouti City and nearby districts.

The deficit in groundwater recharge capacity is worsening.¹⁰⁹ Sea level rise poses a significant threat to already declining water quality, particularly with respect to saltwater intrusion into the coastal aquifer. Sea levels are expected to increase between 8 and 39 cm in years to come compared to 1990 levels.¹¹⁰ In urban areas, coastal development activities have eliminated the protection once afforded by mangrove forests. Coupled with excessive pumping of groundwater, as well as overexploitation of surface and groundwater for municipal use, saltwater intrusion into the aquifer from projected sea level rise poses a severe risk to the country's urban areas. This is especially critical during the northeast monsoon season (October-May), when the predominant tides flow from the Red Sea, bringing high salinity levels. Sea level rise and floods might also increase coastal erosion, affecting people and marine ecosystems along the coast.

Prolonged droughts have meant a lack of agriculture opportunities and loss of livestock, the main income sources for farmers and pastoralists, which exposes them to significant food insecurity and malnutrition. Djibouti experienced eight major droughts over the past three decades. The severe drought of 2008, ranked as the worst drought in 60 years, caused severe water shortages and food crisis, affecting 340,000 people and causing a loss of 50 to 70 percent of the livestock. The drought cost the agriculture sector an estimated US\$96 million.¹¹¹ More recently, prolonged drought affecting the Horn of Africa, combined with the regional political instability, have induced massive migration to Djibouti, which is accentuating water stress¹¹² and creating conflict in some areas between migrants and host communities.

Climatic vulnerabilities contribute greatly to malnutrition in the country. Although Djibouti has benefited from international support¹¹³ for drought mitigation, food production is still limited to only 10 percent of the country's food needs, with reliance on food imports to fill the gap. However, high poverty and high food prices translate into a high prevalence of undernourishment. About 33 percent of children are malnourished – one of the highest rates in the world. The poorest households spend nearly 80 percent of their consumption expenditure on food.

Main Water Sector Challenges

Access to water supply in Djibouti is a major constraint to economic development. There is an extreme scarcity of water for livelihoods and economic activity. Water resource availability is only 500 cubic meters

¹⁰⁹ <https://www.afdb.org/fileadmin/uploads/afdb/Documents/Environmental-and-Social-Assessments/Djibouti%20-%20Drinking%20Water%20Supply%20and%20Sanitation%20Project%20for%20Rural%20Areas%20and%20Secondary%20Centres%20of%20Tadjoura%20Arta%20and%20Ali%20Sabieh%20Regions%20-%20ESMP%20Summary.pdf>

¹¹⁰ <https://www.gfdrr.org/sites/default/files/publication/climate-change-country-profile-2011-djibouti.pdf>

¹¹¹ See Djibouti's Post Disaster Need Assessment of October 2011.

¹¹² https://ec.europa.eu/europeaid/sites/devco/files/factsheet-producing-safe-drinking-water-djibouti_en.pdf.

¹¹³ US\$13.2 million were allocated to Djibouti for drought mitigation based on the initial assessment. Of this amount, US\$3.0 million was specifically approved for the PRODERMO - an ongoing World Bank project for rural community development and water mobilization (PRODERMO, P117355, \$8.83 million, 2012-2017- designed to scale up relevant activities for innovative approaches for water harvesting, agriculture and livestock production.

per capita per year, far below the 1,000 cubic meters per capita per day threshold. Only 50 percent of the population of Djibouti City is connected to the public water supply through individual connections, the other half having drawn water from connected neighbors or from public standpipes.¹¹⁴ Water demand is rapidly increasing given the demographic growth, especially in the capital. The growth in demand for piped water is estimated at 6 percent per year in the capital and at more than 70 percent in rural areas, where water scarcity has hit the hardest. These conditions constitute a serious bottleneck for economic development and the sustainability of the population.

Access to sanitation in Djibouti is another major challenge. Djibouti City has only one wastewater treatment plant (3,700m³/day), operational since 2014, and 6 pumping stations. But the sewerage network covers only 18 percent of the population in Djibouti ville. Limited access to sanitation in both urban and rural areas causes a high incidence of waterborne diseases, which is the second leading cause of death among children under five. Extending access to improved sanitation is imperative to reduce those adverse effects. The expected connection pipeline to bring additional drinking water (in an estimated quantity of 100,000 cubic meters per day) from neighboring Ethiopia would increase access to drinking water. However, challenges to increase coverage for sanitation in the country and build new wastewater treatment plants remain.

