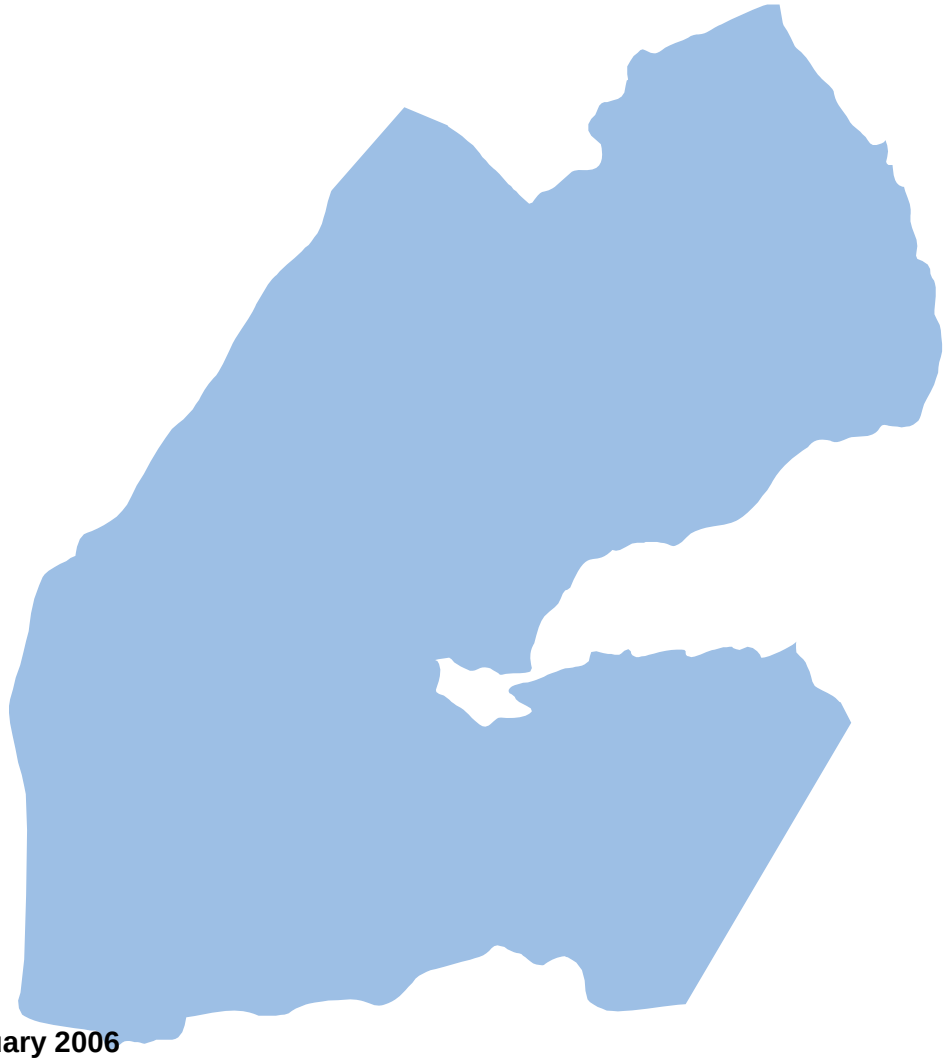
Djibouti
Economic Performance Assessment



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Djibouti
Economic Performance Assessment

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Sponsored by the Economic Growth office of USAID's Bureau of Economic Growth, Agriculture and Trade (EGAT), and implemented by Nathan Associates Inc. under Contract No. PCE-I-00-00-00013-00, Task Order 004, the Country Analytical Support (CAS) Project, 2004-2006, has developed a standard methodology for producing analytical reports to provide a clear and concise evaluation of economic growth performance in designated host countries. These reports are tailored to meet the needs of USAID missions and regional bureaus for country specific analysis. Each report contains

- A synthesis of data drawn from numerous sources, including World Bank publications and other international data sets currently used by USAID for economic growth analysis, as well as accessible host-country data sources;
- International benchmarking to assess country performance in comparison to similar countries and groups of countries; and
- An easy-to-read analytic narrative that highlights areas in which a country's performance is particularly strong or weak, thereby assisting in the identification of future programming priorities.

Under the CAS Project, Nathan Associates will also respond to mission requests for in-depth sector studies to examine more thoroughly particular issues identified by the data analysis in these country reports.

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Electronic copies of reports and materials relating to the CAS project are available at www.nathaninc.com. For further information or hard copies of CAS publications, please contact

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A NOTE ON DJIBOUTI DATA

The set of publicly accessible statistics for Djibouti is limited in scope, timeliness, and reliability. Many economic indicators are taken from the International Monetary Fund (IMF) First Review under the Staff Monitored Program IMF report (November 2004), which provides estimates for 2003 and projections for 2004 on the basis of work conducted in June 2004. Other important data sources include Djibouti's Poverty Reduction Strategy Paper (PRSP) of March 2004 and the World Bank's Country Assistance Strategy for Djibouti (March 2005). The summary table on notable strengths and weaknesses is unavoidably limited to indicators for which data are available.

The standard methodology for this Economic Performance Evaluation series includes benchmarking against comparator countries selected by the host USAID mission (in this case REDSO). In view of Djibouti's highly atypical economic structure, however, USAID agreed that the standard procedure of selecting comparator countries would be inappropriate. The benchmarking analysis is therefore based on comparisons to the median value for lower-middle-income countries globally, and, where relevant, to a regression estimate of the statistical norm for a country with Djibouti's characteristics.

HIGHLIGHTS OF DJIBOUTI'S PERFORMANCE

Economic Growth	Djibouti has achieved an economic growth rate of about 3 percent in recent years, but this is too low to have a significant impact on living standards or poverty reduction.
Poverty	Forty-two percent of Djibouti's population lives in extreme poverty; both poverty and inequality appear to be on the rise.
Gender	Gender inequity is a major impediment to economic development; women have been disproportionately deprived of access to education and productive opportunities.
Fiscal and Monetary Policy	Macroeconomic stability has been maintained, but government expenditure is well above the normal range for Djibouti's level of economic activity. Also, the fiscal framework is heavily dependent on donor funding.
Business Environment	Limited data indicate that institutional constraints severely impair private sector development. Scores for control of corruption, rule of law, and regulatory quality are all low.
Financial Sector	Data suggest that inefficiency in the financial sector constrains investment and business development; domestic credit to the private sector is shrinking relative to GDP.
External Sector	The balance of trade in goods is structurally in deficit, but the service and income balances are consistently in surplus. Aid is a major source of financing, and FDI has risen substantially in recent years.
Economic Infrastructure	Aside from the port, Djibouti's infrastructure is in poor condition. Utility costs, especially for water and power, are very high, and telephone density and Internet penetration are low compared to LMI standards.
Health	Health conditions are very poor, as reflected in a very low life expectancy, high maternal mortality rate, and high child malnutrition rate.
Education	Djibouti's human capital endowment is very weak, as reflected by low levels of educational attainment.
Employment and Workforce	Unemployment is extremely high and rising. Weak human resources, over-regulation in labor markets, and a weak enabling environment for private investment hinder improvements.
Agriculture	Agriculture contributes little to GDP, but more than one-fourth of the people depend on agriculture for their livelihood, at very low levels of productivity.

Note: Relative statements about performance are based on international benchmarking; the methodology used for this analysis are explained in the appendix.

NOTABLE STRENGTHS AND WEAKNESSES—SELECTED INDICATORS

Indicator, by Topic[a]	Strength	Weakness
Growth Performance		
Growth of labor productivity		✓
Poverty and Inequality		
Human poverty index		✓
Poverty headcount %, national poverty line		✓
Demography and Environment		
Adult literacy rate		✓
Age dependency rate		✓
Gender		
Adult literacy rate, male to female ratio		✓
Gross enrollment rate, male to female ratio		✓
Fiscal and Monetary Policy		
Government expenditure, percentage of GDP[b]		✓
Inflation rate	✓	
Wages and salaries, percent of government expense		✓
Business Environment		
Rule of Law Index		✓
Regulatory Quality Index		✓
Financial Sector		
Interest rate spread, lending rate minus deposit rate		✓
Money supply (M2), percentage of GDP	✓	
External Sector		
Aid, percentage of GNI		✓
Debt service ratio, percentage of exports (2003)	✓	
Trade, percentage of GDP	✓	
Foreign Direct Investment, percentage of GDP (2004)	✓	
Economic Infrastructure		
Internet users per 1,000 people		✓
Telephone density, fixed line and mobile, per 1,000 people		✓
Telephone cost, average local call		✓
Health		
Maternal mortality rate, deaths per 100,000		✓
HIV prevalence		✓
Life expectancy at birth		✓

Indicator, by Topic[a]	Strength	Weakness
Child immunization rate		✓
Prevalence of child malnutrition (weight for age)		✓
Education		
Persistence in school to grade 5, percentage of total	✓	
Net primary enrollment rate (total)		✓
Pupil-to-teacher ratio, primary school		✓
Employment and Workforce		
Unemployment rate		✓
Agriculture		
Agriculture value added per worker, constant 1995 USD		✓
Cereal yield		✓

[a] *The chart identifies selected indicators for which Djibouti's performance is particularly strong or weak relative to benchmark standards; details are discussed in the text. The separate Data Supplement presents a full tabulation of the data examined for this report, including the international benchmark data, along with technical notes on the data sources and definitions.*

[b] *Government expenditures as a percentage of GDP are included in this table because their level was very high relative to the level of economic activity for a country as small as Djibouti.*

1. Introduction

This paper is one of a series of Economic Performance Assessments prepared for the EGAT Bureau to provide USAID missions and regional bureaus with a concise evaluation of a broad range of indicators relating to economic growth performance in designated host countries. The report draws on a variety of international data sources[1] and uses international benchmarking against the median for lower-middle-income countries to identify major constraints, trends, and opportunities for strengthening growth and reducing poverty.

The methodology used here is analogous to examining an automobile dashboard to see which gauges are signaling problems. Sometimes a blinking light has obvious implications—such as the need to fill the fuel tank. In other cases, it may be necessary to have a mechanic probe more deeply to assess the source of the trouble and determine the best course of action.[2] Similarly, the Economic Performance Assessment is based on an examination of key economic and social indicators, to see which ones are signaling problems. In some cases a "blinking" indicator has clear implications, while in others, a detailed study may be needed to investigate the problems more fully and identify an appropriate course for programmatic action.

The analysis is organized around the mutually supportive goals of transformational growth and poverty reduction.[3] Rapid and broad-based growth is the most powerful instrument for poverty reduction. At the same time, many measures aimed at reducing poverty and lessening inequality can help to underpin rapid and sustainable growth. These interactions create the potential for stimulating a virtuous cycle of economic transformation and human development.

Transformational growth requires a high level of investment and rising productivity. This is achieved by establishing a strong enabling environment for private sector development involving multiple elements: macroeconomic stability; a sound legal and regulatory system, including secure contract and property rights; effective control of corruption; a sound and efficient financial system; openness to trade and investment; sustainable debt management; investment in education, health, and workforce skills; infrastructure development; and sustainable use of natural resources.

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[1] The primary source for international data is the latest update from USAID's internal Economic and Social Database. This database is compiled from a wide variety of original sources and maintained by the Development Information Service under PPC/CDIE. It is accessible through the USAID intranet. The report also uses readily accessible public information sources.

[2] Sometimes, too, the problem is faulty wiring to the indicator—analogous here to faulty data.

[3] In USAID's white paper *U.S. Foreign Aid: Meeting the Challenges of the Twenty-first Century* (January 2004), transformational growth is a central strategic objective, both for its innate importance as a development goal and because growth is the most powerful engine for poverty reduction.

In turn, the impact of growth on poverty depends on policies and programs that create opportunities and build capabilities for the poor. We call this the pro-poor growth environment.[4] Here, too, many elements are involved, including effective education and health systems; policies facilitating job creation; agricultural development (in countries where the poor depend predominantly on farming); dismantling barriers to micro and small enterprise development; and progress toward gender equity.

