Djibouti: Staff-Monitored Program: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

August 4, 2005

The following item is a Letter of Intent and a Memorandum of Economic and Financial Policies of the government of Djibouti. The document, which is the property of Djibouti, is being made available on the IMF website by agreement with the member as a service to users of the IMF website. This memorandum describes the policies that is implementing in the framework of a staffmonitored program. A member's staff-monitored program is an informal and flexible instrument for dialogue between the IMF staff and a member on its economic policies. A staffmonitored program is not supported by the use of the Fund's financial resources; nor is it subject to the endorsement of the Executive Board of the IMF.

REPUBLIC OF DJIBOUTI
The Minister of Economy,
Finance, and Planning
Responsible for Privatization
No. 613/MEFPP

Djibouti, August 4, 2005

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Rato:

1. The economy and social situation in Djibouti remain fragile despite seven years of adjustment efforts under IMF-supported programs (1996–99 Stand-By Arrangement and 1999–02 Poverty Reduction and Growth Facility—PRGF). The fiscal position has gradually been restored, and progress has been made toward the government finance reform.

2. These programs have made it possible to stabilize fiscal revenue, streamline fiscal expenditure, increase social spending, and reduce the sizeable domestic fiscal arrears since 2001. However, the structural reform program, intended to remove obstacles to growth, has not been completed, and as a result, economic growth has not been strong enough to foster job creation and poverty reduction.

3. In light of this record, the Djibouti authorities embarked in 2004 on the country's first staff-monitored program (SMP) with the Fund. The results of this SMP have proved modest, essentially owing to an increase in expenditure much greater than forecast in the SMP and the limited progress made in implementing a number of structural reforms aimed at improving the competitiveness of the economy.

4. The government therefore deems it essential, given past experience, to continue the partnership started with the IMF on the basis of a new program. The measures proposed in the attached Memorandum reflect the authorities' political commitment to pursuing the reforms, while taking account of the necessity of efficiently meeting the requirements for additional external resources to finance the government's poverty reduction strategy.

5. The objective announced by the Djibouti authorities is to establish two consecutive quarters of satisfactory performance, so as to initiate a PRGF-supported program in 2006, with a view to financing the Poverty Reduction Strategy Paper (PRSP).

6. The government believes that the policies described in the attached Memorandum clearly reflect the authorities' commitment to economic reforms and lay a solid foundation for implementing their economic policy. The government, therefore, requests that Fund staff closely monitor the implementation of this program covering the

period July 1–December 31, 2005, with the same rigor as is done under Fund-supported programs.

7. The government will also provide IMF staff with all necessary information to assess policy implementation and fulfillment of the program targets. The authorities intend to review progress under the program with Fund staff at regular, three-month intervals.

8. The government appreciates the help that the IMF has provided in preparing economic reform programs since 1996 and attaches great importance to continued collaboration with the IMF.

Sincerely yours,

/s/

Ali Farah Assoweh
Minister of Economy,
Finance, and Planning,
Responsible for Privatization

/s/

Djama M. Haïd
Governor
Central Bank of Djibouti

REPUBLIC OF DJIBOUTI

MEMORANDUM ON ECONOMIC

AND FINANCIAL POLICIES

I. Introduction

1. In light of the disastrous financial consequences of the civil war that lasted from 1991 to 1994, the government entered into a stand-by arrangement (1996–99) in April 1996 and then received assistance under the Poverty Reduction and Growth Facility (PRGF) from October 1999 to December 2002. During those six years of fiscal adjustment, the authorities made considerable efforts to put the macroeconomic framework in order.

2. The major steps taken by the Djibouti authorities to restore fiscal balance in the short and medium terms through various structural adjustment programs led to an improvement in the economic aggregates such as GDP growth and inflation, but unfortunately did not reduce poverty, as shown by the results of the latest household survey conducted in July 2002 (EDAM-2).

3. Bearing in mind the poverty prevalent in the country and nevertheless concerned with maintaining the fiscal stability so painstakingly achieved, the Djibouti authorities have embarked on a poverty reduction process. Accordingly, the government has entered into a commitment with the international community to halve poverty by 2015, by taking steps toward achieving the Millennium Development Goals (MDG).