Large disparities in the provision of potable water and sanitation across regions, and weak water production and management, are due largely to the monopoly of the state-owned water utility, ONEAD (*Office National de l'Eau et de l'Assainissement de Djibouti*), which operates the only existing wastewater treatment plant in the country. ONEAD provides potable water and sanitation services essentially only for the capital city, relying on 85 wells for water production and on one desalination plant, located in Ali Sabieh. The deficit of drinking water supply in the capital is estimated at 65 percent and the demand estimated at 80,000 m³/day. In addition to limited availability, the water distribution system is inefficient, leading to significant losses of quantity. The cost of water production is estimated at US\$1.7 per cubic meter compared to revenues from tariffs of US\$0.45 per cubic meter, which results in recovery of only 26.5 percent of the production cost. More challenges will be added to the high cost of water production from the ongoing projects financed by different donors¹¹⁵ to increase the water supply from 32,000 m³/day to 222,500 m³/day within the next two years (an increase of more than 220 liters per capita per day).

Djibouti lacks an integrated national water and sanitation sector strategy. The high salinization of its aquifers is due to limited water planning and the excessive exploitation of groundwater resources. There is need for a holistic, clear and updated sector strategy for water and sanitation provision, covering water resource management, water supply and sanitation, water quality and conservation, wastewater treatment, and production and distribution systems. The strategy also needs to address the

¹¹⁴ For water supply in Djibouti City, 94 percent of households use pipe-borne water (41 percent in the home, 40 percent in courtyards and 13 percent from a public standpipe). In rural areas, pipe-borne water is used by only 27 percent of households (3.6% in households, 4.4% in courtyards and 19.4% from a public standpipe).

¹¹⁵ EU is currently the main player in the water sector. Ongoing investments by other donors total close to US\$450 million: (a) US\$322 from China Exim Bank for the cross-border water project with Ethiopia, to address the water shortage in the south, namely Ali-Sabieh, Arta and Dikhil; (b) a €63 million grant from the European Union for construction of a desalination plant in Djibouti; (c) US\$56 million from several donors (European Union, the African Development Bank, Kuwait Fund for Development, Arab Funds for Social Development) for renewal of the water distribution network.

modernization of institutional structures and the regulatory regime, as well as ecological issues such as the protection of aquifers and the development of new deep aquifers. Currently, the EU is financing a €1 million analytical study to review the performance of the entire water sector, including an organizational, financial and technical audit of the water utility to improve its efficiency. The results of this work will be used to guide reforms in the water sector.

Climate change mitigation and adaptation

To mitigate risks from floods, the Government put in place a disaster risk management program and constructed a dam in 2006, to protect the capital from flash floods. This measure improved disaster preparedness and helped reduce damage during the flood of 2013. An early warning system and emergency preparedness plans were also put in place to assist the Government in managing flood hazards.

The Government has also been proactive in putting in place some climate adaptation measures. National adaptation priorities¹¹⁶ have been defined for 2035, broken down into multiple strategies: (a) reducing vulnerability to drought; (b) protecting against rising sea levels; (c) improving access to water; (d) protecting biodiversity; and (e) reinforcing the resilience of rural populations. In its Nationally Determined Contribution (NDC), submitted to the UNFCCC in August 2015, Djibouti has emphasized the urgent need to adapt to climate change. Djibouti has prepared both a National Adaptation Program of Action (NAPA) in 2006 and National Communication under the UNFCCC, which form the basis of its planning for adaptation to date. The Ministry of Habitat, Urbanism, Environment, and Land Management is the primarily responsible for implementation. In addition, given the country's proneness to natural disasters, in 2006 the Government created an Executive Secretariat for Risk and Disaster Management, which coordinates natural disaster technical matters as well as prevention, mitigation and response activities, encompassing adaptation to the anticipated effects of climate change.

Despite these positive steps, climate variability and change have not yet been mainstreamed into national policy and planning processes, including efforts toward poverty reduction. Further, accountability is lacking under Djibouti's inadequate environmental regulations, as are appropriate monitoring systems to deal with potentially vulnerable populations. Meanwhile, to help overcome existing challenges posed by climate change and related disasters, some adaptability measures need to be considered in different sectors as well as at the institutional level:

- a. ***Agriculture and food security***: The underdevelopment of the agricultural sector is due to the small area of developed land and lack of effective irrigation. The Government's food security strategy aims at: (i) leasing land for agriculture in other countries in the region, particularly Ethiopia and Sudan, to create a buffer stock of food, as arable land is limited in Djibouti; and (ii) developing more arable land in the country through irrigation systems and mobilization of surface water. In addition, to mitigation the impact of drought, the Government should consider (i) scaling up innovative approaches for water harvesting, agriculture and livestock production to reduce food

¹¹⁶ Djibouti NDC, available at http://www4.unfccc.int/Submissions/INDC/Published%20Documents/Djibouti/1/INDC-Djibouti_ENG.pdf.

