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Djibouti: First Review Under the Staff-Monitored Program

This paper on the first review under the staff-monitored program for **Djibouti** was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **November 19, 2004**. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of **Djibouti** or the Executive Board of the IMF.

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DJIBOUTI

First Review Under the Staff-Monitored Program

Prepared by the Middle East and Central Asia Department

Approved by Amor Tahari and Matthew Fisher

November 19, 2004

- **Background**. Djibouti's macroeconomic performance and progress in adopting structural reforms under the 1999–2002 Poverty Reduction and Growth Facility (PRGF) arrangement was mixed. At the time of the 2003 Article IV consultation discussions (January 2004), Executive Directors considered that a period of solid policy performance would have to precede Board consideration of any successor arrangement. In May 2004, management approved a one-year staff-monitored program (SMP), covering the period January–December 2004. The staff report for the SMP was distributed to the Board for information and posted on the Fund's public's web site.

- **SMP**. The main objectives of the SMP are to (i) further strengthen the fiscal position; (ii) reduce domestic arrears in line with a 10-year reduction program in place; and (iii) establish a track record of policy implementation (based on the unfinished structural reform agenda under the previous PRGF arrangement), including the promotion of good governance and transparency.

- **Mission**. Discussions on the first review under the SMP covering performance through the end of June 2004 were held in Djibouti from September 5 to September 12, 2004. The staff team consisted of Messrs. Fasano (Head), Mikhael, and Peter (all MCD). Mr. Kumah (Resident Representative) assisted the mission and participated in the discussions. The mission met with the ministers of economy, finance, and planning; commerce and industry; and presidential affairs; the central bank governor; the general secretary of the government; other senior government officials; as well as representatives of the donor community, the private sector, and commercial banks.

- **Key review issues**. Fiscal performance was broadly on track through end-June 2004, and macroeconomic stability was maintained, but progress in implementing key structural reforms to enhance the country's competitiveness has been limited. The authorities remain optimistic that all the envisaged reforms can be implemented by year-end, including the new labor and investment codes. The attached letter of intent (LOI) and supplementary memorandum of economic and financial policies (MEFP) updates the authorities' program for the second half of the SMP.

- **The principal authors** of the report are U. Fasano, M. Mikhael, and E. Kumah.

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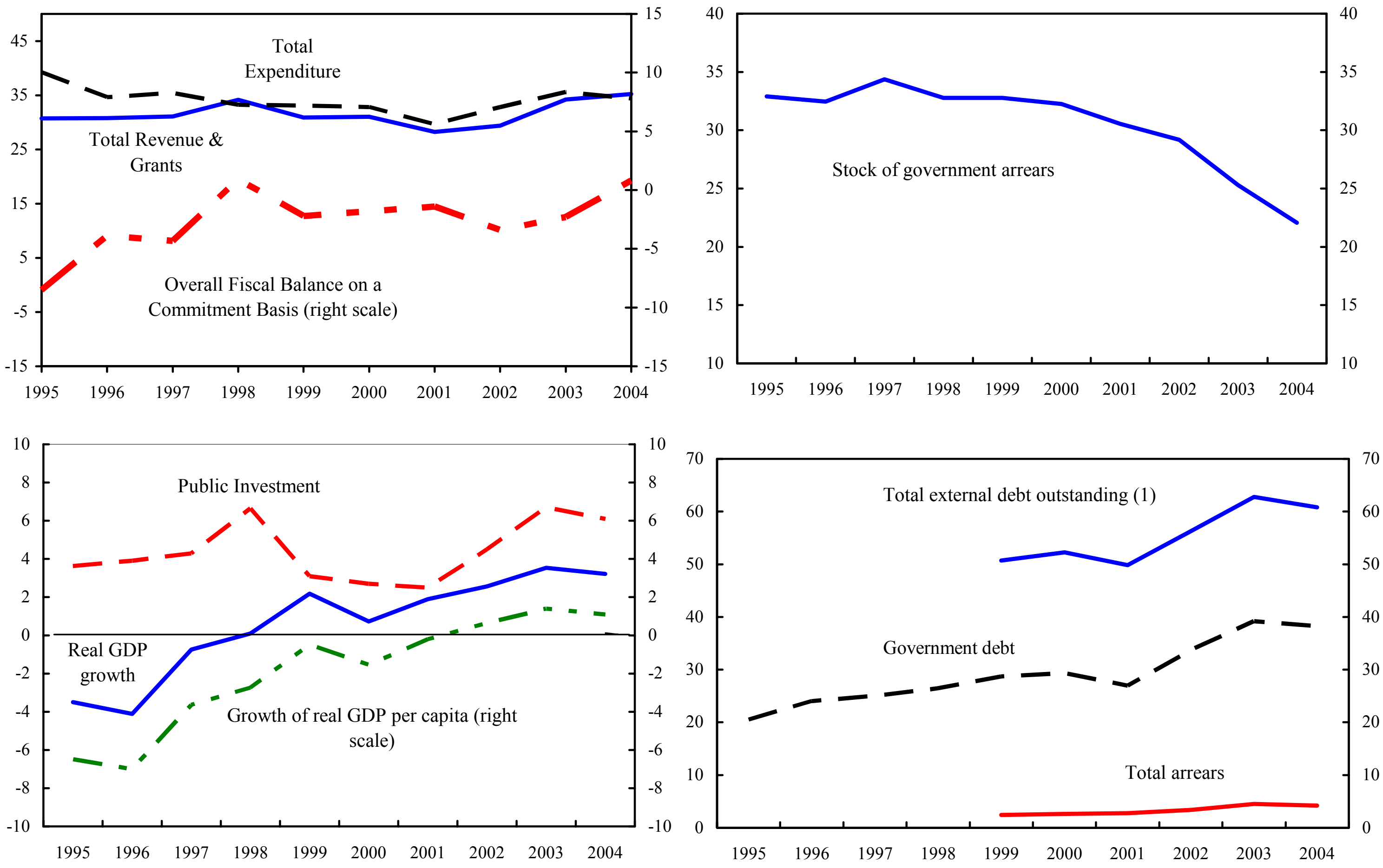
I. Background and Recent Developments

1. **Although Djibouti's macroeconomic performance improved in 2003, no progress was made in advancing structural reforms to improve the country's competitiveness**. The overall fiscal deficit (on a commitment basis, including grants) narrowed, government savings increased, and the clearance of domestic arrears accelerated (Figure 1 and Table 1). However, this improvement mainly reflected an important increase in revenue from new military cooperation agreements, notably with France and the United States, rather than a stronger fiscal effort, as nonpriority spending rose significantly. Amid low inflation, real GDP growth in Djibouti's service-oriented economy is estimated to have accelerated to 3.5 percent in 2003 from about 2 percent, on average, in 2001–02, owing to higher consumption (by the increased presence of foreign military personnel stationed in the country) and investment (owing to the construction of a new oil terminal mostly financed by foreign investors, and the establishment of a new public enterprise to distribute water in the southern part of the country) (Table 2). This led to a deterioration in the external current account deficit to 7.6 percent of GDP in 2003 from 6.8 percent in the previous year, with the external debt rising to about 63 percent of GDP by end-2003. Nevertheless, with population growing at about 2 percent a year, economic growth has remained inadequate over the past years for achieving meaningful poverty reduction and reducing high unemployment (officially estimated at over 50 percent). This has reflected limited progress in implementing structural reforms to enhance the country's competitiveness under the 1999–2002 PRGF arrangement. Moreover, the structure and effectiveness of public spending have not been conducive to an important improvement in social indicators, with limited progress made in moving toward a more pro-poor spending structure, despite the sharp increase in nonearmarked military-related revenue.

2. **Under the SMP, the authorities aimed at further strengthening the fiscal position, reducing domestic arrears, adopting a more pro-poor expenditure policy, and enhancing growth prospects.**[1] Program policies focus on improving tax collection, controlling the wage bill, reducing nonproductive spending, and strengthening the institutions responsible for formulating, executing, and monitoring the budget. Structural reforms seek to improve the country's competitiveness by enhancing labor market flexibility and streamlining procedures to promote investment through the adoption of new labor and investment codes, as well as by restructuring the power and water sectors with technical assistance from the

[1] The program's objectives are also consistent with the strategy set in Djibouti's full Poverty Reduction Strategy Paper (PRSP) (EBD/04/41, 5/6/04), which was approved by the Boards of the IMF and IDA in early June 2004, as well as with Fund Board recommendations made at the time of the 2003 Article IV consultation discussions (January 2004).

Figure 1. Djibouti: Selected Economic Indicators, 1995-2004
(In percent of GDP, unless otherwise indicated)



Sources: National Authorities, and IMF Staff estimates and projections.
1) Includes government and publicly-guaranteed debt and arrears.

World Bank. The promotion of good governance and transparency is also an important objective of the SMP, starting with the publication of the Chamber of Accounts and Fiscal Discipline's 2002 report (a prior action under the SMP),[2] social spending reports (structural benchmarks under the SMP), and the 2002 central bank accounts.

3. **During the first half of the year (January–June 2004) under the SMP:**

- **Macroeconomic stability was maintained**. Under the currency board arrangement, the average annual inflation rate remained low at 2.3 percent through end-June 2004, though inflation has accelerated since the second quarter on account of higher import prices, namely oil and food products. Economic growth was, however, weaker than expected, as transshipment activity declined by about 18 percent during the first half of 2004 from a year earlier, owing to bottlenecks in the container port that resulted from the rapid growth in this activity in the past few years and limited capacity. Investment in new port equipment is underway to address these bottlenecks.

- **Djibouti's consumer price index-based real effective exchange rate depreciated further through end-June 2004**. Reflecting relatively low domestic inflation, and the weakening in international markets of the U.S. dollar to which the local currency is pegged under the currency board arrangement, it depreciated by about 25 percent from its peak in 2001 (Figure 2).

