

## **Djibouti: Joint Staff Assessment of the Poverty Reduction Strategy Paper**

The attached Joint Staff Assessment (JSA) of the Poverty Reduction Strategy Paper for **Djibouti**, prepared by the staffs of both the World Bank and IMF, was submitted with the member country's Poverty Reduction Strategy Paper (PRSP) or Interim PRSP (IPRSP) to the Executive Boards of the two institutions. A JSA evaluates the strengths and weaknesses of a country's poverty reduction objectives and strategies, and considers whether the PRSP or IPRSP provides a sound basis for concessional assistance from the Bank and Fund, as well as for debt relief under the Enhanced Heavily Indebted Poor Countries (HIPC) Debt Initiative. The Boards then decide whether the poverty reduction strategy merits such support.

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INTERNATIONAL DEVELOPMENT ASSOCIATION  
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DJIBOUTI

Poverty Reduction Strategy Paper

Joint Staff Assessment

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and the International Monetary Fund (IMF)

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**I. OVERVIEW**

1. **Djibouti's full Poverty Reduction Strategy Paper (PRSP) has progressed considerably when compared to the Interim PRSP (I-PRSP)**—presented to the Boards of the International Development Agency (IDA) and the International Monetary Fund (IMF) in November 2001. This progress is built on a number of areas: (a) the large scope of the consultative and participatory process, as illustrated by consultations with the poor, NGO groups, and the donor community; (b) the engagement of virtually all line ministries in the process, ensuring that the PRSP is closely linked to sectoral strategies proposed by these ministries; (c) the deeper treatment of key cross-cutting issues, emphasizing the need to improve governance and public sector performance, foster private sector development, and reduce gender disparities; (d) the adoption of quantified targets, although limited, that use the Millennium Development Goals (MDGs) as benchmarks and indicators for monitoring and evaluation, with explicit timetables for achievement; and (e) the preparation of a consistent macroeconomic framework, the costing of sectoral strategies, and the projection of the financing needed to attain the sectoral/MDG targets.

2. **Djibouti's PRSP offers a comprehensive strategic framework that will guide the country's poverty reduction efforts over the medium term.** The targeted reduction in poverty is predicated on enhancing the conditions for stronger growth and equitable income distribution. In this context, the staffs welcome the emphasis in the PRSP on maintaining fiscal prudence, improving the cost-effectiveness and allocative efficiency of public service delivery (such as primary health care, education, and basic infrastructure), and addressing the

sharp deterioration in the country's external competitiveness by tackling deficiencies in public sector management, the regulatory regime, the judicial system, and reforming the investment and labor codes. Improving financial intermediation and increasing transparency and accountability in public finances are also likely to promote private sector development and enhance growth prospects.

3. **A number of challenges will need to be addressed as the PRSP moves into the implementation phase.** Sectoral programs should be clearly prioritized and costed more carefully, as well as better linked to the national budget and the medium-term expenditure framework. Prioritization of planned public investment is particularly relevant in the event that external financing is not forthcoming as envisaged in the PRSP. On the other hand, private sector development could be hindered if structural and governance reforms are not expedited in order to improve the country's external competitiveness. Making substantial progress in addressing the severe competitiveness problem that Djibouti faces is key if the proposed strategy is to provide a credible framework for reducing poverty and concessional assistance. The staffs welcome the authorities' intention to start implementing these reforms during 2004. Sustained assistance from donors will also be required for PRSP implementation, including technical assistance and a large increase in grants. A strong focus on technical support will also be needed for strengthening capacity within the government in the areas of macroeconomic and public finance management, and poverty analysis and evaluation, as well as for improving the country's statistical system with the objective of producing comprehensive and accurate statistics for policy making and analysis.

4. **The Joint Staff Assessment (JSA) discusses the PRSP in several key dimensions.** These include the participatory process (Section II); poverty diagnosis (Section III); evaluation of the poverty reduction strategy (Section IV); public expenditure program and financing (Section V); targets, indicators, and monitoring (Section VI); and risks to the strategy (Section VII). Section VIII presents the conclusions of this assessment.

