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Djibouti: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

June 23, 2011

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LETTER OF INTENT AND MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

Djibouti, June 23, 2011

Mr. John Lipsky
Acting Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Sir:

1. This letter of intent is to inform you of the progress made by Djibouti in 2010 and early 2011 within the framework of the Extended Credit Facility (ECF). It also presents the government's intentions concerning the economic policies and reforms envisaged for the remainder of 2011.
2. The objectives of the ECF-supported program approved in 2008 remain valid. These objectives are consistent with our determination to turn Djibouti into a hub for trade, logistics, and related services, as well as financial services. The ECF-supported program will remain aligned with the National Initiative for Social Development (INSD) which sets out Djibouti's strategy in regard to economic development and poverty reduction.
3. Preliminary data suggest that the program is on track. The FY 2010 deficit meets the program target of 0.5 percent of GDP, achieved through expenditure control (including the absence of extrabudgetary expenditures) in the context of lower-than-anticipated tax revenue (Table 1). The other performance criteria and indicative targets for end-December 2010 were also met with the exception of social spending which was slightly below the target. However, although the end-2010 performance criterion for new gross domestic arrears has been observed, overall net repayment of arrears in 2010 fell short of the program amount, due to delays in payment of a portion of the stock of historic arrears, notwithstanding larger payments of military pensions, to Djibouti-Telecom, and to private suppliers. Furthermore, the continuous performance criteria on non-accumulation of external arrears and the accumulation of new domestic arrears (due to delays in wage and pension payments) were breached in early 2011. Structural benchmarks are now met (Table 2), except for (i) the timely production and publication on the Ministry of Finance's website of the TOFE (continuous structural benchmark,) during the first half of 2011, on account of the delay in the preparation of fiscal data and (ii) the adoption by the cabinet of a new customs code before end-March 2011 (*structural benchmark for end-March 2011*); the code was approved in June. We did not contract any non-concessional debt during 2010 or the first months of 2011.
4. To achieve the ECF objectives, our program for 2011 is predicated on: (i) the pursuit of prudent fiscal policy consistent with the safeguarding of social expenditure; (ii) the strengthening of public financial management; (iii) the maintenance of debt sustainability;

(iv) the modernization of the financial sector; and (v) the enhancement of the competitiveness of the economy through further structural reform.

I. RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK FOR 2011

5. The suspension of transshipment activity and the slowdown in trade with Ethiopia weakened growth in 2010, which fell to 3.5 percent compared to 5 percent in 2009. Inflationary pressures intensified in 2010, mainly as a result of increases in world food prices, and in the prices of a number of commodities, as well as in the transportation cost of merchandise to Ethiopia. Consequently, the average inflation rate increased to 4 percent in 2010 compared to 1.7 percent in 2009. Competitiveness, as measured by the real effective exchange rate, improved through 2008. Since then, the trend has reversed on account of the appreciation of the Djibouti franc relative to the euro, lower inflation levels notwithstanding.

6. Growth is expected to rise to 4.8 percent in 2011 thanks to the resumption of transshipment activity, the stabilization of the situation in Ethiopia, and intensification of services, particularly in banking and telecommunications (mobile telephony and internet). In 2011, inflation is projected to rise to 8.5 percent on account of the considerable increase in global food and fuel prices.

7. The current account deficit stabilized at 4.8 percent of GDP in 2010. However, the deficit is expected to rise again in 2011 to 10.4 percent, on account of an increase in imports associated with the resumption of FDI, as well as the impact resulting from rising food and oil prices on world markets. International reserves, after having increased by approximately US\$20 million during the years 2009-2010, attaining a level of US\$231 million at end-2010, will slightly increase in 2011 thanks inter alia to the resumption of investments and disbursements under the ECF. The stock of external debt has continued to decline, reaching approximately 56 percent of GDP at end-2010 and is expected to decline to 53 percent by end-2011.

8. Despite the positive growth rates achieved in recent years, the food security situation remains critical, due to high world food prices, and poor rainfall over the past four years which has adversely affected the harvests of small farmers. The sizes of herds are 30-50 percent smaller than their 2003 levels, and according to the most recent national nutritional survey (March 2011), malnutrition is still affecting over 12,000 children under five throughout the country. The food security situation in urban areas is serious: 14.5 percent of the urban population (Djibouti Ville and the five regional capitals) are facing food insecurity.