4. Moreover, the objective of reducing poverty in Djibouti, which is the cornerstone of any development-oriented action in the country, falls within the framework of the Poverty Reduction Strategy Paper (PRSP) drawn up by the government. The basic objective of this PRSP is to create a momentum toward growth and accumulation of human capital that can sustainably reduce poverty and unemployment, and improve the living conditions of all citizens. It is based on a long-term vision aimed at taking advantage of the country's strategic assets, its geographic location and its port, and developing its human resources to achieve a radical improvement in the competitiveness of the economy and give it an advantageous position in the global economy.

5. The Djibouti authorities thus embarked, in 2004, on the country's first staff-monitored program (SMP) with the Fund. The results of this SMP have proved modest, essentially owing to an increase in expenditure much greater than forecast in the SMP and to nonobservance of the set timetable in the implementation of a number of structural reforms aimed at improving the competitiveness of the economy.

6. The government therefore deems it essential, given past experience, to continue the partnership started with the IMF, on the basis of a new program. The measures proposed in this Memorandum reflect the authorities' political commitment to pursuing the reforms while taking account of the necessity of efficiently meeting the requirements for additional external resources, to finance the government's poverty reduction strategy.

7. The objective announced by the Djibouti authorities is to establish two consecutive quarters of satisfactory performance, so as to initiate a PRGF as of 2006, with a view to financing the Poverty Reduction Strategy Paper (PRSP).

II. National Economic Developments in 2004

8. In 2004, the authorities succeeded in preserving macroeconomic stability as a result of larger-than-expected growth in additional revenue. The overall fiscal deficit (commitment basis, including grants) remained at about 2.1 percent of GDP, and gross public indebtedness (including domestic arrears) was reduced to 89.4 percent of GDP. Notwithstanding, the domestic fiscal deficit[1]—an indicator of domestic fiscal effort—widened by 1.3 percent of GDP to 5.5 percent of GDP, owing to a 0.6 percent drop in domestic revenue—generated by the upsurge in oil prices—and a 0.7 percent overall rise in spending. Domestic arrears fell by DF 1.8 billion short of that achieved in 2003, and this led to a net accumulation of arrears to the private sector. The authorities thus financed a portion of the fiscal deficit by drawing on their deposits at the central bank, which dwindled to 0.1 percent of GDP at end-2004 (a year earlier, they accounted for 0.7 percent of GDP).

9. The authorities also honored their commitment to contract only concessional debt and to meet their external payment obligations when due.

10. Briefly, sectoral developments in the national economy in 2004, compared with the previous year, were as follows:

- Overall, the volume of port traffic declined by 19 percent as a result of the reduction in transshipment trade (-15 percent), which alone represented more than 85 percent of all port activities.

- Air transport, by contrast, recorded a satisfactory performance, notably in aircraft movements (+10 percent) and passenger traffic (+17 percent). However, freight fell by 20 percent during the period.

- Traffic on the railway linking Djibouti and Ethiopia continued to decline, with the volume of merchandise transported falling by 25 percent (notably, a decrease of 43.7 percent for Ethiopian imports).

- With a total of 120,657 truck movements, road transport between Djibouti and Ethiopia decreased by 6 percent.

11. The production of running water by the national water authority (ONED) remained virtually the same (-0.1 percent), while the production of electric power by the national electricity company (EDD) rose by 4.3 percent. In addition, the invoiced consumption of these two public enterprises increased during the year by 3 percent and 4 percent, respectively.

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[1] The basic fiscal balance is defined as domestic revenue (excluding military receipts from France and the United States) minus expenditure financed from domestic resources.

12. The general price level, measured by the consumer price index, went up by 3.1 percent in 2004, compared with 2 percent in 2003. This increase is attributable to the combined effect of the upward movement in the euro/U.S. dollar rate and the enormous hike in oil prices on the world market.

13. The total money supply, which now stands at FD 87,754 billion, increased by 13.9 percent in a year, as a result of the growth of currency (+11.2 percent) and in foreign currency deposits (+30.9 percent). The money supply offsetting items were marked by the upturn in the foreign assets of commercial banks (+27.4 percent) and the modest growth of domestic credit (+1.5 percent).

14. Public investment project disbursements for 2004 totaled FD 6,616 billion, or 17 percent more than recorded the previous year.

