



***DJIBOUTI***

***2024 -***  
***June***

***Components: Revenue***

***Modules: RM I – Tax Policy***

*DJIBOUTI*

| <b>PROJECT SUMMARY</b>         |                                   |
|--------------------------------|-----------------------------------|
| <b>COUNTRY:</b>                | Djibouti                          |
| <b>LEAD DEPARTMENT:</b>        | FAD                               |
| <b>REGION:</b>                 | MCD                               |
| <b>PROGRAM ID:</b>             | [To be filled out by Secretariat] |
| <b>PLANNED DATES:</b>          | FY25 – FY27                       |
| <b>FUNDING PROGRAM TITLE:</b>  | GPFP Djibouti                     |
| <b>PROJECT MANAGERS:</b>       | Sébastien Leduc – T1 (Lead)       |
| <b>RM I – TAX POLICY:</b>      | Sébastien Leduc – T1              |
| <b>ESTIMATED BUDGET</b>        | \$737,004                         |
| <b>BUDGET FOR ENDORSEMENT:</b> | \$167,086                         |

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*DJIBOUTI***ACRONYMS**

|       |                                               |
|-------|-----------------------------------------------|
| CD    | Capacity Development                          |
| FAD   | IMF's Fiscal Affairs Department               |
| METAC | IMF's Middle East Technical Assistance Center |

## *DJIBOUTI*

### I. PROJECT PURPOSE

**Djibouti has expressed a desire to continue receiving support from the IMF's Fiscal Affairs Department (FAD) to identify and implement reforms to increase revenue.** Revenue mobilization remains a key priority for Djibouti. The country's low and declining tax ratio has constrained its ability to maintain macro stability and promote sustainable and inclusive growth. Investments in healthcare and education are lagging peers, and Djibouti has made only limited progress towards achieving the Sustainable Development Goals.

**The new project will focus on supporting the Ministry of Budget on tax policy reform.** The key underlying objective will be to improve the quantity and quality of public revenues raised through taxes. In doing so, consideration will be given to the tax system's impact on economic efficiency, fairness across various taxpayer, transparency, and ease of administration and compliance. The project will help Djibouti improve tax policy design incrementally through sound and coherent reforms that can be implemented over the medium term.

**The estimated budget for this two-year project is \$737,004 but endorsement is requested for \$167,086 through FY25.** Endorsement for future plans will be requested at a later date as funding for the program is secured and reform plans gain traction. The fairly limited size of the project (particularly for FY25) reflects our expectation that we will continue collaborating closely with the Middle East Technical Assistance Center (METAC) in providing capacity development (CD) support to Djibouti on tax policy.

### II. BACKGROUND

#### Macro-fiscal situation

**Despite experiencing a strong economic rebound in 2023, with GDP growth of around 7 percent, Djibouti's fiscal stance remains fragile.** External public debt to GDP increased from 33.9 percent at end 2013 to 68 percent at end 2022. While immediate pressures should ease as a result of a debt reprofiling agreement with the country's main creditor, a sustainable strategy for public finances in the medium term remains a high priority. In particular, Djibouti's overall and external public debt will remain in debt distress due to outstanding arrears. Moreover, recent regional events (e.g., situation in Yemen, Ethiopia, and Somaliland) have increased uncertainty and made it even more important for Djibouti to build additional fiscal buffers to withstand possible future external shocks.

#### Country engagement and alignment to reform priorities

**Tax revenues are insufficient to fund basic government programs and create necessary fiscal space.** At 11.1 percent of GDP in 2023, Djibouti's tax-to-GDP ratio is several percentage points below averages observed in other lower middle-income countries (15.7 percent), non-oil Middle East and Northern Africa countries (15.8 percent), and sub-Saharan Africa countries (15 percent). Also of concern is the fact that Djibouti's tax ratio has been on a consistent downward trend since 2015, at which point in time tax revenues stood at 14.3 percent of GDP. While several different exogenous shocks—such as the COVID pandemic and conflict in neighboring Ethiopia—have undoubtedly contributed to this decline, its persistence over such a long period of time points to core deficiencies in the design and administration of

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the tax laws. Given limited resources and capacity within the country, CD can provide much-needed assistance to identify, prioritize, and implement needed reforms.