II. GOVERNMENT FINANCE

A. Fiscal Policy

9. Our fiscal policy remains focused on three key areas, namely: fiscal rebalancing for the purposes of maintaining debt sustainability and non-monetary financing of fiscal deficits;

the safeguarding of fiscal space for social expenditure; and the strengthening and modernization of fiscal management.

10. Fiscal performance improved in 2010 compared to 2009. We have strengthened tax revenue collection, in particular of direct taxes, thanks mainly to the payment of taxes by the port companies; and of domestic nontax revenue, specifically collection of dividends. The decline in the level of spending in 2010 is attributable to a decrease in current expenditure, as well as in capital expenditure. We kept the wage bill within the limits of the program through our policy of freezing recruitment in the public sector (except, as envisaged under the program, for health and education personnel and the year-on-year slide in nominal wages, apart from promotions).

11. The 2011 budget law, which was adopted by the National Assembly at end-2010 (*prior action for the second and third reviews*), envisaged a deficit target of around 0.1 percent of GDP. In order to make up for the delays in domestic arrears payments planned in 2010, we intend to achieve a budget surplus of around 0.4 percent of GDP by means of a rigorous fiscal policy, through efforts focusing on revenue and expenditure. Our goal is to achieve a stable revenue/GDP ratio of 20.2 percent in 2011 compared to 2010 through improvements in tax and customs administration. With regard to expenditures, we will continue to freeze recruitment and will limit the growth in government wages. The new employment programs in the public sector will be managed through staff redeployment. Expenditures on goods and services will continue to include repayment of accumulated domestic arrears vis-à-vis *Electricité de Djibouti* (EDD) and *Office National de l'Eau et de l'Assainissement de Djibouti* (ONEAD) in 2009. Social spending and investment will rise in line with the poverty reduction objectives of the INDS. However, we intend to defer some capital expenditure in the amount of 0.2 percent of GDP, with the option to execute such expenditures this year in the event that revenues perform better than anticipated. Financing will be primarily external, which will allow the government to replenish its deposits with the domestic banking system, and in particular at the CBD.

12. To cope with rising commodity prices, we will rely primarily on a policy of subsidizing food and fuel prices to mitigate their impact on the population. Cereal production (approximately 8000 tons in 2010) in Ethiopia and Sudan, managed by the Djiboutian Company for Food Security, is sold on the local market at subsidized prices, with the aim of stabilizing domestic food prices, at an estimated budget cost of DF 103 million. Regarding the energy sector, starting in 2011, we have stabilized the price of diesel by reducing excises for a total loss of tax revenue of about DF 400 million. We also fixed the price of kerosene at an affordable level for the most vulnerable segments of the population by means of a subsidy of about DF 60 million for 2011. To enhance the transparency of subsidies, we will prepare a summary financial statement for FY 2010 of the food security program by end-June 2011. We will make available on a regular basis the operating accounts of the food security company. With regard to energy products, we are committed to withdraw subsidies when world oil prices have stabilized, while developing better targeted social safety nets.

13. One of the major challenges we face is unemployment, which affects a significant portion of our workforce, and especially the youth. To ensure a better match between training and employer needs, we have, on the occasion of the appointment of the new government, undertaken institutional reorganization by assigning vocational training to the Ministry of National Education. We also opened a logistics training center to encourage training in skilled jobs to meet the needs of high-tech sectors such as port, transport and energy. To facilitate the employment of young graduates outside the civil service, we established an insertion fund and we are funding through the state budget credit facilities to support the creation of companies (seven business projects were already approved and have been launched). In addition, we established a guarantee fund as collateral for loans that will be granted within this framework.

B. Fiscal Reforms

14. In 2011, we intend to press ahead with fiscal reforms, with the aim of strengthening the capacity of tax revenue collection, expenditure control, as well as budget planning and management.

15. In order to enhance budget revenue, we adopted in June the customs code aiming at its modernization consistently with the COMESA zone code (*structural benchmark for March 2011*). We also intend to: (i) include in the 2012 budget the lowering of the VAT threshold from DF 80 million to DF 50 million (*structural benchmark for December 2011*), and strengthen the unit in charge of the VAT with qualified human resources (*structural benchmark for December 2011*); (ii) improve the information system through the extension of the single identifier system (NIF) so as to include firms subject to declaration of direct taxes, and strengthen coordination of the units in charge of managing the VAT and direct taxes; (iii) enhance the operational efficiency of the tax center opened in 2011 in the municipality of Balbala in accordance with a grass-roots policy designed to equip each major region in the country with similar centers (payment offices) in the context of the decentralization process; (iv) launch the work of the commission established in the context of the LFI (budget law) and including the tax, customs, and ANPI offices, which should review the conditions for granting exemptions for new investments, albeit without modifying those incentives already granted, and produce a list of beneficiaries; (v) subject beneficiary enterprises to reporting requirements, put in place necessary staff entrusted with estimating tax expenditures, and prepare a report on these expenditures to be annexed to the 2012 revised budget law (*structural benchmark for end-June 2011*); and (vi) install the ASYCUDA customs revenue management software with effect from the month of August at the port level, and comprehensively by end-December 2011 (*structural benchmark for end-December 2011*). Furthermore, the ASYCUDA system will integrate the NIF through an interface with the Directorate General of Taxes so as to better identify taxpayers.