- **Fiscal performance was broadly on track**. All end-March 2004 and most end-June fiscal targets were observed, except the ceiling on expenditure on goods, services, and transfers, which was 0.1 percent of GDP higher than projected under the program. Nonetheless, these expenditures fell by about 1.3 percent of GDP by end-June 2004 from a year earlier, while the wage bill remained constant in percent of GDP. Domestically financed spending not subject to a ceiling under the program increased by 0.5 percent of GDP over the same period, mostly on account of higher investment.[3] Stricter enforcement resulted in a significant increase in the collection of direct tax arrears, but overall domestic revenue collection declined slightly owing to: (i) a lower demand for some petroleum products; and (ii) cuts for socio-political reasons in excises levied on so-called "social petroleum products" (e.g., kerosene and

[2] The SMP was approved on the basis of the authorities' confirmation that the publication of the 2002 Chamber of Accounts and Fiscal Discipline report was approved in May 2004 and was expected to be published within the next 60 days (see Appendix II of Djibouti—Staff Monitored Program). However, the authorities indicated during the first review that the 2002 report will be posted in the Chamber's public website by end-October 2004. This has not been done yet.

[3] It is possible that some expenditure classified as investment should have been classified as transfers, particularly transactions related to the newly created water public company.

diesel)[4] in order to smooth the increase in retail prices of higher world oil prices. The overall fiscal deficit (on a commitment basis, including grants) declined to 0.2 percent of GDP through end-June 2004 from 1 percent a year earlier, and the basic fiscal deficit—an indicator of the government's fiscal effort—to 2.1 percent of GDP from 2.5 percent over the same period.[5]

- **The authorities cleared more domestic arrears than initially planned**, with much of this decline taking place in the first quarter of 2004.

- **External payment arrears to multilateral institutions were cleared**. The government and public enterprises have continued to accumulate arrears to bilateral donors, notably Italy and Spain, but only on disputed debt.

  The end-March and end-June indicative targets of net banking system financing to the government were missed, mostly owing to a larger-than-expected drawdown in government deposits at the central bank in part to repay external debt.[6] Nevertheless, the slippage was relatively small in percent of broad money, and as a result, net claims on the government accounted for only 0.3 percent of broad money supply growth through end-June 2004 (Table 4). The floor on net international reserves ($10 million) was also missed—albeit by a relatively small margin. Meanwhile, banking credit to the private sector and public enterprises declined further through end-June 2004—a trend observed since 2001—as banks seem to remain reluctant to increase credit in an environment of high nonperforming loans (about 26 percent of total loans), and long delays in pursuing delinquent borrowers in court.

4. **The latest available information shows that Djibouti's fiscal performance was mixed in July 2004**. Nonwage domestically financed spending rose significantly in that month when compared to the average monthly expenditure level for the first half of the year. In particular, expenditure on goods and services increased by about 34 percent (leading to a net accumulation of domestic arrears to the private sector) and maintenance and investment,

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[4] The government regulates domestic fuel prices, but it has avoided subsidizing them, even the so-called "social petroleum products." Tax and nontax revenue on petroleum products declined by 14 percent in nominal terms in the first half of 2004 relative to the same period in 2003. Their overall volume fell by 6 percent over the same period, despite an almost 8 percent increase in the volume of social petroleum products.

[5] The basic fiscal balance is defined as the overall fiscal balance (on a commitment basis) excluding grants, foreign-financed expenditure, and military-related transactions (revenue as well as tied expenditure).

[6] Under the currency board arrangement in place since the 1940s, the central bank cannot lend to the government. The authorities have also refrained from borrowing long term from commercial banks.

Figure 2. Djibouti: Real Effective Exchange Rate Index, January 1990–July 2004
(1990=100)

Sources: National authorities; and IMF, Information Notice System.

by 26 percent.[7] On the revenue front, the July data confirm the continuing decline in the collection of petroleum products receipts, as the authorities reduced surcharges and excises to mitigate the social impact of rapidly rising world oil prices, leading to a deterioration in the basic fiscal deficit by 0.8 percent of GDP to 2.9 percent at end-July 2004. Notwithstanding this deterioration, the overall fiscal deficit (on a commitment basis) remained at 0.2 percent of GDP through end-July 2004 (as was the case through end-June 2004), reflecting the military-related disbursement made by France in July under the 10-year agreement (Table 3).

5. **Preliminary monetary data through the end of September 2004 show that several monetary indicative targets were not observed**. The target of central bank international reserves was missed by $0.6 million relative to its floor of $10 million, and net central bank credit to the government by DF722 million (equivalent to about 0.6 percent of GDP), as the government continued to draw down its deposits at the central bank. The authorities observed for the first time under the SMP the target on commercial banks' net credit to the government. As a result, overall net banking system credit to the government accounted for only 0.5 percent of broad money supply growth through end-September 2004, amid rapidly increasing commercial banks' net foreign assets. This rapid increase in net foreign assets has reflected further improvements in the liquidity position of households, as wages in the public sector have been paid on time, and a further decline in credit to the nongovernment sector.

6. **Limited progress has been made in implementing structural reforms, in particular those to improve the country's competitiveness**. The end-March structural benchmark (the reorganization of the ministry of finance) was implemented with some delay (Table 2, Attachment II). Only two (out of eight) end-June structural benchmarks were adopted: the enactment of the Free-Zone Law, and the publication of a report on priority social expenditure posted on the ministry of finance's public web site. The demobilization of ex-combatants was partially adopted, with 171 being demobilized instead of the planned 250. None of the other end-June structural measures were implemented, including the new labor and investment codes. On a similar note, the adoption of the unification and simplification of the tax exempt regime (a key end-September structural benchmark) was postponed until the end of the year. In contrast, the central bank put in place a regulatory framework for microfinance ahead of schedule. The authorities have complied with the continuous structural benchmarks, such as the monthly cash-flow management plan, but there have been some delays lately in reporting fiscal data and providing detailed information on current expenditure.

[7] No detailed information was made available to explain the increase in goods and services in July 2004.

II. Policy Discussions

7. **The policy discussions centered on the need to sustain the improvement in the country's fiscal position in the remainder of the year and steadfast structural reforms to create the basis for sustainable growth**. The staff reiterated that a satisfactory implementation of the policies and reforms under the SMP was needed to further enhance donors' support to achieve the country's development goals and allow for the start of discussions on a possible successor PRGF arrangement next year.

A. The Macroeconomic Framework and Policies

8. **Real GDP growth in 2004 is expected to remain slightly above population growth for the second consecutive year (Table 1)**. As a result of the decline in transshipment port activity, however, growth was revisited downward from 4.1 percent to 3.2 percent. The authorities indicated that they expect a gradual recovery in transshipment port activity in the coming months, as the bottlenecks in the current port facility are being addressed. They also noted that large foreign direct investment (FDI) underway to build a new oil terminal (first phase of the development of a new port site to be completed in May 2005) should sustain economic activity in the period ahead. Average consumer prices are projected to rise by almost 3 percent in 2004 in light of higher import prices and the depreciation of the local currency. Despite high world oil prices, the external current deficit may only be slightly larger than in 2003, reaching 8 percent of GDP, as a result of an increase in the net service and income surplus (Table 5). The overall balance of payments is expected to record a surplus for the fourth consecutive year, owing to rising FDI and other net capital inflows.

9. **Under the supplementary 2004 budget, the authorities target a slightly larger overall fiscal surplus to reduce domestic arrears in line with SMP objectives**.[8] Despite lower revenue from petroleum products and nonearmarked grants, government saving is expected to reach 3.4 percent of GDP in 2004 owing to higher military-related revenue (Table 6). Domestically financed spending on maintenance and investment, which is not subject to a ceiling under the SMP, should increase somewhat relative to the 2004 budget Although as a result of these developments, the basic fiscal deficit is projected to be 0.9 percent of GDP worse than initially programmed, when compared to 2003's outcome, this deficit is likely to decline, reflecting lower overall domestically-financed spending. The supplementary 2004 budget has maintained the initial targets for central bank and commercial banks financing of the government.

10. **The authorities agreed with the staff that continued restraint of domestically financed government current expenditure is essential to the success of the SMP and to maintain a stable macroeconomic environment**. Accordingly, the 2004 supplementary

[8] The supplementary 2004 budget is currently under consideration by the National Assembly. Presidential directives were already issued in September in line with the supplementary budget's objectives.

budget law kept the ceiling on spending on goods, services, and transfers within the targeted level under the SMP, despite recent slippages. In addition, it instituted a freeze on new hiring in the second half of the year, which will lead to a decline in the wage bill to 13.4 percent of GDP from 14.2 percent in 2003 (Table 6). In line with SMP objectives, expenditure structure is expected to become more pro-poor and pro-growth in 2004 (Box 1).

11. **The staff urged the authorities to keep up efforts to avoid any further deterioration in tax and nontax revenue in the second half of the year.** In this context, the staff cautioned the authorities on smoothing retail petroleum prices and granting ad hoc tax exemptions to imports.[9] The authorities stressed that their intention is to avoid subsidizing petroleum products, but a rapid pass-through of rising world oil prices could significantly worsen the social conditions in the country. They also indicated that several steps have been taken to improve domestic revenue collection in the second half of 2004. These include tightening border controls to reduce smuggling activities of alcohol and tobacco; launching the initial phase of the integrated computerized system for customs for Djibouti; and agreeing with the port authorities to pay the port dividends owed to the government within the current calendar year. The staff supports the authorities' request for technical assistance (TA) from the Fund to implement a value-added tax (VAT) in 2006–07, and a TA mission is tentatively scheduled to take place in early 2005.