insecurity, improve household nutrition, and strengthen other rural livelihood activities such as fisheries and handicrafts; (ii) scaling up priority community investment projects, including water structures (underground cisterns, open-air reservoirs, shallow wells and pastoral and agricultural wells), grazing area set-asides and irrigated areas; (iii) supporting projects to mobilize water resources for small-scale agriculture, livestock, and other community-based rural investments; (iv) enhancing the capacity of rural communities to manage water and agro-pastoral resources in the project areas, using a participatory or community-based development¹¹⁷ approach; (v) rehabilitating or constructing small water harvesting¹¹⁸ or collection infrastructure for drinking water, livestock and agriculture; (vi) promoting soil and water conservation activities to protect water structures and to enhance vegetation regeneration around these structures; (vii) enhancing the production and value addition of agricultural and livestock activities around water points; (viii) strengthening the organizational, technical, and management capacity at the community level and regional staff; (ix) introducing improved irrigation techniques to Djibouti farmers.

- b. **Coastal resources:** Coastal resources are threatened by aims to i) build soft and hard coastal protection structures to preserve critical coastal land and infrastructure); (ii) promote integrated coastal resource management, including support for research on coastal vulnerability.
- c. **The Government's health sector strategy aims to:** (i) strengthen the monitoring, awareness raising, and rapid response capacity of the health system, with particular regard to diseases which have a direct climate link; (ii) promote research on climate change and health, particularly to understand the health impacts of climate in vulnerable locations; (iii) secure local drinking water supplies and proper drainage, as an essential step towards curbing water-borne diseases; (iv) increasing coordination between the country's health sector and broader development players to ensure that health concerns related to climate change are mainstreamed into development activities.

Interventions to address water challenges

Integrated water sector strategy: Given the country's water scarcity and the expectation that this situation will be exacerbated under future climate conditions, there is a need to amend the current strategy to focus on adaptation activities, including rainwater harvesting and water efficiency measures. For example, the Government could (a) limit the impact of flooding by developing an integrated urban water management plan to better manage storm water; (b) develop an institutional framework to encourage wastewater reuse; (c) promote appropriate measures to protect water resources for Djibouti City; (c) promote the development and management of surface waters, including investments in water monitoring and information systems as a basis for more efficient and equitable use of water resources in

¹¹⁷ The ongoing Rural Community Development and Water Mobilization Project (PRODERMO, P117355, \$8.83 million, 2012-2017) aims at increasing access of rural communities to water and enhance their capacity to manage water and agro-pastoral resources in the project areas, using a participatory approach.

¹¹⁸ As water harvesting is only practical when rain falls, improved access to water in this case is therefore dependent on rainfall availability.

all sectors; (di) develop and implement water-saving infrastructure for different types of water use; (e) promote greater responsibility at the community level to manage water resources in view of climate change and variability.

Strategic water resource management with a focus on aquifers: There is a need to improve groundwater management and monitoring and analyze the potential of artificial groundwater recharge. The example of Israel is very relevant to Djibouti case: (a) the aquifer can be used for strategic storage, much like a dam but without evaporation; (b) the desalination is used for base load instead of peak demand; (c) the artificial recharge of the aquifer will be through the treated wastewater and any flash floods.

Institutional support for the water supply sector: With the high-profile infrastructure projects financed by other donors, including a large desalination plant and a water connection pipeline to bring water from neighboring Ethiopia, new challenges will arise as ONEAD takes over the operation of the completed facilities. ONEAD would need to (a) prepare an integrated approach to water resources management; and (b) obtain technical support to manage and operate the facilities.

Improved efficiency of ONEAD: Through the existing program to reduce Non-Revenue Water (NRW¹¹⁹), ONEAD was able to reduce the NRW from 42 percent in 2013 to 36 percent at the end of 2015. However, with the desalination project will come new challenges, including the high cost of water production. Thus, there will be more need to (a) reduce water losses, and (b) improve financial viability of ONEAD to overcome the additional costs of water production. Both of these issues could be addressed through a performance-based contract. A successful example of this approach is the case of Lebanon, where a performance-based contract enabled the utility to move from intermittent to 24/7 water supply.

Expanding access to water and sanitation: There is also an urgent need to improve access to and quality of water and sewerage services in urban and rural areas. Specific areas for intervention include (a) rehabilitation of sanitation network; (b) construction of a new wastewater treatment plant to enable increased connections to the public sanitation network; (c) upgrading of the existing water supply network and reservoirs to accommodate addition supply.