## II. PARTICIPATORY PROCESS

5. **The authorities invested considerable effort in building national ownership of the PRSP by strengthening the institutional framework.** In line with staff recommendations drawn from the I-PRSP, the government reinforced the inter-ministerial steering committee (IC) in charge of the preparation of the full PRSP. The IC was assisted by a national advisory commission, chaired by the minister of finance, and composed of senior government officials, representatives from the National Assembly, private sector, and civil society organizations. The commission was supported by a permanent secretariat and eight thematic working groups that helped in formulating sector strategies and investment priorities. To ensure an adequate integration of the gender dimension in the PRSP, representatives of women's groups were also included in the thematic working groups.

6. **National ownership of the PRSP was also strengthened by broadening the consultative process.** The national advisory commission organized a number of national and regional workshops and several rounds of consultations with government agencies, civil

society organizations, trade unions and private sector representatives. However, the consultative process was not without difficulties. These reflected a widespread difference of opinions among stakeholders on how to address Djibouti's development challenges, and the trade-offs between the large and urgent demands for improved public services and the need to preserve fiscal sustainability over the medium term. At the end, the PRSP was validated through a national workshop where the authorities presented a revised version of the PRSP, incorporating comments from the various stakeholders, including the donor community. Yet, some issues raised during the consultative process did not receive adequate attention in the document. These included: (a) the impact of growing widespread consumption of khat (a stimulant drug) on labor productivity, health and children's education; (b) the role of the informal sector in the country's development process; and (c) the lack of effective co-ordination across government units for policy planning and implementation. The PRSP was formally endorsed by the government on March 1, 2004.

### III. POVERTY DIAGNOSIS

7. **The authorities made a special effort towards filling the knowledge gap on poverty that was identified in the I-PRSP.** Two national surveys were carried out in 2002. The first survey—the EDAM-IS2 (*Enquête Djiboutienne Auprès des Ménages-Indicateurs Sociaux II*)—focused on poverty and socio-economic indicators, and the second one—the EDSF-PAPFAM (*Enquête Djiboutienne sur la Santé et la Population*)—on health and population indicators, including the sedentary and nomadic populations. The PRSP took advantage of data generated by these surveys to update the poverty assessment made in 1996. Bearing in mind methodological differences that hinder the comparability of these assessments, it seems that the macro-level gains made since the mid-1990s (gradual recovery in economic activity and improvement in the fiscal position) have not translated into a reduction in income poverty. According to EDAM-IS2 data, the incidence of extreme poverty (defined in Djibouti at \$1.8 per day) has increased from 34.5 percent to 42.2 percent of the total population between 1996 and 2002.<sup>1</sup> This increase in income poverty is explained by the continued decline in per capita income (owing to sluggish real GDP growth and a rapid population growth) and by deepening inequalities. Income distribution is highly skewed in favor of those able to find employment in the formal sector.

8. **The poverty surveys, however, suffer from a number of conceptual and methodological caveats.** These include: (a) the absence of an adequate sampling framework (the latest population census dates back to 1983); (b) the choice of poverty lines (relative and absolute) that are high by international standards; (c) and the lack of methodological soundness in data collection and analysis. Furthermore, the lack of detailed information on household consumption patterns, access to social services, and asset ownership hinders a clear assessment on the sources and dynamics of poverty. Indeed, non-income measures of

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<sup>1</sup> The EDAM-IS2 also defines a relative poverty line evaluated at \$3 a day, under which poverty increased from 64.9 percent to 74.4 percent between 1996 and 2002.

income (such as school enrollment) may suggest that the increase in poverty in the second half of the 1990s was probably less severe. The government is planning to fill this gap by carrying out a detailed household budget-consumption survey in 2004. The staffs expect that this planned survey will help strengthen the diagnosis of poverty and inequality in income distribution in future updates of the PRSP and guide the country's poverty reduction efforts.