The evaluation presented in this paper must be interpreted with caution, because a concise analysis of this sort cannot provide a definitive diagnosis of economic problems or simple answers to questions about programmatic priorities. Instead, the aim of the analysis is to spot signs of economic growth problems on the basis of a review of selected indicators, subject to limits of data availability and quality. For Djibouti, data constraints are particularly serious. Nonetheless, an analysis of the data available should provide insight into the potential paths for USAID intervention to complement on-the-ground knowledge and further in-depth studies.

The remainder of the report discusses the most important results of the diagnostic analysis, in three sections: Overview of the Economy; Private Sector Enabling Environment; and Pro-Poor Growth Environment. Table 1-1 summarizes the topic coverage. The appendix briefly explains the criteria used for selecting indicators and the benchmarking methodology and includes all the indicators constituting the standard template for this report.

Table 1-1
Topic Coverage

Overview of the Economy	Private Sector Enabling Environment	Pro-Poor Growth Environment
• Growth Performance • Poverty and Inequality • Economic Structure • Demographic and Environmental Conditions • Gender	• Fiscal and Monetary Policy • Business Environment • Financial Sector • External Sector • Economic Infrastructure • Science and Technology	• Health • Education • Employment and Workforce • Agriculture

[4] A comprehensive poverty reduction strategy also requires programs to reduce the *vulnerability* of the poor to natural and economic shocks. This aspect is not covered in the template because the focus is economic growth programs. In addition, it is difficult to find meaningful and readily available indicators of vulnerability to use in the template.

2. Overview of the Economy

This section reviews basic information on Djibouti's macroeconomic performance, poverty and inequality, economic structure, demographic and environmental conditions, and indicators of gender equity.[5] Some of the indicators cited here are descriptive rather than analytical and are included to provide context for the performance analysis.

GROWTH PERFORMANCE

With an estimated GDP per capita of $790 in 2004,[6] Djibouti ranks at the low end of the World Bank's lower-middle-income (LMI) group. During the five years to 2004, GDP growth averaged just 2.2 percent per year. Although the growth rate improved to 3.2 percent in 2003 and an estimated 3.0 percent in 2004, it is still far below the median for LMI countries of 5.1 percent. In absolute terms, Djibouti's growth rate is far too low to yield tangible improvements in living standards for a population that has been expanding by nearly 2 percent per year (Figure 2-1). According to the country's PRSP, Djibouti needs to achieve at least 2 percent growth in per capita terms, along with a decline in income inequality of at least 2 percent per year, to yield any considerable impact on poverty.[7] Even this modest target is insufficient to deliver better lives in the medium term for the people of Djibouti. Thus, there is a critical need to achieve and sustain higher growth rates. The fundamentals for rapid growth in Djibouti, however, are weak.

Growth is driven by investment and productivity gains. In 2004, gross fixed investment in Djibouti reached an estimated 18.3 percent of GDP (Figure 2-2) from a low of 8.3 percent in 2001. Even with this improvement, investment in Djibouti still stands below the average for LMI countries of 22.1 percent, and it is too low to support rapid growth. Moreover, it is too soon to say whether this recent increase will be sustained. A large share of capital formation is controlled by the public sector, with private investment averaging a meager 8.6 percent of GDP over the past five years (though the figure jumped to 12.3 percent in 2004).

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[5] The separate Data Supplement provides a full tabulation of the data for Djibouti and the international benchmarks, including indicators not discussed in the text, as well as technical notes for each indicator.

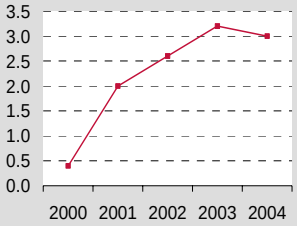
[6] The IMF World Economic Outlook database, which is the standard source for this indicator, reports this level of GDP per capita (in current U.S. dollars) for Djibouti in 2004. Different figures may be found in other data sources.

[7] See Djibouti Poverty Reduction Strategy Paper (PRSP), IMF Country Report 04/152, March 2004, p. 5.

Figure 2-1
Real GDP Growth

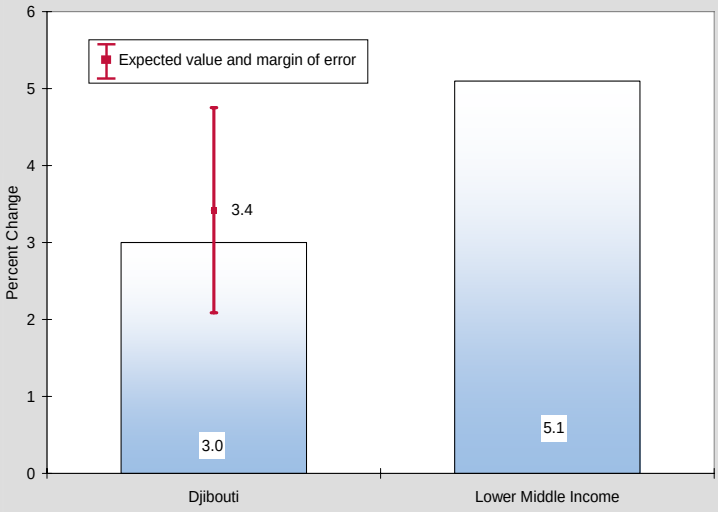
GDP growth has accelerated over the past five years but is still low.

Time Series

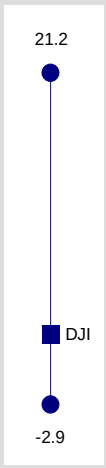


Year	Value
2000	0.4
2001	2.0
2002	2.6
2003	3.2
2004	3.0
Summary for 2000–2004	
Five-year average	2.2
Trend growth rate	N/A

Comparison to LMI Group, Most Recent Year



Global Standing



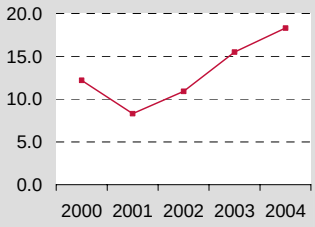
Source: World Economic Outlook

CAS Code: 11p3

Figure 2-2
Share of Gross Fixed Investment

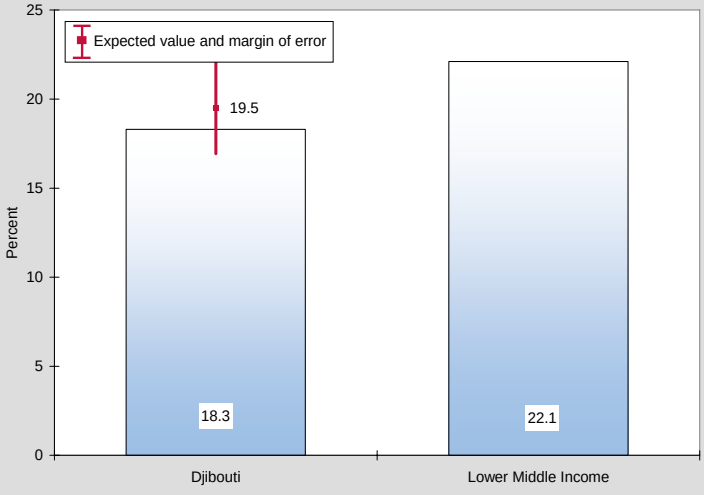
Gross fixed investment has increased, but is too low to support rapid growth.

Time Series

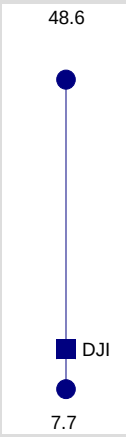


Year	Value
2000	12.2
2001	8.3
2002	10.9
2003	15.5
2004	18.3
Summary for 2000–2004	
Five-year average	13.0
Trend growth rate	15.4

Comparison to LMI Group, Most Recent Year



Global Standing



Source: World Economic Outlook

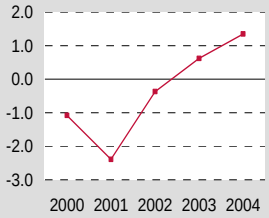
CAS Code: 11s3

The productivity of investment has also been weak. This can be seen in the incremental capital-output ratio (ICOR) of 5.8 for the period 2000–2004, which indicates that nearly $6 of gross investment has been needed per $1 of extra output. Although this is not much different from the average ICOR of 5.6 for the LMI group, countries with efficient investment tend to have ICOR values of 4 or less, implying that each unit of output growth requires much less capital. Even worse is the growth of labor force productivity, which fell at an annual average rate of 0.4 percent during the five years to 2003 (Figure 2-3). Programs aimed at improving labor productivity are imperative for faster growth.

Figure 2-3
Growth of Labor Force Productivity

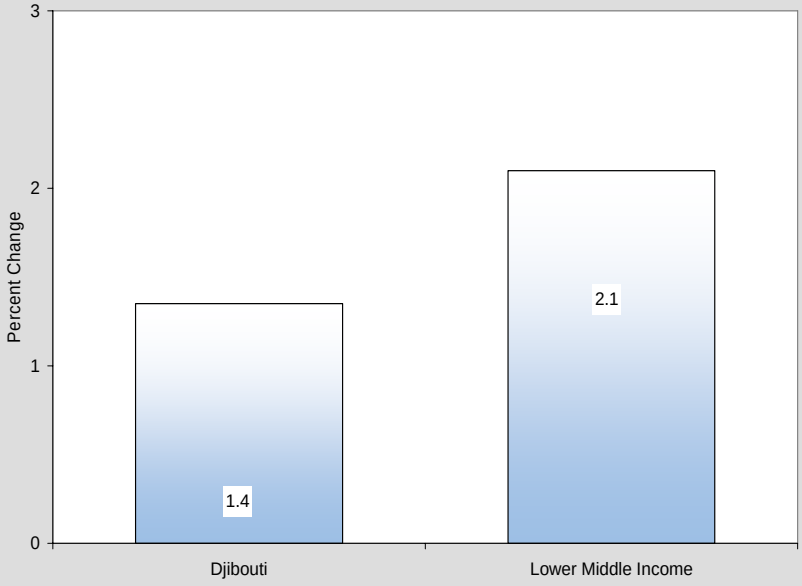
Labor force productivity has been weak.

