Djibouti’s logistics sector will grow rapidly in the coming years, establishing the country as a major conduit for East Africa trade. Chinese firms will be instrumental in providing the necessary capital and expertise. Realising the wider economic aims of the 2035 strategy, however, including the development of a manufacturing export sector, will be much more challenging.

Implementing Vision 2035: Djibouti makes huge gains in business climate rankings

Djibouti’s long-term economic strategy aims to achieve ambitious rates of economic growth and industrialisation, including sustained annual real GDP growth above 7.5% until 2035. For context, this would be significantly faster than the IMF’s forecast for average annual growth of 3.8% in sub-Saharan Africa over 2019-23, albeit roughly in line with Djibouti’s average growth of 7% over the past five years.[1]

The strategy also targets diversification of the economy away from logistics and public sector employment, towards sectors including manufacturing, construction, tourism, business process offshoring and renewable energy.

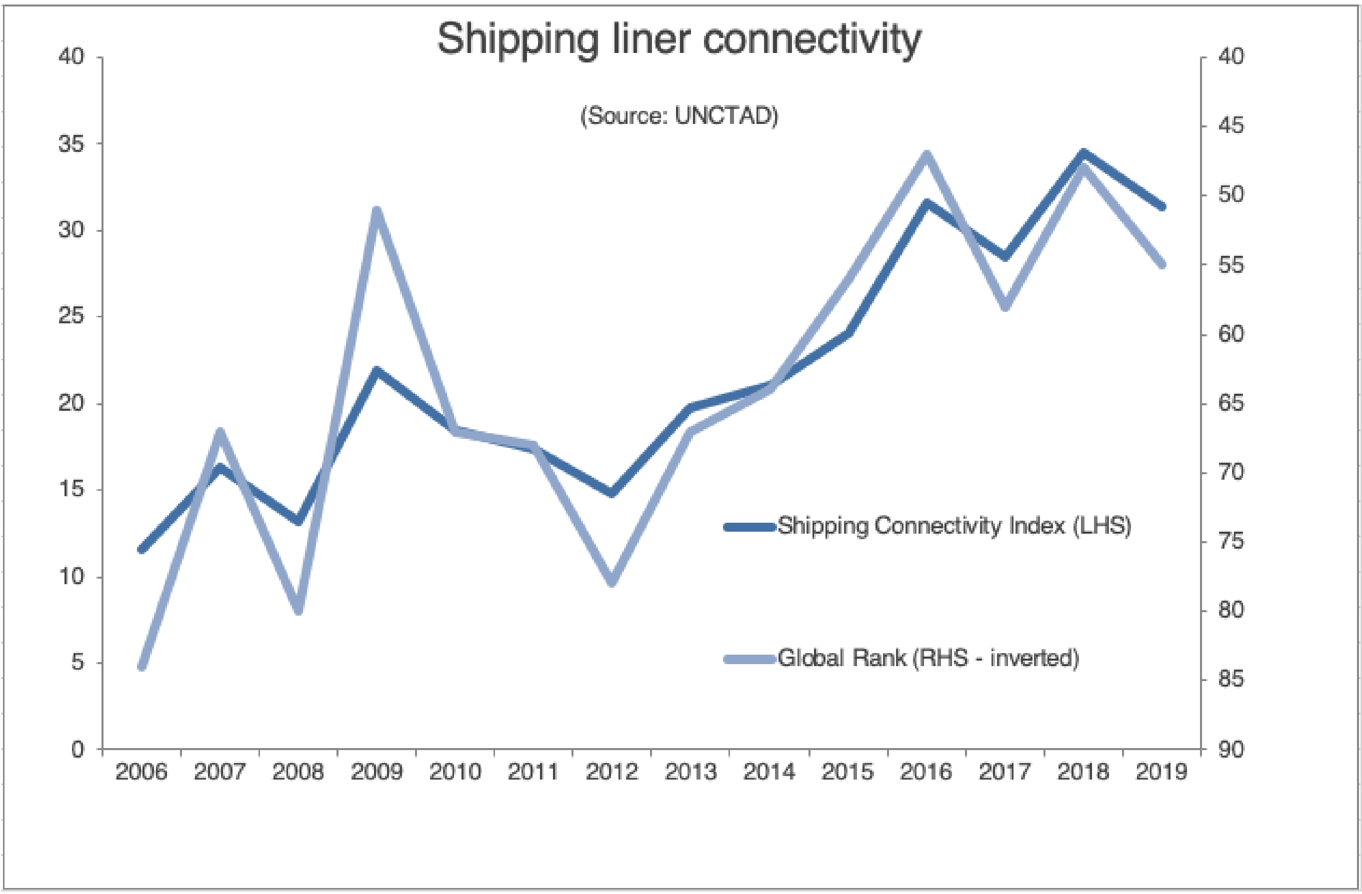
The government’s goal is to attract international firms into an expanding set of free trade zones in the city of Djibouti. Existing facilities include the Djibouti Free Zone and the DAM Commercial Free Zone, while the government is constructing the new $3.5bn Djibouti International Free Trade Zone (DIFTZ) in partnership with China.