16. The budget slippage at end-2009 prompted us to strengthen expenditure control and public financial management. With regard to expenditure control, in 2010 we strengthened the coordination among the main structures of the ministry of finance through the

establishment of a department in charge of auditing and monitoring the accounts of public institutions within the treasury directorate, the establishment of a centralized accounting agency for hospitals, as well as strengthening the status of government accounting staff in public enterprises. In addition, the ministry of finance has implemented preventive expenditure control measures such as continuous unannounced inspections at five ministries during 2010 in order to update the single roster of civil servants, in addition to the physical inventory of government assets. With respect to financial transparency and management, we prepared bimonthly cash-flow programming exercises on a commitment basis, broadened to include the Ministries of Education and Health, and we also annexed the budgets of the water and youth funds to the 2011 budget law.

17. In 2011, we plan to continue these efforts by: (i) pursuing the policy of transferring the balances of public accounts and projects funded by donors to the single treasury account; (ii) pressing ahead with preparations to introduce a medium-term fiscal framework (MTEF) for the 2013 budget law by finalizing the recruitment of qualified professionals for the Budget Directorate (*structural benchmark for end-June 2011*) and, if necessary, by amending the organic and budget laws for the 2013 budget, thanks to support from our partners, in particular the IMF and UNDP; (iii) posting of the monthly fiscal reporting table (TOFE) on the internet site of the ministry of finance with a maximum lag of two months (*continuous structural benchmark*); and (iv) revitalizing efforts to implement the new budget nomenclature, currently delayed by financing difficulties, to be introduced in the context of the 2013 budget, with the help of an appropriate software program that we plan to purchase during 2011 (*structural benchmark for end-December 2011*).

18. We remain determined to reduce the stock of domestic arrears, including those accumulated in 1995-2001, with the possible support of donors, and to prevent further accumulation. We will: (i) tighten controls over the public expenditure chain in order not to accumulate further arrears, except for those due to the one-month delay in payment of wages to civil servants and three months of contribution to the retirement fund, which we intend to reduce to the extent that available resources permit; (ii) monitor regularly the status of domestic arrears and the execution of payments to public utilities (which will be reported to Fund staff on a quarterly basis) in the context of bimonthly cash-flow programming exercises; and (iii) continue to remain cautious in the programming of budget allocations related to current expenditure and social spending, as well as to external financing resources that have not yet been signed.

19. We intend to: (i) prepare by end-June 2011 a summary table on the cross-debts situation of public enterprises, and to pursue the process of consolidating cross-debt between the government and the public enterprises concerned by signing the agreements on cross-debt (*structural benchmark for end-September 2011*); and (ii) repay over the period 2010-12 the full amount of cumulative payments arrears recorded in 2009, using specific budget lines in expenditure on goods and services.

III. EXTERNAL DEBT

20. Progress made in relations with Paris Club creditors has made it possible to finalize bilateral agreements and implementation of the second phase of the October 2008 agreement. We have signed bilateral agreements with France, Germany, and Spain. In accordance with the clause on comparability of treatment under the Paris Club agreement, we have signed bilateral agreements with Saudi Arabia, and we have contacted the United Arab Emirates and Kuwait in order to begin negotiations with a view to obtaining treatment similar to that accorded by the Paris Club.

21. To preserve debt sustainability, we will continue to contract only concessional loans and we will strictly prioritize projects to be financed, including in the context of the INDS. In this context, under the auspices of the Minister of Finance, we will enhance coordination among the various ministerial departments in connection with government borrowing programs, as well as the related policies and actions. The arrears accumulated to Paris Club creditors, resulting from internal coordination problems, were all paid in May 2011. In future, we undertake to avoid all accumulation of external arrears, and to this end, we will strengthen the tracking of debt service payments, including by systematically checking the execution of these payments with creditors.