Time Series



Year	Value
1999	-1.1
2000	-2.4
2001	-0.4
2002	0.6
2003	1.4
Summary for 1999–2003	
Five-year average	-0.4
Trend growth rate	N/A

Comparison to LMI Group, Most Recent Year



Source: World Development Indicators

CAS Code: 11s1

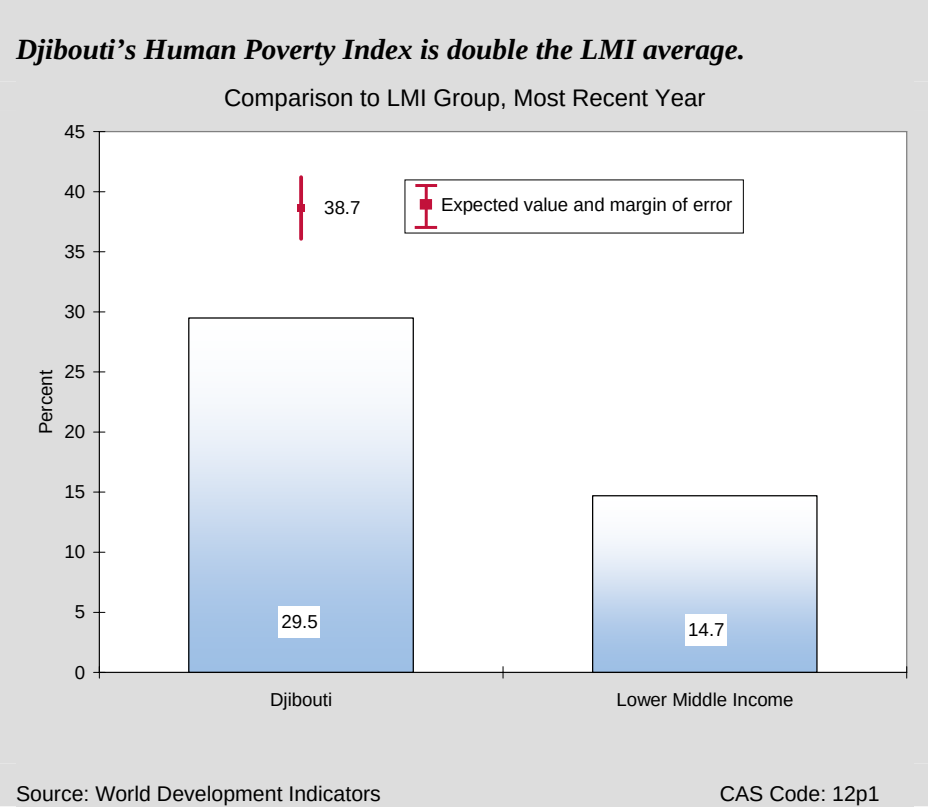
POVERTY AND INEQUALITY

Latest estimates for Djibouti show an increase in the poverty headcount, as measured by the national poverty line, from 34.5 percent in 1996 to 42.2 percent in 2002.[8] Although the poverty rate is better than the LMI average of 49.0 percent, international comparisons for this indicator can be misleading because definitions of the poverty line differ from country to country. In absolute terms, the figures reveal serious problems with poverty in Djibouti and are corroborated by the UNDP's Human Poverty Index, which measures deprivation in health and education, as well as income. On a scale of 0 (no deprivation) to 100 (maximum deprivation), Djibouti's score improved from 34.3 in 2003 to 29.5 in 2004. This is significantly better than the regression

[8] The national poverty line used here is defined as the extreme or indigent poverty line, which was evaluated at DF 114,096 per adult per year, or USD $1.8 per day.

estimate of 38.7 for a country with Djibouti's income, but much worse than the LMI median of 14.7 (Figure 2-4).

Figure 2-4
Human Poverty Index



Income inequality in Djibouti is not high by international standards, as evidenced by a Gini coefficient of 40.9 in 2002; but the Gini value has increased from 39.5 in 1996,[9] which suggests that income gains from growth have been skewed toward the non-poor. Furthermore, a large part of national income is derived from rents on the port, military base rentals, and financial support from donors (as discussed below), which are channeled mainly through the government budget. A significant part of this rent is passed on to government employees through relatively high wages, leaving inadequate resources for social expenditures, social transfers, and public investment.[10]

[9] Economic Performance Assessments normally measure inequality by the share of income or expenditure accruing to the poorest 20 percent of households, but this indicator was unavailable for Djibouti. The Gini coefficient is a widely used alternative measure of inequality, with values ranging from 0 for total equality to 100 for total inequality. According to the World Bank, households in the highest 20 percent of the income distribution in Djibouti have an average expenditure eight times higher than those in the lower quintile. Source: Country Assistance Strategy for Djibouti, International Development Association (World Bank), Report No. 31613-DJ, March 2005, p. 4.

[10] World Bank, Country Assistance Strategy, p. 1

Djibouti completed a PRSP in March 2004. The strategy focuses on four main themes: (1) strengthening Djibouti's competitiveness to create conditions for strong and sustainable growth; (2) accelerating the development of human resources through social programs aimed at reducing poverty and gender disparities; (3) regional and local development through investments in water and basic services in poor neighborhoods, in both rural and urban areas; and (4) improving governance and public sector management, including transparency and accountability to improve efficiency and the distribution of benefits to the poor. These are highly appropriate priority areas for donor support to help Djibouti reduce poverty and inequality.

ECONOMIC STRUCTURE

The structure of Djibouti's economy has changed little in the 25 years since independence. The only major changes in the past decade have been an upsurge in the use of the port since 1998 by landlocked neighbor Ethiopia and the establishment of a permanent U.S. military base.[11] The economy is based on services: the port, the railway, the civil service, the French military garrison, and German and U.S. military bases (since 2002). The service sector accounted for an average of 81.6 percent of GDP over the five years to 2001, while industry and agriculture accounted for 14.8 and 3.7 percent respectively. The manufacturing sector is miniscule, accounting for only 3.3 percent of GDP.[12] Manufacturing is limited mainly to food processing and shipbuilding, providing very limited employment opportunities. Djibouti's high factor costs and low labor productivity, as well as other weaknesses in the business environment (discussed below), have limited the country's potential for stimulating employment and investment in export-oriented manufacturing.

No data on employment per sector were available for Djibouti in standard international sources. However, the PRSP estimates that the rural sector employs 28.5 percent of the population.[13] The sharp disparity between the share of workers in the rural sector and agriculture's tiny share of GDP reveals that rural productivity is extremely low in comparison to other sectors of the economy. Measures to enhance agricultural productivity or accelerate job creation outside agriculture can therefore have a strong impact on livelihoods and on overall productivity growth for the economy.

DEMOGRAPHY AND ENVIRONMENT

In 2004, Djibouti's population was estimated at 715,520 people. The estimated rate of population growth has been decelerating from 2.3 percent in 2000 to 1.4 percent in 2004. Because demographic changes usually occur over a much longer time, this rapid decline calls into question the accuracy of the figures. Taking the figures at face value, population growth in Djibouti is now on par with the median for LMI countries. Slower population growth will contribute to more rapid growth of per capita income over the next two decades, while easing the growth of demand for public services, including education and health. For the immediate future, however, the age

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[11] Djibouti Country Profile July 2004, The Economist Intelligence Unit, London, pp. 20-21

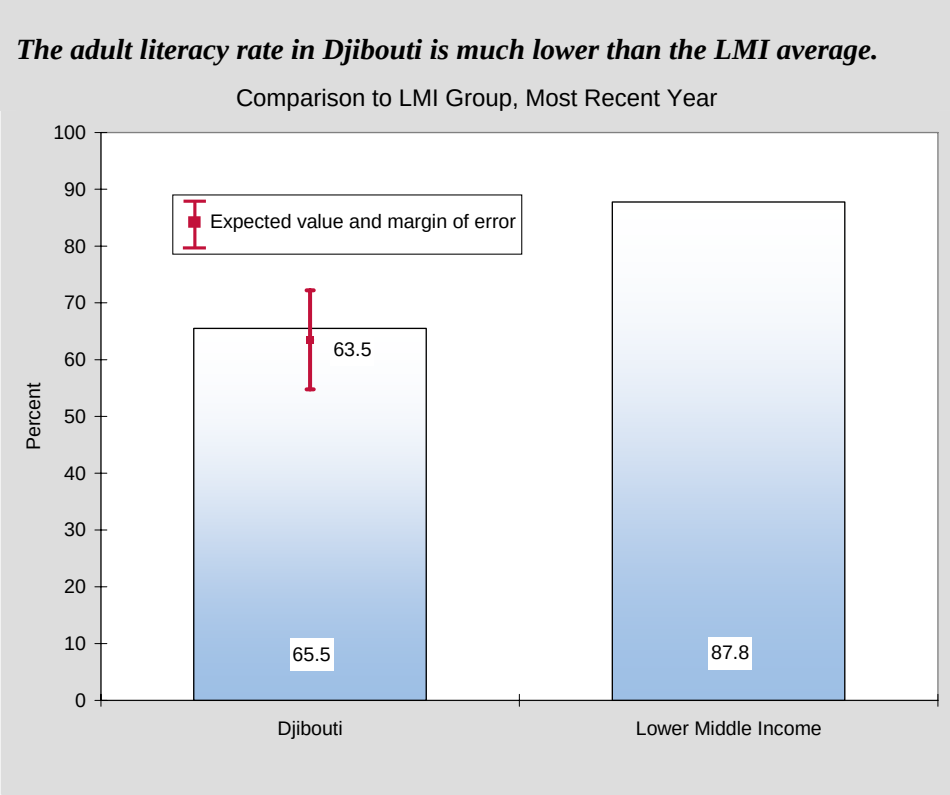
[12] Djibouti Country Profile July 2004, p. 26

[13] See Djibouti PRSP, pp. 11, 84.

dependency ratio remains very high, with 0.85 dependents per person of working age, compared to an average of nearly 0.6 for LMI countries. A high age dependency rate is both a cause and a symptom of deep poverty.

The population is also poorly endowed with human capital. The adult literacy rate of 65.5 percent in 2003 is far below the average of 87.8 percent for LMI countries—a legacy of a weak education system (Figure 2-5). Adult literacy programs targeting the poor and women—groups with especially high illiteracy—could contribute greatly to faster socioeconomic progress.

Figure 2-5
Adult Literacy Rate



With 84.1 percent of the population living in urban areas in 2004,[14] Djibouti has one of the highest urbanization rates on the African continent. Nearly two-thirds of the population resides in the metropolitan area of Djibouti-Ville. The urbanization rate has risen from 82.2 percent in 2000, as urban centers experience a rapid and unplanned expansion of precarious settlements that lack basic infrastructure such as safe drinking water, sewage treatment, housing, and transportation.

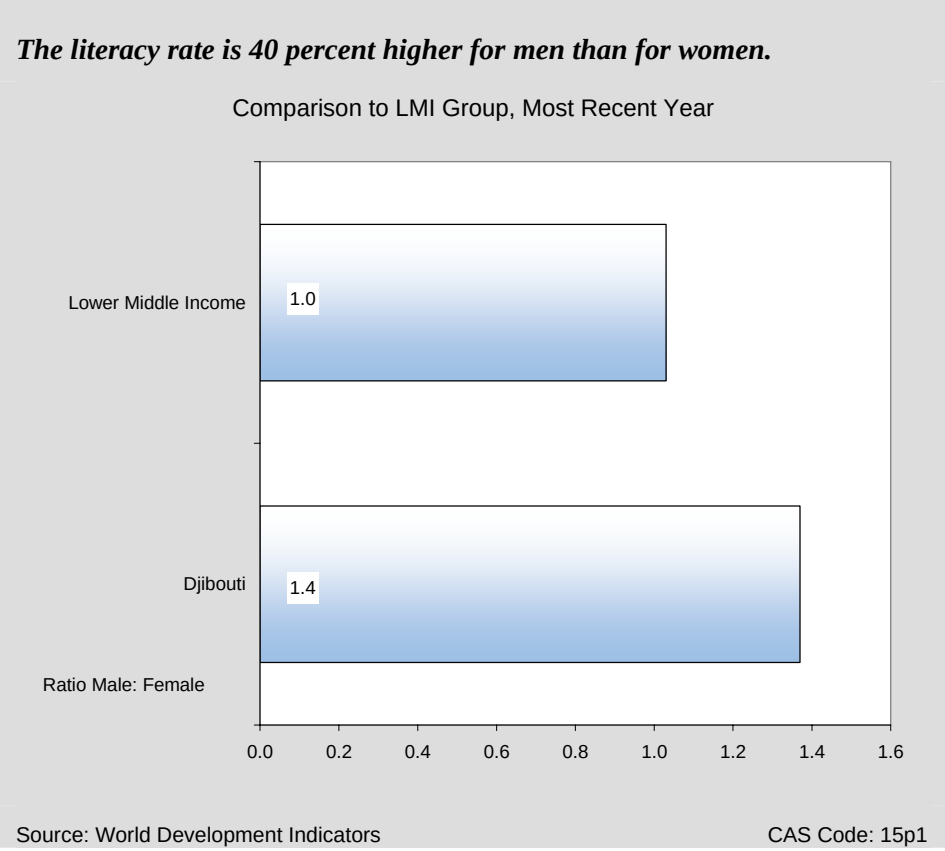
[14] The source for the urbanization rate is the World Development Indicators 2005 database. This rate appears to be at odds with the estimate cited in the PRSP that the rural sector employs 28.5 percent of the population; these figures are not directly comparable—one refers to population and the other to employment.