III. Trends During the First Five Months of 2005

15. In May 2005, the fiscal position improved, compared to the previous month, and this enabled the authorities to reduce the arrears accumulated during the first four months of the year from FD 885 million to FD 670 million. However, the cumulative fiscal position through May 2005 worsened from a year earlier, with the domestic fiscal deficit widening from 2.1 percent of GDP to 2.4 percent. Notwithstanding, if we consider the tax and fiscal efforts made in May alone, without taking account of the cumulative amount for the first five months of the year, a huge improvement of the fiscal position can be observed.

16. As regards economic activity, the first five months of 2005, compared with the same period in 2004, show the following:

(a) An improvement in port traffic, up 5 percent owing to stronger exports; and
(b) An annual inflation rate of about 3 percent.

17. At end-May, the government external arrears totaled US$28 million, of which US$26.5 million owed to Spain and Italy, and US$1 million to the African Development Bank (AfDB). Italy has proposed an agreement to provide for debt rescheduling. That debt conversion agreement stipulates that Djibouti will record the outstanding amount in the budget and earmark it for the financing of social or environmental projects in the country.

IV. Medium-Term Strategy and Macroeconomic Framework (2005–07)

18. The country's medium-term development strategy is announced in the PRSP finalized at the beginning of 2004. The program of reforms is hinged on the establishment of a favorable macroeconomic and structural environment with the following objectives:

- Adoption of a medium-term fiscal policy likely to reduce the financial vulnerabilities while improving the composition of public expenditure in support of growth and poverty reduction; and

- Growth driven by the private sector, with the promotion of an attractive climate for private investment. The strategy pursued is based on four key actions: (i) the establishment of a legal framework conducive to private investment; (ii) the improvement of labor conditions; (iii) the pursuit of the reforms aimed at reducing the costs of production factors and improving the management of public enterprises; and (iv) the strengthening of good governance.

19. In this context, the primary macroeconomic objectives set for the period 2005–07 are as follows:

- To ensure average real GDP growth of 4.6 percent, supported by a high level of public and private investment;

- To contain inflation, as measured by the consumer price index, at 2 percent (except in cases of international exogenous shocks);

- To consolidate fiscal management and control, with efforts made in favor of tax modernization and the strengthening of the public expenditure procedures to be followed; and

- To maintain the ratio of government debt service to GDP at 1.5 percent.

20. However, the acceleration of growth that is at the heart of the reform cannot occur unless the private sector reacts favorably to the reforms. These essential structural reforms will be implemented on the basis of the following key positions:

- In the area of tax reform, the objectives are to improve revenue collection with a view to reducing the tax burden without disturbing the overall fiscal balance;

- For public expenditure, the objective is to improve management through more efficient functioning of the productive utilities and social services: education (including training) and health (including prevention and hygiene);

- For the structural reforms, the objective is to improve the external competitiveness of the economy, with the adoption of reforms of the Labor, Commercial, and Investment Codes, and to set up an operational one-stop shop;

- Improvement of the banking system through the enhancement of supervision; and

- Out of awareness that the establishment of a climate conducive to the development of private investment is dependent on reducing the costs of production factors, the government will, in particular, pursue in 2005 the reforms of public enterprises (Electricité de Djibouti, Office National des Eaux de Djibouti, and Djibouti-Télécom), as well as the improvement of their financial profitability. The finalization of these reforms will require the financial support of donors and lenders, and notably of the World Bank. To achieve these objectives, the government will set up, within the Ministry Finance responsible for Privatization, a unit responsible for ensuring observance of the pertinent terms and conditions.

V. Program for 2005

A. Macroeconomic Framework

21. Essential features of the outlook for 2005 and subsequent years are: (i) a sustainable growth rate, and (ii) increased competitiveness of the economy. For the government, these two key issues must be addressed if the national poverty reduction strategy is to become a reality.

