AFRICAN DEVELOPMENT BANK GROUP

DEMOCRATIC REPUBLIC OF CONGO (DRC) : EXCEPTIONAL EXTENSION OF INTERIM PERIOD UNDER THE ENHANCED HIPC INITIATIVE

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DEMOCRATIC REPUBLIC OF CONGO (DRC)

NOTE ON EXCEPTIONAL EXTENSION OF THE INTERIM PERIOD UNDER THE ENHANCED HIPC INITIATIVE

I. INTRODUCTION

1.1 The Democratic Republic of Congo (DRC) reached its decision point under the Enhanced HIPC Initiative in July 2003[1]. As a result, the Bank Group committed to provide DRC with US$ 905.1 million of HIPC Initiative debt relief, in end-2002 NPV terms (US$1.8 billion, in nominal terms). Under the modalities of HIPC assistance, debt relief takes effect at the decision point, with no more than 40 percent of HIPC relief provided during the interim period -- between decision and completion points. The anticipated maximum duration of the interim period is three years, after which the remaining 60 percent is to be provided at the completion point in the form of irrevocable debt relief. The country would benefit from ADF debt cancellation under the MDRI after the completion point.

1.2. The Bank Group has already extended DRC's interim debt relief assistance from September 2007 to December 2008 in accordance with the criteria approved by the Boards of Directors in May 2005[2] on the provision of additional interim period debt relief. In July 2007, the level of debt relief granted by the Bank Group to DRC reached 27.8 percent of the commitment, which was below the authorized maximum ceiling of 40 percent debt relief during the interim period. The additional debt relief was able to prevent reoccurrence of arrears in DRC vis-à-vis the Bank Group. Furthermore, there is the precedence that the Bank Group could extend the provision of the interim debt relief on a case-by-case basis in a situation where some interim period HIPCs hit the 40 percent interim relief limit before reaching their completion points. Guinea and Guinea-Bissau[3] have benefited from an increase in exceptional interim debt relief from 40% to 50%, and 40 to 60% of the total debt relief committed by the Bank Group, respectively.

1.3 The cumulative debt relief provided to DRC as at end December 2008 reached 35.2 percent of the total debt relief commitment[4] at decision point which is still below the maximum ceiling. However, the maximum interim relief ceiling of 40 percent will be reached in July 2009. Following discussions with the World Bank, and in line with new developments, DRC is expected to reach completion point by end December 2009. In order to avoid repetitive extensions and also to accommodate any delays in DRC reaching the completion point, it is proposed that the limit for the interim debt relief be increased from 40 to 50 percent of the total debt relief committed.

1.4 The purpose of this paper is to seek the Boards of Directors approval to increase DRC's interim debt relief from 40 percent to 50 percent of the HIPC assistance and to extend the interim period to December 2010. This will help reduce DRC's debt service payments to

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[1] For more information, refer to DRC – HIPC Approval Document: Decision Point under the Enhanced Framework (Ref. ADB/BD/WP/2004/52 - ADF/BD/WP/2004/51, dated 9 June 2004).

[2] For more information, see Provision of Additional Interim Period Debt Relief under the Enhanced HIPC Initiative (ADB/BD/WP/2005/44- ADF/BD/WP/2005/49) of 27 May 2005.

[3] Guinea– Exceptional Extension of Interim Period under the Enhanced Framework (Ref. ADB/BD/WP/2008/115/ Approval, dated August 1, 2008) and Guinea Bissau– Exceptional Extension of Interim Period under the Enhanced Framework (Ref. ADB/BD/WP/2008/114/ Approval, dated July 16, 2008).

[4] The total commitment corresponds to US$1,371.7 million, in NPV terms, taking into account the arrears clearance portion within DRC's special debt relief arrangement

the Bank Group and provide a fiscal space for continued social service and poverty reducing expenditures while giving the country a better chance of adhering to the IMF's supported program and reaching the HIPC completion point. Increasing the ceiling for the interim debt relief and extending the period for interim debt relief to December 2010[5] would also prevent DRC from falling into arrears with its debt service payments to the Bank Group.