Rapid urban growth is a breeding ground for unemployment and exclusion.[15] Programs aimed at urban development and workforce development may be priorities for donor intervention.

GENDER

Gender equity is central to poverty alleviation in countries such as Djibouti, where women have been disproportionately deprived of access to education and productive opportunities. These problems are reflected in the fact that the adult literacy rate was nearly 40 percent higher for men than for women in 2002 (latest year of data) (Figure 2-6). Educating women should be a top priority not only on principle, but also because female education plays a catalyzing role in economic growth: better educated women are more productive, have fewer children, are less prone to fall victim to HIV/AIDS, and pass along better health and education to their children.

Figure 2-6
Male-to-Female Adult Literacy Ratio



Focusing on the school-age population, Djibouti's gross enrollment rate at all levels in 2004 was 31 percent higher for males than for females, reflecting continued gender inequity in education. By comparison, the median LMI country has already achieved gender equity—with the male-to-female ratio at or near 1—for both adult literacy and gross enrollment. Reflecting the inequities in

[15] Djibouti PRSP, p. 3

education, the integration of women into the labor force is still limited. The participation of women in the job market is marked by a very low employment supply rate: 35 percent, compared to 73 percent for men.[16]

Turning to equity in health, the male-to-female ratio for life expectancy is 0.96, reflecting that women live somewhat longer than men. This is comparable to the LMI average of 0.93. Even so, life expectancy in Djibouti is extremely low for both men and women, at just under 43 years. In all respects, gender themes are a vital cross-cutting consideration for donor programs.

[16] Djibouti PRSP, p. 27

3. Private Sector Enabling Environment

This section reviews indicators for key components of the enabling environment for encouraging rapid and efficient growth of the private sector. Sound fiscal and monetary policies are essential for macroeconomic stability, which is a necessary (though not sufficient) condition for sustained growth. A dynamic market economy also depends on basic institutional foundations, including secure property rights, an effective system for enforcing contracts, and an efficient regulatory environment that does not impose undue barriers on business activities. Financial institutions play a major role in mobilizing and allocating saving, facilitating transactions, and creating instruments for risk management. Access to the global economy is another pillar of a good enabling environment, because the external sector is a central source of potential markets, modern inputs, technology, and finance, as well as competitive pressure for efficiency and rising productivity. Equally important is development of the physical infrastructure to support production and trade. Finally, developing countries need to adapt and apply science and technology to attract efficient investment, improve competitiveness, and stimulate productivity growth.

FISCAL AND MONETARY POLICY

Djibouti's macroeconomic performance has been mixed. Because Djibouti has a currency board, which pegs the Djibouti franc to the U.S. dollar,[17] inflation (a Millennium Challenge Account [MCA] eligibility criterion) has remained very low, averaging 2 percent from 2000 through 2004. Nonetheless, the country faces some fiscal problems. The overall budget deficit (cash basis) widened from 2.0 percent of GDP in 2001 to 5.0 percent in 2003, though the IMF estimated that the deficit would decline to 0.9 percent in 2004 because of tighter spending and an increase in official grants.

Government expenditure has been very high for a country with Djibouti's level of income, indicating that the public sector commands a disproportionate share of economic resources.[18] Expenditures reached 34.4 percent of GDP in 2004, compared with a regression benchmark of

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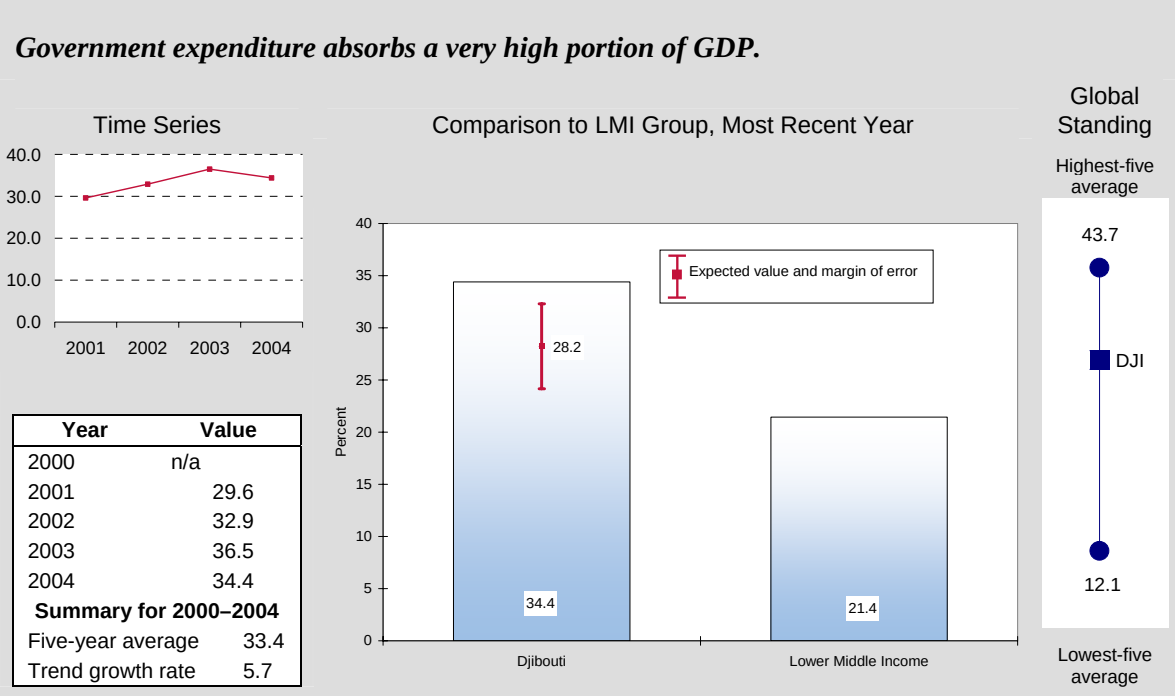
[17] Dfr 177.72: US$1.

[18] The World Development Indicators 2005 database adopts new categories for government finance statistics. As a result, the database has fiscal data for very few developing countries, and group medians for these fiscal variables are not meaningful because of the limited sample size. The international benchmarking analysis for fiscal indicators is therefore based on data from WDI 2004.

28.2 percent and an average for LMI countries of 21.4 percent (Figure 3-1). Expenditures in 2004 were dramatically higher than in 2001, when the figure was 29.6 percent of GDP; over the same period, domestic revenues decreased slightly, from 23.3 percent of GDP in 2001 to 22.0 percent in 2004. The revenue yield is better than the LMI average, but well below the estimated regression benchmark for a country with Djibouti's characteristics (Figure 3-2). The main source of fiscal stress, however, is clearly on the expenditure side of the budget.

Figure 3-1
Government Expenditure as Percentage of GDP



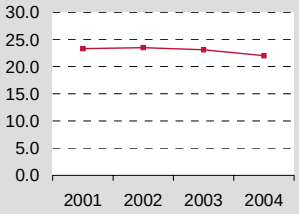
Fiscal consolidation has been a major component of recent reform programs agreed on with the IMF. The main objectives have been to increase revenue and rationalize expenditures. The central problem with public spending has been an excessive wage bill. Although wages and salaries dropped from 49.9 percent of government expenditures in 2000 to 39.1 percent in 2004, they still crowd out resources needed for social expenditures (Figure 3-3). Furthermore, Djibouti remains heavily dependent on donor financing to fill the large gap between expenditure and domestic revenue. According to the Economist Intelligence Unit, the IMF is also concerned about the high level of unorthodox financing through arrears to suppliers, estimated at an extraordinary 23.1 percent of GDP in 2003.[19]

[19] Djibouti Country Profile July 2004, p. 22

Figure 3-2
Government Revenue as Percentage of GDP

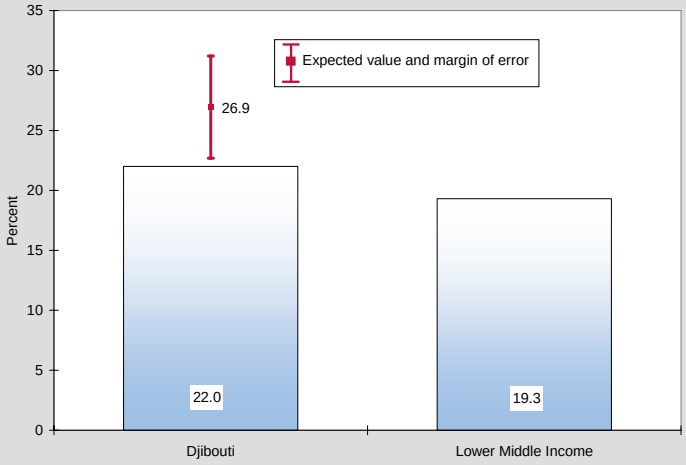
Revenue performance is below the regression benchmark, but better than the LMI average.

Time Series

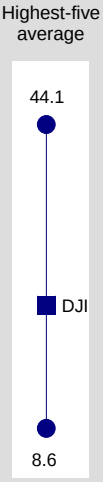


Year	Value
2000	n/a
2001	23.3
2002	23.5
2003	23.1
2004	22.0
Summary for 2000–2004	
Five-year average	23
Trend growth rate	-1.9

Comparison to LMI Group, Most Recent Year



Global Standing



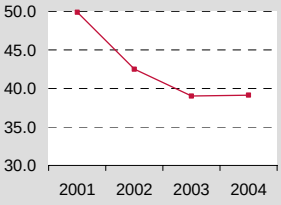
Source: World Economic Outlook

CAS Code: 21p2

Figure 3-3
Wages and Salaries as Percentage of Government Expenditure

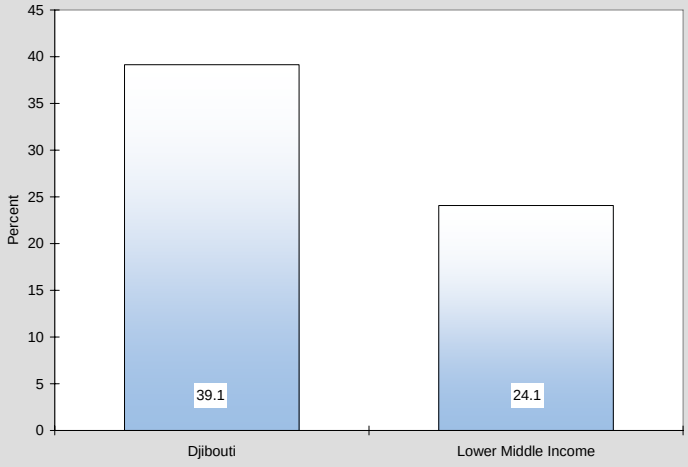
A very high share of government expenditure is absorbed by wages and salaries.

Time Series

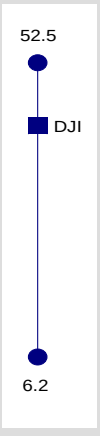


Year	Value
2000	n/a
2001	49.9
2002	42.5
2003	39
2004	39.1
Summary for 2000–2004	
Five-year average	42.6
Trend growth rate	-7.8

Comparison to LMI Group, Most Recent Year



Global Standing



Source: World Economic Outlook

CAS Code: 21s1a

IMF Program Status for Djibouti

Djibouti's Poverty Reduction and Growth Facility (PRGF) expired in January 2003. The IMF then implemented a Staff Monitored Program (SMP) to track performance before a new PRGF could be considered. An IMF mission in July 2005 reached an understanding with the authorities to extend the SMP to December 2005. Government performance during this period will determine whether a new three-year PRGF arrangement can be negotiated in 2006. The IMF team noted that the government has taken steps to improve the fiscal accounts and welcomed the government's stated intention to improve external competitiveness through structural reforms in line with the PRSP, including reforms to the labor, commercial, and investment codes, and simplification of the tax exemption regime. The IMF urged consideration of policies other than selective tax exemptions to increase competitiveness, such as the planned construction of the Doraleh port, a new free trade zone, and expanded trade within the COMESA block.