IV. MONETARY AND FINANCIAL POLICIES

22. Our monetary policy will remain anchored by the currency board arrangement, which serves our economy well by ensuring price stability. We undertake to maintain the coverage of all our foreign currency-denominated liabilities and a rate of coverage higher than 105 percent of reserve money and government deposits at the CBD.

23. The growth in credit and deposits in 2009 and 2010 was very high on account of the arrival of new banks and continuing demand for credit by the private sector. However, these strong trends were reversed in first quarter 2011 on account of a decrease in overdrafts on checking accounts, which represent 57 percent of credit to the private sector, linked to uncertainty during the electoral period. While the banking sector has grown substantially in recent years, the financial sector has remained sound, with a relatively low level of NPLs and disputed claims, and has experienced an expansion in financial products and electronic banking transactions.

24. Conscious that banking system growth increases the existing pressure on bank supervision and regulation, we are implementing our reform program in accordance with the main recommendations of the Financial System Assessment Program. We have undertaken efforts to strengthen supervision by reorganizing the structure in charge of supervision and creating a unit dedicated to supervision, in accordance with recommendations made by technical assistance missions from the IMF and Banque de France (*structural benchmark for end-June 2011*). We have also recruited two staff members (*structural benchmark for end-June 2011*), in addition to the senior official already hired for the unit, and we have begun

training the staff members in techniques indispensable for effective off-site and on-site supervision. We also conducted the on-site inspection of two banks during 2010, and of three banks during the first half of 2011, and we intend to inspect three other banks and three exchange bureaus by the end of the year, in addition to exercising continuous off-site supervision of banks. The preparation of the operating manuals for the banking law and of the supervision tools should be in place by end-December 2011.

25. With regard to the strengthening of banking regulations, the draft laws on Islamic finance and financial cooperatives were submitted in December 2010 to the National Assembly, which adopted them in January 2011. Furthermore, all banks are now submitting financial statements allowing for the identification of risks such as those related to credit, liquidity, and exchange transactions, in addition to their internal audit reports; the imposition of penalties on banks that fail to meet the requirements for disclosure of their financial statements on a regular basis has been tightened. We have also improved regulations governing microfinance. The banking law submitted to the National Assembly at the end of last year (*structural benchmark for end-December 2010*), and adopted in January 2011, makes provision for raising the required minimum capital, which will be trebled and increased to DF 1 billion over a period of up to three years, in addition to tightening licensing procedures. Furthermore, we are preparing for the introduction of reserve requirements, which will constitute an important new tool for liquidity management by CBD.

26. We are mindful of the challenges associated with the implementation of the various banking laws approved in the first half of 2011. Accordingly, we will make every effort to develop a roadmap based on a precise timetable to enforce these laws (*structural benchmark for end-September 2011*). In this context, the finalization of the operating manuals for the banking law and the supervision tools should be put in place by end-December 2011.

27. We are going to pursue our efforts to develop the financial sector and to promote access to finance. With the help of our development partners (World Bank, AfDB, Islamic Development Bank, and UNDP), we will continue to work to: (i) improve access to microfinance for individuals and small and medium enterprises by establishing a dedicated unit within the CBD; (ii) improve the management of existing units such as the bank risk unit, and move towards the establishment of a credit bureau; (iii) facilitate mobile banking operations; and (iv) strengthen the payments system. Technical assistance provided by IMF will facilitate the implementation of the new banking law.

28. To ensure the integrity of the CBD's operations, we are implementing the recommendations of the IMF safeguards assessment mission. Starting with the 2010 report, audit reports will be completed within six months of the end of the financial year, and the letter setting forth the audit opinion, as well as the financial accounts, will be published on the CBD's internet site (*structural benchmark for end-December 2011*). We have strengthened internal control by updating existing procedures and set up an internal audit unit separated from CBD operations. The Board of Directors will adopt in the coming weeks an official timetable of quarterly meetings of the board of directors in accordance with our

undertakings in this matter. We have broadened the powers of the CBD board (*structural benchmark for end-June 2011*) and for this purpose, we have created an audit committee within the board for the purpose of monitoring internal controls.

29. We are currently remedying the weaknesses in the area of AML/CFT. The CBD, working with the ministry of justice, has submitted to the National Assembly a draft amendment Law on AML and two separate draft laws on combating terrorism and combating terrorist financing, respectively. The draft laws were adopted by the National Assembly in May 2011.