1.5 Following this introduction, Section 2 highlights DRC's recent economic developments. Section 3 assesses the country's progress in the implementation of the HIPC completion point triggers. Section 4 provides the rationale in support of the extension of the interim period for DRC as well as the related financing modalities. The recommendation for Boards' approval is presented in section 5.

II RECENT ECONOMIC DEVELOPMENTS

2.1 The 2008-2012 Results-Based Country Strategy Paper for the Democratic Republic of Congo (DRC), approved by the Boards in October 2008, provides a comprehensive overview of recent socio-economic developments.[6] Ranked as one of the poorest countries of the world despite its immense natural resources, DRC is facing a very difficult economic and social situation. More than 71 percent of the population live below the poverty line. The per capita GDP was estimated at US$130 in 2006 as against a Sub- Saharan African average of US$ 842. However, economic performance has improved significantly following the gradual return to peace and progress. The annual GDP growth over the past five years was about 5 percent. This revival is the result of the growth of activities in the service sectors, agriculture, agro-industry, public construction and works, and mining sectors.

2.2 DRC adopted the IMF Staff Monitored Program (SMP) in 2007 to further strengthen fiscal discipline, improve governance, undertake structural reforms, establish credibility for good economic management, and lay the foundation for sustained economic growth and progress toward the MDGs. Reforms are on-going to strengthen tax administration and revenue collection, rationalize expenditure procedures and establish an affordable and efficient civil service. Furthermore, the authorities remain committed to meeting the requirements of the Extractive Industries Transparency Initiative. The program should pave the way for a medium-term program that could be supported by a PRGF arrangement in 2009. Following its December 2008 mission, the IMF found overall satisfactory the implementation of Government economic program during 2008. Most of the quantitative and structural reforms have been implemented except: (i) the merger of operations between *Office de contrôle Congolais (OCC)* and *Office des Douanes et Accises (OFIDA)* due to legal constraints; and (ii) emergency expenditures due to overspending on security.

2.3 However, the food crisis, the oil price surge and the international financial crisis affected the economy since the second quarter of 2008. A prudent monetary policy helped buffer the effect of the international oil and food price increases. The monthly inflation rate that reached 4.2 percent in April 2008, because of the import inflation, decreased to 3.47 percent in July and 1.06 percent in August. Nevertheless, the real GDP growth rate, which was projected at 10 percent in 2008, will be only 8 percent compared to 6.3 percent in 2007.

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[5] DRC is expected to reach the completion point by end-December 2009, but it is envisaged to extend the interim period up to December 2010 in order to avoid repetitive extensions while accommodating any delays in reaching the completion point.
[6] DRC– Results-Based Country Strategy Paper – 2008-2012 (ADB/BD/WP/2008/142-ADF/BD/WP/2008/90) of September 2008.

It is even envisaged that DRC's economic situation in 2009 would be more difficult. Lower mining exports and the associated indirect spillover effects will significantly reduce economic activity and weaken the balance of payments. In order to help DRC respond to the difficult environment, on the fiscal front, the IMF envisages providing financial assistance through the Rapid-Access Component of its Exogenous Shocks Facility in an amount up to twenty-five percent of the quota (about US$200 million).

III ASSESSMENT OF PROGRESS IN THE IMPLEMENTATION OF THE COMPLETION POINT TRIGGERS

Assessment of Completion Point Requirements

3.1 The authorities have reached an understanding with the donor community on a series of completion point triggers agreed at decision point. The implementation of the full PRSP, public expenditure management and, use of budgetary savings is ongoing and confirmed as satisfactory. On the other hand, implementation is partially done in the following areas: (i) governance and service delivery in priority sectors, (ii) social and rural sectors, and (iii) debt management. The remaining requirements will be assessed during IMF missions in 2009, and DRC is expected to reach its completion point during 2009.

3.2 PRSP. The full PRSP was completed through a participatory process, and adopted by the Government in July 2006. The newly elected Government endorsed it in March 2007. The PRSP and the JSAN were presented to the Bank World's Boards of Directors in May 2007. The Government made the PRSP its document of reference and used it extensively to elaborate its Program for 2007-2011. The PRSP progress report in 2008 is being finalized.