B. Structural Reforms

12. **The authorities are optimistic that all envisaged structural reforms under the SMP could be implemented by year-end.** They stressed that the delays encountered in adopting these reforms reflected a challenging reform agenda, and the need to build up the necessary political consensus. The new labor code has been recently approved by the cabinet, while the unification of the registry of civil servants and the computerization of direct tax administration are moving forward. A World Bank mission took place recently to discuss plans to restructure the power and water sectors (Table 2, Attachment II). Following recommendations made in the joint staff assessment of the PRSP (EBD/04/44, 05/13/2004), the authorities are prioritizing an ambitious list of public investment projects proposed in the PRSP as well as strengthening the mechanisms to evaluate them.

13. **The staff welcomed the authorities' commitment to adopt all the planned structural reforms under the SMP by year-end**. Following the recent creation of a free zone, it stressed that these reforms are essential to consolidate the improvement in the country's competitiveness and maintain the attractiveness of investing in the rest of the country, otherwise the authorities risk keeping Djibouti in a low growth path and creating an

[9] Tax exemptions on imports under the investment code increased from 1.6 percent of total investment in the first half of 2003 to 12 percent a year later; and exemptions granted by decree (ad hoc) from 4.6 percent to 7 percent over the same period.

unbalanced regional growth.[10] The private sector was also concerned with the investment bias that has been created under the new Free-Zone Law.

14. **On the financial sector,** the staff welcomed the progress made in putting in place an appropriate regulatory framework for microfinance. The authorities informed the mission that the revised banking law and central bank charter (an end-June structural benchmark) were sent at end-September to the cabinet; and the National Assembly is expected to approve them before the end of the year. **On external policy issues**, the staff welcomed the elimination of external arrears to multilateral organizations and encouraged the authorities to seek resolution on disputed debts to bilateral donors in order to maintain full support from the international community—a round table is tentatively scheduled in January 2005.

15. **The staff noted the recent improvement in Djibouti's statistical system**. In particular, new balance of payments data, in line with the fifth Edition of the *Balance of Payments Manual* and recommendations made by Fund technical assistance, were recently completed. The revised current account balance is now showing surpluses for most years since 1991, mainly on account of revised data on imports of goods and services (Appendix III).[11] As a result of improvements in the external debt database, the outstanding stock of external debt at end-2003 was revised downward by about $41 million. The ministry of finance's public web site was recently upgraded, posting a wide range of economic and financial information. However, important deficiencies remain in the country's statistical system, particularly in the national accounts, in part owing to lack of adequate human resources. The staff encouraged the authorities to submit the metadata as soon as possible to complete the country's participation in the General Data Dissemination System (GDDS).

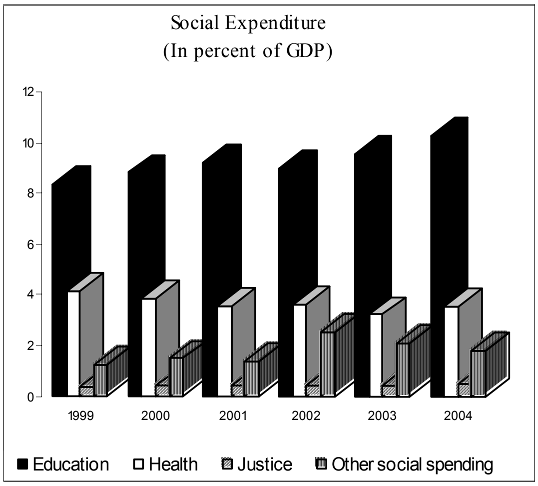
[10] A comprehensive analysis of the competitiveness of the Djibouti economy is planned for the 2005 Article IV consultation discussions expected to take place next February.

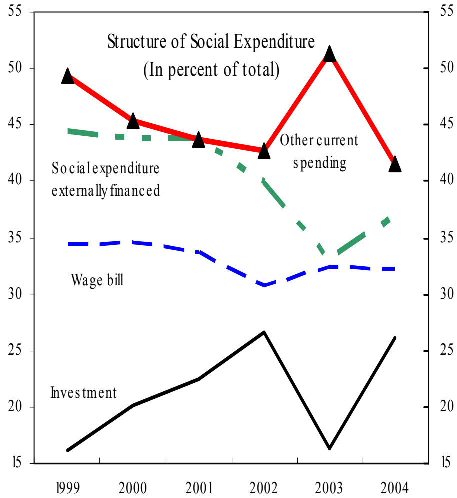
[11] The revised balance of payments data were not reflected in the staff report tables because a revision of the national accounts, taking into account the new balance of payments statistics, has not been completed yet.

Box 1. Djibouti: Social Spending

The authorities recently posted in the ministry of finance's public web site a preliminary study on social spending in Djibouti covering the period 1999–2004, based on revised budget data and also actual data for the first half of 2004. The study indicates that social spending increased from about 14 percent of GDP in 1999 to slightly above 15 percent in 2003 and is expected to rise further this year (to about 16 percent), with the rise equally divided between current spending and investment. In terms of sectors, much of this increase reflected higher spending on education, which is likely to reach 10 percent of GDP in 2004 (or 63 percent of social spending), in line with the 10-year strategy (2000–10) to promote education. In contrast, expenditure on health presented a downward trend through 2003, mostly as a result of the retirement of health workers. Spending on justice and sanitation has remained extremely low at less than 0.5 percent of GDP over the past years. These figures indicate that spending on education and health are relatively higher than the average for other low-income countries, though Djibouti's human development is among the lowest in the world.

The composition of social spending has improved over the period. The share of investment in social spending is expected to rise to 26 percent in 2004 from 16 percent in 1999. However, the wage bill and transfers (which includes nonwage benefits, such as housing) have continued to account for more than 80 percent of current social spending, leaving little for nonwage expenses. The financing composition of social spending has also changed over time. The government has fully financed the increase in current social spending from 1999 to 2004, and about one-third of the increase in investment. As a result, social spending externally financed is expected to decline to 37 percent of total in 2004—though it should remain at about 6 percent of GDP (the average level observed from 1999 to 2004). Higher military-related revenue since 2002 has given room to the government to increase domestically financed social spending.





Source: National authorities.

III. Program Risks and Monitoring

16. **Downside risks to the program remain important**. Implementing the structural reform agenda will require more determined efforts by the authorities, including a clear sense of ownership within the government to fully support the planned reforms. Nevertheless, the upcoming presidential elections (scheduled for April 2005) could limit policy reforms and expenditure control, as happened in previous election years. Thus, the next months will test the authorities' commitment to successfully completing the SMP. Key donors have conditioned nonearmarked budgetary aid to good performance under the SMP and a Fund-supported program.

17. **The staff will continue to monitor the SMP on a quarterly basis using quarterly indicative targets, structural benchmarks, and reviews**. A second review mission is envisaged for the end of November 2004, based on performance at end-September 2004, and a third review in February 2005, in parallel with the 2005 Article IV consultation discussions, based on performance at end-2004.[12]

IV. Staff Assessment

18. **Djibouti's progress in establishing a strong track record of policy reforms and implementation under the SMP was mixed through end-June 2004**. Fiscal policy was in line with the program's objectives through end-June 2004, the stock of domestic arrears declined more than initially planned, and external arrears to multilateral institutions were cleared. Although the indicative targets of net banking system credit to government were not observed, its contribution to broad money supply has been low, amid rapidly rising net foreign assets. However, most importantly, no progress was made in implementing longstanding structural reforms, in particular those to improve the country's competitiveness. Moreover, if July's fiscal trend of declining domestic revenue and rising domestically financed expenditure continues in the rest of the year, it could lead to an important deterioration in the fiscal accounts, jeopardizing the program's fiscal objectives for the second half of the 2004. Thus, a continuation of the track record established to date would not provide an adequate basis for moving to a PRGF arrangement at the end of the SMP.

19. **The staff welcome the authorities' commitment to keep expenditure under control in line with the SMP's objectives**. In this context, the supplementary 2004 budget has kept the ceiling on spending on goods, services, and transfers within the targeted level under the SMP, despite recent slippages. The increase in public investment envisaged in the rest of 2004 will need to have a clear impact on the poor in line with PRSP objectives. On the revenue front, the staff cautioned the authorities on smoothing retail petroleum prices and granting ad hoc tax exemptions to imports. These policies could offset efforts underway to improve revenue collection in other areas, hindering the objective of reducing domestic

[12] Since the beginning of 2004, the authorities have agreed to publish in the IMF's public web site all Fund documents on Djibouti.

arrears as initially budgeted, despite the sharp decline in nonearmarked budgetary aid expected in 2004. The staff support the authorities' request for technical assistance to adopt a value-added tax (VAT).

20. **Determined efforts by the authorities are needed to implement the longstanding structural reforms planned under the SMP**. The staff recognize the difficulties in adopting a challenging reform agenda and the need to achieve a political consensus. Without a satisfactory implementation of these reforms and achieving the quantitative targets, the authorities would not build the necessary strong track record of policy implementation to start discussions on a possible successor PRGF arrangement , and considerations would need to be given to a possible extension of the SMP.

