United Nations Conference on Trade and Development

Investment Policy Review

Djibouti

Summary

UNITED NATIONS
New York and Geneva, 2013

Summary

Located on the coastline of the Horn of Africa, Djibouti is strategically positioned between Africa, Asia and Europe. The country also enjoys political stability and relative social peace. Growth in annual gross domestic product (GDP) rose from an average of 3.5 per cent in the period 2000-2010 to 4.8 per cent in 2012. Djibouti is one of the African countries that have explicitly included foreign direct investment (FDI) issues in its policy documents since the early 2000s. In addition, the National Agency for Investment Promotion (ANPI), founded in 2001, is one of the pioneers on the continent.

However, Djibouti faces enormous challenges. A significant proportion of the population lives below the poverty line and unemployment affects half of adults and three quarters of youths. The skills level of the labour force is low, while the cost of labour is anomalously high. Moreover, while port development has been prioritized, Djibouti's road and rail infrastructure remains underdeveloped. At the same time the cost of electricity and telecommunications is among the highest in the region. These factors have dampened Djibouti's competitiveness and, consequently, its economic and social development.

Following public consultations, the Government adopted the National Initiative for Social Development (INDS) in 2007. The development strategy outlined in the INDS refers to the strengthening of economic growth through private sector development. The role of FDI is also mentioned, including the objective of stabilizing inflows at 20 per cent of GDP during the period 2011–2015. This constitutes a significant increase compared to previous years. Despite this ambitious goal, the country does not yet have a formal strategy for attracting FDI.

Djibouti has nevertheless received significant FDI flows in the 2000s that peaked in 2008. With an average annual FDI inflows of almost $150 per capita during the period 2006-2011, the performance of Djibouti was markedly better than that of countries in the Common Market for Eastern and Southern Africa (COMESA) and LDCs. Mainly concentrated in port and related activities (about 50 per cent), these investments came predominantly from the United Arab Emirates (around 70 per cent). However, the impact of existing investment on the local economy, though difficult to measure, is still limited, and relatively few jobs have been created. Subject to strong competition in international markets and the lasting effects of the recent financial crisis, the prospects of attracting substantial FDI inflows will depend largely on strong political will and a clear strategy.

Against this background, the Government of Djibouti requested UNCTAD to undertake an Investment Policy Review (IPR) with the express request for the review to include a strategy to attract FDI. Based on the Investment Policy Framework for Sustainable Development (IPFSD), recently developed by UNCTAD, the proposed strategy in the IPR invokes the 11 principles of the IPFSD, with the aim to leverage FDI to achieve sustainable development and inclusive growth outcomes. Specific recommendations for the development and effective implementation of this strategy follow the IPFSD’s guidelines for national investment policies and take into account options for international investment agreements. The IPR also presents various examples of best practices from other countries, including LDCs. These examples show that despite enormous challenges, various options exist to attract FDI and that success depends on the efforts of all stakeholders in the implementation of the reforms identified.

Discussions with stakeholders conducted during UNCTAD's fact-finding missions in Djibouti and detailed analysis of the investment policy, regulatory and institutional framework informed the identification of the main weaknesses in the business environment. These weaknesses explain the lack of confidence in the Djiboutian economy and have served as an obstacle to increased investment. Furthermore, an explicit link between FDI and the role it can play in the development process is insufficiently detailed in government policy. The authorities are aware of the need to clarify their vision, develop a strategy to attract FDI and to better target promotional efforts at the sectoral level. These actions should also help to harmonize the Government's message on the role of FDI and its potential contribution to the national development process.

In this context, the IPR proposal to the Government of Djibouti comprises a multidimensional strategy to attract FDI, focusing on the following main elements:

(a) Initiate legal and regulatory reforms to improve the business environment;

(b) Invest significantly in infrastructure and human capital;

(c) Target attraction of FDI according to priority sectors;

(d) Stimulate public-private dialogue; and

(e) Strengthen investment-related institutions.

1. Set in motion ambitious legal and regulatory reforms to improve the business environment

The analysis of the legal and regulatory framework affecting FDI and the resultant recommendations are a central tenet in Djibouti's IPR. The analysis covers a wide range of national policies ranging from business development to the functioning of the labour market, corporate taxation and land titles. It also deals with international investment agreements, including the treatment and protection of foreign investors.

The analysis shows that Djibouti's investment framework is both complex and opaque. Complexity and opacity are detrimental to both the Government and investors, as they increase the costs of doing business and country risk. The lack of clarity in the legislation and changes in its orientation, introduced during the last decade, make their interpretation and implementation difficult. This is reflected in international rankings which place Djibouti among the countries where it is difficult to do business.

Several legal and regulatory reforms are suggested in the IPR to improve the business climate. The adoption of a new investment code based on international best practices is recommended to signal the Government's commitment to establish an environment for investors that is transparent, stable and predictable. Priority elements will include clarity on the conditions of entry, establishment and treatment of foreign investors and better guarantees of protection. In addition, the investment code should specify the degree of openness to FDI advocated by the authorities in Djibouti and establish through a "negative list" areas that are not accessible to foreign investors. This will eliminate the confusion that currently characterizes Djibouti's legal framework on the openness of some sectors to FDI.