¹¹⁹ NRW is water produced, but lost before reaching users

Annex 7. Data Diagnostic

Country: Djibouti

Date: May 23, 2017

Section 1: General Information about the Statistical System	
Legal status of NSO	https://unstats.un.org/unsd/dnss/docViewer.aspx?docID=580#start
Statistical Legislation (latest)	Une Direction de la Statistique, Law, 1998
NSDS/Statistical masterplan	http://www.paris21.org/sites/default/files/Djibouti%20NSDS%202011-15.pdf

Section 2: Micro data						
Type of census/survey	Latest (Year)	Second latest (year)	Representativeness (national, regional, urban/rural)	Data accessibility (open access/with permission/no access)	Optional disaggregation (Y/N)	
					Sex	Regional
Censuses						
Population Census	2009	na	National	No access	-	-
Agriculture Census	-	-	-	-	-	-
Business/establishment census	-	-	-	-	-	-
Surveys						
Household Survey on	-	-	-	-	-	-
Household survey on education (e.g. MICS)	MICS	-	-	Open access	-	-
Household survey on health (e.g. DHS, MICS)	MICS	-	-	Open access	-	-
Labor force Survey	-	-	-	-	-	-
Business/establishment survey	-	-	-	-	-	-
Other (specify)						

Section 3: Macro data				
Does the country subscribe to the IMF SDDS or participate in the eGDDS?	eGDDS			
If eGDDS	Periodicity		Timeliness	
	e-GDDS	Country	e-GDDS	Country
National accounts: Gross Domestic Product by Production	Q	A	1Q	NA
Consumer price index	M	M	2M	1M
Central government operations	Q	M	1Q	2M
Balance of payments	Q	A	1Q	10M
External debt	Q	Q	2Q	1Q
Merchandise trade	M	Q	12W	1M
Production index	M	-	12W	-
Employment	A	-	3Q	-
Unemployment	A	-	3Q	-
Producer Price Index	M	-	1M	-

Section 4: Compliance with WBGs core data standards			
	WBG Standard	Compliant (Y/N)	Actual yearly interval or %
Household survey of income or consumption	One every 3 years	N	-
PPP price survey	One every 3 years	N	6 Years
CRVS	<ul style="list-style-type: none"> • 80% of births registered • 60% of deaths registered with cause of death 		

Section 5: Statistical Capacity Indicators	
Method	40.0
Source Data	40.0
Periodicity	80.0
Overall (Memo: Overall Average all IDA)	53.33

Section 6: Data Openness Indicators	
Open Data Barometer Score	-
Open Data Index Score	26.1

Annex 8. Analyzing three hypotheses about Djibouti's development challenges

Djibouti is small, fragile country located in a region characterized by fragility spillovers. It has a difficult climate and still emerging institutions. To what extent is the growth that has been observed actually a predictable outcome of these circumstances? The analysis in the preceding chapters allows us to cast the SCD as testing three hypotheses about Djibouti's development experience: first, whether the size of the economy inhibits scale and competition; second, whether the elasticity of employment to growth is low and, if so, reasons why; and finally, whether Djibouti has sufficiently exploited the benefits of its strategic location.

A8.1 Is the high-cost base economy due to small state size?

With small population and land area, small states usually face limited human capital as well as labor market and capacity constraints due to diseconomies of scale, which makes private sector-led growth difficult to accomplish. Considering reduced opportunities for economies of scale, it can be costly to provide public services to small, scattered populations.ⁱ In addition, with a small GDP combined with high cost of public services, it is common for small states to have higher debt-to-GDP ratios (UN-DESA, 2014).ⁱⁱ However, each small state has its own country-specific characteristics that can either exacerbate these challenges or become an opportunity for inclusive growth. World Bank studies show that Mauritius and some small states in the Caribbean have benefitted from leveraging their skilled work force and good IT systems. Other small state success stories include Bahrain, Brunei, Estonia, Malta and Qatar, which have achieved higher income by building on their limited assets despite their small economic size.

Djibouti displays many of the constraints or challenges that are typically associated with small states. However, the SCD analysis shows that the driving factors behind Djibouti's performance are not rooted in the fact that the country is small. In fact, Djibouti possesses sufficient characteristics and potentials to overcome the disadvantage of size.

- a. While most small states suffer from high costs of delivering services to scattered populations, Djibouti has its population highly concentrated in and around the capital city. This means that the cost of service delivery is not driven by geography and could be much reduced because of this population density. Further, small investments in public services could have larger impacts compared to a big country.
- b. The remoteness of some small states adds an economic cost, as they are geographically far removed from international trade partners. However, Djibouti is located at the gateway to the Red Sea, on one of the world's busiest shipping routes between the Indian Ocean and the Mediterranean. This could be an enormous asset if exploited through good governance and equitable development policies.
- c. Many small states suffer from poor ICT connectivity, which affects their services sector as well as manufacturing, trade and other aspects of the economy. Djibouti also has poor connectivity, but not because of lack of internet broadband or inadequate submarine fiber optic cables. In fact, Djibouti has enormous comparative advantage as the landing site of the undersea fiber optic ICT

cables. However, the ICT sector remains uncompetitive, with high prices and low penetration of mobile broadband and internet. This weak performance is due to (i) the state monopoly over the sector, and (ii) the Government's policy choice of serving international markets rather than expanding broadband access in the domestic market, where more capacity could be allocated at a reduced price.