3.3 With respect to **macroeconomic stability and public expenditure management**, IMF confirmed as overall satisfactory the implementation of Government economic program during 2008. Most of the quantitative and structural reforms have been implemented. Even the Treasury account recorded a surplus at the end of August 2008. Despite this relative performance, the intensification of the conflict in eastern provinces of the country and the increase in spending on security led to weakening in public expenditure and a drop in international reserves. The budget-execution system is improving because of the implementation of a modernized budget-execution system that provides information from commitment to payment, and allows for the monitoring of arrears. IMF missions will be conducted in the first quarter of 2009 to assess the implementation of the SMP and continue discussions on a new PRGF arrangement.

3.4 Regarding **Governance and service delivery in priority sectors**, the reforms aim at aligning public expenditure with poverty reduction priorities. The current mid-term expenditure framework which will structure the annual budgets following the sector-based priorities was conducted through an institutional and governance review. The framework focuses on needs in the health and basic education sectors as well as HIV/AIDS, agriculture and rural development. Related national procurement strategy and program of capacity building are still in draft form. However, the authorities have committed to finalize the procurement code and related strategy which should be adopted by the Council of Ministers and Parliament, and to make them operational.

3.5 For **social and rural sectors**, health sector and education sector strategies are completed; rural development strategy is still under preparation. Social and rural sectors have their priority action plans (PAP) elaborated in the framework of the thematic groups. These PAP have not yet been implemented mainly due to financing constraints and weaknesses in capacity of coordinating the activities. Slowness in the implementation of the reforms agreed is due to capacity weaknesses in public services. However, there is some progress made in certain components of social and rural sectors.

3.6 Regarding **Debt management** issues, DMFAS/SYGADE (*new public debt management software*) is already installed by UNCTAD; the public external debt outstanding is also recorded, the training of the relevant staff on debt management is completed and OGEDEP[7] is now producing and publishing the debt service required statistics. Even though there are some difficulties in debt service projection due to weaknesses in terms of institutional capacity, the authorities remain strongly committed towards strengthening technical capacity of the public debt management agency. Debt management and capacity building should be complemented by improvements in the collaboration of various government bodies involved in the contracting and payment of public debt in line with decree 08/04 with respect to strengthening OGEDEP's role.

3.7 In conclusion, even, though, DRC has not fulfilled all the completion point triggers, there have been some progress in meeting six out of seven triggers. See annex I, for further details on the implementation of the completion point triggers.

Cooperation Agreements with the Chinese Firms (Chinese Deal)

3.8 The authorities recently signed a cooperation agreement for a significant externally-financed investment program in mining and infrastructure with Chinese firms. IMF and the World Bank are trying to get full information on the concessional nature of China's financing, particularly in the Great Lakes countries. The implications of this agreement, in particular for debt sustainability, are being carefully assessed before discussions on a possible new PRGF arrangement can be concluded. The Government and the IMF continue to find a right balance between infrastructure development, the need to maintain macroeconomic stability and the respect for government agreements on the debt relief initiative. The Authorities and the IMF agreed to wait for the conclusions of new debt sustainability analysis which is supposed to be finalized in the first quarter of 2009.

IV. EXTENSION OF INTERIM DEBT RELIEF AND FINANCING MODALITIES

Extension of Interim Debt Relief

4.1 When DRC reached its decision point under the HIPC Initiative in July 2003[8], the Bank Group approved debt relief estimated at US$ 905.1 million, in NPV terms for the country to enable it reach its completion point by December 2007.[9] DRC experienced some slippages in fulfilling all the conditions for its completion point but continues to make progress in reaching completion point. The implementation of PRSP, public expenditure management and, utilization of budgetary savings are confirmed as satisfactory; while the

[7] The Office de Gestion de la Dette Publique (OGEDEP), the principal agency charged with handling debt issues, is part of the Ministry of Finance and Budget.
[8] For more information, please refer to DRC – HIPC Approval Document: Decision Point under the Enhanced Framework (Ref. ADB/BD/WP/2004/52 - ADF/BD/WP/2004/51 dated 9 June 2004).
[9] The total commitment corresponds to US$1,371.7 million, in NPV terms, taking into account the arrears clearance portion within DRC's debt relief treatment.