Improving the business environment also requires a number of measures, including the establishment of simpler administrative procedures that are faster and less costly for business creation and taxation. Entrepreneurship is the starting point for many investments, thus it is important to create the conditions necessary to stimulate the Djiboutian private sector and foster its creativity. To this end, the IPR suggests a corporate taxation regime that contains measures to promote the development of small and medium-sized enterprises (SMEs). In addition to these measures, it is necessary to align initiatives in labour market conditions, competition and access to land to the development objectives of the country and the needs of investors.

The establishment of a climate of confidence also encompasses the demonstration of the political will to improve governance and correct irregularities in the judicial system. This includes the application of the law on conflict of interest for public servants, and intensifying the fight against corruption. In this regard, this report urges the speedy completion of the draft law on corruption that is currently under way. The ongoing cooperation with key partners to organize a series of meetings and seminars on good governance and transparency should also help build capacity and improve the efficiency of the administration.

2. Invest significantly in infrastructure and in human capital

The competitiveness of a country depends heavily on the availability and quality of infrastructure and human capital. Foreign investment in key sectors such as tourism, agriculture and light industry remains limited in Djibouti because of the lack of competitiveness of its infrastructure and human capital. Reversing this situation requires major structural reforms to allow the private sector to inject some of the capital needed for infrastructure improvements. The country would indeed benefit from a legislative and institutional framework promoting public-private partnerships. The IPR also recommends that the Government consider cutting electricity prices to reflect the recent improvements brought by the connection to Ethiopia’s hydro-electricity network. Concerning water, the recent bilateral cooperation agreement with Ethiopia is strategically important to increase the supply and reduce costs.

To develop human capital, Djibouti is advised to adopt a national policy for skills formation, with input from all key stakeholders. Such a policy should be guided by the aim to better match training and employment requirements. Tools specific to its implementation include the establishment of a training fund and tax incentives for training.

3. Target FDI attraction in priority sectors

The Government has identified a relatively large number of sectors as priorities for the diversification of the economy and facilitating sustainable development. It has also stressed the desire to attract FDI. To achieve this, the Government provides different tax incentives for various sectors. The granting of incentives does not necessarily consider the attractiveness of these sectors for foreign investors nor is it complemented by a sector-specific strategy to attract FDI. Consequently, the impact of these measures is generally limited and rather modest volumes of FDI are attracted in these sectors.

The IPR recommends that the Government reprioritize the sectors where it wants to attract FDI so as to better facilitate actual investment inflows into the country In this regard, the IPR suggests a more strategic identification of sectors prioritized for attracting FDI. This would allow for measures aimed at attracting FDI to be tailored around the specific characteristics of a particular sector. These include measures that are regulatory nature as well fiscal ones, such as tax incentives. Specific sectoral targeting will also help to better define accompanying sector-specific investment promotion activities.

UNCTAD's IPR identified fisheries, and transport and logistics as two priority sectors in the short term. Tourism and, to a lesser extent, agriculture also hold promise. However, infrastructural and local market constraints temper the potential, at least in the short term. Finally, although the telecommunications sector is not listed among the priority areas of the Government, the IPR suggests that a gradual opening to FDI, guided by an appropriate regulatory framework, would improve the services provided to users in terms of both price and quality. This would also have positive effects on the activities of other sectors, such as services.

Achieving and maintaining competitiveness in priority sectors requires keeping an edge over competitors. To achieve this edge, the IPR offers the Government of Djibouti a dynamic approach that focuses on the analysis of competitive drivers of profitability in different sectors and understanding the strengths and weaknesses of competitor countries. To remain relevant, sectoral strategies should be revised regularly, through the use of a monitoring and evaluation mechanism. The effectiveness and credibility of such a mechanism depends on the availability of good quality statistics. The Government is aware of the need to improve the quality of national statistics. To achieve this objective it has developed a master plan for statistics. This plan should be implemented as a matter of priority and be accompanied by capacity-building in data collection and analysis, including statistics related to investments.

4. Encourage public-private dialogue

The definition and implementation of a strategy to attract FDI and its sectoral components require joining all the forces of the nation. Such a gathering of forces will release the energy essential for the development of Djibouti's economy. In this regard, the IPR recommends that the initiative to institutionalize the leadership of the Head of State through a mechanism of public-private dialogue — the High National Council of Public-Private Dialogue — is rapidly operationalized.

5. Strengthen the institutions dealing with investment

The Djiboutian Government has taken initiatives to reform the institutional framework for investment. Despite these efforts, there are still many overlapping mandates of institutions involved in investment promotion and private sector development. Similarly, coordination mechanisms are inadequate.

To drive its strategy of attracting FDI optimally, it is essential that Djibouti streamlines the institutional framework for investment to make it more conducive to exchanges between all relevant institutions. In addition, the IPR calls for the strengthening of the ANPI so that it is able to better fulfil its mandate to attract investors to the country. The IPR also highlights the need to improve sectoral targeting and the systematic monitoring of investors.