- d. For many small states, recurrent shocks related to natural disasters, climate or financial shocks constrain the fiscal space. Although Djibouti faces prolonged droughts that exacerbate poverty and constrain human development, the lack of fiscal space as well as growing debt concerns stem mostly from the Government's policy and investment choices. Under the vision of making the country a trade and logistics hub, the Government chose to debt-finance infrastructure development with non-concessional loans, while failing to enact reforms that would translate the investment into revenue generation to service the debt, while catalyzing the job-creating potential of the private sector.
- e. Many small states have narrowly based economies like Djibouti's, and also have difficulty spreading risks across sectors. Although Djibouti's arid climate does not allow for expansion of agriculture, sectors such as tourism, industrial development and fisheries remain unexploited opportunities to grow the economy. To unleash this potential, however, some key structural and governance constraints will need to be addressed.
- f. While private sector led-growth is considered difficult to achieve for many small states due to the lack of economies of scale, Djibouti's location near large markets such as Ethiopia and COMESA countries compensates for its small domestic market. In addition, with its geostrategic location, Djibouti has the potential to attract firms to service those large markets, if the regulatory environment were more business friendly and costs of production were competitive. Indeed, the delay in the emergence of a buoyant private sector is due primarily to the range of (man-made) constraints identified in Chapter 2. In addition, Djibouti hosts many foreign military bases. The presence of foreigners with strong purchasing power offers an additional source of domestic demand for goods and services. Taking advantage of such demand would require a domestic production sector of good quality and an arrangement with those bases to pursue a certain percentage of their goods from the domestic market.
- g. Many small states are vulnerable to external shocks, as they rely on international financing to supplement their budget. But Djibouti's vulnerability to external shocks is derived from an economic model built around port activities serving mostly one country – the landlocked neighbor Ethiopia. The vulnerability is exacerbated by having nearly no domestic production and relying on imports for basic goods. By addressing the structural constraints and diversifying the economy, Djibouti could reduce its vulnerability to external shocks.
- h. Djibouti is considered a fragile state according to the World Bank Group's definition. However, in Djibouti the drivers of fragility differ from those other fragile states. A recent World Bank

assessment on resilience and risk¹²⁰ concluded that while being in a turbulent region makes Djibouti fragile through exposure to regional insecurity, the major internal drivers of fragility are the governance system and the limited inclusion of citizens in the development process.

The SCD analysis shows that the high costs in Djibouti do not stem from the attributes of a small state. Rather the challenges appear to be rooted in governance failures, which have deeper implications for (a) private sector development and human capital quality, which reduces inclusiveness of growth; and (b) institutional management capacity, resulting in weak macroeconomic fundamentals and posing risks to sustainability.

The *World Development Report 2017 on Governance and the Law* notes that effective implementation of policies designed to achieve stated objectives **requires commitment, coordination, and cooperation – the 3Cs**. These are the key determinants of policy effectiveness, as they enable agreements among actors that effectively change behavior in the policy arena.

The Government must ensure **commitment** to policies in the face of changing circumstances. To effectively implement reforms, ministries, departments, and agencies (MDAs) must coordinate across a range of institutions and stakeholders. This coordination helps ensure that each actor along the results chain remains committed to delivery of the envisaged core inputs, outputs and outcomes, and is delivering on key results areas for which they are responsible.

Coordination is needed across public and private sectors as well as government and non-government stakeholders, all of which have an important role to play in economic and social transformation. However, in Djibouti, information sharing remains a huge constraint, within institutions and across institutions and key players. Throughout the SCD stakeholder consultation, participants across government agencies as well as private sector, civil society organizations (CSO), and representatives of the political opposition pointed to the lack of information sharing as a major constraint to timely implementation of projects and reforms, the quality of services delivery, and the acquisition of training to build capacity. They also pointed to the non-transparency of information about laws and available opportunities. CSOs, in particular, are constrained by a lack of structure, weak technical and institutional capacity, and limited financial means. These factors contribute to a situation in which opposing political parties and civil society organizations play little role in the development of public policy or in holding the government to account.

Cooperation is needed to ensure that all citizens are engaged at all stages of the design and implementation of national development plans. This is critical to counter imbalances in the policy arena that impede development effectiveness.