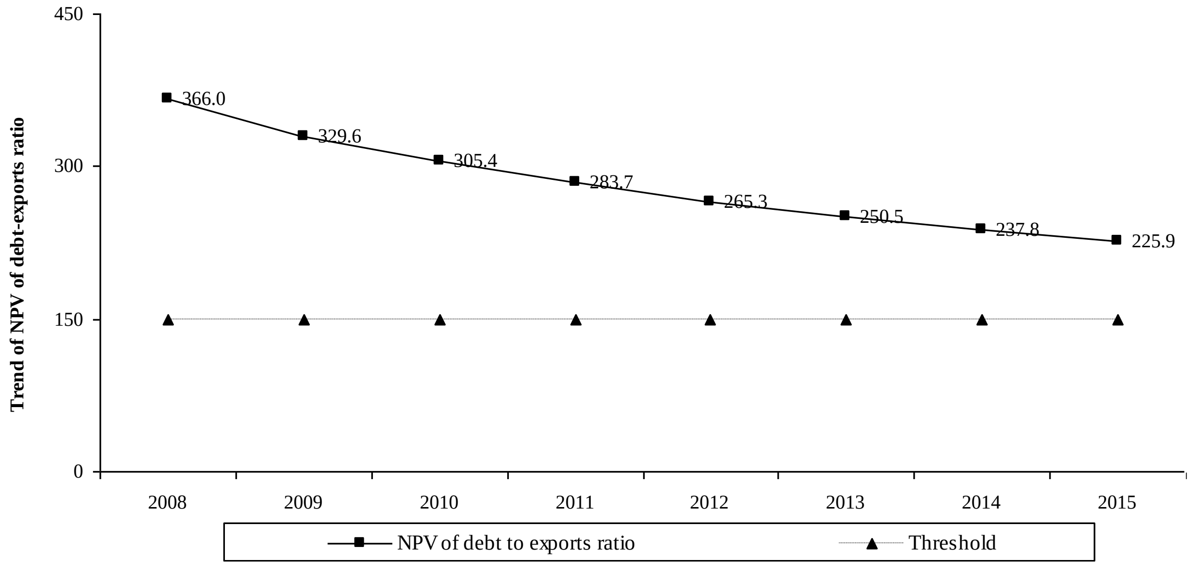
implementation of governance and service delivery, social and rural sectors are partially done. The level of debt relief granted by the Bank Group reached 35.2 percent of the commitment at end December 2008. This leaves some room for additional debt relief from the Bank with support from the HIPC Trust Fund, up to the authorized maximum ceiling of 40 percent debt relief during the interim period (*see Annex III*). However, DRC's interim assistance will reach this ceiling in July 2009 with the country not reaching its completion point. Hence, an exceptional extension of interim would be required to assist the country in reaching the completion point.

Justification for Extending Interim Debt Relief

4.2 Management has proposed to extend additional debt relief to DRC beginning January 2009 under a satisfactory assessment of DRC's prospect for fulfilling the key completion point triggers as presented in *Annex I*. Furthermore, this extension of the provision of interim debt relief would provide to the country necessary time to fully implement the remaining completion point triggers and help DRC keep on track full satisfactory performance of the IMF ongoing Staff Monitoring Program in order to enhance the likelihood of concluding a new PRGF in 2009. In addition, these efforts should prevent DRC from falling into a new cycle of accumulating arrears vis-à-vis the Bank Group, thus avoiding budgetary constraints on public expenditures and reducing DRC's vulnerability to adverse external developments.

4.3 The sensitivity analysis carried out at decision point indicates that DRC's ability to service its external debt after HIPC relief is particularly vulnerable to the following factors. These are the use of new borrowing to compensate for possible limited external grant assistance, the implementation of HIPC assistance, as well as the continued implementation of the reform agenda. The achievement of a robust external debt position will also depend on real GDP growth and export performance. The Bank Group's HIPC contribution represents about 14.3 percent of the NPV of debt stock. Strong and sustained efforts by the Bank Group which is pivotal would be required for DRC's long term sustainability of its external debt. From 2009 onward, the NPV of debt to exports would increase from about 330 percent to 377 percent staying above the 150 percent threshold. See chart 1 below and annex II on the conclusions of the 2007 Article IV Consultation with DRC for more details on its unsustainable debt situation.