Elements of the macroeconomic framework for 2005 are as follows:

- An increase of the real GDP growth rate to 3.2 percent, supported by an upturn in port and road traffic, owing to the rise in Ethiopian trade and the inauguration of the Doraleh oil terminal, and an increase in externally financed public projects;
- An inflation rate of about 3 percent, reflecting the combined effects of the depreciation of the U.S. dollar and the rise in oil prices on the world market;
- A narrowing of the domestic fiscal deficit—from 5.5 percent of GDP in 2004 to 3.8 percent of projected GDP in 2005 as a result of a nominal increase of about 5.2 percent in domestic revenue and a decrease of about 1 percent in expenditure financed from domestic resources. This narrowing of the deficit would facilitate the settlement of at least DF 730 million of the government's net domestic arrears in 2005, after a net accumulation of DF 670 million from end-2004 to end-May 2005; and
- A current account deficit representing less than 1 percent of GDP.

22. The principal economic policy measures planned within the SMP framework are discussed below.

B. Fiscal Policy

23. The Djibouti authorities undertake to draft and submit to the National Assembly a 2005 supplementary budget consistent with the projections established in June/July 2005 in collaboration with Fund staff. They also undertake to use any additional revenue (over and above the current projections mentioned in the supplementary budget) to pay domestic arrears and increase government deposits at the Central Bank of Djibouti.

24. **As regards domestic revenue**, the measures planned for achieving the objectives set forth in the 2005 supplementary budget are as follows:

- To improve the collection rate achieved by the tax and customs administration, based on: (i) the computerization of tax units, (ii) passing on to consumers the increase in world oil prices, and (iii) limiting and streamlining ad hoc tax exemptions; and

- To adopt immediate measures and revise the timetable proposed by the technical assistance mission from the IMF Fiscal Affairs Department (FAD), with a view to introducing VAT in Djibouti.

25. **On the expenditure side**, the planned measures are as follows:

- To limit wage bill growth through: (i) the placing on retirement of civil servants and government contractual employees that have reached retirement age, and (ii) not recruiting new personnel in the nonpriority and security (military, etc.) sectors; and

- To reduce the expenditure related to the following items:

    a. Housing subsidies for civil servants;

    b. Transfers to public enterprises that are able to meet their own needs; elimination of the practice of assuming liability for the water and electricity bills of public bodies such as Radio et Télévision Djibouti, the Palais du Peuple, and the Hassan Gouled Stadium; and

    c. Trips abroad.

26. To **improve public expenditure management**, the government undertakes to:

- Put into operation the computerized central database (single database) in 2006;

- To continue strict implementation of the monthly Cash Flow Plan;

- To eliminate check conversions with the following institutions: ONED and Djibouti Télécom;

- To computerize expenditure procedures by end-December 2005;

- To publish on the Ministry of Finance website the monthly fiscal reporting table (TOFE), beginning with the June 2005 TOFE, and in-depth half-yearly reports on progress achieved in the reorientation of expenditure for the poor and investment financed from domestic resources, with a delay of no more than three months;

- To begin the preparatory work for establishing social safety net arrangements for the most vulnerable segments of the population, with World Bank assistance;

- To include in the budget external financing of all types (grants and loans), including any amounts received within the framework of international military assistance, and dividends of public enterprises; and

- To include in the budget all extrabudgetary expenditure and revenue (including military).

C. External Sector Policy

27. The activity of debt management and monitoring is one of the government's priorities. Debt management has improved considerably since the introduction of the Debt Management and Financial Analysis System (DMFAS) program. This improvement can be seen in the viability of the database that has been fully entered on the system and the tracking of repayments for which authorization has been the responsibility of the DFE since the Decree of May 6, 2004.

28. For 2005, the government will pursue its prudent debt management policy, not contracting or guaranteeing any nonconcessional loans. In addition, the government undertakes to include in the external debt service the charges related to new external borrowings, while avoiding the accumulation of further external and domestic payment arrears.

29. Furthermore, the government has renewed contacts with Italy, which has proposed debt conversion into social sector and environmental projects. A Djibouti mission is planned for September 2005 to finalize the technical aspects of the rescheduling agreement. The authorities undertake to renew contacts with Spain by end-2005, with a view to finding a definitive solution to the problem of the cumulative external arrears to this Paris Club member country.

30. Also, as regards domestic debt, the government will observe the order of priority among the various creditors in the 10-year domestic payment arrears settlement plan (private creditors, government wage-earners, social public agencies, and public enterprises) adopted at end-2002.

