FINDING NEW PATHS FOR GROWTH IN DJIBOUTI

Mehdi Benyagoub

Introduction: A recent report on Djibouti, *Un Nouveau Modele de Croissance pour Djibouti*, was the product of a joint effort between the Djibouti government and the World Bank. The report posits a long-term vision for Djibouti’s economic development with specific measures that form a road map for long term, sustainable growth. The strategic message of the report are summarized below.

The Unsustainability of the Current Growth Model: The current growth model is highly capital intensive and dependent on rent-seeking, thus presenting sustainability and diversification challenges. Growth has increased recently, reaching 4.6% on average between 2005 and 2010. However, accelerated growth in the 2000s came after a decade (1990s) of significant output decline, following that era’s political turmoil. Also, recent growth is tightly linked to strong inflows of foreign investment, financing the new port and hotel infrastructure. These investments are due to Djibouti’s strategic geographic location at the entrance to the Red Sea, owing to the presence of foreign military bases and its status as Ethiopia’s sole means of access to the sea. Over the long term, the challenge for Djibouti will be to achieve and maintain a high growth rate that is inclusive and more diverse in terms of job creation.

A weak private sector: Historically the government has played an important role in Djibouti’s economy but with today’s fiscal constraints, growing the private sector is the only way to sustain and promote growth, provide jobs, and reduce poverty. The private sector remains very small and not well organized. With only 141 businesses that are considered “structured”, most businesses are microenterprises in the services sector. Entrepreneurship is weak and motivated mostly by short-term opportunities, government contracts, or one-off commercial operations. Obstacles in the business environment constitute the main reason for the weakness of the private sector. In the World Bank’s 2013 Doing Business report Djibouti ranks 171th out of 183 countries. In particular, regulatory barriers and the tax burden on businesses hinders the creation and formalization of businesses. The cost of electricity, one of the highest in the world, represents another major obstacle.

---

1 Mehdi Benyagoub, Finance and Private Sector Development, Middle East and North Africa Region (MNSF1), the World Bank. This Quick Note was cleared Simon C. Bell, Sector Manager MNSF1.
3 Ibid.
Djibouti’s Social and Unemployment Challenges: The overall unemployment rate hovers around 60% and is estimated at more than 70% for young people (under the age of 30). Recent economic growth has failed to generate enough job opportunities to curb unemployment and the medium- and long-term prospects are deeply concerning. In addition, with the arrival of a young and increasingly well-educated population into the job market, demographic pressures will intensify in coming years. The number of unemployed graduates—a new phenomenon in Djibouti—could thus grow considerably in the future. In order to begin addressing unemployment issues, the annual rate of job creation would need to double. Even in the most optimistic scenario, unemployment could only be brought below 50% by around 2020. Mass unemployment is thus an endemic reality that can only be eradicated over the long term.

The level of unemployment in Djibouti can be attributed to a number of factors. First, the economic growth model, which is highly capital intensive, does not create enough job opportunities. In addition, the training available is not geared to the labor market’s increasing need for technicians, supervisors, and employees able to speak various languages, especially English. Finally, the cost of labor is very high in Djibouti relative to worker productivity. This lack of competitiveness is explained primarily by the high cost of living linked to rents (income from the military bases, foreigners’ consumption, fiscal revenues going to finance the public sector wage bill, etc.). The cost of labor is driven up further by the high level of social contributions and taxes. At the same time, the rate of extreme poverty remains high; estimated at 42% of the population. In a society where mass unemployment reigns, where work does not contribute to socialization and where the vast majority of young people are out of work, the consumption of khat has become an important factor of social cohesion (more than 75% of khat users are under 25 years of age). These conditions appear ultimately unsustainable and as the Arab Spring has shown, social stability cannot be maintained for long in a context where the young and increasingly well educated, are deprived of economic prospects.

Djibouti’s Untapped Economic Potential: Fortunately Djibouti is endowed with natural assets. The study focuses on four growth sectors: tourism, fisheries, telecommunications, and transport/logistics. The selection of these sectors was based on two criteria: the existence of a comparative advantage and the capacity to create jobs. For each sector, an expert performed an in-depth analysis aimed at assessing the situation, identifying constraints, and proposing a development vision for the future.

Opportunities in Tourism: The tourism sector is the most promising in terms of job creation. Djibouti currently welcomes 50,000 tourists a year; most are business travelers visiting because of the presence of foreign military bases. However lodging capacities are limited (1,200 beds), reflecting low levels of investment in the sector. The contribution of tourism to growth and employment is small - only 4,500 people work in the sector. Still, Djibouti, has natural assets, including a diverse and rare marine life, unique geological landscapes, and a rich cultural and archeological heritage.
Many of these sites could be eligible for UNESCO classification. Tourism demand focused on the Red Sea is especially dynamic, as evidenced by the increasing popularity of tourism in Sharm el-Sheikh and Hurghada. Djibouti could position itself as a first-class tourist destination in the region. According to World Bank projections Djibouti could attract up to 500,000 tourists by 2030. Although highly ambitious, this projection is feasible, provided an effective strategy is put in place. Countries such as Cape Verde have managed to increase tourism tenfold in fewer than 15 years. Tapping this potential will require removing major constraints weighing on the sector. The country has no real tourism policy, accessibility by air is inadequate, and it suffers from a serious image problem.