This analysis suggests that programs to strengthen fiscal management, budget planning, and tax administration remain a high priority. The government needs to improve public services and pursue a more pro-poor expenditure policy while gradually reducing dependence on foreign aid.

BUSINESS ENVIRONMENT

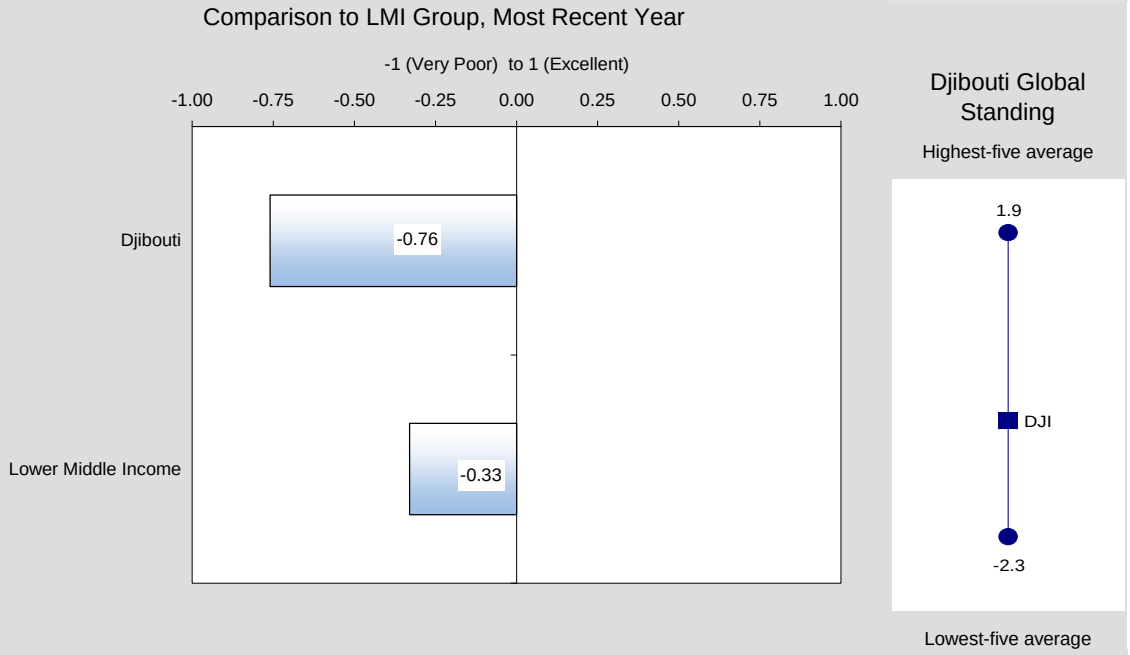
Institutional barriers to doing business, including corruption in government, are critical determinants of private sector development and prospects for achieving sustainable growth. Corruption in Djibouti is perceived as a pervasive and growing problem. This can be seen in the World Bank Institute's Control of Corruption Index. For 2004, Djibouti received a score of -0.94, on a scale of -2.5 (very poor) to + 2.5 (excellent), with 0 as the global mean. Only 14 percent of countries received a lower rating than Djibouti. In addition, Djibouti's performance has worsened since 2002, when it received a score of -0.72.[20] These scores suggest that corruption is a serious impediment to growth in Djibouti, which must be taken into account in all donor programs.

The World Bank's Doing Business database does not cover Djibouti, but two other MCA indicators provide useful insight into the country's business environment. The World Bank's Rule of Law Index measures the extent to which citizens have confidence in and abide by the rules of society. Djibouti scored -0.61 (on a scale of -2.5 to +2.5). This is slightly below the average of -0.51 for LMI countries. The World Bank's Regulatory Quality Index measures the incidence of market-friendly policies, taking into account such factors as price controls, bank supervision, and perceptions of excessive regulation. On this index Djibouti scores -0.76, which is much worse than the LMI average of -0.33 (Figure 3-4).

[20] The World Bank's Control for Corruption Index is used here in lieu of Transparency International's Corruption Perception Index, which does not cover Djibouti. The World Bank's corruption score is a primary indicator for MCA eligibility. (See http://info.worldbank.org/governance/kkz2004/sc_country.asp)

Figure 3-4
Regulatory Quality Index

Djibouti's low score denotes less market friendly policies, which hinder private sector development.



Source: World Development Indicators CAS Code: 22p4

The indicators available—despite the absence of more complete data—convey a consistent message that institutional constraints severely impair private sector development. Initiatives to control corruption and promote institutional reform clearly merit a high priority for donor agencies and government programs, particularly in view of the underlying need to increase investment and productivity. Donor agencies may also consider initiatives to develop better data on the business environment, including adding Djibouti to the Doing Business survey.

FINANCIAL SECTOR

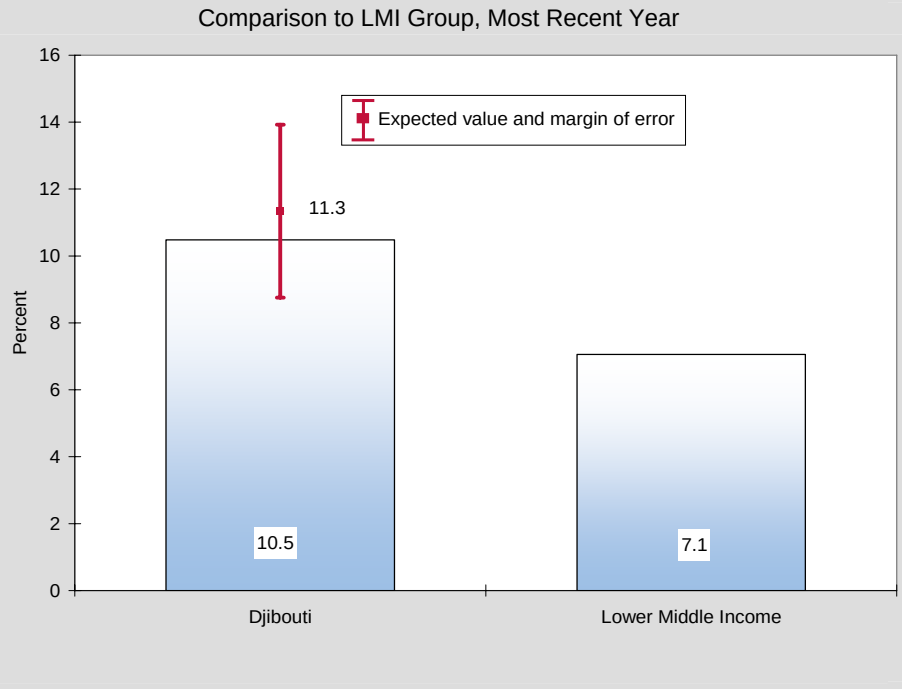
A sound, efficient, and competitive financial sector is fundamental for mobilizing saving, allocating financial resources, fostering entrepreneurship, and improving risk management. Djibouti's financial sector performance is comparable to LMI standards with respect to size, depth, and credit intermediation to the private sector. However, credit to the private sector has been decreasing and the efficiency of the financial sector appears to be weak. Much remains to be done to overcome these barriers to foster business and investment growth.

For a country at this level of income, Djibouti has a large banking system. It has a high ratio of broad money (mainly deposit balances) to GDP—reaching 64.2 percent in 2003. This monetization indicator is well above the regression benchmark of 38.8 percent for a country with Djibouti's characteristics as well as the LMI median of 40.5.

Some signs are troubling, however. Most notably, domestic credit to the private sector has shrunk from 32 percent of GDP in 2000 to 22.5 percent in 2003, slightly below the LMI median of 24.6 percent. Additionally, the interest rate spread between loan and deposit rates climbed from 8.7 percent in 2001 to 10.5 percent in 2003 (Figure 3-5). A high interest rate spread suggests inefficiency in the banking sector. The figure for Djibouti is below the regression benchmark of 11.3, but well above the LMI average of 7.1 percent, which is high in absolute terms. Furthermore, the trend toward a higher interest rate spread points to deteriorating loan conditions for borrowers. A similar inference can be drawn from the real interest rate, which has been high in recent years, averaging nearly 10 percent.

Figure 3-5
Interest Rate Spread

Djibouti has a high interest rate spread, suggesting inefficiency in the financial system.



Source: World Development Indicators CAS Code: 23p2

Part of the problem with the banking system is a weak institutional environment to facilitate lending and reduce risks. For most countries, the World Bank's Doing Business survey provides valuable information on the institutional environment for lending (such as the cost to create collateral and an index of legal rights of borrowers and lenders). Unfortunately, this information is not available for Djibouti. Nevertheless, the IMF reports that banks seem to be reluctant to increase credit in an environment of nonperforming loans (about 26 percent of total loans), and

long delays in pursuing delinquent borrowers in court.[21] Furthermore, competition in the sector is very weak, with two banks accounting for about 95 percent of deposits and issuing more than 85 percent of credit.[22] The concentrated market undoubtedly contributes to the high interest rate spread. All of these factors seriously constrain borrowing by the private sector, inhibiting business growth and investment.

EXTERNAL SECTOR

Fundamental changes in international commerce and finance, including reduced transport costs, advances in telecommunications technology, and lower policy barriers, have fueled a rapid increase in global integration in the past 25 years. The international flow of goods and services, capital, technology, ideas, and people offers great opportunities for Djibouti to boost growth and reduce poverty by stimulating productivity and efficiency, providing access to new markets and ideas, and expanding the range of consumer choice. Globalization also creates new challenges in the need for institutions, policies, and regulations to take full advantage of international markets, develop cost-effective approaches to cope with adjustment costs, and establish systems for monitoring and mitigating the associated risks.

As could be expected from Djibouti's geography, the economy is strongly integrated with international markets. The ratio of trade (exports plus imports of goods and services) to GDP reached 107 percent in 2001, compared to an average of 78.1 percent for LMI countries. Despite a slight decline in 2004, exports of goods and services have grown by an average of 6.3 percent per year in the past five years, a rate that compares favorably to the regression benchmark of 3.6 percent and to the average of 5.8 percent growth for LMI countries. The trade statistics for Djibouti, though, can be misleading, because they include a large volume of re-exports. For 2002, the Economist Intelligence Unit reports that re-exports constituted more than 80 percent of the total. This is not surprising given the absence of significant production capacity in the country. Merchandise exports from Djibouti are mainly live animals and skins. Imports, which are the main source of manufactured goods, foodstuffs, and capital goods, have grown rapidly, in part because of the construction of the Doraleh port complex. The narcotic qat has accounted for about 10 percent of imports. [23]

Services are by far the largest source of foreign exchange. Although the merchandise trade balance is structurally in deficit, the service and income balances are consistently in surplus.[24] Still, the overall current account balance has been consistently negative, with an average deficit of 7 percent of GDP during the period 2001–2004.