V. COMPETITIVENESS AND STRUCTURAL REFORMS

30. By virtue of the currency board arrangement, Djibouti's attractiveness for investors depends crucially on the competitiveness of its economy, which is still hampered by the high costs of the principal production inputs and weakness of the business climate. Accordingly, we are strongly committed to pursuing our structural reform program, which aims at lowering energy and water costs, and improving the legal and regulatory framework.

31. We have made major progress in regard to structural reforms, especially on the Investment and Commercial Codes and the law on industrial property. The Labor Code is now in force, and collective agreements for the various sectors and enterprises were finalized at end-2010 as anticipated. The sections of the new Commercial Code that had yet to be finalized, namely laws on corporations and bankruptcy, were completed at end-2010. The Commercial Code as a whole was approved by the Council of Ministers in December 2010 and is expected to be adopted by the National Assembly in 2011.

32. We are pursuing the reforms in the energy and water sectors. The consulting firm IDEA has completed the report on the restructuring and adjustment of human resources for the EDD. We are pursuing the implementation of the validated recommendations of the final study. The interconnection with Ethiopia's electric power grid has now been completed, enabling Djibouti to achieve a substantial reduction in energy costs. We will define a consistent national energy strategy agreed with donors. With World Bank support, we will conduct a study which will make to determine the various options for thermal energy. Finally, in the water sector, the ONEAD is considering a major donor-financed seawater desalination investment program.

VI. DATA

33. The continuing quality issues affecting our statistical database continue to hamper our efforts to design and monitor economic policy. With the support of our development partners, we intend to enhance the quality, coverage, and timeliness of economic data, particularly with regard to national accounts, balance of payments, and government finance. First of all, the government focused in early 2010 on strengthening the legal framework through a law on the organization of statistical activity and the structure of the national statistical system, which has been approved by the National Assembly in June 2011. With

regard to the statistical base, we had completed the general population census in 2009. With the support of our development partners, the survey of economic activities should be completed in 2011, which will enable us to incorporate the data into national accounts estimates. A harmonized consumer price index is being finalized within the COMESA and will be implemented as of January 2012 after the household consumption survey scheduled for end-September 2011.

VII. PROGRAM MONITORING

34. The quantitative performance criteria for end-June 2011 (pertaining to the fifth review) and end-December 2011 (pertaining to the sixth review) have been slightly revised to reflect the changing macroeconomic scenario, and will continue to guide program implementation (table 1 and TMU). Some of the program reforms will be the subject of structural benchmarks (tables 2 and 3).

VIII. CONCLUSION

35. In light of the overall performance of the program and based on the policies set forth in this letter, we hereby request waivers for the non-observance of the criterion relating to the non-accumulation of external arrears and criterion relating to the non-accumulation of new domestic arrears, and the completion of the fourth review of the ECF, with the disbursement of SDR 1.476 million.

36. The government believes that the policies and measures set forth in this letter are sufficient to achieve the ECF program objectives. We will rapidly adopt all additional measures necessary to attain the program objectives. We will consult with Fund staff at our own or the Fund's initiative prior to adopting such measures or changes to the policies described in the attached MEFP. We will provide the IMF with such information as the Fund may request regarding progress made in implementing its economic and financial development policies, and in the context of efforts to achieve the program objectives.

Yours sincerely,

/s/

Ilyas Moussa Dawaleh
Minister of Economy and Finance,
in Charge of Industry and Planning

/s/

Djama M. Haïd
Governor
Central Bank of Djibouti

Table 1. Djibouti: Quantitative Performance Criteria and Indicative Targets, 2010-12 1/

(In millions of Djibouti francs; unless otherwise indicated)

(Cumulative flows)