#### IV. EVALUATION OF THE POVERTY REDUCTION STRATEGY

9. **The staffs concur with the strategic priorities set forth in the PRSP.** In line with the MDGs, the authorities aim at reducing extreme poverty by over 6 percentage points between 2002 and 2006 to 36.1 percent of households and to below 20 percent by 2015. Targets are also set for most other MDGs. In light of weak policy implementation in previous years, these targets are ambitious. To achieve them, the PRSP defines four priority areas (“pillars”) of action: (a) creating the conditions for higher and sustainable economic growth through macroeconomic stability and a reform of the legal framework to stimulate private investment and reduce the cost of doing business in Djibouti; (b) accelerating human resource development through investment in education, health and social protection; (c) promoting regional development, upgrading basic infrastructure, and preserving natural resources in an environmentally sustainable manner; and (d) strengthening governance through greater transparency and accountability in public financial management, progressive decentralization, and institutional capacity building. However, effective implementation of the strategy will require a refinement of the priorities, reinforcement of the implementation capacity, and the forceful implementation of structural reforms to improve the country's competitiveness.

##### A. Macroeconomic Framework

10. **The PRSP contains a consistent macroeconomic framework.** The projections—which envisage stronger real growth, low inflation, and higher spending on priority social sectors—support the aim of improving living conditions for the poor and creating job opportunities. To achieve the ambitious targets of the PRSP, the authorities have planned a large public investment program (PIP) of about \$293 million (equivalent to 47 percent of 2003 GDP) from 2004 to 2006. About 15 percent of the program is expected to be domestically financed through budgetary resources and the rest (\$250 million) externally financed. The authorities have so far secured external financing for \$117 million—of which half is in the form of grants. The implementation of the economic development strategy and the PIP could be seriously constrained by the available resources. The authorities recognize that an unprecedented increase in external aid will be required to cover the large fiscal and external financing gaps, projected to reach about 7.5 percent of GDP in 2006, and maintain the official debt within manageable levels (see Section V below).

11. **The PRSP aims for an average annual real GDP growth rate of 4.6 percent over the period 2004–06**—almost double the average economic growth experienced in the past few years. Although the PRSP elaborates on potential new sources of growth, such as tourism, manufacturing, fishing, livestock, and geothermal energy, it recognizes that port

services will likely remain the backbone of the country's economy and the main source of growth over the foreseeable future. Attracting foreign direct investment will be essential to support the planned expansion of the country's port facilities and associated free zone. However, the long-run impact on growth and poverty reduction of this expansion will likely depend on the magnitude of its spillover effects on the rest of the economy. For the private sector to take full advantage of the new opportunities, the authorities should be ready to adopt all necessary measures to significantly reduce Djibouti's relatively high labor and other production costs, put in place a business-friendly environment, and address shortcomings in the legal and regulatory regimes. It is encouraging that the authorities plan to adopt key reforms to this end, such as the new labor and investment codes, in the course of 2004, while focusing on developing human resources. Nevertheless, in light of the slow progress in implementing key policy reforms in the past and the country's weak absorptive capacity, the projected growth rate seems unrealistic, as it assumes full implementation of key structural and governance reforms, the full achievement of an exceptionally large PIP, and a sharp increase in grant financing (which is typically highly volatile), as well as forthcoming FDI to finance the expansion of the port and the development of the free zone. The staffs urge the authorities to revise regularly the projections of aggregate and sectoral growth rates in line with past trends and grounded on an adequate analysis of the main sources of, and obstacles, to growth.

12. **The PRSP states that the authorities' strategy for promoting growth is also based on enforcing a stable macroeconomic environment.** Indeed, the domestic fiscal balance—defined as total revenue (excluding grants) minus domestically financed spending—is expected to record a surplus equivalent, on average, to about 2 percent of GDP in the period 2004–06 (rising from an estimated surplus of 0.8 percent in 2003).<sup>2</sup> To achieve this target, the PRSP points out that fiscal policy over the medium term will be based on (a) increasing the tax yield; (b) intensifying tax collection efforts; (c) adopting a value-added tax (VAT) in 2006; (d) controlling the wage bill by freezing recruitment in the civil service, (except in priority areas, such as education, health, and the judiciary), continuing with the demobilization program of ex-combatants, retiring eligible civil servants, and adopting a single computerized registry for civil servants; (e) cutting non-priority spending by better controlling government consumption of utilities (electricity, telephone, and water) and reducing domestically financed military expenditure; and (f) improving the efficiency of public spending. The domestic fiscal surplus is, in part, required to progressively pay off the government's domestic arrears over the next ten years in line with the plan envisioned at the end of the 1999–2002 PRGF arrangement. The 2004 budget (which alters the structure of budget expenditure in favor of priority sectors) and the planned adoption of fiscal reforms (such as integration and simplification of the existing tax exemptions) represent steps in the right direction.