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[21] Djibouti: First Review Under the Staff Monitored Program, IMF Country Report No. 04/372, November 2004, p. 6

[22] Djibouti Country Profile July 2004, p. 27

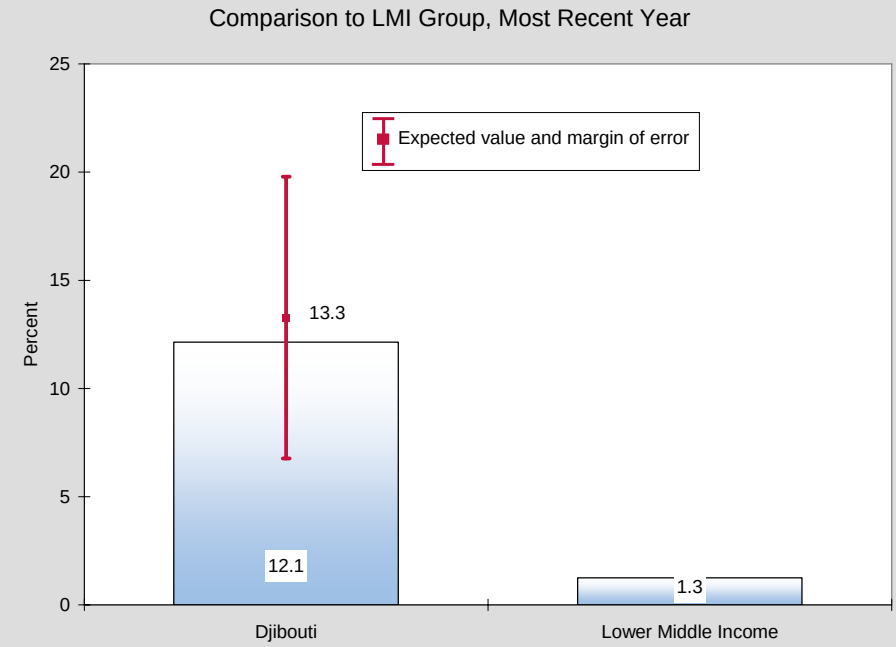
[23] Djibouti Country Profile July 2004, p. 28. According to this source, Djiboutians are major consumers of qat, a stimulant with a chemical structure similar to that of amphetamine. The drug is imported daily from Ethiopia. Some estimates suggest that qat accounts for 25–40 percent of household expenditures. Its health effects are disputed, but its economic impact— loss of working time and productivity—is clearly negative. Qat has been banned in Eritrea, Tanzania, and Somalia, but is legal in Djibouti.

[24] Ibid, p. 29

International aid plays a central role in Djibouti's economy and has been a major source of balance-of-payments financing as well as budget financing. Aid inflows averaged 12.2 percent of gross national income (GNI) over the five years to 2003. This figure exceeds the LMI average by more than 10 percentage points, but it is in line with the regression estimate for a country with Djibouti's characteristics (Figure 3-6).

Figure 3-6
Aid as a Percentage of GDP

Djibouti is heavily dependent on foreign aid.



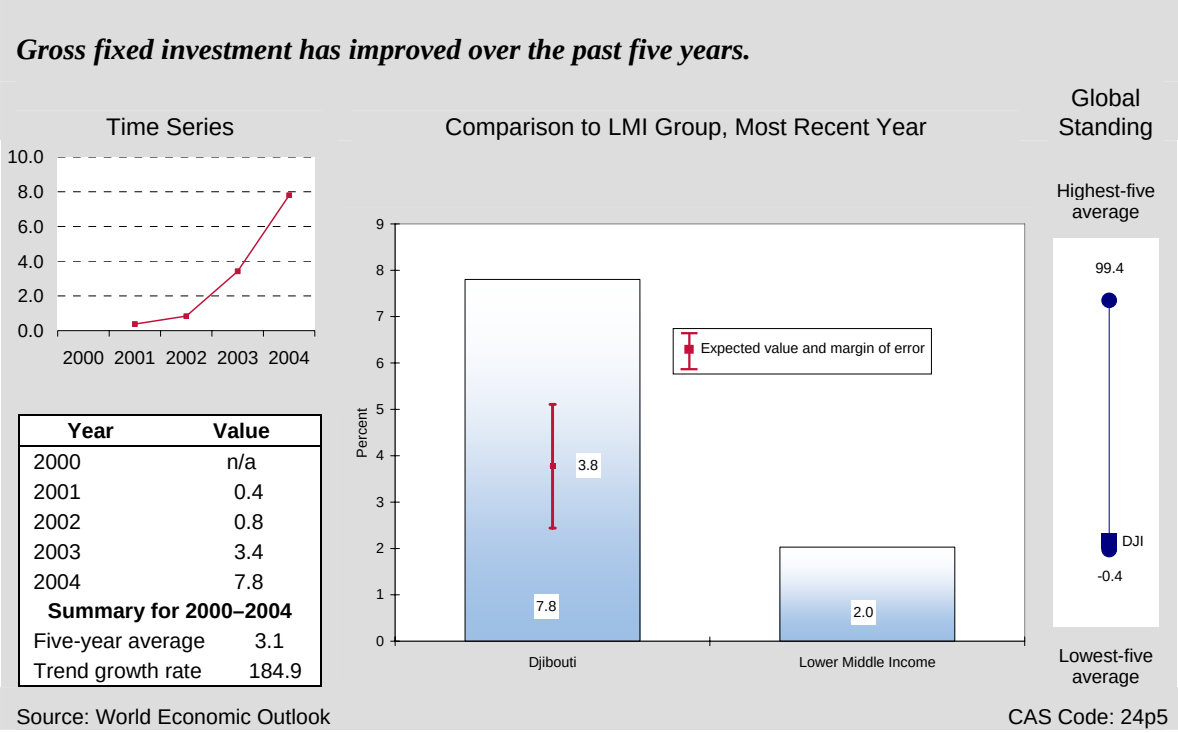
Source: World Development Indicators CAS Code: 24p1

Djibouti's external debt is not a major problem. The majority of debt financing is contracted on concessional terms, and the present value of debt is just 43.7 percent of GNI. Although this is a sharp increase from 31.5 percent in 2000, it is near the low end of the normal range indicated by the regression benchmark for Djibouti and equal to the average for LMI countries. In addition, debt service obligations averaged just 7.5 percent of exports over the five years to 2004, which compares favorably to the average of 11.6 percent for LMI countries. Although the debt burden is manageable now, the recent trend of new borrowing can lead to major problems if it continues.

One way to reduce aid dependence and the need for borrowing is to attract more foreign direct investment (FDI). FDI rose substantially in the past five years, to 7.8 percent of GDP in 2004. This is well above the regression benchmark of 3.8 percent and the average of 2.0 percent for LMI countries (Figure 3-7). FDI into Djibouti, however, amounted to just 0.4 and 0.8 percent of GDP in 2001 and 2002, respectively, and the recent increase reflects the implementation of just three projects: the oil terminal, a new port facility, and the free zone. Efforts to improve the

business environment, the infrastructure, and other production factors must not be relaxed, or FDI may fall back to very low levels after the current projects are finished.

Figure 3-7
FDI as Percentage of GDP



A more immediate problem with the external sector is that the level of foreign exchange reserves is very low. For the past five years, reserves have averaged 3.2 months of import cover, barely above the three-month threshold that is usually considered a sign of high susceptibility to external shocks. Such shocks could jeopardize the stability of the currency board arrangement. The low level of reserves underscores the importance of measures to expand foreign exchange earnings and attract larger net inflows of FDI.

ECONOMIC INFRASTRUCTURE

A country needs good physical infrastructure—for transportation, communications, power, and information technology—to strengthen competitiveness and expand productive capacity. It is difficult to benchmark the quality of Djibouti's infrastructure because of the lack of data. The main source for infrastructure indicators in this series of country reports is the Global Competitiveness Report, from the World Economic Forum,[25] but it does not cover Djibouti.

[25] This section normally relies on perception indicators to assess infrastructure quality and adequacy because objective measures of infrastructure quantity often have little diagnostic value. For example, a low value for kilometers of paved roads does not imply that there is a problem to be fixed, Because unpaved all-weather roads may be more efficient than paving secondary and tertiary roads in poor countries.

Neither are standard World Development Indicators data on electricity production and consumption, the rail network, or paved roads available for Djibouti.

Data on the telecommunications infrastructure are available, and they indicate that conditions in Djibouti are not very good. For example, 2003 estimates indicate a telephone density of only 49.7 lines per 1,000 people. Although this is in line with the estimated regression benchmark of 44.6 lines per 1,000 people, it is merely one-fifth the LMI average (272.6). The trend, however, is impressive, with telephone density increasing four-fold in the past four years, from 14.7 lines per 1,000 in 1999. This increase reflects rapid growth in the cellular phone system. Djibouti's Internet infrastructure is similarly experiencing rapid growth from an extremely low base. The country reported 9.7 Internet users per 1,000 people in 2003, compared to 2.2 in 1999. Even so, the latest figure is far below the LMI average of 39.8 users per 1,000 people.

One notable area of infrastructure improvement is the country's international port, which has benefited greatly from higher traffic volume since the Ethiopian–Eritrean war in 1998. Djibouti derives substantial revenue from port rents. The port is a lifeline to the interior and is being developed as the engine for growth and employment. This major project, including private investment to upgrade infrastructure such as an oil terminal, a deep-water container terminal, and an industrial and commercial free zone in the Doraleh area, is at the heart of the PRSP strategy. Expansion of Ethiopian transit traffic and of trade with the African hinterland is also a high priority for the government, which is reflected in its plans to rehabilitate the Djibouti–Galafi road and prepare for a concession to develop the rail link between Djibouti and Addis Ababa.

The PRSP identifies utilities as a serious obstacle to improving competitiveness. The high costs of water and power—sectors in which the government maintains a monopoly—constrain private sector growth and bar access to utilities by the poor. According to the World Bank, the prices for electricity and water are much higher than in other countries in the region. In Djibouti, tariffs for electricity and water service are the highest in the Middle East and North Africa: an average of US$0.20 per kWh for electricity and US$1.10 per m^3 for water, compared to the Middle East and North Africa average of US$0.07 per kWh for electricity and US$0.28 per m^3 for water.[26]

High utility costs particularly deter prospective manufacturing. An overhaul or privatization of these industries will be central to Djibouti's success in becoming a regional trans-shipment hub. The government should also consider liberalizing or tendering for concession other infrastructure services such as telecom and future port activities. This opening up of service provision, in turn, will attract more foreign investment, boost productivity, and potentially attract more donor support for improving transportation links.

SCIENCE AND TECHNOLOGY

Science and technology are central to dynamic growth because technical knowledge is a driving force for productivity and competitiveness. For LMI countries such as Djibouti, transformational development increasingly depends on acquiring and adapting technology from the global economy and applying it in ways that are appropriate to their level of development. A lack of

[26] Country Assistance Strategy for Djibouti, p. 15.

capacity to acquire and use technology prevents an economy from benefiting fully from globalization.

Unfortunately, few international indicators of science and technology are available. Information on Djibouti is especially sparse because the country is not included in the World Economic Forum's FDI technology transfer index, which measures executive perceptions of the extent to which FDI brings in new technology. Similarly, data are unavailable for standard indicators such as spending on research and development (R&D) or the number of patent applications. Countries in the LMI group average just 0.3 percent of GDP on R&D expenditures and 13 patents filed by residents per year. The average score on the FDI technology transfer index is 4.6 (on a scale of 1 to 7).

About the only data available for Djibouti are on Internet users. As discussed above in the technology section, Internet use has risen rapidly in recent years, but remains very low by all standards.

Given the vital role of technology in modern economic growth, Djibouti should seek investment projects with the potential for technology transfer while strengthening local capacity to absorb technology through education and training, particularly in math, science, and technical skills. Furthermore, collecting data on science and technology indicators would help the government monitor improvements in this area.

4. Pro-Poor Growth Environment

Although rapid growth is the most powerful and dependable instrument for poverty reduction, the link between growth and poverty reduction is not mechanical. In some cases, income growth for poor households outpaces the overall rise in per capita income, while in others, growth benefits the non-poor far more than the poor. A pro-poor growth environment stems from policies and institutions that improve opportunities and capabilities for the poor while reducing their vulnerabilities. Pro-poor growth is associated with improvements in primary health and education, the creation of jobs and income opportunities, the development of skills, access to microfinance, agricultural development (in countries with a large rural population), and gender equity.[27] This section focuses on four of these issues: health, education, employment and the workforce, and agricultural development.