In addition to the 3Cs, principles of good governance are needed to limit asymmetries of power, ensure inclusion in decision-making, and strengthen institutional capacity. The country remains characterized by weak institutions, lack of enforcement of laws and contracts, and lack of voice and accountability. There is also an absence of modern human resources systems to support merit-based nomination and promotion and results-based performance management, which has resulted in the persistence of a civil service culture that lacks accountability and facilitates the evasion of responsibility. The country's many governance failures are translated through policies and institutions that continue to thwart private sector

¹²⁰ World Bank, 2017, Resilience and Risks Assessment

development for jobs creation. These failures include the high presence of competition-limiting SOEs; an unequitable tax system that creates economic distortions; a burdensome regulatory environment for businesses; lack of effective implementation of existing private sector development policies; and a poorly developed financial market and institutions. Other governance failures translate into weak institutional capacity, which results in poor public service delivery and low human capital; and in weak economic and institutional management, which pose risks to sustainability.

A8.2 Is the elasticity of employment to growth low?

The estimated elasticity of employment to growth is greater than 1. However, even in 2015, most employment was in the public sector and most private sector employment was informal. Based on the 2015 employment survey, public sector jobs represented 60 percent of total employment. Formal private sector jobs accounted for 10 percent of employment, while informal private sector jobs were 30 percent the same year. This suggests that the quantity and quality of jobs remains a challenge for Djibouti. The high share of informal jobs reflects the fact that the private sector remains constrained. Reforms to ease the business environment, level the playing field for competition, and undo state monopolies are urgently needed to empower the private sector to absorb the unemployed and future young graduates, estimated at 4,000 to 5,000 a year.

A8.3 Has Djibouti exploited all the benefits associated with its location?

Djibouti seems not to have fully leveraged its mega-investments in port and ICT to make growth more inclusive and sustainable. The ongoing Berbera port development in Somaliland could pose a potential threat to Djibouti's trade with Ethiopia, so relying only on trade with Ethiopia as the main driver of growth will soon face some limits. Djibouti could leverage its location near dynamic COMESAⁱⁱⁱ, the Chinese's Belt and Road Initiative (BRI) and its comparative advantage as the landing site of the under-sea fiber optic ICT cables to make itself more attractive to foreign firms, not only for services, but also for industrial activities.

References

- [1] Ahsan, Reshad and Devashish, Mitra. 2016. *Can the Whole Actually Be Greater Than the Sum of Its Parts? Lessons from India's Growing Economy and Its Evolving Structure. Chapter 1 in McMillan et al (eds), Structural change, fundamentals, and growth: A framework and Case Studies*. The International Food Policy Research Institute (IFPRI).
- [2] Becker, Gary. 2008. *Human Capital, the Concise Encyclopedia of Economics, 2008*. Library of Economics and Liberty. <http://www.econlib.org/library/Enc/HumanCapital.html>
- [3] Blackman, Sue and Baumol, William. 2008. *Natural Resources, the Concise Encyclopedia of Economics, 2008*. Library of Economics and Liberty. <http://www.econlib.org/library/Enc/Productivity.html>
- [4] Briaux, Justine ; Carles, Sophie ; Fortin, Sonia ; Renk, Andréa ; Kameli, Yves ; Abubra, Laura ; Rollet, Pascaline ; Martin-Prevel, Yves ; Savy, Mathilde. 2017. *Evaluation d'impact et analyse de coûts du programme de transferts monétaires*. PDC Togo, World Bank, UNICEF, Institut de Recherche pour le Développement.
- [5] Brisset, Quentin and Chaudeurge, Etienne. 2016. *La Guerre Civile à Djibouti (1991-1994), Patrimonialisation et Personification des Relations de Pouvoir dans la Corne de l'Afrique*. SciencesPo, Rennes. https://iepweb.sciencespo-rennes.fr/bibli_doc/download/918
- [6] Brixi, Hana; Lust, Ellen; Woolcock, Michael. 2015. *Trust, Voice, and Incentives: Learning from Local Success Stories in Service Delivery in the Middle East and North Africa*. Washington, DC.: World Bank.
- [7] Commission on Growth and Development. 2008. *Growth Report: Strategies for Sustained Growth and Inclusive Development*. Washington, DC.: World Bank.
- [8] Criscuolo, Chiora; Gal, Peter; Menon, Carlo. 2014. *The Dynamics of Employment Growth: New Evidence from 18 Countries*. CEP Discussion Paper No 1274.
- [9] Direction de la Statistique et des Etudes Démographiques (DISED). 2015. *Enquête djiboutienne sur l'emploi, le secteur informel et la consommation*.
- [10] Department for International Development (DFID). 2004. *What is Pro-Poor Growth and Why Do We Need to Know?: Pro-Poor Growth Briefing Note 1*. DFID, London.
- [11] Department for International Development (DFID). 2008. *Growth: Building jobs and prosperity in developing countries*.
- [12] Djibouti Department of Statistics and Demographic Studies (DISED). 2016. *Enquête sur l'emploi, le secteur informel et la consommation des ménages (EDESIC 2015-16); Situation de l'emploi à Djibouti en 2015*.
- [13] Dollar, David and Kraay, Aart. 2002. *Growth Is Good for the Poor*. Journal of Economic Growth 7, pp. 195–225.
- [14] El-Kogali, Safaa and Krafft, Caroline. 2015. *Early Childhood Development in the Middle East and North Africa: Expanding Opportunities for the Next Generation*. Washington, D.C.: The World Bank.