Table 1. Djibouti: Selected Economic and Financial Indicators, 2001–04

Population (2003) 710000
GDP per capita (2003) USD 881

	2001	2002	Est. 2003	Proj. 2004
National income and prices				
Nominal GDP (in millions of Djibouti francs)	101,932	105,210	111,070	117,862
Real GDP per capita (annual change in percent)	-0.2	0.6	1.4	1.1
Real GDP (annual change in percent)	1.9	2.6	3.5	3.2
Consumer prices (annual average)	1.8	0.6	2.0	2.8
		(In percent of GDP)		
Investment and Saving				
Investment	8.3	10.9	15.5	18.3
Of which: Private investment 1/	5.8	6.5	8.8	12.3
National saving	2.7	4.1	7.9	10.3
Central government operations				
Total revenue and grants	28.2	29.4	34.2	35.2
Of which: Tax revenue	20.5	21.1	20.6	19.8
Total expenditures	29.6	32.9	36.5	34.4
Of which: Investment expenditures	2.5	4.5	6.7	6.1
Overall balance (on a commitment basis)	-1.4	-3.5	-2.3	0.8
Change in total arrears (decrease -)	-0.6	-0.7	-2.7	-1.8
Overall balance (cash basis)	-2.0	-4.2	-5.0	-0.9
Total gross public debt 2/	82.4	88.5	91.4	85.8
Of which: Stock of domestic arrears 3/	29.3	27.8	23.6	20.4
Basic fiscal balance 4/	...	...	-4.2	-3.0
		(Change from preceding December; in percent of broad money)		
Money and credit				
Broad money	7.5	15.7	17.8	13.3
Net foreign assets	16.1	15.7	19.4	14.0
Net domestic assets	-8.6	0.0	-1.6	-0.7
Of which				
Claims on the central government (net)	1.1	2.8	0.5	-0.4
Claims on nongovernment sector	-8.2	-2.9	-1.2	-0.8
		(In millions of USD)		
External sector				
Current account	-32.0	-40.1	-47.4	-52.8
(in percent of GDP)	-5.6	-6.8	-7.6	-8.0
Trade balance	-187.4	-204.1	-249.2	-283.0
Exports, f.o.b.	75.7	82.5	89.0	89.8
Imports, f.o.b.	263.1	286.6	338.2	372.8
Net services and income	122.7	123.4	158.1	173.9
Capital account	10.2	34.9	59.7	69.1
Overall balance	39.9	48.0	65.2	60.7
Official external debt after rescheduling (in percent of GDP) 5/	49.8	56.3	62.8	60.8
Debt service to exports of goods and services 6/				
Obligations basis after rescheduling	7.3	7.4	7.9	7.5
Memorandum items:				
Currency board cover (in percent) 7/	115.8	114.9	113.8	114.3
Exchange rate (DF/US$) end-of-period	177.7	177.7	177.7	…
Real effective exchange rate				…
(End-year change in percent; depreciation -) 8/	3.3	-8.4	-11.5	-3.7

Sources: Djibouti authorities; and IMF staff estimates and projections.

1/ The increase in 2003 and 2004 reflects the start of construction of the oil terminal and new port facility and free zone.

2/ The ratio of total debt to GDP has declined because the government has been paying domestic arrears in the last few years and external debt data were recently revised downward by the authorities.

3/ Domestic arrears include wage arrears and arrears to private and public suppliers for goods and services, and to the pension fund.

4/ Basic fiscal balance is defined as the overall fiscal balance (on a commitment basis) excluding grants, military related transactions, and foreign financed expenditures.

5/ Public- and publicly guaranteed debt of the central government and public enterprises.

6/ Exports of locally produced goods and nonfactor services.

7/ Gross foreign assets of the Central Bank of Djibouti (CBD), in percent of monetary liabilities (reserve money and government deposits at CBD).

8/ Data through end-July 2004 in percent change over end-December 2003.

Table 2. Djibouti: Contribution to Nominal GDP Growth, 2001–04

(In percent)

	2001	Est. 2002	Est. 2003	Proj. 2004
Nominal GDP growth	100.0	100.0	100.0	100.0
Total consumption	47.3	81.7	125.3	100.4
Nongovernment	87.8	16.0	83.4	107.5
Government	-40.5	65.7	41.9	-7.1
Gross investment	-99.1	93.4	98.5	63.9
Nongovernment	-96.0	27.2	51.7	68.2
Government	-3.1	66.2	46.8	-4.3
Net exports	151.8	-75.1	-123.8	-64.3

Sources: Djibouti authorities; and Fund staff estimates and projections.

Table 3. Djibouti: Fiscal Developments, June–July 2004

(In percent of GDP)

	June 2004	Change in June 2004 relative to June 2003	July 2004	Change in July 2004 relative to July 2003
Total revenue and grants	16.4	0.8	20.1	2.0
Domestic revenue	10.9	-0.1	12.4	-0.6
Tax revenue	9.9	0.1	11.3	-0.1
Of which : Surcharges on petroleum products	0.2	-0.1	0.2	-0.2
Non-tax revenue	1.0	-0.2	1.1	-0.5
Of which : Excises on petroleum products	0.5	-0.2	0.6	-0.3
Military-related revenue	3.0	0.4	4.1	1.5
Grants	2.5	0.5	3.6	1.1
Of which : Nonearmarked	0.0	-0.2	0.0	-0.2
Domestically-financed expenditure	13.0	-0.8	15.2	-0.4
Subject to a ceiling under the SMP	11.5	-1.3	13.4	-1.1
Wage bill	6.8	0.0	7.8	0.1
Goods, services, and transfers	4.7	-1.3	5.6	-1.3
Not subject to a ceiling under the SMP	1.5	0.5	1.8	0.7
Maintenance	0.4	0.2	0.5	0.2
Capital expenditure	0.8	0.3	1.0	0.4
Interest payments	0.2	0.0	0.3	0.1
Overall fiscal balance (on a commitment basis) 1/	-0.2	0.8	-0.2	2.2
Basic fiscal balance 1/ 2/	-2.1	0.4	-2.9	-0.8

Sources: National authorities; and IMF staff estimates.

1/ Positive change = decline in the deficit.
2/ Defined as overall fiscal balance (on a commitment basis), excluding grants, earmarked military-related transactions, and externally-financed spending.

Table 4. Djibouti: Balance of Payments, 2001–04

(In millions of U.S. dollars; unless otherwise indicated)

	2001	2002	Est. 2003	Proj. 2004
Current account (including grants)	-32.0	-40.1	-47.4	-52.8
(In percent of GDP)	-5.6	-6.8	-7.6	-8.0
Trade balance	-187.4	-204.1	-249.2	-283.0
Exports, f.o.b.	75.7	82.5	89.0	89.8
Of which:				
Locally produced goods	14.0	15.3	17.0	18.3
Imports, f.o.b. 1/	263.1	286.6	338.2	372.8
Services and income (net)	122.7	123.4	158.1	173.9
Services (net)	110.1	113.0	117.2	126.5
Income (net) 2/	12.6	10.4	40.9	47.4
Unrequited transfers	32.7	40.6	43.6	56.3
Private (net)	-5.9	-3.7	-3.7	-3.5
Official (net)	38.6	44.4	47.3	59.8
Capital account	10.2	34.9	59.7	69.1
Foreign direct investment 3/	2.2	5.0	21.4	51.7
Public sector (net)	7.9	29.9	38.3	17.5
Errors and omissions (including other private capital)	61.7	53.2	52.9	44.4
Overall balance (deficit -)	39.9	48.0	65.2	60.7
Financing	-39.9	-48.0	-65.2	-60.7
Monetary movements (increase -)	-47.6	-49.8	-77.7	-60.7
Central bank 4/	-0.4	-4.5	-26.3	2.3
Of which:				
Liabilities to the IMF	-2.6	-1.0	-0.4	-0.3
Commercial banks	-47.2	-45.3	-51.4	-63.0
Exceptional financing 5/	7.7	1.8	12.6	0.0
Memorandum items:				
Central bank gross foreign assets	70.3	74.5	100.9	97.9
In number of months of imports 6/	3.1	3.1	3.5	3.1
Official external debt 7/				
In millions of U.S. dollars	285.8	333.2	392.3	403.2
In percent of GDP	49.8	56.3	62.8	60.8

Sources: Data provided by the authorities; and Fund staff estimates and projections.

1/ The increase in imports during the projection period reflects rising investment on the oil terminal and on both the new port facility and free zone.

2/ Includes the U.S. rent of a military base and the French tax compensation.

3/ Reflects FDI on oil terminal, and new port facility and free zone.

4/ Excluding disbursements from the IMF and AMF in 2001 and 2002.

5/ Includes both changes in overdue and non-overdue obligations, secured debt relief, and program financing from IMF, AMF, World Bank, and AfDB.

6/ Imports of goods for domestic use and nonfactor services.

7/ Revised data.

Table 5. Djibouti: Central Government Fiscal Operations, 2001- 04

(In millions of Djibouti francs)

	2001	2002	Est. 2003	Initial Prog. 2004	Proj. 1/ 2004
Revenues and grants	28,774	30,947	37,962	41,796	41,485
Domestic revenue	23,702	24,720	25,637	26,727	25,918
Tax revenue	20,862	22,164	22,928	23,621	23,310
Direct taxes	9,248	9,804	10,281	10,705	10,755
Indirect taxes	11,614	12,360	12,647	12,916	12,555
Nontax receipts	2,840	2,556	2,709	3,107	2,608
Military related revenue	...	...	5,583	4,896	6,596
Grants	5,072	6,227	6,742	10,173	8,971
Of which : nonearmarked grants	876	1,042	1,350	1,100	220
Total expenditure	30,215	34,659	40,490	41,013	40,497
Current expenditure	27,688	29,964	33,054	33,151	33,353
Wages and salaries 2/	14,804	14,721	15,819	15,943	15,848
Goods and services	4,709	6,544	7,992	7,421	7,313
Of which : Foreign financed military expenditure	360	360	1,517	1,517	1,517
Maintenance	515	606	480	650	725
Transfers	3,533	3,717	4,203	4,350	4,808
Interest	301	239	389	535	563
Foreign-financed current spending	3,826	3,774	3,471	3,902	4,096
Investment expenditure	2,527	4,695	7,436	7,862	7,144
Domestically-financed	709	1,371	2,224	1,619	1,800
Foreign-financed	1,818	3,324	5,212	6,243	5,344
Overall balance (on a commitment basis, including grants)	-1,441	-3,713	-2,528	783	988
Change in arrears (cash payments = -)	-605	-695	-3,031	-2,165	-2,097
Of which : Domestic arrears	-631	-658	-3,065	-2,165	-2,097
Overall balance (cash basis)	-2,046	-4,407	-5,558	-1,382	-1,109
Financing	2,046	4,407	5,468	1,382	1,109
Domestic financing (net)	598	1,578	211	-415	-414
Bank financing	598	1,578	307	-319	-318
Central bank	579	146	476	-131	-131
Commercial banks	19	1,432	-169	-187	-187
Nonbank financing	0	0	-96	-96	-96
External financing (net)	1,447	2,829	5,257	1,797	1,523
Disbursements	1,808	3,494	5,697	2,571	2,297
Amortization payments	-361	-665	-440	-774	-774
Memorandum items:					
Basic fiscal balance 3/	...	...	-4,653	-2,446	-3,531
Government savings 4/	218	285	3,438	4,103	4,019
Domestic revenue 5/	23,702	22,620	25,637	26,727	25,918
Domestically-financed expenditure	24,003	26,847	30,290	29,173	29,449
Current expenditures	23,294	25,476	28,066	27,554	27,649
Capital expenditures	709	1,371	2,224	1,619	1,800
Grants in percent of total revenue	17.6	20.1	17.8	24.3	21.6
Foreign-financed spending in percent of total spending	19.9	21.5	25.2	28.4	27.1