HEALTH

The provision of basic health services is a major form of human capital investment and a significant determinant of growth and poverty reduction. Although health programs do not fall under the EGAT bureau, an understanding of health conditions can influence the design of economic growth interventions.

Djibouti's performance on health indicators shows critical difficulties, though the country has made progress in a few areas. Life expectancy is commonly used as an indicator of overall health conditions. Djibouti's average life expectancy is alarmingly low, at 43.0 years (in 2003). This is one of the lowest figures in the world. By comparison, the LMI average is 69.5 years, and the regression benchmark for Djibouti, which includes an adjustment to reflect low life expectancy in Africa, is 49.8 years (Figure 4-1).

Another very troubling indicator is the maternal mortality rate, estimated at 730 per 100,000 live births (compared to the LMI average of 110), and the infant mortality rate of 103.1 per 1,000 live births (compared to the LMI average of 7). In addition, the World Bank estimates that 14 percent of children under the age of five suffer from acute malnutrition, while 31 percent have chronic malnutrition.[28] Diarrheic illnesses—stemming in part from a lack of access to improved

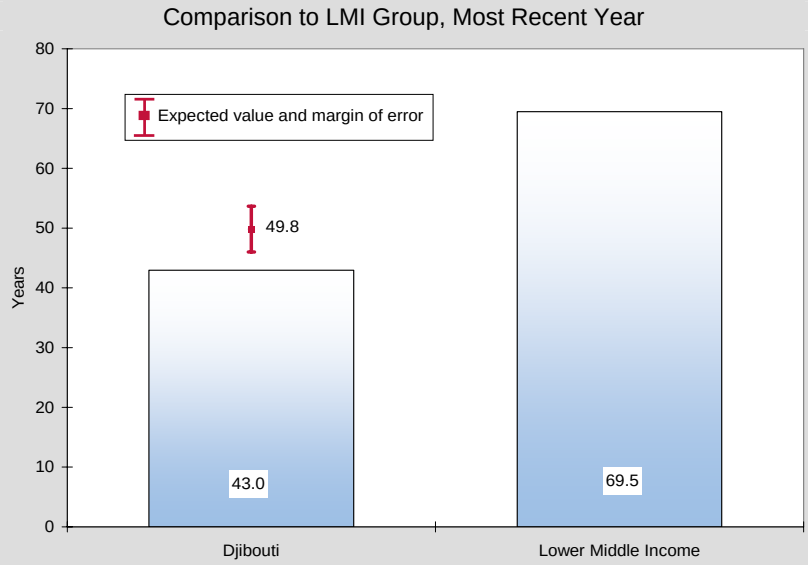
[27] For economic growth programming, the template does not cover emergency relief.

[28] The 2005 World Development Indicators database gives a figure of 18.0 percent for the prevalence of child malnutrition. The higher figures cited in the text are from the 2005 Country Assistance Strategy for Djibouti.

sanitation services—and respiratory infections are the most common causes of infant and child mortality. Indeed, only 50 percent of the Djibouti population has access to improved sanitation, which is well below the 74 percent LMI average. Improvement in these health indicators, including halving maternal and infant mortality rates by 2015, is a major objective of the 2004 PRSP.

Figure 4-1
Life Expectancy at Birth

Life expectancy is exceedingly low, indicating poor health conditions overall.



Source: World Development Indicators CAS Code: 31p2

Two encouraging signs of progress can be seen: in the fight against HIV/AIDS and in child immunization. HIV prevalence declined from double-digit rates five years ago—11.8 percent in 1999—to an estimated 2.9 percent in 2003. Similarly, the child immunization rate has improved markedly, from an extremely low 23 percent in 1999 to 67 percent in 2003. These improvements have occurred while health expenditure remained steady at 3.3 percent of GDP (latest data for 2002), which is on par with the average for LMI countries. Despite this progress, overall health conditions remain poor, HIV/AIDS is still a serious problem, and child immunization still has a long way to go to match the LMI average of 93 percent coverage. Both donor support and intensified efforts by the government are needed to improve health services and conditions as an end in itself and also as means to higher productivity and more rapid growth.

EDUCATION

Although the data on Djibouti's education system are limited, the indicators available show that Djibouti is not on track to meet the Millennium Development Goals in this area. One remarkably low indicator is the primary enrollment rate. For 2004, net enrollment is estimated at 36 percent,

just a fraction of the LMI average and less than half the regression benchmark (Figure 4-2). The difference between male and female primary enrollment rates—40 percent and 32 percent, respectively—is large.

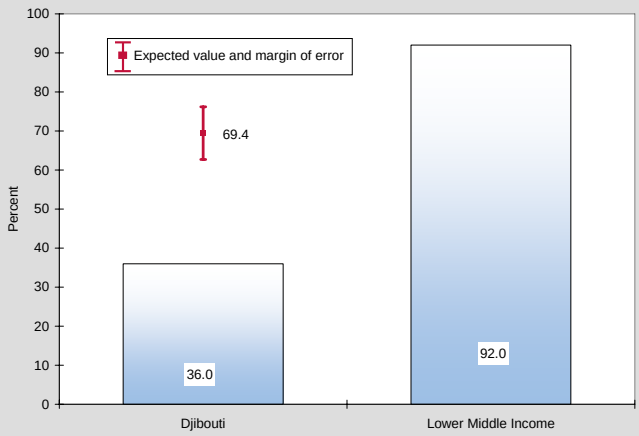
Figure 4-2
Net Primary Enrollment Rate

Net primary enrollment is among the lowest in the world.

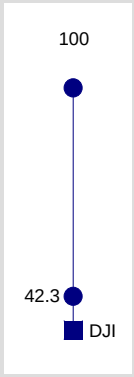
Time Series

Year	Value
2000	30
2001	32
2002	34
2003	n/a
2004	36
Summary for 2000–2004	
Five-year average	33
Trend growth rate	N/A

Comparison to LMI Group, Most Recent Year



Global Standing



Source: World Economic Outlook

CAS Code: 32p1a

Although enrollment rates are extremely low, most children who do enter the school system reach fifth grade. According to World Bank data, persistence to grade 5 was 88 percent in 2002 (the latest year of data). This is better than the LMI group average of 81.2 percent and well above the regression benchmark of 71.4 percent for a country with Djibouti's characteristics. The estimates for male and female students are 89 percent and 85 percent, respectively, for 2001.

Net enrollment rates have been increasing slowly: in 1999 net enrollment was at 30 percent, and in 2004, 36 percent. UNESCO's estimate of the gross primary enrollment rate—which includes all primary students rather than just those of the appropriate age group—is also extremely low, at 42 percent in 2004. Thus, the PRSP objective of increasing the primary enrollment rate to 73 percent by 2005 is highly unrealistic. The longer-term goal of achieving universal primary enrollment by 2015 could still be achieved with a major policy effort and a commitment to large financial support.

It is difficult to gauge education quality from the numbers, but a rough proxy is the pupil–teacher ratio for primary schools. For Djibouti, the pupil–teacher ratio was 34 in 2002 (latest estimate), compared to the LMI average of 21.6. Public expenditure on education has amounted to 2.2 percent of GDP, only slightly below the LMI average of 2.4 percent.. However, because Djibouti's income is near the bottom of the LMI group, spending on education is much lower

than the LMI average in absolute terms. The best remedy for this is rapid and sustained growth, to increase the resources available for investment in human capital.

Djibouti must do a better job of addressing its education deficiencies, using its resources as effectively as possible. Sustained donor support is also essential to help Djibouti improve its education outcomes, which are crucial for enhancing labor productivity, attracting investment, reducing unemployment, improving health conditions, and alleviating poverty.

EMPLOYMENT AND WORKFORCE

Faced with an unemployment rate estimated at 59 percent in 2002 (latest data), along with low educational attainment, and relatively slow growth, Djibouti confronts a huge challenge to create productive jobs and income-generating opportunities for the growing population.[29] In addition to absorbing the current excess of low-productivity labor, the demographic statistics show that a large youth bulge will enter the labor force each year in the medium term. If jobs are lacking, these conditions create the risk of civil instability. More income opportunities are also needed to improve gender equity in the labor force; as mentioned in the gender section, only 35 percent of women participate in the labor market (compared to 73 percent for men).

In view of this supply pressure on the labor market, the over-riding policy priority must be to attract job-creating investments by improving the business climate, while creating a foundation for productivity growth through education, training, and better health care. Programs to facilitate earning opportunities in the informal sector are also vital because formal employment will not be available for all job seekers. Furthermore, the legal and regulatory framework of the labor market hinders investment, job creation, and labor reallocation. The World Bank's Index of Rigidity of Employment does not cover Djibouti, so no direct measure of the difficulty of hiring and firing is available. However, the 2004 PRSP gives a high priority to making the labor market more competitive to increase employment. An important part of the strategy includes the revision of labor legislation and the introduction of more flexibility in hiring and in the setting of salaries by the market.[30] Laws and regulations that unduly reduce labor market flexibility are a significant cause of poor employment performance and a drag on dynamic efficiency. Although the issues are politically very sensitive, labor market reforms may be a high priority for long-term success in stimulating growth and reducing poverty.

AGRICULTURE

Djibouti's economy is not heavily dependent on agriculture. As discussed in the Economic Structure section, agriculture contributes just 3.7 percent of GDP. For the most part the country is a food importer rather than a food producer. The small role of agriculture reflects more the country's natural resource base, with little arable land, an arid climate, and a limited water

[29] Djibouti PRSP, p. 35.

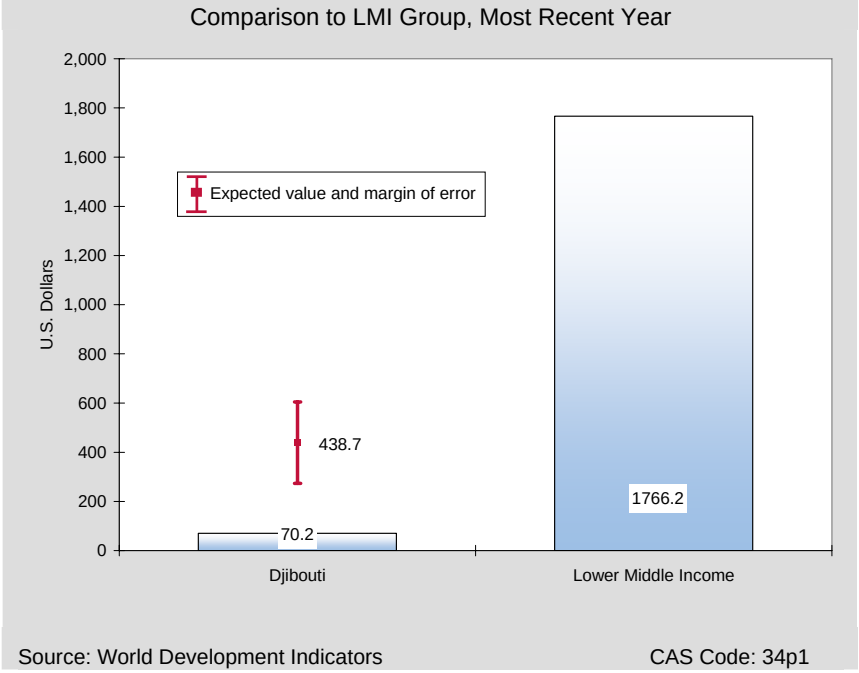
[30] Djibouti PRSP, p. 53

supply. Nonetheless, the rural sector provides the livelihood, however meager, for 28.5 percent of the total population.[31]

The poor conditions for agriculture are evident in figures for value added per worker, which averaged just $71 in the sector from 1995 to 2000. These figures are extraordinarily low compared to the LMI average of $1,766 per worker (Figure 4-3). Conditions have not improved since 2000; the FAO estimates that total crop production in 2004 was virtually unchanged from 15 years ago, and livestock production has hardly increased. The estimated yield in cereal cultivation, likewise, has remained fixed at an estimated 1,625 kg per hectare during the five years to 2004, well below while LMI average of nearly 2,434 kg per hectare.