D. Structural Reforms: Improvement of Competitiveness and Poverty Reduction

31. The government puts great store by the promotion of private investment, which is the engine of economic growth. To achieve this objective, the government will finalize by December 2005 the revision of the laws on the various tax exemptions, with a view to harmonizing and integrating them into the 2006 Budget Law and the General Tax Code. These arrangements will facilitate the simplification and streamlining of the exemptions system. The authorities undertake to adopt the Investment Charter in 2006.

32. Also, to contribute to labor market flexibility, the council of ministers in November 2004 adopted the draft Labor Code drawn up on a tripartite basis (government-employers-unions), including comments received from the International Labour Office (ILO). This Labor Code will have to be passed by the National Assembly by end-December 2005.

33. The authorities will promote the development of private initiative, with the implementation of a strategy and mechanisms in support of small and medium-sized enterprises and industries (SMEs and SMIs). The purpose of the approved management center set up within the Djibouti Chamber of Commerce is to assist private operators in their management and eventually to enhance their competitiveness on both the national and regional markets. The authorities will also strengthen the expansion of microfinance, in particular by formulating a national microfinance strategy, already being drafted in collaboration with the Central Bank of Djibouti.

34. The authorities will create the best possible conditions to encourage private initiative, by formulating an energy restructuring plan. With World Bank support, a study on the social impact of energy costs on poverty was completed in May 2005. The strategy can therefore be finalized for providing the population with greater access to available energy at lower cost.

35. As regards the strengthening of good governance, the government plans to enhance and streamline public expenditure management. Overall, the aim will be to consolidate the current gains, along the following lines:

- Effective application of the new procedures for budget preparation and expenditure tracking and control;
- Strengthening of fiscal control through the publication of the 2003 report of the Audit and Fiscal Discipline Office;
- Publication of the audited financial statements of public enterprises; and
- Implementation of the recommendations on the real sector by end-September 2005, with a view to participating as soon as possible in the IMF’s GDDS.

36. To complete the Commercial Code, the government recently sought UNDP support, and a new timetable will be established by end-2005. The authorities undertake to adopt the Commercial Code in 2006.

VI. Program Monitoring

37. Program performance will be monitored on the basis of quarterly indicative targets, structural benchmarks, and quarterly progress assessments by IMF staff. The indicative targets at end-September and December 2005, as set forth in Table 1, relate to: a ceiling for (i) the wage bill; (ii) goods, services, and transfers; (iii) the basic fiscal deficit; (iv) net commercial bank credit to the government; and (v) net government borrowings from the Central Bank; and to a floor for (vi) net repayments of domestic arrears; and (vii) the coverage of the currency board arrangement (100 percent).

38. Furthermore, the SMP also provides for a zero ceiling with respect to nonconcessional external debt contracted or guaranteed by the government and to the accumulation of further external arrears, and the authorities will have to take practical steps

to settle all the external arrears accumulated during the first half of 2005 to the multilateral institutions.

39. The government of Djibouti will not apply restrictions to payments and transfers related to international transactions, impose new restrictions on trade, or intensify the restrictions in force, for balance of payments reasons; adopt multiple exchange rate practices; or be a party to bilateral payment agreements providing for restrictive practices with other IMF member countries.

40. Djibouti will periodically consult the IMF, in accordance with pertinent Fund policies, regarding its progress in the implementation of the policies and measures described within the SMP framework.

/s/	/s/
Ali Farah Assoweh Minister of Economy, Finance, and Planning, Responsible for Privatization	Djama M. Haïd Governor Central Bank of Djibouti
August 4, 2005	August 4, 2005

Table 1. Djibouti: Revised Indicative Targets in the Staff-Monitored Program
(In millions of Djibouti francs; unless otherwise stated)

	2004	Cumulative Flows From January 2005 (Unless stated otherwise)			
		Real.	Real.	Prog.	Prog.
	Dec. 31	Mar. 31	June 30	Sept. 30	Dec. 31
1. Ceiling on the wage bill	16,291	3,918	8,435	12,353	16,870
2. Ceiling on expenditure on goods, services, and transfers domestically financed	12,454	3,496	7,145	9,527	11,909
3. Ceiling on the basic fiscal balance (excluding military-related receipts from France and the United States)	-6,435	-2,396	-3,086	-4,115	-4,733
4. Ceiling on the net credit of commercial banks to the government	-291	-86	-409	-201	-201
5. Ceiling on the net credit of the central bank to the government	905	-17	-235	-150	-322
6. Floor on the repayment of domestic arrears	-1,265	-267	88	0	-730
7. Floor on currency board cover	116.4	115.4	109.8	100.0	100.0

Source: Djibouti authorities.