Table 5. Djibouti: Central Government Fiscal Operations, 2001- 04 (concluded)

(In percent of GDP)

	2001	2002	Est. 2003	Initial Prog. 2004	Proj. 1/ 2004
Revenues and grants	28.2	29.4	34.2	35.5	35.2
Domestic revenue	23.3	23.5	23.1	22.7	22.0
Tax revenue	20.5	21.1	20.6	20.0	19.8
Direct taxes	9.1	9.3	9.3	9.1	9.1
Indirect taxes	11.4	11.7	11.4	11.0	10.7
Nontax receipts	2.8	2.4	2.4	2.6	2.2
Military related revenue	...	...	5.0	4.2	5.6
Grants	5.0	5.9	6.1	8.6	7.6
Of which : Nonearmarked grants	0.9	1.0	1.2	0.9	0.2
Total expenditure	29.6	32.9	36.5	34.8	34.4
Current expenditure	27.2	28.5	29.8	28.1	28.3
Wages and salaries 2/	14.5	14.0	14.2	13.5	13.4
Goods and services	4.6	6.2	7.2	6.3	6.2
Of which : Foreign financed military expenditures	0.4	0.3	1.4	1.3	1.3
Maintenance	0.5	0.6	0.4	0.6	0.6
Transfers	3.5	3.5	3.8	3.7	4.1
Interest	0.3	0.2	0.4	0.5	0.5
Foreign-financed current spending	3.8	3.6	3.1	3.3	3.5
Investment expenditure	2.5	4.5	6.7	6.7	6.1
Domestically-financed	0.7	1.3	2.0	1.4	1.5
Foreign-financed	1.8	3.2	4.7	5.3	4.5
Overall balance (on a commitment basis, including grants)	-1.4	-3.5	-2.3	0.7	0.8
Change in arrears (cash payments = -)	-0.6	-0.7	-2.7	-1.8	-1.8
Domestic arrears	-0.6	-0.6	-2.8	-1.8	-1.8
Overall balance (cash basis)	-2.0	-4.2	-5.0	-1.2	-0.9
Financing	2.0	4.2	4.9	1.2	0.9
Domestic financing (net)	0.6	1.5	0.2	-0.4	-0.4
Bank financing	0.6	1.5	0.3	-0.3	-0.3
Nonbank financing	0.0	0.0	-0.1	-0.1	-0.1
External financing (net)	1.4	2.7	4.7	1.5	1.3
Disbursements	1.8	3.3	5.1	2.2	1.9
Amortization payments	-0.4	-0.6	-0.4	-0.7	-0.7
Memorandum items:					
Basic fiscal balance 3/	...	...	-4.2	-2.1	-3.0
Government savings 4/	0.2	0.3	3.1	3.5	3.4
Domestic revenue 5/	23.3	21.5	23.1	22.7	22.0
Domestically-financed expenditure	23.5	25.5	27.3	24.8	25.0
Current expenditures	22.9	24.2	25.3	23.4	23.5
Capital expenditures	0.7	1.3	2.0	1.4	1.5
GDP at market prices (in millions of Djibouti francs)	101,932	105,210	111,070	117,862	117,862

Sources: Djibouti authorities; and Fund staff estimates and projections.

1/ These projections are consistent with the 2004 supplementary budget.
2/ Includes severance payments to military personnel being demobilized.
3/ Basic fiscal balance is defined as the overall balance on a commitment basis excluding grants, earmarked military related transactions, and foreign financed expenditures.
4/ Defined as domestic revenue plus nonearmarked grants and military related revenues minus domestically financed current expenditure.
5/ Following a new military agreement with France, there is a break in the revenue series from 2003 onward. Before that date, all military related receipts from France were part of the tax and nontax revenue, while afterwards, only part of the payment is.

DJIBOUTI: RELATIONS WITH THE FUND
(As of September 30, 2004)

I. Membership Status: Joined: December 29, 1978; Article VIII

II. General Resources Account:

	SDR million	Percent of Quota
Quota	15.90	100.00
Fund holdings of currency	14.80	93.08
Reserve position in Fund	1.10	6.92

III. SDR Department:

	SDR million	Percent of Allocation
Net cumulative allocation	1.18	100.00
Holdings	0.05	4.02

IV. Outstanding Purchases and Loans:

	SDR million	Percent of Quota
PRGF arrangements	13.63	85.72

V. Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
PRGF	10/18/1999	01/17/2003	19.08	13.63
Stand-by	04/15/1996	03/31/1999	8.25	7.27

VI. Projected Obligations to the Fund
(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2004	2005	2006	2007	2008
Principal		0.55	1.09	1.82	2.73
Charges/Interest	0.04	0.09	0.09	0.08	0.07
Total	0.04	0.64	1.18	1.90	2.79

VII. Implementation of HIPC Initiative: Not Applicable.

Safeguards assessments

Under the Fund's safeguards assessment policy, the Central Bank of Djibouti (BCD) is subject to the transitional procedures with respect to the PRGF arrangement, which was approved on October 18, 1999 and expired on January 17, 2003. The transitional procedures require a review of only the BCD's external audit mechanism. This assessment determines whether the BCD publishes annual financial statements that are independently audited in accordance with internationally accepted standards.

The last external audit assessment was completed on July 24, 2001. The assessment concluded that the BCD's current external audit mechanism may not be compliant with the international auditing standards promulgated by the International Federation of Accountants, and recommendations had been made to the authorities, as reported in "Djibouti: Report on the External Audit Mechanism." In response to staff recommendations, the BCD hired, in August 2002, external auditors from Ernst & Young to audit the 1999, 2000, and 2001 accounts. This audit was completed by end–2002. The 1999–2001 audited financial statements have recently been transmitted to the Fund, but the authorities do not intend to publish them at this stage.

Since 2003, the BCD has its accounts audited on a yearly basis in accordance with international auditing standards. The audit of the 2002 financial statements was completed by Ernst & Young at end-2003 and published in the *Journal Officiel* of August 31, 2004. The accounts of 2003 were audited in June 2004.

Exchange arrangements

Djibouti has a currency board arrangement. The Djibouti franc is pegged to the U.S. dollar at the rate of DF 177.721 = $1. Djibouti maintains an exchange system that is free of restrictions on payments and transfers for all international current and capital transactions.

Article IV consultation

Djibouti is on an annual consultation cycle. Discussions for the 2003 Article IV consultation were held in Djibouti from February 21 to March 7 and July 13 to 20, 2003. The staff report, the selected issues paper, and the statistical appendix were discussed by the Executive Board on January 7, 2004, and posted on the IMF's public web site, together with a Public Information Notice, on March 19, 2004.

FSAP participation, ROSC, and OFC assessment

Djibouti has not participated in any of the above-mentioned exercises.

Technical assistance

FAD—Budget control and cash management of the treasury	April 2000
FAD—Direct tax reform	September 2000
FAD/MCD—Budget control and cash management of	February 2001

the treasury	
FAD—Tax administration and possible introduction of a VAT	April 2002
STA—Government finance statistics	May 2001
STA—National accounts and balance of payments statistics	January 2002
STA—Balance of payment statistics	November 2003
MFD—Banking supervision	December 2002
MFD—Banking supervision	December 2003

Resident representative

A resident representative has been stationed in Djibouti since October 1998.

DJIBOUTI: RELATIONS WITH THE WORLD BANK

The World Bank (the Bank) has been more active in Djibouti since the start of the last Country Assistance Strategy (CAS) process in 2000. The strategic focus of the CAS (FY 01–04) was to support the government's effort to reduce poverty by:

(i) giving priority to reversing one of the lowest rates of school enrollment in the world, addressing the deteriorated health situation, in particular in the critical area of HIV/AIDS, and promoting more direct support programs to the poor through an active public works and community service program;

(ii) reestablishing and consolidating fiscal stability and improving economic competitiveness through pension system reform, wage bill reduction, preparation of public enterprises for privatization; and

(iii) rehabilitating infrastructure and services related to the port as the main source of growth.

The assistance program under the existing CAS is comprised of five credits and one supplemental credit in support of the following areas:

- In the social area, the program is comprised of a school access and improvement project; a health sector development project; an HIV/AIDS, malaria and tuberculosis control project; a social development project to improve the social safety net; and recently approved flood emergency rehabilitation project to alleviate the problems of the affected families by the flood. Implementation and results of these projects are satisfactory. The school access and improvement project will be implemented a year ahead of schedule. The gross enrolment rate has reached 52 percent compared to 39 percent at the start of the project in 2001.

- In support of growth, a supplemental credit was approved in 2003 that strengthened the original emergency international corridor rehabilitation credit approved a year before the CAS. The projects have helped Djibouti take advantage of Ethiopia's shift in routing its trade through Djibouti as a result of the regional conflict.