- [15] European Commission for Humanitarian Aid and Civil Protection (ECHACP). 2017. *Echo Factsheet*. Djibouti, March 2017.
- [16] FEWSNET. 2017. Djibouti Remote Monitoring Update. June 2017. <http://fewsn.net/east-africa/djibouti/remote-monitoring-report/june-2017>
- [17] Field, Alexander. 2008. *Productivity*. The Concise Encyclopedia of Economics, 2008. Library of Economics and Liberty. <http://www.econlib.org/library/Enc/Productivity.html>
- [18] Food and Agriculture Organization (FAO). 2017. Food Outlook: Biannual Report on Global Food Markets (June). <http://www.fao.org/3/a-i7343e.pdf>
- [19] Galasso, Emmanuela and Adam Wagstaff. 2016. The economic cost of stunting and how to reduce them. World Bank Policy Research Note. <http://pubdocs.worldbank.org/en/536661487971403516/PRN05-March2017-Economic-Costs-of-Stunting.pdf>
- [20] Gelvanovska, Natalija; Rogy, Michel; Rossotto, Carlo Maria. 2014. *Broadband Networks in the Middle East and North Africa: Accelerating High-Speed Internet Access. Directions in Development--Communication and Information Technologies*. Washington, DC.: World Bank.
- [21] Ghosh, Swati and Kraay, Aart. 2000. *Measuring growth in total factor productivity*. World Bank, Economic Policy Note No. 42.
- [22] Hausmann, Richard; Rodrik, Dani; Velasco, Andres. 2005. *Growth Diagnostics*. Cambridge, MAL John F. Kennedy School of Government. March 2005.
- [23] Ianchovichina, Elena and Lundstrom, Susanna. 2009. *Inclusive Growth Analytics Framework and Application*, Policy Research Working Paper No. 4851: World Bank.
- [24] International Monetary Fund (IMF). 2014. *Sustaining long run growth and macroeconomic stability in low income countries – the role of structural transformation and diversification*. IMF Policy Paper. <https://www.imf.org/external/np/pp/eng/2014/030514.pdf>.
- [25] International Monetary Fund. 2015. *Fiscal policy and long-term growth*. IMF policy paper <https://www.imf.org/external/np/pp/eng/2015/042015.pdf>
- [26] International Monetary Fund (IMF). 2015. *Poverty, Growth, and Inequality in Sub-Saharan Africa: did the walk match the talk under the PRSP approach?* International Monetary Fund, W P/15/122
- [27] International Monetary Fund. 2015a. *Fiscal Monitor: Now Is the Time: Fiscal Policies for Sustainable Growth*. Washington: International Monetary Fund.
- [28] International Monetary Fund (IMF). 2016. *Article Iv Consultation—Press Release; Staff Report; and Statement by The Executive Director for Djibouti*. IMF Country Report No. 17/87., pp 32
- [29] International Monetary Fund (IMF). 2016a. *Djibouti. Selected Issues*. IMF Country Report No. 16/249. available at <https://www.imf.org/external/pubs/ft/scr/2016/cr16249.pdf>