Figure 4-3
Agriculture Value Added per Worker

Djibouti's value added per worker is extremely low by any standard.



Source: World Development Indicators CAS Code: 34p1

The main agricultural products are coffee, coffee derivatives, and livestock. Opportunities exist to expand livestock production. Djibouti is already a regional hub for livestock trade and is better equipped than its neighbors to gain access to raw materials (feed and cereals) and to export livestock cost-effectively. Donors may want to explore supporting the development of fisheries. Djibouti's long coast offers considerable potential, but the country has no fish-processing activities. Oasis farming, which encompasses irrigated palm plantations, orchards, market gardens, and small-scale livestock breeding to reduce the ongoing problem of desertification, is

[31] Djibouti PRSP, p.84

another initiative to be considered. These activities would contribute to food security in rural areas, reduce poverty where it is most prevalent, and provide new opportunities for women.

The agricultural sector could therefore generate employment, income, and foreign exchange. The overall trend of low productivity and low growth, however, is not expected to change. This expectation is mirrored in the government's focus on initiatives and projects addressing other sectors that are more productive to spur economic growth.

Appendix. Indicators

CRITERIA FOR SELECTING INDICATORS

The scope of the paper is constrained by the availability of suitable indicators. Indicators have been chosen to balance the need for broad coverage and diagnostic value on the one hand and the need for brevity and clarity on the other. The analysis covers 15 economic growth–related topics, examining more than 100 variables. For the sake of brevity, the write-up in the text highlights issues for which the "dashboard lights" appear to be signaling important problems, which suggests possible priorities for USAID intervention. The accompanying table lists all the indicators constituting the standard template for this report. The separate Data Supplement contains the complete data set for Djibouti, including data for the benchmark comparisons, and technical notes for every indicator.

For each topic, the analysis begins with a screening of *primary performance indicators*. These Level I indicators are selected to answer the question, Is the country performing well or not in this area? The primary indicators also include descriptive variables such as per capita income, the poverty head count, and the age dependency rate.

In areas of weak performance, the analysis proceeds to review a limited set of *diagnostic supporting indicators*. These Level II indicators provide more details about the problem or shed light on *why* the primary indicators may be weak. For example, if economic growth is poor, one can examine data on investment and productivity as diagnostic indicators. If a country performs poorly on educational achievement, as measured by the youth literacy rate, one can examine determinants such as expenditure on primary education, and the pupil-teacher ratio.32

The indicators have been selected on the basis of several criteria. Each must be accessible through USAID's Economic and Social Database or public sources, particularly those available on the Internet. The indicators must be available for a large number of countries, including most USAID client states. The data must be sufficiently timely to support an assessment of country performance that is suitable for strategic planning purposes. Data quality is another consideration. For example, subjective survey responses are used only when actual measurements are not available. Besides a few descriptive variables, the indicators must also be useful for diagnostic purposes. Preference is given to measures that are widely used, such as Millennium Development Goal indicators, or evaluation data used by the Millennium Challenge Corporation. Finally, an effort has been made to minimize redundancy. If different indicators provide similar information, preference is given to the one that is simplest to understand. For example, both the Gini

[32] Deeper analysis of the topic using more detailed data (Level III) is beyond the scope of this series.

coefficient and the share of income accruing to the poorest 20 percent of households can be used to gauge income inequality. We use the income share because it is simpler and more sensitive to changes.

BENCHMARKING METHODOLOGY

Comparative benchmarking is the main tool used to evaluate each indicator. The analysis draws on several criteria rather than a single mechanical rule. The starting point is a comparison of performance in Djibouti relative to the average for countries in the same income group globally —in this case, LMI countries.[33] For added perspective, the average for the five best- and five worst-performing countries globally is also examined. Most comparisons are framed in terms of values for the latest year of data from available sources. Five-year trends are also taken into account if they shed light on the performance assessment.[34]

For selected variables, a second source of benchmark values uses statistical regression analysis to establish an expected value for the indicator, controlling for income and regional effects.[35] This approach has three advantages. First, the benchmark is customized to Djibouti's specific level of income. Second, the comparison does not depend on the exact choice of reference group. Third, the methodology allows quantifying the margin of error and establishing a "normal band" for a country with Djibouti's characteristics. An observed value falling outside this band on the side of poor performance signals a serious problem.[36]

Finally, where relevant, Djibouti's performance is weighed against absolute standards. For example, the unemployment rate in Djibouti 2002 was 59 percent. Regardless of the regional comparisons or regression results, this is high and needs to be reduced.

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[33] Income groups as defined by the World Bank for 2004. For this study, the average is defined in terms of the mean; future studies will use the median instead, because the values are not distorted by outliers.

[34] The five-year trends are computed by fitting a log-linear regression line through the data points. The alternative of computing average growth from the end points produces aberrant results when one or both of those points diverges from the underlying trend.

[35] This is a cross-sectional OLS regression using data for all developing countries. For any indicator, Y, the regression equation takes the form: Y (or ln Y, as relevant) = a + b * ln PCI + c * Region + error – where PCI is per capita income in PPP$, and Region is a set of 0-1 dummy variables indicating the region in which each country is located. When estimates are obtained for the parameters a, b, and c, the predicted value for Djibouti is computed by plugging in Djibouti-specific values for PCI and Region. Where applicable, the regression also controls for population size and petroleum exports (as a percentage of GDP).

[36] This report uses a margin of error of 0.66 times the standard error of estimate (adjusted for heteroskedasticity, where appropriate). With this value, 25 percent of the observations should fall outside the normal range on the side of poor performance (and 25 percent on the side of good performance). Some regressions produce a very large standard error, giving a "normal band" that is too wide to provide a discerning test of good or bad performance.

INDICATORS

Indicator, by Category	Level[a]	MDG, MCA, or EcGov[b]	CAS Code
OVERVIEW OF THE ECONOMY			
Growth Performance			
Per capita GDP, $PPP	I		11P1
Per capita GDP, current US$	I		11P2
Real GDP growth	I		11P3
Growth of labor productivity	II		11S1
Investment Productivity - Incremental Capital-Output Ratio (ICOR)	II		11S2
Gross fixed investment, % GDP	II		11S3
Gross fixed private investment, % GDP	II		11S4
Poverty and Inequality			
Human poverty index	I		12P1
Income-share, poorest 20%	I		12P2
Population living on less than $1 PPP per day	I	MDG	12P3
Poverty headcount, by national poverty line	I	MDG	12P4
PRSP Status	I	EcGov	12P5
Population below minimum dietary energy consumption	II	MDG	12S1
Poverty gap at $1 PPP a day	II		12S2
Economic Structure			
Labor force structure	I		13P1
Output structure	I		13P2
Demography and Environment			
Adult literacy rate	I		14P1
Age dependency rate	I		14P2
Environmental sustainable index	I		14P3
Population size and growth	I		14P4
Urbanization rate	I		14P5
Gender			
Adult literacy rate, ratio of male to female	I	MDG	15P1
Gross enrollment rate, all levels, ratio of male to female,	I	MDG	15P2
Life expectancy at birth, ratio of male to female	I		15P3
PRIVATE SECTOR ENABLING ENVIRONMENT			
Fiscal and Monetary Policy			
Govt. expenditure, % GDP	I	EcGov	21P1
Govt. revenue, % GDP	I	EcGov	21P2
Growth in the money supply	I	EcGov	21P3
Inflation rate	I	MCA	21P4

Indicator, by Category	Level[a]	MDG, MCA, or EcGov[b]	CAS Code
Overall govt. budget balance, including grants, % GDP	I	EcGov	21P5
Composition of govt. expenditure	II		21S1
Composition of govt. revenue	II		21S2
Composition of money supply growth	II		21S3
Business Environment			
Corruption perception index	I	EcGov	22P1
Doing business composite index	I	EcGov	22P2
Rule of law index	I	MCA / EcGov	22P3
Cost of starting a business, % GNI per capita	II	EcGov	22S1
Procedures to enforce contract	II	EcGov	22S2
Procedures to register property	II	EcGov	22S3
Procedures to start a business	II	EcGov	22S4
Time to enforce a contract	II	EcGov	22S5
Time to register property	II	EcGov	22S6
Time to start a business	II	EcGov	22S7
Financial Sector			
Domestic credit to private sector, % GDP	I		23P1
Interest rate spread	I		23P2
Money supply, % GDP	I		23P3
Stock market capitalization rate, % of GDP	I		23P4
Cost to create collateral	II		23S1
Country credit rating	II	MCA	23S2
Legal rights of borrowers and lenders index	II		23S3
Real Interest rate	I		23S4
External Sector			
Aid , % GNI	I		24P1
Current account balance, % GDP	I		24P2
Debt service ratio, % exports	I	MDG	24P3
Export growth of goods and services	I		24P4
Foreign direct investment, % GDP	I		24P5
Gross international reserves, months of imports	I	EcGov	24P6
Gross Private capital inflows, % GDP	I		24P7
Present value of debt, % GNI	I		24P8
Remittance receipts, % exports	I		24P9
Trade, % GDP	I		24P10
Concentration of Exports	II		24S1
Inward FDI Potential Index	II		24S2
Net barter terms of trade	II		24S3
Real effective exchange rate (REER)	II	EcGov	24S4

Indicator, by Category	Level[a]	MDG, MCA, or EcGov[b]	CAS Code
Structure of merchandise exports	II		24S5
Trade policy index	II	MCA / EcGov	24S6
Economic Infrastructure			
Internet users per 1000 people	I	MDG	25P1
Overall infrastructure quality	I	EcGov	25P2
Telephone density, fixed line and mobile	I	MDG	25P3
Quality of infrastructure—railroads, ports, air transport, and electricity	II		25S1
Telephone cost, average local call	II		25S2
Science and Technology			
Expenditure for R&D, % GNI	I		26P1
FDI and technology transfer index	I		26P2
Patent applications filed by residents	I		26P3
PRO-POOR GROWTH ENVIRONMENT			
Health			
HIV prevalence	I		31P1
Life expectancy at birth	I		31P2
Maternal mortality rate	I	MDG	31P3
Access to improved sanitation	II	MDG	31S1
Access to improved water source	II	MDG	31S2
Births attended by skilled health personnel	II	MDG	31S3
Child immunization rate	II		31S4
Prevalence of child malnutrition (weight for age)	II		31S5
Public health expenditure, % GDP	II	EcGov	31S6
Education			
Net primary enrollment rate	I	MDG	32P1
Persistence in school to grade 5	I	MDG	32P2
Youth literacy rate	I		32P3
Education expenditure, primary, % GDP	II	MCA/ EcGov	32S1
Expenditure per student, % GDP per capita—primary, secondary, and tertiary	II	EcGov	32S2
Pupil-teacher ratio, primary school	II		32S3
Employment and Workforce			
Labor force participation rate, females, males, total	I		33P1
Rigidity of employment index	I	EcGov	33P2
Size and growth of the labor force	I		33P3
Unemployment rate	I		33P4
Agriculture			
Agriculture value added per worker	I		34P1

Indicator, by Category	Level[a]	MDG, MCA, or EcGov[b]	CAS Code
Cereal yield	I		34P2
Growth in agricultural value-added	I		34P3
Agricultural policy costs index	II	EcGov	34S1
Crop production index	II		34S2
Livestock production index	II		34S3

[a] *Level I — primary performance indicators, Level II — supporting diagnostic indicators*

[b] *MDG — Millennium Development Goal indicator*
MCA — Millennium Challenge Account indicator
EcGov — Major indicators of Economic Governance, which is defined in USAID's Strategic Management Interim Guidance to include "microeconomic and macroeconomic policy and institutional frameworks and operations for economic stability, efficiency, and growth." The term therefore encompasses indicators of fiscal and monetary management, trade and exchange rate policy, legal and regulatory systems affecting the business environment, infrastructure quality, and budget allocations.