Portfolio Status. The current portfolio has six active projects, including the most recently approved flood emergency rehabilitation project. The portfolio is valued at $84.26 million, of which 63 percent is for health and social development projects; 25 percent for transport/infrastructure projects; and about 12 percent for the education as the first education project is ending. The portfolio status has strengthened and improved. Program performance was good and the development objectives were achieved satisfactorily for all portfolio projects.

Looking ahead, the Bank is in the process of preparing a CAS Update covering the period FY2005–08 with the objective of aligning its program of strategic assistance to the full Poverty Reduction Strategy Paper (PRSP), approved by the Bank's Board on June 8, 2004. The CAS Update Program was discussed with the government in July 2004 and is scheduled for Board presentation at the end of November 2004. It aligns IDA's assistance to the PRSP along three of its main focus areas:

(i) revitalizing growth by enhancing competitiveness (through wage level adjustment, investment and institutional reform of water and energy sectors to improve efficiency; lower costs of doing business and widen service delivery, as well as improvement in port infrastructure as the backbone of growth);

(ii) developing human resource by moving to the second phase of the adaptable program lending in education, generating employment, and strengthening social safety nets; and

(iii) promoting good governance through a more efficient and transparent public finance management and procurement.

A Consultative Group Meeting (round table) is expected to take place in the third quarter of the Bank's FY2005.

DJIBOUTI: STATISTICAL ISSUES

Outstanding statistical issues

21. Economic and financial statistics suffer, although unevenly, from deficiencies with regard to their quality, coverage, periodicity, timeliness, and dissemination. The situation is especially critical for the national accounts and to some extent the fiscal data. However, recent developments indicate an increasing awareness of the importance of statistics among government officials. In 2002, the authorities created the Directorate for Statistics and Demographic Studies (DISED) by merging the National Directorate of Statistics (DINAS) and the Central Bureau of Census in order to enhance the capacity of the statistical system and the efficient use of available resources. The improvement in the database on external debt launched in 2002 was finished last year, leading to a downward revision of the outstanding stock of debt by about $40 million. New balance of payments data in line with the *5th Edition of the Balance of Payments Manual* were recently completed, with the revised data now showing current account surpluses instead of deficits during much of the 1990s. In February 2004, the authorities indicated their intention to participate in the Fund's General Data Dissemination System (GDDS), and a coordinator was named. The ministry of finance's public web site (http://www.ministere-finances.dj/) was also upgraded, posting, among other things, quarterly information on the real sector, and monthly information on fiscal and monetary accounts, available through the first quarter of 2004; monthly price data available through June 2004, and annual data on external debt available through end-2003.

National accounts

22. The existing national accounts estimates follow the *1968 System of National Accounts*. The 1998 revision led to some improvements in the methodology of compilation. A supply side approach, however, remains the mainstay of the compilation method. There continues to be a focus on main GDP aggregates, with demand-side GDP aggregates are only available in nominal terms. This revision fell short of correcting the serious shortcomings in Djibouti's national accounts arising from the underlying weaknesses in basic data sources and, particularly, a lack of financial and human resources—the latest available official data on national accounts covers the year 2002. These factors explain, in part, the limited progress made in implementing the recommendations of the 2002 national accounts and balance of payments statistics mission. Renewed urgency to revise national accounts data is warranted by the revised balance of payments data showing significant current account surpluses instead of deficits for most years since 1991 (see paragraph 7 below).

Prices

23. The Consumer Price Index (CPI) is the only available measure of inflation in Djibouti. The CPI compiled by the French government for French expatriate residents in Djibouti was initially used as a proxy for a Djibouti CPI. This index, however, was not representative of the country's consumption basket. Therefore, in late 1998, the Fund staff

began to track Djibouti price developments by utilizing: (a) sub-indices from the French CPI that were representative of Djibouti consumption; and (b) weights derived from a recent Djibouti household survey. The new national CPI, available monthly, is now considered to be the official measure of monthly price developments since April 1999.

Government finance

24. Fiscal data compilation improved over the past few years—data are now available monthly. The coordination unit in the ministry of economy and finance (MOEF), established in July 1998 to improve data coverage and timeliness, has made progress in fulfilling its mandate. Among the encouraging initiatives taken was the recent computerization of the treasury accounts, which will likely improve the coverage, quality, timeliness, consolidation, and consistency of cash management data. Another encouraging step is the improvement of data on domestic budgetary arrears through the comprehensive audit of these arrears finalized in 2002 with assistance from the European Union and the World Bank. Foreign-financed capital expenditure and some foreign-financed current expenditures and their financing (i.e., grants and loans) have been reported since the 1999 budget. However, additional efforts are needed to improve the compilation of budgetary data, particularly at the institutional level, in order to fulfill the recommendations of the 2001 government finance statistics mission.

Monetary accounts

25. Monetary statistics are generally adequate. To improve sectorization of monetary data, commercial banks were instructed in July 1999 to initiate a program for accurately identifying the residency status of customers and to report balance sheet data to the Banque Centrale de Djibouti (BCD)[13] beginning with the end-December 1999 reporting period. Monetary statistics cover the central bank, two operating commercial banks, and one bank in liquidation. To facilitate users' access to the statistics compiled by the BCD, the authorities initiated the publication of a quarterly bulletin in 1995 and increased its periodicity to a monthly bulletin beginning in 2001. Monetary data are also posted on the BCD's web site (http://www.banque-centrale.dj/).

26. Following a request from the BCD, an IMF Statistics Department (STA) mission will visit Djibouti in early December 2004 to assist the BCD in compiling monetary and financial statistics in accordance with the Fund's methodology as described in the *Monetary and Financial Statistics Manual*.

[13] *Banque Nationale de Djibouti* before 2000.

External sector

27. Substantial progress has been made in improving balance of payments data in line with recommendations made by Fund technical assistance missions over the past few years. At the end of August 2004, new balance of payments data adhering to the standards set forth in the *5th Edition* of the *Balance of Payments Manual* has been sent to STA. The new data set incorporates improvements involving transit trade to neighboring countries, imports by the foreign military forces stationed in Djibouti, and the treatment of the rent paid by the United States for the military base. The revised current account balance is now showing surpluses for most years since 1991, mainly on account of revised data on imports of goods and services. The new presentation separates for the first time private capital flows from errors and omissions. However the amount of identified net private capital flows remains very small – not exceeding on average ± USD 4 millions – and does not contribute to reducing significantly the size of errors and omissions. In addition the distinction between residents and nonresident accounts in banking statistics still appear to be highly uncertain. The BCD has also started to establish a first version of Djibouti's international investment position (IIP) for 2003 and to collect balance of payments data on a quarterly basis. IMF staff will present the revised data once the authorities have revised the national accounts accordingly.

28. The last STA TA mission to Djibouti (November 2003) concluded that further efforts have to be devoted to improving coverage, periodicity, and accuracy of international accounts data and to better integrate and reconcile them with national accounts data. The customs administration needs to ameliorate collection of imports data, which still seem to significantly underestimate true levels of imports. To improve the response rate from the private sector to data inquiries from the BCD, the law on the charter of the BCD needs to be amended to enable the BCD to collect and compile balance of payments and IIP statistics. Finally, the cooperation among the different official agencies involved in collecting and compiling national and international accounts data could be improved by creating a national statistical committee composed of all parties involved and responsible for reconciling and validating all data before their publication.

29. To strengthen external debt management, the authorities launched, in 2002, a project to improve the database on external debt with financial and technical assistance from the World Bank and UNCTAD. The new debt management system, centralized within the *Direction du Financement Extérieur* (DFE) of the MOEF, became operational in mid-2003, following an inventory of external loans contracted or guaranteed by the government and appropriate training of staff. The system establishes revised external debt statistics based on information received from creditors and covering the period from 1999 onward. As a result, the outstanding stock of public and publicly-guaranteed external debt (including arrears) was revised downward at end–2003 by about $41 million. This revision can be decomposed into an increase of $21.5 million of public enterprise debt and a decrease of $62.7 million of central government debt.

Djibouti: Core Statistical Indicators as of November 9, 2004

	Exchange Rates	Interna-tional Reserves	Reserve/ Base Money	Central Bank Balance Sheet	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Governme nt Balance	GDP/ GNP	External Public Debt	
												Service	Stock
Date of latest Observation	Sept 2004	Sept 2004	Sept 2004	Sept 2004	Sept 2004	Dec 2003	July 2004	March 2004	Dec 2003	July 2004	Dec 2003 1/	June 2004	June 2004
Date Received	Oct 2004	Oct 2004	Oct 2004	Oct 2004	Oct 2004	Oct 2004	Sept 2004	Sept 2004	Feb 2004	Sept 2004	Sept 2003	Sept 2004	Sept 2004
Frequency of Data 2/	M	M	M	M	M	M	M	Q	A	M	A	Q	A
Frequency of Reporting	M	M	M	M	M	M	M	Q	A	M	A	Q	A
Source of data	Central Bank	Central Bank	Central Bank	Central Bank	Central Bank	Central Bank	DISED/ Ministry of Finance	DISED/ Central Bank	DISED/ Central Bank	Ministry of Finance	DISED/ Ministry of Finance	DFE/ Ministry of Finance	DFE/ Ministry of Finance
Mode of reporting	Fax/ Cable to IMF	Fax/ Cable to IMF	Fax/ Cable to IMF/ E-mail	Fax/ Cable to IMF/ E-mail	Fax/ Cable to IMF/ E-mail	Fax/ Cable to IMF or Mission/ E-mail	Fax Cable to IMF or Mission	Fax Cable to IMF or Mission	Fax Cable to IMF or Mission	Fax Cable to IMF or Mission/ E-mail	Fax Cable to IMF or Mission	Mission	Mission
Confidentiality 3/	C	C	C	C	C	C	C	C	C	C	C	C	C

1/ GDP data is entirely estimated by the staff on the basis of partial data, provided by the authorities.
2/ D = Daily; W = Weekly; M = Monthly; Q = quarterly; A = Annual.
3/ C = Unrestricted.