Table 2. Djibouti: Structural Benchmarks for the Staff-Monitored Program

I. Structural benchmarks

End-September 2005

- Publish the 2003 report of the Audit and Fiscal Discipline Office in the *Journal Officiel*
- Publish a detailed report on priority social spending in 2004 on the website of the Ministry of Finance

End-December 2005

- Ensure adoption of the new labor code by the National Assembly
- Publish the 2004 audited financial accounts of the public enterprises (Djibouti Telecom, EDD, and ONED)
- Complete the proposed unification and simplification of the tax exemption regime by merging the various preferential tax regimes and by including remaining exemptions in the general tax code
- Finalize the unified civil servant registry in 2005 and adopt it in 2006
- Complete the computerization of the expenditure chain
- Establish a new timetable for finalizing the commercial code in 2006
- Adopt the VAT measures proposed in Table 3

II. Continuous structural benchmarks

- Strictly apply the monthly cash-flow plan
- Eliminate the practice of exchanging checks with ONED and Djibouti Telecom
- Limit pre-payment order expenditure to such outlays as are stipulated by law
- The government will report to the IMF each quarter, with a lag of four weeks, its monetary data, data on foreign debt, and the TOFE

Table 3. Djibouti: Preparations for the Introduction of the VAT

Draft Timetable

Recommended Action	Implementation
Develop the modernization program and design the action plan.	November 2005
Approval by the Minister of Finance.	December 2005
1. Administrative organization	
• ***Taxpayer identification***	
Give the DRD exclusive authority for registration;	December 2005
Make use of the taxpayer identification number (NIF) obligatory, subject to penalty;	January 2006
Delete all identifying data from the NIF.	December 2005
• ***Management by taxpayer category***	
Assign the task of managing all large enterprise taxes to the Large Enterprise Unit (SGE);	January 2006
Merge the files of large enterprises and manage them chronologically;	January 2006
Remove the flat tax exclusion for small enterprises, and assign the task of managing enterprises liable for the flat tax to the Small and Medium-sized Enterprise Unit (SPME);	January 2006
Assign the task of managing entities that are liable only for the Payroll Tax (ITS) to the SGE;	December 2005
Introduce mandatory self-assessment for the itemized Professional Profit Tax (IBP);	December 2005
Introduce mandatory self-assessment for the VAT;	July 1, 2008
Arrange for the VAT liability option to automatically trigger the itemization option for the IBP.	July 1, 2008
• ***Tax audit***	
Extend targeted audits to all taxes and all structures;	December 2005
Review the selection criteria for corporate audits, and focus programming on audits of preferential tax regimes;	March 2006
Improve programming transparency with formal proposals and rationale for rejections;	March 2006
Reactivate and strengthen the inquiry and investigation team (*brigade d'enquêtes et des recherches*).	December 2005
• ***Collections***	
Discontinue issuing assessment rolls for self-assessed taxes;	June 2006
Transfer enforced collections powers from the SDR to the SGE and SPME;	July 1, 2006
Adopt an enforced collections strategy that prioritizes first-time delinquent taxpayers and those with the largest tax debts;	November 2005
Discontinue estimated assessments for enterprises that are winding up and overstatements of tax bases.	December 2005
• ***IT***	
Complete the inclusion of enterprises in the AGIR;	December 2005
Make the necessary adaptations for computerized VAT management and processing of requests for credit refunds;	July 2008
Establish and computerize the interfaces between the tax and customs administrations, as well as the departments in charge of public procurement.	July 2007
• ***Customs administration constraints***	
Accelerate the necessary steps for accession to the WCO;	January 2006