### III. PROJECT MODULES - DESCRIPTION

This proposal will provide CD support to Djibouti in the area of tax policy. FAD CD will support improvements within the strategic objectives presented in Table 1 below:

**Table 1. Summary of Objectives covered by the Proposal**

| Component | Module            | Objective                       |
|-----------|-------------------|---------------------------------|
| Revenue   | RM I / Tax Policy | Improve Tax Policy Design - TPD |

#### A. RM I – Tax Policy

##### Scope

**Djibouti has limited analytical capacity and would greatly benefit from continuing to receive CD on tax policy.** Recent Article IV missions have consistently identified domestic revenue mobilization as a key priority. While authorities are cognizant of the need to mobilize additional tax revenue, they struggle to identify suitable reform options and implement meaningful changes to the country's tax policy framework. Part of the challenge is that tax policy is defined in a fragmented and rather *ad hoc* basis from year to year, with no underlying expertise in the area of tax policy. As in all countries, political economy considerations are also at play. The new CD project would allow FAD to continue building capacity in Djibouti on tax policy analysis, which would promote informed decision making consistent with the dual objectives of improving the quantity and quality of tax revenue.

##### Program Objectives

**The tax policy module will build on previous CD engagement and closely support Djiboutian authorities in identifying options for tax policy reform.** Authorities previously expressed a preference for a sequential tax-by-tax approach to receiving CD on tax policy. We viewed this as an appropriate form of engagement considering the country's limited absorptive capacity, the need to prioritize reforms, and the merits of ensuring appropriate sequencing over time. The new project will continue providing tailored CD in this manner, in support of various objectives including strengthening institutional settings, building capacity among technical staff, and motivating changes among more senior staff. Our approach to CD delivery—e.g., in terms of CD modality and CD outputs—will, however, remain flexible to ensure that the project continues to meet authorities' needs going forward.

##### Expected Results (outcomes)

**The project will assist authorities in identifying and prioritizing tax policy reforms.** Capacity in Djibouti is low, particularly when it comes to tax policymaking for which there is currently no specialized unit. The project will help fill the void through knowledge transfers to technical staff and strategic policy-oriented dialogue with high-level officials. Some of the expected outcomes from the project include:

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- **Adoption of legislative amendments consistent with our recommendations.** Expectation is that our recommendations will be debated upon internally and that some will eventually be retained and implemented through the annual Budget Law;
- **Increase in tax revenue**, which is a key priority for the country considering the low and declining tax ratio;
- **Improved coherence within the tax policy framework** to ensure that public policy objectives are being achieved in an efficient manner;
- **A more equitable tax system**, where horizontal and vertical equity is improved; and
- **Improved transparency and accountability**, for instance through improved tax expenditures reporting.

## IV. ORGANIZATIONAL ARRANGEMENTS

### B. Country Engagement

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**Djibouti has been the beneficiary of several CD missions on tax policy in recent years and has had a good track record in implemented recommended reforms.** Missions delivered in 2017 and 2018 focused on tax expenditure assessment and reporting. They resulted in the production of Djibouti's first tax expenditures report. A diagnostic mission was planned for March 2020 but was postponed due to travel restrictions linked with the COVID-19 pandemic. Given authorities' preference to await the resumption of travel before reinitiating engagement, a pause in our engagement ensued. A scoping mission later visited Djibouti in March 2023 to assess authorities' needs and initiate a dialogue on a medium-term partnership on tax policy reform. Our first substantive engagement was a review of the value added tax (VAT) through remote and in-person missions in 2023. Authorities proved once again highly receptive to our advice and already introduced two of our recommendations in Budget 2024. After FAD participation in the Article IV mission in January 2024, a desk review of the latest draft of the new investment code followed in February 2024. Lastly, a CD mission on the wage tax was delivered in March 2024.