Djibouti, October 25, 2004

Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Managing Director:

1. The economy and the social situation in Djibouti remain fragile despite seven years of adjustment efforts under IMF-supported programs (a stand-by arrangement from 1996 to 1999, and a Poverty Reduction and Growth Facility (PRGF) arrangement from 1999 to 2002). The fiscal position has gradually been restored and progress has been made toward the reform of public finances.

2. These programs have made it possible to stabilize tax revenues, rationalize budgetary outlays, increase social spending, and reduce, since 2001, the sizeable domestic fiscal arrears. However, the structural reform program intended to remove obstacles to growth has not been completed, and as a result, economic growth has not been strong enough to foster job creation and reduce poverty. Consequently, the government believes it essential to continue its partnership with the IMF under a new staff-monitored program covering the period January-December 2004.

3. Last year, the government approached IMF staff to negotiate a second arrangement under the PRGF. However, staff concluded that because of substantial additional budgetary resources from military agreements with France and the United States, the Republic of Djibouti would not, for the time being, need an IMF program with drawings. Moreover, during its recent 2003 Article IV discussions, the Executive Board of the IMF expressed the wish that the authorities establish a strong track record of implementing their economic and financial policies before concluding such an arrangement. In particular, the Board hoped to see completion of the last program's structural reform agenda to enhance growth, as well as the adoption of a budget for 2004 that would support growth and poverty reduction.

4. The main objectives of our economic program were set forth in the Memorandum on Economic and Financial Policies approved by the management of the IMF in May 2004. This document describes the government's commitments for the period July 1–December 31, 2004.

5. The measures proposed in the Supplementary Memorandum reflect the authorities' political commitment to pursuing reforms, while bearing in mind the importance of mobilizing additional external resources in support of the government's poverty reduction strategy.

6. The government believes that the policies described in the attached Supplementary Memorandum clearly reflect the authorities' commitment to economic reforms and lay a

solid foundation for implementing their economic policy. The government therefore requests that IMF staff closely monitor execution of this program covering the period January 1–December 31, 2004, as is usually done under IMF-supported programs with drawings.

7. The government will also provide IMF staff with all necessary information to assess policy implementation and fulfillment of the program targets. The authorities intend to review progress under the program with IMF staff at regular, three-month intervals.

8. The government appreciates the help that the IMF has provided in preparing economic reform programs since 1996 and attaches great importance to continued collaboration with the IMF.

Very truly yours,

__________ s____________	__________ s ____________
Yacin Elmi Bouh	Djama M. Haïd
Minister of Economy, Finance,	Governor
and Planning, in charge of Privatization	Central Bank of Djibouti

DJIBOUTI – SUPPLEMENTARY MEMORANDUM ON ECONOMIC AND FINANCIAL POLICIES FOR THE SECOND HALF OF 2004

I. INTRODUCTION

1. In order to return to a sound macroeconomic environment, the government adopted a Poverty Reduction and Growth Facility (PRGF) arrangement in 1999.

2. After three years of implementation (1999–2002), this program has made it possible to stabilize tax revenues, rationalize budgetary outlays, and increase social spending. Consequently, the government believes it essential to continue its partnership with the IMF under a staff-monitored program (SMP) covering the period January-December 2004.

3. The main objectives of our economic program were set forth in the Memorandum on Economic and Financial Policies attached to the Letter of Intent sent to the management of the IMF in February 2004. This memorandum describes the government's commitments for the period July 1–December 31, 2004.

4. The measures proposed in the memorandum reflect the authorities' political commitment to pursuing reforms, while bearing in mind the importance of mobilizing additional external resources in support of the government's poverty reduction strategy.

II. NATIONAL ECONOMIC DEVELOPMENTS IN THE FIRST HALF OF 2004

5. In the first six months of the year covered by the SMP, Djibouti's economic results were moderate. The consumer price index (CPI) indicates an increase in prices of 1.5 percent since the beginning of the year.

6. The average annual inflation rate remained low (about 2.3 percent), albeit with a tendency to accelerate in the second quarter of 2004, owing to the higher prices of oil and food imports associated with the fall of the U.S. dollar on the international market.

7. Economic growth slowed in the first half of 2004, probably as the result of a slump in port activity, despite a sharp increase in private investment in projects such as the Doraleh oil facility.

8. Fiscal performance was generally on track throughout the first half of 2004. Indeed, budget execution over the period shows a degree of fiscal consolidation. Overall, the level of revenue at end-June 2004 exceeded the amount at the same time last year and was sufficient to cover current expenditure.

9. Although domestic revenue increased relative to the first half of 2003, thanks to the rise in direct taxes and the domestic consumption tax (TIC), certain categories of indirect taxes and fees decreased, owing in particular to: (i) a reduction in oil imports caused by the

hike in world prices, (ii) the government's desire to keep the retail prices of oil products affordable and not pass on the whole of the world price increase to consumers, and (iii) the smuggling of tobacco and alcohol from neighboring countries.

10. On the expense side, outlays on goods, services, and transfers rose slightly above program estimates. Indeed, transfer increased following the implementation of social programs, with more training for auxiliary healthcare workers, expanded enrollment capacity in the teacher training center, introduction of the *service national adapté* (youth training program), and pensions for disabled former combatants.

11. The surge in investment expenditure can be explained in part by domestically financed capital expenditure (in addition to outlays on equipment and infrastructure, three factories were started up in Ali-Sabieh in 2003) and by the growing counterpart funds granted by the government to externally financed investment projects.

12. The government honored all of its external debt commitments, but continued to accumulate external arrears toward Italy and Spain, with whom external debt rescheduling talks are in progress.

13. The small amounts of external payment arrears on nonreschedulable debt to bilateral and some multilateral lenders that had accumulated at end-March and end-June have since been paid.

14. At end-March 2004, all of the budgetary targets had been met, as had the end-June targets regarding the floor on fiscal revenue, the ceiling on the wage bill, and the net accumulation of domestic arrears.

15. The indicative monetary targets were not met. At end-June 2004, the three indicative monetary criteria had not been attained.

16. The floor on net international reserves was set at US$9.5 million, as opposed to US$10 million in the SMP.

17. In June, the government used its deposits with the Central Bank of Djibouti (BCD) to pay certain current expenses and external debt services resulted in nonobservance of the ceiling on net BCD credit to the government.

18. Advances granted to the government by commercial banks between December 2003 and June 2004 led to nonobservance of the ceiling on net commercial bank credit to the government. At the same time, government deposits in commercial banks grew by DF 22 million.

19. In the area of financial sector reforms, the central bank stepped up its capacity-building efforts in the first six months of 2004 with the resumption of the staff continuing

training program, with support from the IMF (balance of payment statistics, anti-money laundering, portfolio investment, and macroeconomic management).

20. As in the four previous fiscal years, the 2003 external audit of the central bank was conducted in June 2004 by an international audit firm. Furthermore, the BCD financial statements (balance sheet and income statement) for 2002 were published in the Official Gazette of the Republic of Djibouti of August 31, 2004. Finally, in March 2004, the monetary authorities adopted a regulation governing the operations of savings and loan banks and authorized the IFAD to begin operations.[14]

21. Implementation of the structural reform program was delayed. Certain prior actions fell behind schedule.

22. However, during the first half of the year, the government also promulgated the law creating free-trade zones, demobilized a total of 411 combatants instead of the 500 cited in the SMP, and drafted a detailed report on social spending. Nonetheless, the five structural measures planned for end-March and end-June were not implemented.

23. Moreover, the revised drafts of the banking law and the central bank charter have not yet been submitted to the Council of Ministers. Publication of the report of the *Chambre des Comptes et de Discipline Budgétaire* (audit and fiscal discipline office) has been postponed.

24. We were also able to adhere to the monthly cash-flow management plan and the data reporting requirement.

III. Economic and Fiscal Policies from July to December 2004

25. The government made a commitment under the SMP to further stabilize the major economic aggregates and implement significant structural reforms, with the objective of promoting sustainable economic growth and taking steps to reduce poverty. The actions taken should qualify the government to receive assistance from the international community. We will continue to pursue this objective in the second half of 2004.

26. The program for July-December 2004 is based on a macroeconomic framework in which real GDP growth is projected at 3.2 percent, and inflation is contained at 2.8 percent despite inflationary pressure from higher international prices. The 2004 supplementary budget is based on expenditure targeted under the SMP.

[14] The regulation on savings and loan banks was published in the Official Gazette of June 13, 2004.

A. Fiscal Policy

27. The 2004 supplementary budget, to be presented to the National Assembly in October, projects a cash-basis deficit of DF 1,109 billion (0.9 percent of GDP). This supplementary budget, for which no budgetary support from the European Union and France (SAS) will be received, is nonetheless in line with the fiscal criteria of the SMP and provides for the use of domestic funds to settle domestic arrears amounting to DF 2.097 billion. To meet these criteria in the second half of 2004, it will be necessary, on the one hand, to mobilize more revenue and, on the other, to exercise greater control over operating costs, particularly outlays on goods, services, and transfers.

28. With regard to projected revenue, the 2004 supplementary budget estimates an increase of DF 102 million (0.09 percent of GDP), which will mean an increase of 2.3 percent in GDP from the first to the second half of 2004, as a result of: (i) a higher collection rate, (ii) more frequent inspections of imported goods, (iii) more rigorous border controls, and (iv) computerization of the tax administration will make it possible to achieve this objective.

29. The government has agreed to limit spending to 34.3 percent of GDP. However, all measures to increase social spending—particularly on education and health—will be maintained. Current expenditure will fall from 31 percent of GDP in 2003 to 28 percent in 2004. This represents an increase of 0.3 percent over the original budget, attributable for the most part to a significant increase in maintenance outlays in the wake of major repair work on public infrastructure in the first six months of 2004.