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<sup>2</sup> Excluding military-related revenue from France and the United States, the domestic fiscal balance is expected to record a deficit equivalent to about 1.5 percent of GDP by 2006, down from 4.2 percent in 2003.

13. **Djibouti's fiscal position is, however, likely to remain fragile over the medium term.** Although the wage bill is expected to decline gradually in percent of GDP in the period ahead, the authorities should consider additional measures to further reduce the wage bill, which at 12 percent of GDP in 2006 will still absorb about half of domestic revenue. In addition, it is uncertain whether military related budgetary assistance, particularly from the United States will remain at the current level equivalent to about 2 percent of GDP over the medium term. Thus, the staffs strongly recommend that the authorities consider this source of government revenue as exceptional rather than permanent. In light of this and the dependence of the public investment program on an exceptionally large amount of grant financing, government spending should be planned with caution and within a medium-term framework. In addition, given the limits to absorptive capacity and the already relatively large public sector, raising foreign-financed capital expenditure by 9 percent of GDP between 2004 and 2006 would need to proceed in parallel with sustained capacity building and reforms of the public expenditure management system to manage the risk that these additional funds would not be used effectively. Future progress reports could benefit from a fiscal sustainability analysis, assessing the fiscal risks associated with different outcomes for growth, debt sustainability ratios and the overall fiscal deficit. In this context, it would be necessary to put forward alternative macroeconomic scenarios, including a conservative case that factors in the eventuality that the PRSP target growth rates, investment and donor financing are not achieved.

14. **A stronger link should be established between the budget process and the PRSP.** With the budget covering only one-year cycle, there is a need for an integrated cycle of medium-term policy formulation and budget preparation. Thus, as the PRSP is implemented, it is advisable that the government establishes a medium-term expenditure planning framework, increases the depth of sectoral analysis, and fully engages sectoral ministries in the budget formulation process. In addition, the authorities should closely monitor spending (both current and capital) on priority sectors on a regular and timely basis. Beginning in 2004, the authorities intend to publish semi-annual reports on social spending.

15. **While the staffs commend the authorities' commitment to improve external competitiveness, the PRSP could have elaborated further on complementary strategies to achieve this objective, including a discussion of alternative exchange rate regimes.** Djibouti's external competitiveness has deteriorated substantially over the last two decades. The PRSP lays out the government's plans to improve competitiveness through actions to reduce transaction costs to private investors and businesses and promote higher factor productivity. Nevertheless, it is doubtful that these measures by themselves will fully address the sharp deterioration in Djibouti's competitiveness. Therefore, the PRSP should have discussed the costs and benefits of a devaluation as an additional policy option to address the sharp deterioration of the country's external competitiveness.

## **B. Structural and Sectoral Policies**

16. **The PRSP presents a comprehensive structural and sectoral reform agenda guiding the country's poverty reduction efforts.** Structural reforms include measures to

promote stronger growth, improve the investment climate, strengthen public finance management, and improve the country's external competitiveness. Sectoral reforms aim at achieving the MDGs over the medium term through a number of measures to strengthen the allocative efficiency and the cost-effectiveness of public spending on social and infrastructure sectors.

17. **However, the PRSP could have drawn lessons from the slow progress in implementing structural reforms in the past and its impact on growth and poverty reduction.** Over the last decades, real GDP growth has remained insufficient to contribute to job creation and poverty reduction. The PRSP could have assessed the reasons behind the lack of a further improvement in Djibouti's fiscal position (in percent of GDP), despite progress made on fiscal reforms since the mid-1990s. On the revenue side, there was no significant improvement in domestic revenue collection efforts. On the expenditure side, there was an increase in non-priority current spending and off-budget outlays. Moreover, limited progress in pursuing the privatization agenda and in reforming the investment, commerce and labor codes also contributed to modest growth. The recent recovery in economic activity (with growth of 2.7 percent a year on average from 2001 to 2003 after almost two decades of real GDP growth averaging less than 1 percent a year) has been mainly attributed to the increasing demand for services by foreign troops stationed in the country, the channeling of a larger share of Ethiopian foreign trade through the port of Djibouti due to regional conflict, and higher public investment, rather than to the adoption of structural reforms.