The DIFTZ opened a pilot phase in 2018, and at 48 sq km it will be Africa’s largest free trade zone once completed in 2027. Along with regulatory reforms, these measures have seen the country surge up the World Bank’s Ease of Doing Business rankings, with the country rising 55 positions to 99th in 2019 alone.

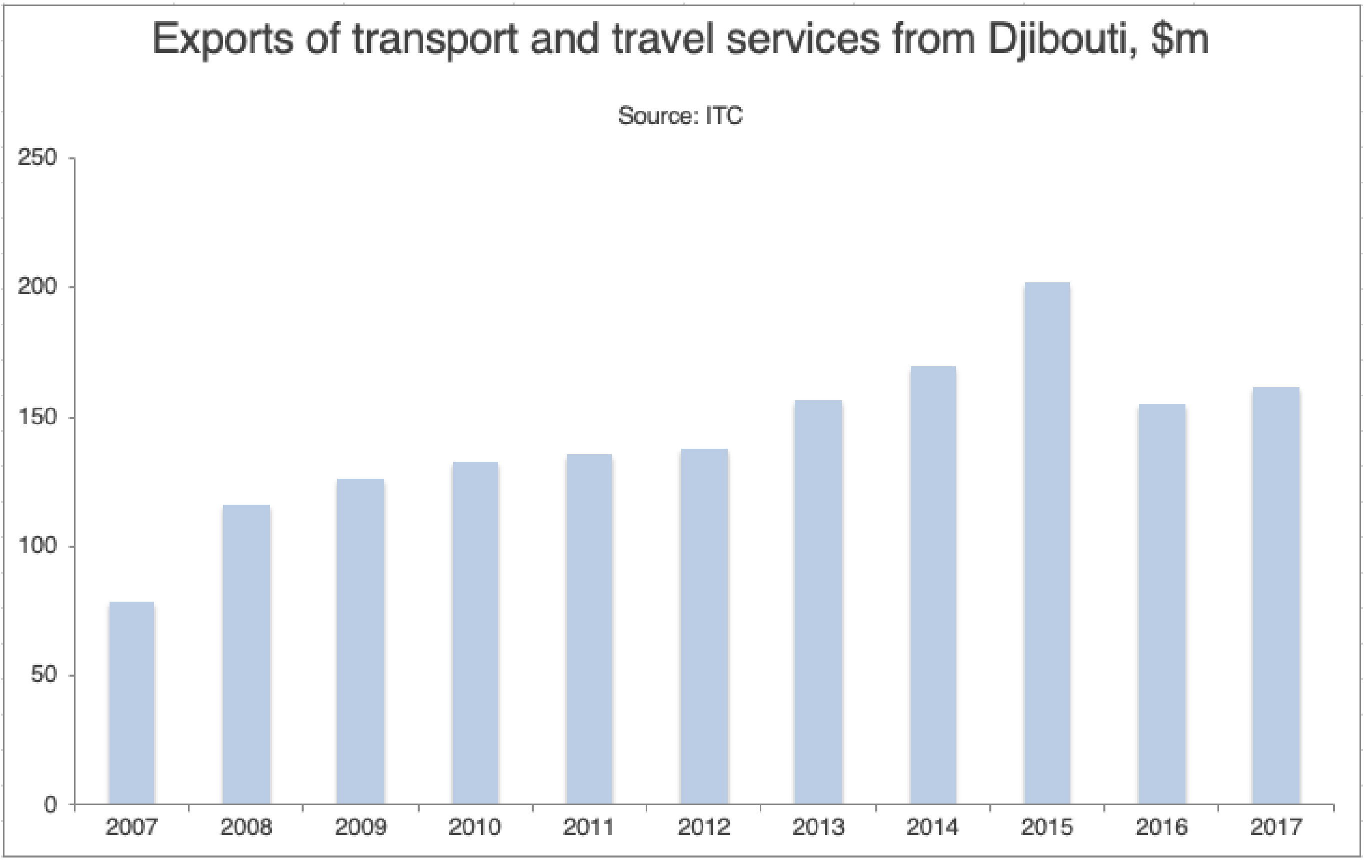
Infrastructure upgrades to strengthen logistics, but reliance on foreign capital carries risk

Expanding the logistics industry is by far the most promising aspect of the 2035 strategy.