- [30] Jabbour, Rock. 2017. *PAEQ Rapport Audit 2016*. Washington, D.C.: World Bank Group. Report No. AUD0009520
<https://hubs.worldbank.org/docs/imagebank/pages/docprofile.aspx?nodeid=28020080>
[http://eprints.soas.ac.uk/9921/1/DESA Governance Economic Growth and Development since 1960s.pdf](http://eprints.soas.ac.uk/9921/1/DESA_Governance_Economic_Growth_and_Development_since_1960s.pdf)
- [31] Khan, Mushtaq. 2007. *Governance, Economic Growth and Development since the 1960s*. DESA Working Paper No. 54 ST/ESA/2007/DWP/54 (August).
- [32] Kowalski, Przemyslaw, Büge, Max, Sztajerowska, Monika, and Egeland, Matias. 2013. *State-Owned Enterprises: Trade Effects and Policy Implications*. OECD Trade Policy Paper No. 147, TAD/TC/WP(2012)10/FINAL, p. 21.
- [33] *Ministère De La Sante Djibouti, Direction De La Statistique et des Etudes Démographiques, and Pan Arab Project for Family Health. 2012. Deuxieme Enquete Djiboutienne Sur La Sante de la Famille: Rapport Final.*
- [34] McMillan, Margaret, Rodrik, Dani, and Sepulveda, Claudia. 2016. *Structural change, fundamentals, and growth: A framework and Case Studies*. The International Food Policy Research Institute (IFPRI).
- [35] OECD. 2008. *Growing Unequal? Income Distribution and Poverty in OECD Countries*.
http://darp.lse.ac.uk/resources/books/GrowingUnequal_OECD.pdf
- [36] Ravallion, Martin. 2001. *Growth, Inequality and Poverty: Looking Beyond Averages*. World Development, Vol. 29, No. 11, pp. 1803-1815.
- [37] Ravallion, Martin. 2004a. *Pro-Poor Growth: A Primer*. World Bank Policy Research Working Paper 3242.
- [38] Romer, Paul. 1990. *Endogenous Technological Change*. Journal of Political Economy, Vol. 98, No. 5, p.2, University of Chicago. <http://pages.stern.nyu.edu/~promer/Endogenous.pdf>
- [39] Romer, Paul. 2008. *Economic Growth*. The Concise Encyclopedia of Economics, 2008, Library of Economics and Liberty. <http://www.econlib.org/library/Enc/EconomicGrowth.html>
- [40] Telecom Regulatory Authority of the Kingdom of Bahrain. 2016. *Telecommunications Retail Price Benchmarking Report for Arab Countries* ([link](#)).
- [41] UNICEF-WHO-The World Bank. 2017. *Joint child malnutrition estimates - Levels and trends*. 2017 edition. <http://www.who.int/nutgrowthdb/estimates/en/>
- [42] World Bank. 2012. *Transport and logistics in Djibouti: contribution to job creation and economic diversification*, World Bank, Report no. 75145.
- [43] World Bank. 2013. *Enterprise surveys: Djibouti country profile 2013. Enterprise surveys country profile*. Washington, DC: World Bank Group.
<https://hubs.worldbank.org/docs/imagebank/pages/docprofile.aspx?nodeid=20378015>
- [44] World Bank. 2014. *Country Partnership Strategy for The Republic of Djibouti FY2014-2017*.

- [45] World Bank Group. 2016. *Breaking Down Barriers: Unlocking Africa's Potential through Vigorous Competition Policy*. Washington, DC: World Bank Group, p. 7.
- [46] World Bank. 2016. *Djibouti Governance Capacity Building State-Owned Enterprise Governance Reform*. Report No: ACS19010, p. 2.
- [47] World Bank. 2016. *World development report 2016: digital dividends overview*. World development report. Washington, D.C.: World Bank Group. <https://hubs.worldbank.org/docs/imagebank/pages/docprofile.aspx?nodeid=25772035>
- [48] World Bank. 2016. *Doing business 2017: equal opportunity for all*. Washington, D.C.: World Bank Group. p. 16. <https://hubs.worldbank.org/docs/imagebank/pages/docprofile.aspx?nodeid=26891939>
- [49] World Bank. 2017. *Djibouti - What tax strategy following the national conference on taxation?* Report No. 113845.
- [50] World Bank. 2017. *Évaluation de la performance en matière de gestion de la dette: Djibouti*. Washington, D.C.: World Bank Group. <https://hubs.worldbank.org/docs/imagebank/pages/docprofile.aspx?nodeid=29752313>
- [51] World Bank. 2017b. *Laying the Groundwork for More Effective Multi-sectoral Action on Stunting in Sub-Saharan Africa*.
- [52] World Bank. 2017. *Preview of Doing Business 2018*. Washington, D.C.: World Bank Group. <https://hubs.worldbank.org/docs/imagebank/pages/docprofile.aspx?nodeid=27681485>
- [53] World Bank. 2017. *World Development Report 2017: governance and the law*. World Development Report. Washington, D.C.: World Bank Group. <https://hubs.worldbank.org/docs/imagebank/pages/docprofile.aspx?nodeid=27136835>
- [54] World Bank. 2018. *World Development Report 2018: Learning to Realize Education's Promise*. Washington, DC: World Bank. doi:10.1596/978-1-4648-1096-1.
- [55] World Economic Forum. 2017. *The Inclusive Growth and Development Report*. WEF, 2017.
- [56] World Trade Organization. 2014. *Trade Policy Review*. WT/TPR/S/305 17 September 2014, p. 33.

Endnotes

ⁱ See World Bank Case studies and constraints of small states at

<http://www.worldbank.org/en/country/smallstates/overview>

ⁱⁱ See also <http://www.worldbank.org/en/news/feature/2017/01/23/small-states-taking-stock>

ⁱⁱⁱ COMESA is the Common Market for Eastern and Southern Africa, with currently 19-members countries: Burundi, Comoros, Democratic Republic of the Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia, and Zimbabwe.