18. **The PRSP rightly recognizes that ensuring pro-poor growth in the medium term requires stepping up actions to promote private sector development—although it contains only a few meaningful initiatives in this area besides the investments in the port sector.** The pickup in economic activity in recent years has not been accompanied by sufficient job creation. The PRSP, therefore, recommends that private investment, especially foreign direct investment in labor-intensive export-oriented sectors, should become a key contributor to economic growth. Key to private sector development is putting in place a business-friendly institutional and legal environment, and improved overall competitiveness. To this end, the authorities should consider protecting and enforcing property rights, curbing burdensome administrative and judicial rulings, ensuring an effective and nondiscriminatory regulatory framework, and improving access to affordable and reliable recourse to dispute resolution. All these elements will need to be strengthened in the authorities' development strategy.

19. **The PRSP puts undue emphasis on the role of the public sector in the development process and as a source of job creation.** Indeed, it presents a long list of public sector initiatives aiming at creating 150,000 new jobs in public works over the medium term. This approach risks further aggravating the current imbalance between public and private sectors in the Djibouti economy, as testified by the recent establishment of three new publicly-owned enterprises. In this context, the authorities should seek public-private partnerships (including the use of build-operate and transfer (BOT) arrangements or



output-based contracting of private providers of public services, particularly in the infrastructure sectors) to implement sectoral strategies to improve the efficiency of service delivery and reduce supply chain bottlenecks, while promoting private sector development.

20. **The PRSP correctly identifies the critical role of the transport, energy, and water sectors in the country's development prospects.** In the **transport sector**, the staffs concur with the authorities' strategy objectives, in particular the emphasis placed on the construction of the new port and the development of a free zone. However, these investments should be conditional on available and identified sources of private funding to ensure that public resources are not diverted from high priority social sectors. The staffs also agree with the PRSP that improved roads would provide less well-off citizens with better opportunities for sharing the fruits of economic growth. The authorities are encouraged to pay special attention to road rehabilitation and maintenance. Responsibility for the administration and management of roads is unclear and better financing mechanisms are needed for road sector maintenance. The staffs encourage the authorities to implement the recommendations of the ongoing sector study aimed at reviewing the road management institutional framework, investments and maintenance financing modalities, and the sector investment program. Regarding the free zones, the staffs urge the authorities to frequently review their impact to make sure that they do not turn out to be a drag on the budget due to incentives and tax exonerations.

21. In the **energy sector**, the authorities envisage enhancing the efficiency and profitability of the electricity company (EED) in order to reduce energy tariffs. To meet the country's energy needs, the authorities also plan to develop alternative sources of energy, including geothermal resources and wind power. However, the staffs remain skeptical about the feasibility of the public-private partnership plan envisaged by the government to finance large-scale geothermal projects in view of the risks involved in their execution. In the **water sector**, the PRSP rightly emphasizes the need to strengthen the institutional framework for water management and enhance the efficiency of the enterprise responsible for the sector (ONED). The staffs are of the view that the increase in budgeted resources for the implementation of the government's water strategy is not commensurate with the pressing need for satisfying the country's current and future water requirements. Moreover, these additional resources should be effectively used in order to enhance water availability and quality throughout the country and ensure accessibility to the poor.

22. The staffs consider that the analysis of the **social sectors (health, education, social protection)** in the PRSP is appropriate and broadly in line with the poverty diagnosis outlined in the document. The PRSP rightly emphasizes that access to social services is a key concern for the poor in Djibouti. In the **health sector**, the staffs agree with the PRSP's focus on enhancing accessibility to health care, notably for the poor populations to improve the quality of health services and the equity of the system. The PRSP also recognizes that additional budget resources, intra-sectoral reallocation, and improved efficiency in the delivery of health services will be needed to achieve this objective. The PRSP emphasizes the importance of improved maternal and child healthcare and suggests measures to achieve the MDGs. The strategy rests on four axes: (a) the reform of the institutional framework;

(b) the improvement of the global health coverage and access to health for the poor; (c) the decentralization and strengthening of community participation in the management of the system; and (d) the establishment of a viable health financing scheme.