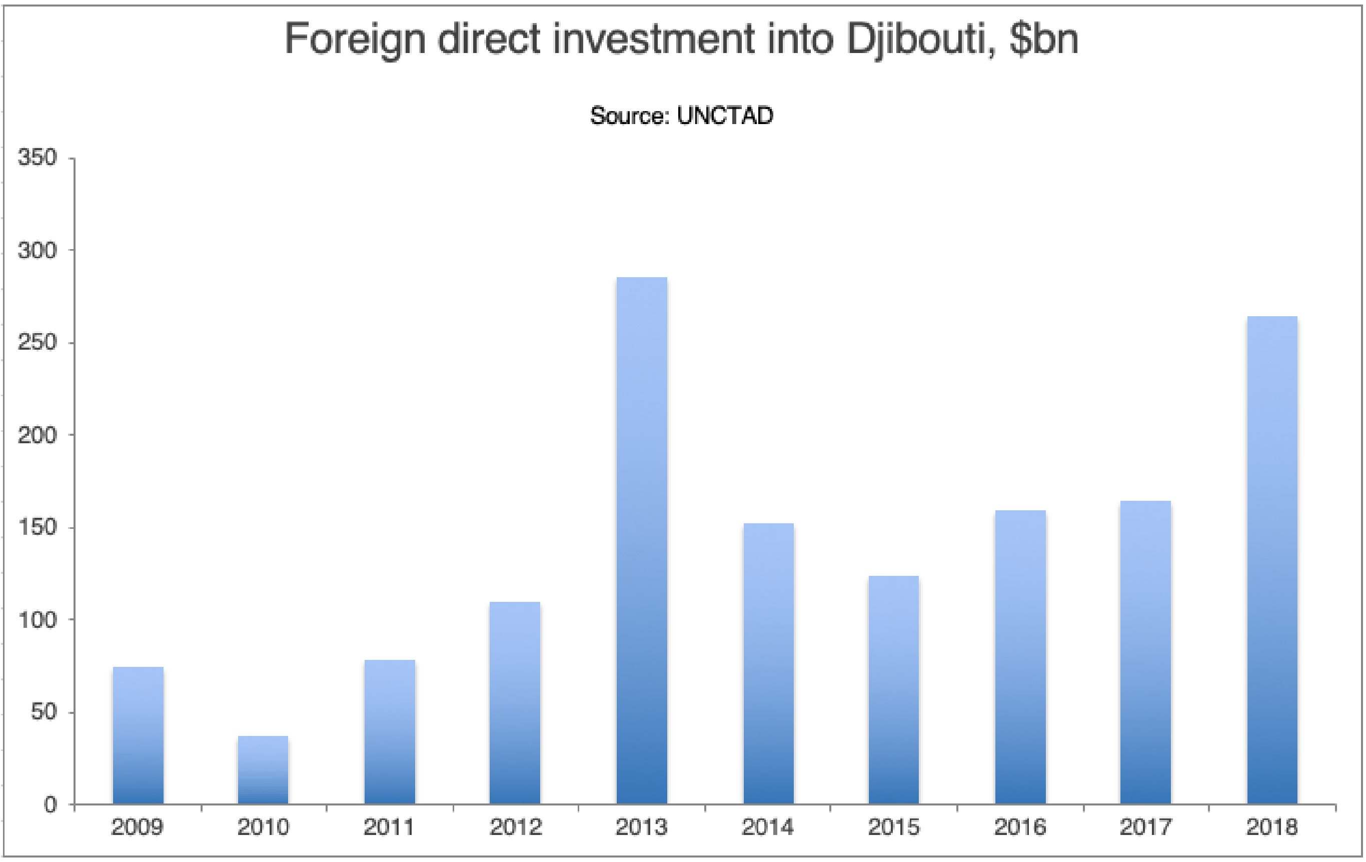
Djibouti already has an established logistics sector, supported by its strategic position on the Bab el-Mandeb Strait and near the Gulf of Aden. The country is a hub for trade into and out of the East Africa region and almost three-quarters of Ethiopia’s trade passed through it in 2018.[2] Recently completed infrastructure projects mean that UNCTAD now ranks Djibouti's ports 55th globally in terms of shipping liner connectivity, compared to 67th a decade ago. Transport infrastructure will be upgraded further in the coming years in line with government plans to construct projects amounting to almost $20bn between 2015 and 2025.[3]