Recommended Action	Implementation
2. Introduction of the VAT	
• ***Guiding principles***	
Select a broad tax base encompassing all economic activities;	January 2007
Maintain a high taxation threshold that is compatible with the administration's capacity;	January 2007
Set a single rate, to facilitate tax management and acceptance.	January 2006
• ***Necessary developments in indirect taxation***	
Develop a tariff structure similar to the CET, and measure the shortfall that will occur with its implementation and discontinuation of the domestic consumption tax (TIC);	ASAP
Study the fiscal impact of the measures to be taken prior to the introduction of the VAT;	ASAP
Define VAT modalities based on the shortfalls;	June 2007
Introduce the VAT, the customs tariff, and all other indirect tax reforms.	January 1, 2009
• ***Preparation of legislation and implementing regulations***	
Commence drafting of the laws and implementing regulations;	2006
Task the VAT working group with designing and testing the forms and the computer system;	March 2007
• ***Exemptions***	
Discontinue exemptions granted by special decree;	June 2006
Reinstate the administration's oversight of enterprises in the free zone and those covered by the investment code;	
Amend the tax code to include the obligation to declare exempt transactions;	Already exists
Reincorporate the provisions from previous regulations into the investment charter and the free zone code, on the basis of whichever is least advantageous, and harmonize them; repeal the old regulations;	March 2007
Impose VAT on all enterprises, including enterprises in the free zone.	January 1, 2008
• ***Credit refunds***	
Allow for immediate refund of VAT credits for exporters and enterprises that are winding up, and deferred refund for others;	January 1, 2009
Audit credit refunds by means of risk analysis and targeted audits.	January 1, 2009
• ***Modalities for introducing VAT***	
Provide training for officers in the VAT mechanisms, and ensure that the VAT is introduced with no new hirings;	March 2007
Take actions for taxpayer outreach;	December 2006
Develop a program to inform taxpayers of their tax obligations.	June 2006

DJIBOUTI—TECHNICAL MEMORANDUM OF UNDERSTANDING

This Technical Memorandum of Understanding contains clarifications on: (1) the indicative targets shown in the annexes to the Memorandum on Economic and Financial Policies (MEFP), (2) basic information to be reported to the IMF though the resident mission, and (3) the plan for program implementation monitoring by the authorities.

I. Indicative Targets

Ceilings set for the following variables:

- **The wage bill** consists, in particular, of all wages, fees, allowances, benefits, and allocations that the government pays to the civilian, military, and security personnel it employs (whether permanently or temporarily), as well as to all other government employees, regardless of the payment method used (cash, check, transfer, other) and regardless of which agency is responsible for making the payments in question (Treasury or other body acting of behalf of the government). The ceilings and targets include savings related to the projected departures on retirement and the net savings related to the program to demobilize security and military personnel.

- **Goods, services, and transfer expenditure** covers all operating costs (excluding the wage bill and maintenance expenditure) of the central government and local governments (including energy costs), as well as government subsidies to private, public, and autonomous bodies. Transfer operations also relate to scholarship awards, participation in building occupancy expenses, pensions and life annuities, contributions to public agencies, as well as consolidation of the peace agreements and the training program for young people. Externally financed military spending is not included.

- **The domestic fiscal balance** is defined as total domestic revenue minus total domestic expenditure. Domestic revenue includes all revenue, excluding grants and receipts related to the military agreements with France and the United States. Domestic expenditure consists of all expenditure (current and development) financed from domestic resources.

- **Net Central Bank credit to the government** is defined as all Central Bank claims on government departments minus the deposits of government departments at the Central Bank. These deposits include: the Reserve Fund, the cash holdings of the Treasury, and miscellaneous deposits. Miscellaneous deposits are primarily made up of: deposits on blocked accounts, deposits related to the payment of exceptional grants, current accounts, deposits on special accounts, and offsetting funds related to loans and grants received by way of external fiscal assistance. These deposits do not include the offsetting funds from external loans and grants that are not earmarked for fiscal support.

- **Net commercial bank credit to the government** is made up of all commercial bank claims on the government (including overdrafts and securities and bonds issued by government departments, held by commercial banks), current accounts, deposits on special accounts, and balancing funds related to loans and grants representing external fiscal assistance. These deposits do not include the balancing funds generated by external loans and grants that are not earmarked for fiscal support. Commercial banks are the two banking institutions currently operating in Djibouti.