23. **In the education sector, the PRSP establishes that enhancing access to education is essential for economic growth and poverty alleviation.** The staffs agree with the interim output indicators and proposed outcome—increase in years of educational attainment, secondary school completion rates, and efficiency-enhancing measures. The staffs encourage the authorities to compile indicators relating to student achievement in order to measure the quality of education. The staffs recommend that the authorities further refine the policy matrix for the education and health sectors by prioritizing projects and programs, bearing in mind absorptive capacity and abiding by annual budgetary allocations. While the PRSP identifies broad sector targets and final outcome indicators, the staffs encourage the authorities to set up realistic intermediate indicators that can be monitored on an annual basis (including input indicators, such as the number of teachers, and output indicators, such as the number of schools built). The proposed policies relating to health and education should contribute to bringing spending on these sectors closer to countries at similar levels of economic development.

24. **The PRSP pays particular attention to social insurance and assistance as key elements of the poverty reduction framework.** In the area of social insurance, it adequately focuses on ensuring the financial viability of the pension funds. It recognizes the importance of completing the pension reform agenda. The PRSP also highlights the need to develop a broad range of social assistance programs, including social safety nets, to help vulnerable groups better cope with risks. The PRSP indicates that other social programs are in preparation, especially for promoting gender equality, creating employment, and facilitating the inclusion of the youth and vulnerable groups in the national development process.

25. The staffs welcome the emphasis on improving **governance and public sector management**. Weak governance was identified in the participatory consultations as a major obstacle to poverty reduction and sustained economic growth in Djibouti. In response to this concern, the PRSP accords a central priority to governance reforms aimed at: (a) enhancing transparency in public expenditure management; (b) promoting greater accountability in the utilization of public funds; and (c) increasing the efficiency and anti-poverty impact of public expenditure. The staffs caution that unless sustained progress is achieved in these areas, the effective delivery of public services and the country's ability to mobilize the large external resources may be compromised.

26. **Improved financial intermediation is essential to achieve stronger growth as envisaged in the PRSP.** Efforts over the past few years have focused on strengthening banking supervision and improving transparency by regularly auditing financial accounts of the central bank in accordance with International Standards on Auditing. The PRSP rightly emphasizes that the legal structure for contractual enforcement and property rights should be reinforced significantly for banks to enforce loan agreements and reduce the risk of not recovering assets in the case of loan defaults. The authorities are currently also developing

microfinance institutions as part of their poverty reduction strategy. The staffs stress that an adequate regulatory environment should be developed for these institutions to fulfill their mission and fend off potential political pressure to direct lending to various interest groups. The Economic and Social Development Fund, established in 2003, could otherwise face difficulties similar to those experienced by the Djibouti Development Bank in the late 1990s that led to its liquidation.

27. With regard to **cross-sectoral issues**, the staffs consider that the **gender** dimension has been adequately addressed, including the analysis of inter-sectoral linkages associated with the reduction of gender disparities. The treatment of the **HIV/AIDS** pandemic, which has grown from a health issue to a serious challenge to development in Djibouti, has been addressed in detail in the PRSP. Future PRSP progress reports could include an analysis of cross-sectoral linkages, such as the impact of education and access to safe water on health outcomes, and the impact of better governance on the efficiency of public service delivery for the poor.

## V. PUBLIC EXPENDITURE PROGRAM AND FINANCING

28. **The PIP underlying the implementation of the PRSP raises a number of issues pertaining to fiscal sustainability as well as the allocation and efficiency of public expenditures.** Given the proposed large size of the PIP,<sup>3</sup> grants will have to account for more than 75 percent of total external financing to be secured over the period 2004–06, if the debt-to-GDP ratio is to remain stable at about 68 percent during that period. In addition, adequate provisioning in future budgets of the recurrent expenditures associated with the PIP will be necessary to reap the maximum benefits from the PIP and ensure sustainability of investments. In this regard, the staffs welcome the government's explicit commitment to include in the national budget the recurrent costs (5 percent of projected capital spending) and counterpart funds (10 percent of projected public investment) associated with the public investment needs.