In terms of demand for logistics services, exports from Ethiopia will boom in the coming years as the country continues to emerge as a manufacturing export hub. Imports into Ethiopia will also increase rapidly due to rising incomes in the country. The IMF forecasts real GDP in Ethiopia to grow at an annual average of 7.4% over 2019-23, the third-fastest pace in sub-Saharan Africa.



The vulnerability of Djibouti's fixed-investment-led growth model is that it relies heavily on inflows of foreign capital. Although the state has funded many infrastructure projects, they have largely been financed through international loans. As a result, the country's foreign debt load will increase to an expected 104% of GDP in 2019, significantly above the IMF's benchmark for emerging economies of 70%.[4]Moreover, the high-risk nature of investing in the country has limited the government's success in attracting foreign capital. Most recently, the government's unilateral termination of DP World's contract to operate the Doraleh Container Terminal in 2018, which the London Court of International Arbitration ruled was illegal, has damaged Djibouti's investment appeal.



Chinese investment to continue strong, in line with BRI plans

Chinese capital has thus far largely met Djibouti's funding requirements. China has lent the country approximately $1.4bn over the past five years and roughly three-quarters of the construction-related debt racked up by public enterprises is owed to the Export-Import Bank.[5] Moreover, China Merchants Group holds a significant stake in the $300m Doraleh Multipurpose Port, while the $3.5bn DIFTZ is partly owned by China-based Dalian Ports Group, IZP and China Merchants Group.

Beijing's long-term strategy in East Africa suggests that funds will continue to pour into Djibouti. Admittedly, heavy reliance on Chinese capital will give China significant political leverage over the Horn of Africa nation and this could complicate policy making in areas such as foreign policy and defence over the coming years.

Nonetheless, rapidly developing the logistics sector appears a priority for policymakers in both countries. From China's perspective, Djibouti has a significant role to play in its multi-decade Belt and Road Initiative (BRI). In acting as a gateway into East Africa, Djibouti forms part of the Maritime Silk

Road, itself a cornerstone in the BRI. Underlining Beijing's long-term interests in the country, it established its first foreign military base in Doraleh port in 2017.