### C. Delivery Modalities

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**CD delivery will prioritize in-person activities due to the country's limited capacity and the need for a more hands-on approach.** This also aligns with authorities' preference for in-person missions. Virtual deliveries will be used to the extent possible when they can increase the efficiency of in-person mission (e.g., pre-mission preparatory work) or when travel is either impossible (e.g., conflict in schedule) or unjustified given task at hand (e.g., mere desk review would suffice given nature of the work).

**As currently planned, CD will mostly comprise of headquarter-led (HQ) missions and staff visits to provide strategic recommendations, conduct regular follow-ups, assess progress, coordinate with other CD providers, and adjust reform implementation plans.** We will remain flexible in our approach and will consider complementing HQ missions with short-term experts and/or workshops as circumstances warrant.

*DJIBOUTI***D. Coordination / Cooperation**

| <b>Coordination</b>                  |                                                                                              |                                                                                    |                        |
|--------------------------------------|----------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------|------------------------|
| <b>Partner</b>                       | <b>Type of coordination</b>                                                                  | <b>Area of coordination</b>                                                        | <b>Frequency</b>       |
| IMF's area department country team   | Sharing of information, insights, and recommendations                                        | Tax policy – priorities, recommendations, and status of reforms                    | Regularly              |
| World Bank                           | Discussion on respective work programs and sharing of information, insights, recommendations | Tax policy – priorities, recommendations, status of reforms and planned engagement | Each visit to Djibouti |
| United Nations Development Programme | Discussion on respective work programs and sharing of information, insights, recommendations | Tax policy – priorities, recommendations, status of reforms and planned engagement | Each visit to Djibouti |
| European Union                       | Discussion on respective work programs and sharing of information, insights, recommendations | Tax policy – priorities, recommendations, status of reforms and planned engagement | Each visit to Djibouti |
| <b>Cooperation</b>                   |                                                                                              |                                                                                    |                        |
| <b>Partner</b>                       | <b>Type of coordination</b>                                                                  | <b>Area of coordination</b>                                                        | <b>Frequency</b>       |
| METAC                                | Joint delivery, HQ oversight, and sharing of work program                                    | Tax Policy – CD delivery                                                           | Regularly              |

**V. RISK ASSESSMENT AND MITIGATION**

| <b>General or Module</b>           | <b>Description</b>                                                                                                                                                  | <b>Risk Assessment</b> | <b>Mitigation Measures</b>                                                                                                                                                                                |
|------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>External climate/conditions</b> |                                                                                                                                                                     |                        |                                                                                                                                                                                                           |
| General                            | World economy, security in the region, etc.                                                                                                                         | Medium                 | Factor authorities' priorities into our work program and remain flexible in delivering the workplan.                                                                                                      |
| <b>Political Support</b>           |                                                                                                                                                                     |                        |                                                                                                                                                                                                           |
| RM I                               | Obtain needed leadership from Budget and/or Finance Ministers and sufficient buy-in from the whole government to enact meaningful reforms in the National Assembly. | Very High              | Engage constructively with high-level officials to ensure that they appropriate themselves of options and that their views are considered and factored into the analysis. Work closely with country team. |

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| General or Module                                            | Description                                                                   | Risk Assessment | Mitigation Measures                                                                                                                                                                                                     |
|--------------------------------------------------------------|-------------------------------------------------------------------------------|-----------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Management and Technical Staff Support and Commitment</b> |                                                                               |                 |                                                                                                                                                                                                                         |
| RM I                                                         | Buy-in and commitment by our direct counterparts at the Budget Ministry.      | Medium          | Engage constructively with high-level officials to ensure that they appropriate themselves of reform options and that their views are considered in the analysis.                                                       |
| <b>Resource Adequacy</b>                                     |                                                                               |                 |                                                                                                                                                                                                                         |
| RM I                                                         | Resource adequacy in Budget ministry, including number of staff and skillset. | High            | Sequence CD and reform proposals to align with country capacity. Offer complementary CD in the form of follow-up engagements or support in legal drafting. Coordinate closely with the revenue administration division. |