	2010				2011						2012					
	Dec. 31				Mar. 31			Jun. 30		Sept. 30		Dec. 31		Mar. 31		
	Performance Criteria				Indicative Targets			Performance Criteria		Indicative Target		Performance Criteria		IT		
	Prog.	Adj.	Prog.	Prel. Act.	Prog.	Adj.	Prog.	Prel. Act.	Prog.	Rev. Prog	Prog.	Rev. Prog	Prog.	Rev. Prog.		
Performance Criteria																
I. Ceiling on accumulation of new domestic arrears 2/ 3/	2,279		1,987	2,079			2,340	2,260	2,260	2,135	2,135	2,279	2,279	2,279		
II. Ceiling on accumulation of new external arrears 3/ 4/	0		0	0			0	0	0	0	0	0	0	0		
III. Ceiling on net credit to government from the banking system	409	882	253	-3,459	-2,448	-937		6	488	-2,015	-1,840	-2,600	-2,600	9		
IV. Floor on government budget balance (ordonnancement) 5/	-971	-1,036	-1,016	1,255	944	-119		-3,124	-2,628	-1,903	-774	-113	883	-85		
V. Ceiling on new medium- and long-term nonconcessional loans contracted or guaranteed by the government and by the CBD 3/	0		0	0			0	0	0	0	0	0	0	0		
VI. Floor on currency board cover 3/ 6/	105		122	105			115	105	105	105	105	105	105	105		
Indicative targets																
I. Floor on social spending	13,346		13,161	2,232			3,296	4,465	6,541	6,697	10,024	8,930	14,451	...		
Memorandum items 1/ :																
Adjuster #1	Projected French, U.S., and Japan military base payments				11,276		10,965	4,646	3,657	4,646	4,024	7,154	7,154	12,736	12,736	6,350
Adjuster #2	External budgetary grants and loans				1,197		874	255	210	505	504	2,548	2,548	3,228	3,228	650
Adjuster #3	Externally financed public investment loans (PIP)				4,000		3,592	2,111	1,411	3,228	3,228	4,466	4,466	6,815	6,815	1,935

1/ See the Technical Memorandum of Understanding (EBS/10/235) for definitions and adjuster calculations.

2/ Arrears on the wage bill and to private suppliers, public enterprises, and pension funds.

3/ To be implemented on a continuous basis.

4/ Includes arrears on direct and guaranteed debt, continuous.

5/ Includes extra-budgetary expenditure.

6/ Gross foreign assets of the BCD in percent of monetary liabilities (reserve money plus government deposits at BCD).

Table 2. Djibouti: Structural Benchmarks under the Extended Credit Facility (ECF) (EBS/10/235)

Measure	Date	Motivation	Status
Budget and revenue management			
1. Strengthening of budget transparency with the monthly publication of the TOFE on the Ministry of Finance website.	Continuous	Fiscal transparency	Not met. The data for December 2010 and January and February 2011 were published after delay, due to a break in the publication of the monthly TOFE.
2. Adoption by the Cabinet of a customs code consistent with the COMESA zone code	March 2011	Regional trade integration	Not met. Adopted in June 2011.
3. Recruitment of qualified staff in the budget Department for the preparation of the MTBF.	June 2011	PFM-Budget process	The recruitment process has been initiated with the publication of the job advert for the four positions (1 lawyer and 3 economists).
4. Acquisition of the software for the introduction of the new budget classification	June 2011 (now December 2011)	PFM-Budget process	The authorities have started consultations with countris in North Africa for the acquisition of the software, but it will be necessary to postpone the deadline to December 2011 because of financing difficulties.
5. Inclusion in the 2012 budget of the lowering of VAT basis from 80 to 50 million FD	December 2012	Strengthening of tax revenue	
6. Increase of human ressources in the unit in charge of VAT	December 2011	Strengthening of tax revenue	
Strengthening of supervision and regulation			
7. Presentation of the banking law to the National Assembly	December 2010	Strengthening banking system regulation	Met. The bill was adopted by the Cabinet in December 2010 and submitted to the National Assembly.
8. Creation of a unit dedicated to supervision, including AML/CFT supervision	June 2011	Strengthening bank supervision and AML/CFT	Met. The unit was created in May 2011 as part of the reorganization of the CBD
9. Recruitment of two staff for the unit dedicated to supervision	June 2011	Strengthening bank supervision and AML/CFT	Met. The two staff have been recruited to strengthen the supervision unit.
Strengthening of the safeguard framework			
10. Adoption of an official timetable for biannual meetings of the Board of Directors and extension of its rights to oversee internal control	June 2011	Strengthening Central Bank governance	The Board of Directors have agreed to set up a committee tasked with monitoring internal control
11. Approval of audit reports and publishing the audit opinion on the CBD website six months after the end of the fiscal year	December 2011	Strengthening Central Bank governance	The external auditors (Ernst & Young) have completed the audit of the final accounts of 2010