**Djibouti’s fishing sector:** Currently Djibouti’s artisanal fishing sector plays a minor role in the economy. The sector employs about 2,600 people, including 600 seamen and the catch is relatively small (1,800 tons). However, Djibouti is rich in maritime resources. The exploitable potential is estimated at more than 30,000 tons with many fishing grounds still unexploited. Market demand is strong and diversified, and fish consumption in the domestic market is growing steadily. There are major export opportunities, particularly to Ethiopia, Europe, and the Gulf states. The development model proposed for the sector features artisanal fishing exclusively, based on three pillars. The first pillar consists of increasing the exploitation of large demersal fishing resources, aided by new, longer-range boats. The second pillar aims at exploiting the resources in small pelagic zones. The third pillar involves experimenting with new fisheries, especially for mollusks and crustaceans. Implementing this vision could boost the annual catch to over 5,000 tons by 2020 and create more than 3,000 direct jobs. To make this a reality, a major training effort would be needed, as Djibouti has deeply rooted pastoral traditions and lacks trained fishermen.

A fisheries policy, based on updated assessments of exploitable potential would have to be formulated and institutional capacities strengthened to monitor the sector.

**The Backbone of the Economy: Transport and Logistics:** The Port of Djibouti is the main port for Ethiopia, a landlocked country with a population of 90 million. Nearly 85% of the traffic in the port of Djibouti is Ethiopian transit shipping. Due to recent port and road improvements, the Djibouti-Addis corridor is preferred by Ethiopian merchants to the Berbera and Port Sudan corridors. The port contributes substantially to the economy, accounting for 20% of GDP and generating 15,000 direct and indirect jobs, or 10% of the actively employed population. As for the future, trade with Ethiopia is set to expand rapidly, owing to that country’s economic growth of 10% per year - expected to continue for the next decade. Djibouti could also strengthen its position as a regional multimodal transport center by diversifying trading partners (to include South Sudan, in particular) and building new transport infrastructure (such as the Addis-Djibouti railway link). With the emergence of new logistics activities, new job opportunities could be had, particularly for skilled personnel (technicians, supervisors, managers). However, unlike other sectors in this study, the transport/logistics sector cannot contribute significantly to reducing unemployment in Djibouti. Highly capital intensive, this sector is undergoing logistical chain improvements, which tends to reduce jobs.

The vision is to solidify Djibouti as Ethiopia’s primary port. To that end, sections of the road corridor are in urgent need of rehabilitation and the country’s transit and trade procedures require simplification. The lack of specialized know-how and lack English language skills is a handicap that must be overcome to ensure that growth in the sector generates more jobs. In the
longer term, development of the transport and logistics sector requires a consistent strategy based on sound feasibility studies and the rationalization of investments.

**Djibouti’s Telecom Potential:** Djibouti is one of the last three African countries (along with Ethiopia and Eritrea) to have a monopoly in the telecommunications sector. Despite an improving trend, access to telecommunications services remains extremely limited compared to other African countries. Mobile telephone and Internet services are expensive and of poor quality. Only three percent of Djiboutian households have Internet access at home, owing to the prohibitive cost of subscribing. The deficiencies in the telecommunications sector are a major obstacle to Djibouti’s competitiveness, as high quality services are necessary to solidify its position as a regional hub, attract foreign investors, and promote the emergence of new sectors of activity.

Djibouti has a large but underutilized infrastructure of undersea cables. Although Djibouti Télécom manages these, it sells the capacity to other countries. In addition to generating substantial, growing income for the operator, this capacity could be used for economic development and jobs. Accordingly, the vision proposed for the sector focuses on two pillars. The first is to modernize the sector by liberalizing markets to reduce costs and improve service quality. This would also have the effect of repositioning Djibouti Télécom in its area of expertise and opening up market segments to private investors. The second pillar is to use the telecommunications infrastructure to promote offshoring activities, especially call centers to provide employment for young graduates with a good command of languages. To make this happen, Djibouti needs a new strategy for the sector and update its regulatory framework. Moreover, given the high level of wages and production factors, attracting investors in the offshoring sector will require incentives (financed with undersea cable revenues) to offset the country’s competitive disadvantages.

**Djibouti’s Governance Challenge:** Djibouti’s economic and social situation is challenging but poverty need not become the country’s fate. Several African countries have lifted people out of poverty and unemployment by maintaining strong economic growth for several decades. Most of these success stories have been in small countries such as Cape Verde and Mauritius, whose populations are as small as Djibouti’s. The decisive factor in the economic development of these countries was the quality of their economic governance. Both Cape Verde and Mauritius show favorable governance indicators on the rule of law, legal security, anti-corruption, and effectiveness of public policies. Djibouti, however, suffers from governance deficits in all these dimensions.

The analysis presented in the report stresses two major institutional problems: weak investor’ contractual rights and weak public policy planning and execution. The current governance model, characterized by weak investor rights and public policy management, has stifled private investment and job creation. Djibouti needs a radical break with its existing mode of governance and win back the private sector’s trust. This process could take several years, given the current level of distrust of the business community in Djibouti. For this strategy to succeed, the government must change investors’ perceptions by sending strong signals demonstrating its capacity to make a credible commitment to change.