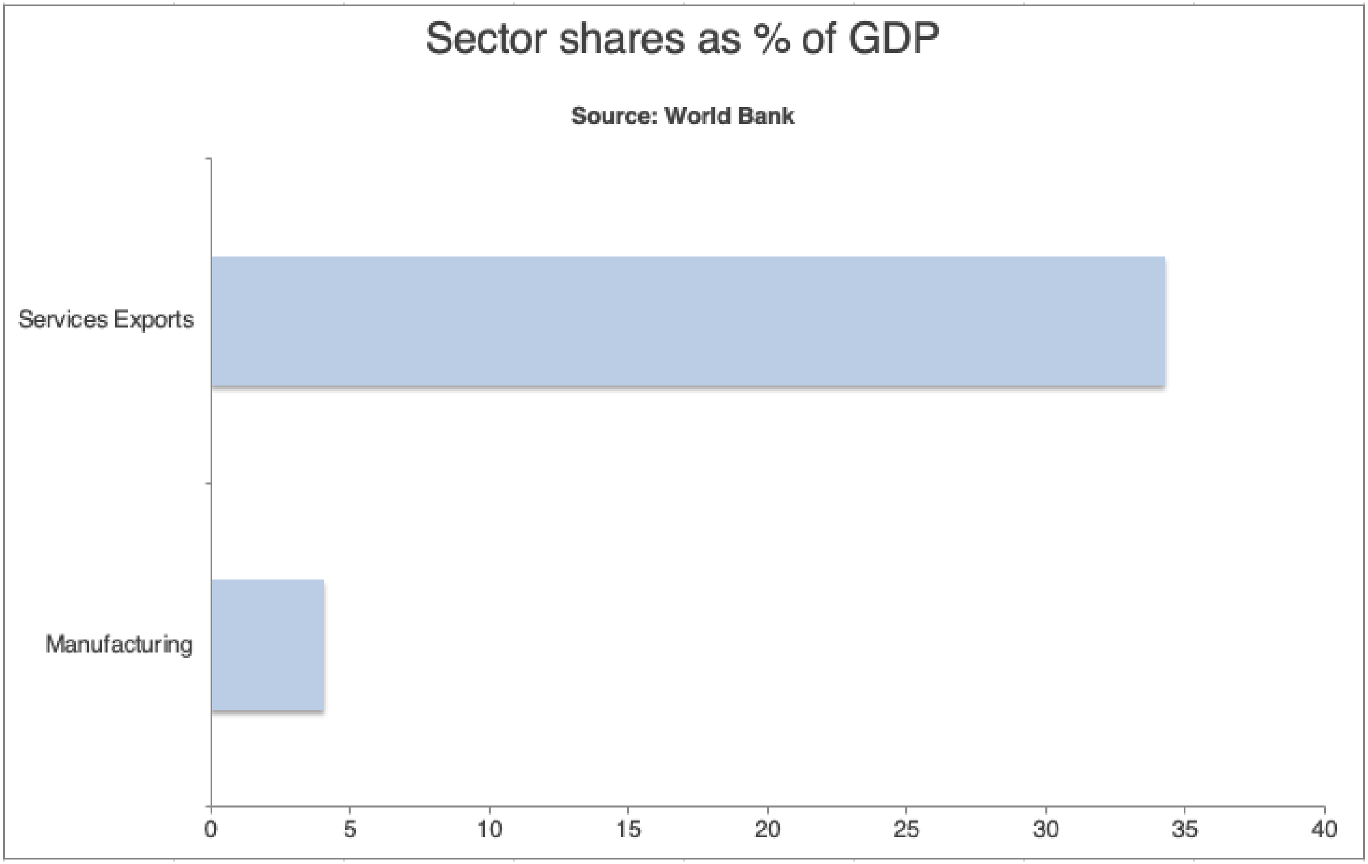
Competition for influence in Djibouti could also strengthen the hand of Djibouti's government in negotiations with China. In particular, Gulf interest and investment is growing. Saudi Arabia opened its first foreign military base in Djibouti in 2018 and diplomatic ties between the two countries have strengthened. Gulf investment in the logistics sector has been disrupted by a dispute between DP World's and the Djibouti government. Nonetheless, Gulf funds will continue to flow into the country as part of the region's engagement in the Horn of Africa in order to influence the Red Sea Basin over the coming years.

Regional competition poses largest risk to logistics growth

The development of transit routes for regional trade other than through Djibouti's ports is the largest risk to realising rapid growth in the logistics sector. Of most concern for Djibouti is Ethiopia's efforts to diversify its export routes. In March last year Ethiopia agreed to develop the Port of Berbera in partnership with the Somaliland Ports Authority and DP World. The following July it signed a peace deal with Eritrea, brokered by Gulf states including Saudi Arabia, which creates potential for Ethiopian firms to utilise Eritrean ports such as Assab and Massawa.

Wider industrialisation hard to achieve

While the logistics sector has strong growth potential, Djibouti's manufacturing sector ambitions face myriad challenges. Factors including a lack of scale, a shortage of skilled labour and the absence of an existing manufacturing base will combine to prevent any significant industrialisation. Manufacturing accounted for only 4.4% of the economy in 2018, and there is little prospect for raising this share significantly.



A domestic population of just under 1m means that any manufacturing investment will need to target exports to East Africa or further afield. Meanwhile, a small and relatively unskilled domestic labour force will preclude both high-tech and large-scale manufacturing. For instance, just over half of secondary-school aged children are enrolled, according to the World Bank. Finally, although newly constructed industrial parks will be completed to high specifications, infrastructure weaknesses in the wider economy could raise costs for manufacturing firms. In particular, electricity supply in Djibouti is unreliable due to a heavy reliance on imports of seasonally erratic Ethiopian hydropower.

John Davies is an economist and has a special interest in emerging markets, global trade and heavy industry. He is the co-founder of research and analysis firm, North Shore Analysis.

Sources:

[1] Centre For Global Development, Policy Paper 121, March 2018

[2] IMF forecasts, 2019

[3] IMF World Economic Outlook database, 2019

[4] Export.gov Ethiopia country profile

[5] Djibouti Vision 2035