29. **In a low income country like Djibouti, fiscal sustainability is also affected by the degree of donors' financing and the country's administrative and absorptive capacity.** Indeed, during the 1990s through 2002, Djibouti faced grants volatility of +/- 54 percent with respect to the average in the period. The PRSP could have, therefore, analyzed how the authorities plan to address the country's limited capacity in light of the projected large increase in public investment from 6.7 percent in 2003 to 16 percent of GDP in 2006. In addition, it could have assessed the macroeconomic impact of both the large increase in grants (which must almost double in per capita terms relative to the level received in the second half of the 1990s) needed to finance the PIP, as well as the high volatility in grant receipts in light of past experience.

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<sup>3</sup> As previously indicated, the PRSP foresees a PIP over the period 2004–06 totaling about \$293 million. In 2004, the macroeconomic framework is based on the budget numbers, which exclude both DF 4.7 billion in financing to be secured as well as DF 881 million in additional grants and loans secured after approval of the 2004 budget by National Assembly.

30. **The sectoral allocation of the public expenditure program associated with the implementation of the PRSP deserves further attention.** The PIP gives a clear priority to education and health, as evidenced by their share in total secured financing (34 percent and 16 percent, respectively). However, the share of other sectors, which have an important bearing on poverty reduction, such as sanitation, housing, water and social affairs, remains relatively low. The PIP also raises issues of intra-sector allocation. This is the case of basic infrastructure sectors (energy, transports, water) where the projected public spending on these sectors does not include adequate resources for operations and maintenance.

31. **Additional work will be needed to improve the equity and efficiency of the public expenditure program.** The public expenditure review conducted by the World Bank and the Djibouti government in 2004 should provide a good basis to determine shortcomings and options for reform in public expenditure management. It is also important to ensure that work on sectoral multi-year public expenditure frameworks be initiated as soon as possible in the context of a medium-term expenditure framework. This will allow sectoral ministries to reflect their budget expenditure requests on a timely basis, and help integrate the PRSP fiscal projections into the national budget in the period ahead. Furthermore, improvements in budgeting, monitoring, and organizational capacity, together with continued dialogue with donors, will be needed to ensure an effective implementation of the investment program commensurate with the country's administrative and absorptive capacity.

## VI. TARGETS, INDICATORS, AND MONITORING

32. **The PRSP presents a set of targets and indicators in a detailed policy matrix that summarizes priority actions in key sectors for 2004–06.** The staffs concur with the poverty focus of the sector targets and their alignment with the MDGs. However, the PRSP could have benefited from a better prioritization of these targets and the quantification of the financing needed to achieve them. In the staffs' view, reaching the MDGs also necessitates an effective partnership with the donor community, a more efficient public sector management, and an improved absorption rate of PRSP-related investments. For most key sectors (in particular, education), the PRSP targets are ambitious and their attainment will require sustained improvements in institutional capacity. The staffs also note that the PRSP only sets broad monitoring indicators for the period beyond 2004. The staffs encourage the government to set specific annual indicators and to link them to the annual budgeting exercise to ensure the achievement of the targets within the established timeframe. It is also important that the selected indicators across sectors adequately reflect the different socio-economic dimensions of poverty spelled out in the PRSP.

33. **The PRSP proposes a set of measures aimed at creating a reliable national information system to improve poverty analysis.** Progress has already been made over the past three years through the conduct of the two household surveys and the merger of two statistical agencies (affiliated to two different ministries) into the new Directorate for Statistics and Demographic Studies (DISED) attached to the ministry of finance. The staffs support the proposed measures, requiring (a) the development of a national socio-economic database through the strengthening of the statistical capacity of the line ministries; (b) the

completion of a population census; (c) the implementation of a program of poverty surveys and analyses (particularly household budget-consumption surveys) to effectively monitor and evaluate the progress of Djibouti's poverty reduction efforts; and (d) the strengthening of the DISED by providing it with adequate human and financial resources.