Floors are set for the following variables:

- **Currency board coverage** is defined as the gross foreign assets of the Central Bank as a percentage of monetary commitments (reserve money plus government deposits at the central bank); and

- **Net repayment of domestic arrears,** which consist primarily of arrears on the wage bill, payments to private suppliers, transfers to retirement funds, etc.

For the purposes of benchmark calculation, the following exchange rates are used: US$1.00 = DF 177.72; € 1.00 = DF 220; and SDR 1.00 = DF 227.1.

II. Information to be Provided to Fund Staff

The authorities will, **as of September 2005**, provide to Fund staff through the resident mission, within no more than a four week delay unless otherwise agreed, the following basic data:

A. Government finance

- Revenue: breakdown of total revenue into: (1) statement of taxes issued, (2) statement of collections, and (3) statement of outstanding collections;

- Expenditure: breakdown of total expenditure into: the wage bill, equipment, maintenance, domestic and external interest, transfers and capital expenditure, and peace consolidation. For each of these expenditure items, the statement of payment authorizations and payments should be provided;

- Bank financing, broken down to show figures for the Central Bank and for the commercial banks. Total flows accumulated from January of the ongoing year to a specific date should be equivalent to the change in the stock between end-December 2004 and the date in question;

- Nonbank domestic financing;

- External financing (committed and disbursed), broken down into loans and grants. The following supporting documents should be attached: (1) statement of project implementation, and (2) statement of external resource mobilization; and
- Cash flow plan updated for the ongoing month, and projection for the following month based on the previous month's outcome.

B. Arrears

- Domestic arrears statement tables for: (1) the ongoing year (2005), (2) the stock at the end of the previous year (2004), and (3) the consolidation of (1) and (2); and
- External arrears statement tables for: (1) the ongoing year (2005), (2) the stock at the end of the previous year (2004), and (3) the consolidation of (1) and (2).

C. Currency

- Monetary survey,
- Central Bank statement,
- Commercial banks statement,
- Net international reserves calculation table, and
- Central Bank and commercial bank credit stock calculation table.

D. External sector

- Flows of loans and grants accumulated from January 1, 2005 to the month preceding the ongoing month;
- Updating of the total debt stock, broken down into government debt and public enterprises debt;
- Updating of the repayment schedule for total debt, broken down into government debt and public enterprises debt; and
- External debt operations other than those related to the above-mentioned arrears, and in particular: (1) debt recently contracted and guaranteed by the government and by the public enterprises; and (2) new related repayment schedule, consolidating the servicing of that debt with the stock of pre-existing debt.

E. Real sector

- Implementation of the Public Investment Program (PIP) since January 1 of the year preceding the date the table is compiled; and
- Price index.

F. Structural reforms

Overview of the structural reforms. Indicate progress made, explain any slippages where applicable, and indicate the expected completion date.

G. Other information

Other information on the principal economic and social measures taken by the government and expected to have an impact on program implementation (revisions made to the legislation, the regulations, and any other pertinent policy documents), to be provided to Fund staff in a timely way for consultation or information.

III. Program Monitoring

To improve program monitoring by the Minister of Finance, the program of reforms will be coordinated and monitored at the level of the Office of the Minister, by the Adviser responsible for the program. The Adviser will head the small Technical Committee composed of the Director of Budget, Revenue, Economy, Finance, Treasury, External Financing, DISED, the SAP coordinator, a representative of the Central Bank, and the IMF resident representative.

Committee meetings will be held twice a month to take stock of the comparison between the financial operations recorded in the Treasury and Central Bank accounts respectively, to examine progress made in the implementation of structural measures, and to discuss other matters that may have an impact on program implementation. These working meetings will facilitate the preparation of the monthly tables on consolidated government operations, the domestic and external debt statement, the monetary survey, the updated cash management plan, and the overview of progress made in the implementation of structural reforms. These tables will be accompanied by a comparative analysis of actual performance compared with the projections, and an implementation schedule explaining the slippages noted and proposing corrective measures.

All of these documents will be forwarded to the Minister of Finance, to the Governor of the Central Bank, and to Fund staff through the IMF resident mission.

/s/	/s/
Ali Farah Assoweh Minister of Economy, Finance, and Planning, Responsible for Privatization	Djama M. Haïd Governor Central Bank of Djibouti
August 4, 2005	August 4, 2005