Table 3. Djibouti: Extended Credit Facility - Additional Structural Benchmarks

Measures	Date	Motivation
(Reformulation of an existing benchmark) Monthly publication of the TOFE on the Ministry of Finance website with a maximum lag of two months	Continuous	Fiscal transparency
Budget and revenue management		
1. Prepare a report estimating fiscal expenditures due to exemptions	June 2012	Strengthening of tax revenue
2. Set up the customs revenue management software SYDONIA for all external trade transactions in Djibouti	December 2011	Strengthening of tax revenue
3. Sign cross-debt agreements with EDD, ONEAD, Djibouti Telecom	September 2011	Financial management
Strengthening of supervision and regulation		
4. Develop a roadmap with a precise timetable for the application of the banking laws	September 2011	Strengthening of banking supervision

ATTACHMENT
TECHNICAL MEMORANDUM OF UNDERSTANDING

I. INTRODUCTION

1. This memorandum defines: (a) the quantitative performance criteria, adjustors, and structural benchmarks for the program supported by the Extended Credit Facility (ECF), which are shown in the Letter of Intent and the related tables; and (b) the scope and frequency of data to be provided for program monitoring purposes.

II. QUANTITATIVE INDICATORS

A. Definitions and Concepts

2. **Test dates.** Quantitative performance criteria are set for June 30, 2011 and December 31, 2011, and must be met at the end of each period, unless otherwise specified.
3. **Government.** For the purposes of the program, “government” is defined as the central government, excluding the social security system.

B. Quantitative Performance Criteria and Indicative Targets

Quantitative Performance Criterion 1: Continuous ceiling on accumulation of new domestic arrears

4. Definition: *New domestic arrears* are defined as payments which are authorized (*ordonnance*) and are past due date on the wage bill and to private suppliers, public enterprises, and pension funds, incurred as of January 1 of the year and up to the end of the complementary period. The wage bill includes all gross salaries, wages, allowances, benefits, and payments, including housing assistance, that the government agrees to pay to civil servants, to military and security personnel (whether permanent or temporary), and to all other government employees, regardless of the means of payment used (cash, check, or other instrument) or the payment agent (the Treasury or another agency acting on behalf of the government). The ceiling on domestic arrears applies to the total unpaid amount subject to the technical lag (reported in the TOFE as “new arrears”), which must not exceed the sum of one month’s wages or three months’ pension fund contributions. The ceiling, set for each quarter in Table 1, should be respected on a continuous basis and will be monitored on a monthly basis.

Quantitative Performance Criterion 2: Continuous ceiling on accumulation of new external arrears

5. Definition: *External arrears* are defined as overdue payments (principal and interest) on external debt contracted or guaranteed by the central government or the Central Bank of Djibouti (CBD), excluding debt subject to rescheduling or cancellation. Technical arrears

(as defined in the loan contract) are not considered external arrears for program monitoring purposes. The ceiling should be respected on a continuous basis.

Quantitative Performance Criterion 3: Ceiling on net banking system credit to the government

6. Definition: *Net banking system credit to the government* is defined as the sum of net bank financing, namely, claims on the government minus government deposits with the financial system.

Quantitative Performance Criterion 4: Floor government budget balance on the commitment-basis (ordonnancement)

7. Definition: *The government budget balance on a commitment-basis* is defined as the overall balance (on a commitment basis, including grants) shown in the fiscal reporting table (TOFE), representing the difference between total revenue (including grants) and total expenditure, including extra-budgetary expenditure.

Quantitative Performance Criterion 5: Continuous ceiling on contracting or guaranteeing new medium- and long-term nonconcessional external debt by the government, the CBD, and public enterprises

8. Definition: Medium- and long-term nonconcessional external debt contracted or guaranteed by the government, the CBD, and public enterprises, is defined as foreign debt defined by the residency of the creditor, maturing in at least one year, contracted or guaranteed by the government, the CBD, and public enterprises, with a grant component (Net Present Value, NPV, compared with the nominal value) of at least 35 percent, based on the currency- and maturity-specific discount rates announced by the OECD (benchmark commercial interest reference rates - CIRR). The ten-year CIRR is applied to debt maturing in at least 15 years; the six-month CIRR is applied to debt maturing in less than 15 years. For program purposes, the definition of debt is set out in Executive board No. 6230-(79/140), as amended by Decision No. 14416(09/91), including commitments contracted or guaranteed for which value has not been received. The ceiling should be respected on a continuous basis.