**VI. CD DELIVERY PLAN****Table 2. Summary of Indicative CD Delivery**

| CD Modalities<br>(Remote or Field-based CD) | FY25 | FY26 | FY27 | FY28 | FY29 | Grand Total |
|---------------------------------------------|------|------|------|------|------|-------------|
| <b>RM I – Tax Policy</b>                    |      |      |      |      |      |             |
| HQ-led CD mission                           | 3    | 2    | 2    | -    | -    | 7           |

Note:

- In-person delivery was chosen in most instances because of limited absorptive capacity, benefits for knowledge transfer and relationship building, *poor technology available in Djibouti*, and *authorities' preference for in-person engagement*.
- Remote delivery was chosen in some instances when the nature of the activity so justified (e.g., desk review).
- Collectively the blend of CD delivery proposed over the duration of this project/program reflects the optimal balance of in-person, remote, and hybrid activities needed to achieve the project/program outcomes taking into account the needs of the country and the resources available.

**Table 3. First year workplan**

| Timing                   | CD Modality             | Proposed Topics of CD                         |
|--------------------------|-------------------------|-----------------------------------------------|
| <b>RM I – Tax Policy</b> |                         |                                               |
| Q2/2024                  | Duty station-based work | Tax Policy Unit (joint with METAC)            |
| Q3/2024                  | Duty station-based work | Desk review of draft measures for Budget 2024 |
| Q1/2025                  | Field-based work        | Input into National Tax Forum                 |

*DJIBOUTI***VII. PROGRAM FINANCIALS**

|                                | <b>FY25</b>      | <b>FY26</b>      | <b>FY27</b>      | <b>FY28</b> | <b>FY29</b> | <b>Total</b>     |
|--------------------------------|------------------|------------------|------------------|-------------|-------------|------------------|
| RM I – Tax Policy              | \$156,155        | \$255,419        | \$277,215        | -           | -           | \$688,789        |
| <b>Subtotal</b>                | <b>\$156,155</b> | <b>\$255,419</b> | <b>\$277,215</b> | <b>-</b>    | <b>-</b>    | <b>\$688,789</b> |
| Trust fund management fee (7%) | \$10,931         | \$17,879         | \$19,405         | -           | -           | \$48,215         |
| <b>Total</b>                   | <b>\$167,086</b> | <b>\$273,298</b> | <b>\$296,620</b> | <b>-</b>    | <b>-</b>    | <b>\$737,004</b> |

The estimated budget for this three-year project is \$737,004, but endorsement is requested for \$167,086 through FY25. Endorsement for future plans will be requested at a later date as funding for the program is secured and reform plans gain traction.

**VIII. TARGETED LOGICAL FRAMEWORK****E. RM I – Tax Policy**

| <b>Objective</b>                                                                                                |                                                                            |
|-----------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------|
| <b>Improve Tax Policy Design - TPD</b>                                                                          |                                                                            |
| <b>Outcome(s)</b>                                                                                               | <b>Indicator(s)</b>                                                        |
| Increased/decreased revenue quantity                                                                            | Laws implementing amendments to raise revenues are passed                  |
|                                                                                                                 | Revenue change                                                             |
| Increased economic efficiency by minimizing economic distortions or addressing externalities or market failures | Adopt legislation that reduces economic distortions.                       |
| Improved distributional fairness across taxpayers due to amended tax rates or base                              | Laws implementing amendments aimed at greater horizontal equity are passed |
|                                                                                                                 | Laws implementing amendments aimed at greater vertical equity are passed   |