34. **An important challenge will be to implement a sustainable monitoring system that promotes public accountability and provides useful information for policy and budget decision-making.** In particular, central data collection and analysis by DISED will need to be reconciled to effectively monitor inputs, outputs, and outcomes at the local level. The staffs welcome the authorities' plan to create an adequate institutional framework to closely monitor the implementation of the PRSP. This framework envisages the creation of a number of committees and commissions that are expected to play a pivotal role at the technical, policy and non-governmental monitoring levels. Nonetheless, the staffs are concerned about the complexity of this institutional setting and the strains that it could place on the country's limited resources. The staffs encourage the authorities to streamline the planned monitoring framework (currently constrained by weaknesses in the country's statistical system), to better define the roles of the various governmental and non-governmental organs, and to specify the resources required to ensure its smooth functioning.

35. **Djibouti should focus in the period ahead on improving its statistical system.** Sound data needed to monitor economic and social progress in the country. In this context, the staffs welcome the authorities' recent decision to participate in the Fund's General Data Dissemination System (GDDS), which will provide important information to the international community to coordinate its technical assistance cooperation projects in this key area in Djibouti.

## VII. RISKS TO THE STRATEGY

36. **The PRSP recognizes that the poverty reduction strategy is very ambitious and that it could be affected by several risks.** It highlights the risk of: (a) delays in implementing macroeconomic and structural reforms, notably, in public finances and state corporations; (b) lower-than-expected grant financing and inflow of FDI and the consequent downscaling of the proposed port development; and (c) lack of coordination and weak monitoring due to institutional weaknesses and capacity constraints.

37. **The staffs concur with the main risks identified in the PRSP but additional ones must also be taken into account.** Poor governance and misallocation of resources could undermine the poverty reduction efforts by, among others, discouraging donor assistance and private investment. Failure to improve basic services delivery could also undermine the credibility of the PRSP more generally. A decline in military-related external budgetary revenue could lead to a sharp deterioration in the fiscal accounts, requiring adjustment measures with adverse effects on growth and poverty reduction. Donors' financial support may turn out to be lower than required to achieve the goals set in the PRSP. Over the long

run, a broader, more diversified growth strategy should be put in place to reduce the risk associated to relying on a single source of growth—the port services. Indeed, a deterioration of the regional security situation could discourage additional investments in port infrastructure, and hinder growth prospects significantly.

38. **Most of these risks could be mitigated if the government maintains a strong political commitment to policy reforms and takes decisive actions to improve public sector governance, the investment climate, and ensure labor market flexibility.** These actions include, among others, the adoption of new investment, commerce, and labor codes, as well as the completion of the privatization agenda of public enterprises and the publication of financial audits of these state corporations. In most of these areas, the government is expected to take important steps in the course of 2004. In addition, the preparation of a fiscal sustainability analysis and alternative macroeconomic frameworks factoring in the risks outlined above should be included among the highest priority actions to be addressed before the next PRSP progress report.

## VIII. CONCLUSION

39. **Djibouti's full PRSP reflects substantial improvements, both in its content and the quality of the process.** However, as explained earlier, the downside risks to the effective implementation of the PRSP are significant. Achieving its ambitious targets assumes that the government will: (a) address organizational and institutional challenges, including the coordination across governmental units; (b) fully implement key structural reforms; (c) closely monitor progress to assess whether the proposed reforms are contributing to the improvement in poverty reduction and in the country's competitiveness and growth prospects, and if not, be ready to adopt additional measures; and (d) focus on synchronizing the preparation of the annual PRSP progress report with that of the budget cycle, so that the priorities in the report can be adequately reflected in the subsequent year's budget. Improved donors' coordination and extensive technical assistance in a wide range of areas as well as a large increase in grants will also be essential to support the country's development strategy.

40. **The staffs of the World Bank and the IMF consider that Djibouti's poverty reduction strategy outlined in the PRSP provides a sound basis for Fund and IDA concessional assistance.** The staffs recommend that the respective Executive Directors of the IMF and the World Bank reach the same conclusion.