Quantitative Performance Criterion 6: Continuous floor on currency board coverage

9. Definition: *Currency board coverage* is defined as the gross foreign assets of the CBD, divided by the sum of government deposits at the CBD and reserve money. The gross foreign assets of the CBD represent the value of the external assets of the CBD, consisting of: (a) monetary gold; (b) SDR holdings; (c) the IMF reserve position; (d) foreign currency holdings; and (e) claims on nonresidents, such as deposits abroad. The foreign assets of the CBD exclude assets that are committed or otherwise encumbered, including but not limited to assets used as collateral or guarantees for foreign liabilities of third parties (assets not immediately available). The floor should be respected on a continuous basis.

Indicative Target 1: Floor on social spending

10. Definition: *Social spending* is defined as subsidies and transfers to public entities, including health organizations, sports clubs, non-profit entities; and transfers to households in the form of scholarships.

III. PROGRAM ADJUSTORS

11. The quantitative performance criteria can be adjusted as follows:

Adjustor 1: French, U.S. and Japanese payments related to the use of military bases

12. Definition: *The ceiling net banking system credit to the government* will be lowered (raised) by the amount of any excess (shortfall) compared with the projected French, U.S. and Japanese payments for 2011, related to the use of military bases (as reported in Table [1] of LOI). *The floor on the government budget balance on a commitment-basis* will be lowered (raised) by the amount of any shortfall (excess) compared with the expected French, U.S. and Japanese payments for 2011, related to the use of military bases (as reported in Table [1] of LOI).

Adjustor 2: Foreign budgetary grants and loans

13. Definition: *The ceiling on net banking system credit to the government* will be lowered (raised) by one-half of any excess (shortfall) in the total amount of the foreign budgetary grants and loans actually disbursed, compared with the program projections (as reported in Table 1 of LOI). *The floor on the government budget balance on a commitment basis* will be lowered (raised) by one-half of any shortfall (excess) in the total amount of the foreign budgetary grants actually disbursed, compared with the program projections (as reported in the Quantitative Indicative Targets Table [1] of LOI).

Adjustor 3: Foreign project loans

14. Definition: *The floor on government budget balance on a commitment basis* will be lowered (raised) by any excess (shortfall) in the total amount of the foreign project loans actually disbursed, compared with the pertinent program projections (as reported in Table 1 of LOI).

IV. REPORTING OBLIGATIONS

15. The authorities will provide the IMF with all data necessary for monitoring economic developments and the results of the program, including but not limited to the specific information below. Any revision of data reported previously will be quickly forwarded to the staff with appropriate explanations.

Real, monetary, and financial sectors:

16. The balance sheet of the central bank, the consolidated balance sheet of the commercial banks, and the monetary survey, within four weeks of the end of the reporting period (the end of each month).

17. The consumer price index, within four weeks of each month-end.

Fiscal sector, including social spending:

18.

- The monthly TOFE data on operations, revenue, expenditure, and budget financing items, including data on capital budget execution, with details on the externally financed portion and the counterpart funds of the central government for which donor terms apply;
- The extra-budgetary expenditure recorded at least quarterly in the TOFE;
- Execution of FSN expenditure, on, at least, a quarterly basis, shown as a separate line in TOFE;
- Repayment of the domestic arrears accumulated in 2009, on at least quarterly basis, shown as a separate line in TOFE;
- Committed expenditure for which payment authorizations (*ordonnancement*) have not been issued (on a quarterly basis).
- Total payments to the public utilities for services executed in the current year, both in DF and as a percentage of the total budgeted for the year, on a quarterly basis.

These data will be provided within 30 days of each month-end.

Arrears:

19. Data on domestic arrears (*ordonnancement* basis) related to: (1) the current year (monthly flows of new accumulations of arrears in all categories); and (2) the stock at the end of the previous year. Consolidated data for (1) and (2) will be reported monthly, within no more than four weeks.

20. External arrears data related to: (1) the current year, and (2) the stock at the end of the *previous year*; consolidated data for (1) and (2) will be reported monthly, within no more than four weeks.

External sector, external assistance and debt:

21. The quarterly balance of payments statistics, end of each quarter with a two quarter lag.
22. The monthly data on foreign grants and loans received by the government and by public enterprises, by creditor and by disbursement currency, within four weeks of each month-end.
23. The monthly data on the evolution of external debt, including arrears and rescheduling operations, within six weeks of each month-end.
24. The monthly list of medium- and long-term external loans contracted and guaranteed by the government for each month, with the following details on each loan: the creditor, the borrower, the amount, the currency, the maturity, the grace period, and the interest rate arrangements. These data will be reported within four weeks of each month-end.
25. The quarterly data on the balance of the external debt stock, by creditor, debtor, and currency, within six weeks of the end of each quarter.