30. It should be noted, however, that there was a 0.6 percent drop in the wage bill resulting from: (i) the civil servant retirement program, (ii) the demobilization of 411 members of the National Security Force, and (iii) a freeze on certain hiring initiatives originally provided for in the 2004 budget. In addition, coercive measures to curb the growth of certain operating expenses (expenses for travel and missions abroad, energy bills, etc) were implemented at the highest levels of government.

B. Financial Sector Reforms

31. With regard to financial sector reforms, the monetary authorities have proposed amendments to the BCD Charter and the Banking Law, and the revised texts were submitted to the Council of Ministers in September 2004. The National Assembly is expected to adopt them by the end of 2004.

IV. Structural Reforms: Strengthening Competitiveness and Poverty Reduction

32. The government, aware that the expansion of private investment is the driving force behind economic growth, continued its efforts to improve the legal framework with the adoption in June 2004 of the law on the free trade zone, which provides incentives for investors seeking to participate in the development of the Doraleh project. Far from discriminating against activities in the rest of the country, this policy is aimed at export activities.

33. At the same time, the task of revising the investment code—although slightly behind schedule (June 2004)—will be completed and the new regulations will be adopted by December 31, 2004. This goal of this reform is to simplify and rationalize the system of tax exemptions.

34. Furthermore, to liberalize the labor market and promote job creation, the government reaffirms its commitment to adopt the draft labor code prepared and proposed by the Ministry of Labor and National Solidarity, before December 2004. The delay in this measure, originally scheduled for June 2004, afforded the opportunity to consider the conclusions and recommendations of the Discussion on Labor Policy.

35. The government will encourage private initiative by implementing a strategy and support mechanisms for SMEs and SMIs. The purpose of the approved management centers will be to facilitate and enhance the competitiveness of small- and medium-sized enterprises. The authorities will also promote the expansion of microfinance, in particular by preparing a national microfinance strategy.

36. The government will create the best possible conditions for private initiative by putting in place a plan to restructure the power and water sectors, in cooperation with the World Bank. The feasibility and environmental impact studies for a wind power project in Grand Bara were recently presented to the National Procurement Commission.

37. The technical committee responsible for drafting a commercial code for Djibouti based on the OHADA Uniform Acts has, with the help of a consultant, already collected a number of legislative and regulatory texts on commercial activities. The work will continue and the necessary resources will be mobilized.

38. Regarding public expenditure, the new provisions on budget preparation and the monitoring and control of expenditure have been in force since April 2004. In addition, a detailed report on the allocation of budgetary social expenditure was prepared by the Ministry of Finance and published on the website of the Ministry of Economy, Finance, and Planning, and the Ministry of Finance recently signed a contract with a consulting group in Benin to computerize the expenditure chain.

39. The publication of the report of the audit and fiscal discipline office on the 2002 budget, which is part of the fiscal consolidation effort, is scheduled for October 2004.

A. Program Monitoring

40. We have put in place a flexible mechanism to coordinate and monitor reforms in the Ministry of Finance, which has allowed us to collect and report data and information on program execution to IMF staff on a timely basis. In this connection, the government has confirmed its commitment to maintaining and strengthening the monitoring mechanism.

41. Program performance will be monitored through quarterly indicative targets, structural benchmarks, and quarterly progress assessments by IMF staff. The indicative targets for the period July-December 2004 are shown in Table 1. The structural benchmarks are listed in Table 2.

Yacin Elmi Bouh
Minister of Economy, Finance,
and Planning, in charge of Privatization

Date: _October 25, 2004__

Djama M. Haïd
Governor
Central Bank of Djibouti

Date: _October 25, 2004

Djibouti: 2004 Supplementary Budget (As a Percentage of GDP)			
	Jan. – June Executed	**July – Dec. Projected**	**2004 Projected**
Revenue and grants	16.4	18.7	35.1
Tax and nontax	10.8	11.2	22.0
Military revenue	3.1	2.5	5.6
Grants	2.5	5.0	7.5
Expenditure	16.6	17.7	34.3
Wages	6.8	6.7	13.4
Transfers and equipment	5.4	4.9	10.3
Investments	2.4	3.7	6.1
Deficit (payment order basis)	-0.2	1.1	0.8
Change in arrears	-0.8	-1.0	-1.8
Deficit (cash basis)	-1.0	0.0	-0.9
Memorandum item: Nominal GDP in DF millions			117,862

Table 1. Djibouti: Revised Indicative Targets in the Staff Monitored Program

(In millions of Djibouti francs; unless otherwise stated)

	2003	Cumulative flows from January 2004 (Unless stated otherwise)						
		Prog.	Prel.	Prog.	Prov.	Prog.	Prov.	Prog.
	Dec. 31	Mar. 31	Mar. 31	Jun. 30	June 30	Sept. 30	Sept. 30	Dec. 31
1. Ceiling on the wage bill	15,819	4,200	3,932	8,200	7,966	11,981	...	15,848
2. Ceiling on outstanding domestic arrears at end of period	26,170	26,000	25,174	25,650	25,255	25,100	...	24,073
Ceiling on external arrears 1/								
Government								
3. Outstanding at end of period	1,175	1,175	1,171	1,175	1,257	1,175	...	1,175
4. New 2/		0	90	0	142	0	...	0
Public enterprises								
5. Outstanding at end of period	2,934	2,934	2,851	2,934	2,907	2,934	...	2,934
6. New 2/	0	0	402	0	194	0	...	0
7. Ceiling on net central bank credit to the government	476	-64	48	-64	221	-97	625	-131
8. Ceiling on net commercial banks credit to the government	-169	-91.9	-78	-91.9	35	-187	-247	-187
9. Ceiling on government borrowing from public enterprises	-96	-48	-48	-48	-48	-96	...	-96
Ceiling on nonconcessional external debt with a maturity of more than one year (except commercial credits)								
10. The government		0	0	0	0	0	...	0
11. Public enterprises		0	0	0	0	0	...	0
12. Floor on government revenue	31,220	6,100	8,376	15,038	16,352	22,724	...	31,623
13. Ceiling on expenditure on goods, services, and transfers	11,378	3,200	2,865	5,500	5,649	7,900	...	10,604
14. Floor on net international reserves (in millions of U.S. dollars)	12.2	10.0	9.1	10.0	9.5	10.0	9.4	10.0
Memorandum items:								
Total external budgetary aid	2,239	0	0	0	0	0	...	220 3/
Loans	889	0	0	0	0	0	...	0
Grants	1,350	0	0	0	0	0	...	220

Source: Djibouti authorities.

1/ Adjusted targets in light of new information received during the September 2004 review mission.
2/ It includes disputed debt towards Italy and Spain
3/ Revised downward from initially DF 1,100 million.

**Table 2. Djibouti: Prior Actions, Indicative Targets,
and Revised Timetable of Structural Benchmarks for the 2004 SMP**

I. Prior actions for the approval by Fund management of the letter of intent and memorandum on economic and financial policies

- Completion of the demobilization of 250 ex-combatants **(done)**.
- Accounting for the use of the $4.75 million disbursed by the United States in October 2002 **(done)**.
- Retirement of government employees entitled to retire **(done)**.
- Publication of the 2002 Report of the Chamber of Accounts and Fiscal Discipline **(partially done)**.[15]

II. Indicative Targets

- See Table 1, Attachment II.

III. Structural Benchmarks

End-March 2004

- Make fully effective the reorganization, adopted end-2002, of the ministry of finance (adoption of the implementing decree) **(done in April 2004)**.

End-June 2004

- Complete the demobilization of 250 former combatants **(partially done, 171 were demobilized)**.
- Finalize the projected unification and simplification of the tax exemption regime by merging the various preferential tax regimes and by including remaining exemptions in the general tax code **(postponed until the end of December 2004)**.
- Have the National Assembly adopt the revisions to the banking legislation and the central bank charter **(postponed until the end of November 2004)**.

[15] The government approved its publication in May 2004, but the report has not been published yet. It is expected to be posted in the Chamber's public web site. However, it has not been published yet.

- Enforce the decree revising the banking legislation **(postponed until the end of November 2004)**
- Adopt the new labor code **(postponed until the end of November 2004)**.
- Adopt a new investment code and revise the legislation on free zones **(partially done).**[16]
- Publish a detailed report on priority social expenditure during the first six months of 2004 **(completed, posted in the ministry of finance's public website in October 2004)**.

End-September 2004

- Adopt the projected unification and simplification of the tax exemption regime by incorporating it into the revised finance law **(postponed until the end of December 2004)**.
- With World Bank assistance, draw up a plan to restructure the power and water sectors **(partially completed)**.[17]
- Implement the unified registry of civil servants **(postponed until the end of December 2004)**.

End-November 2004

- Complete the computerization of the tax administration.
- Adopt the new labor code.

End-December 2004

- Complete the computerization of the tax administration **(brought forward to end-November 2004)**.
- Draft and adopt a commercial code.
- Publish a detailed report on priority social spending during the last six months of 2004.

[16] The authorites approved a new free-zone law.

[17] A World Bank mission took place in October 2004 to review progress in this area.

- Put in place an appropriate regulatory framework for microfinance and subject institutions engaged in this activity to regular supervision by the central bank **(completed)**.

- Implement the unified registry of civil servants.

IV. Continuous Structural Benchmarks

- Rigorously enforce the monthly cash-flow management plan **(ongoing)**.

- Limit pre-payment order expenditure to such outlays stipulated by law **(ongoing)**.

- The government will report to the Fund each quarter, with a lag of four weeks, its data on foreign trade and foreign debt, and each month, with a lag of four weeks, its data on revenues, expenditures, and domestic and external arrears **(ongoing, but lately delays have been experiencing in receiving fiscal data, including detailed current expenditure)**.