Chart 1: Trend of DRC's NPV of debt to exports indicators assuming full HIPC assistance from all donors, including the Bank Group



4.4 Consultations with IDA reveal that the current need to provide additional interim debt relief is unique to the Bank Group because the interim debt relief was granted for an initial period of 3 years, with the possibility of extension to the completion point if there is progress made on the completion point's triggers. For IDA, interim debt relief to DRC, up to a maximum of one-third of the debt relief would be reached in October 2009. An extension of the interim debt relief to DRC does not apply to IDA because DRC is expected to reach its completion point by end-2009. DRC has not yet exhausted IMF 60 percent interim debt relief therefore; the country is still benefiting debt relief from IMF. Currently, discussions on a new PRGF arrangement are still ongoing.

Financing Modalities and Legal Arrangements

4.5 The increase in the interim debt relief limit up to 50 percent of the debt relief committed to DRC, and the extension of interim period to December 2010 will require the mobilization of US$241.8 million, in nominal terms. This HIPC assistance is broken down as follows: (i) US$66.7 million from the HIPC Trust Fund (HTF); and (ii) US$ 175.1 million from the Bank Group's DRC HIPC Special Fund. The proposed financing arrangements for the DRC debt relief is unique and quite different from earlier financing plans for other regional member countries that have qualified for debt relief. DRC's HIPC Special Fund was created as part of DRC's special arrears clearance operation. The fund is administered by the Bank Group. The Bank Group annually allocates resources from an interest recycling mechanism into the account. Similar to HTF, the Fund services a part of DRC's debt obligations falling due. In nominal terms, the DRC HIPC special account will fund the largest share (77 percent) of the amount required for the interim extension and the remaining balance (23 percent) will be funded by the HTF. Table 1 below provides details on the financing arrangements for the extension of this interim debt relief.

Table 1: Indicative Financing Arrangements

(Amounts in US$, nominal terms)

Due Dates	DRC HIPC Special Fund	HIPC Trust Fund Account	Total
Jan-09	43,612,362	16,335,569	59,947,931
Mar-09	-	741,858	741,858
May-09	-	52,166	52,166
Jul-09	45,465,661	12,993,990	58,459,650
Sep-09	-	737,634	737,634
Nov-09	-	53,031	53,031
Jan-10	42,006,858	19,286,100	61,292,958
Mar-10	-	767,539	767,539
May-10	-	52,166	52,166
Jul-10	44,054,765	14,832,929	58,887,694
Sep-10	-	763,275	763,275
Nov-10	-	53,031	53,031
TOTAL	**175,139,646**	**66,669,286**	**241,808,932**

4.6 The extension of interim debt relief will pave the way for DRC to reach its completion point before end of 2010. The additional debt relief will increase the Bank's assistance to DRC from US$482.7 million to US$685.9 million, in NPV terms, during the extended interim period. This assistance will enable DRC to benefit from a reduction of its debt service obligations to the Bank Group from January 2009 to December 2010. Debt relief for the DRC is to be provided, under the enhanced framework of the HIPC Debt Relief Initiative, through the mechanism of debt service relief, in accordance with the terms described in paragraph 4.5. Regarding the portion of contribution which will be made by the HIPC Trust Fund, a revised Agreement will be reached between the Bank Group and the HIPC Trust Fund.

V. CONCLUSION AND RECOMMENDATIONS

5.1 DRC has made significant progress in implementing reforms over the past years. In spite of the notable success in that context, the country experienced slippages in fulfilling the conditions for reaching its completion point under the enhanced HIPC Initiative, and subsequently qualifying for the MDRI. With continued appropriate policies, there are good prospects for strong economic performance by DRC to help the country achieve some of the MDGs.

5.2 Additional interim debt relief would support economic growth and reduce DRC's vulnerability to adverse external developments. This will be crucial in preventing it from falling into a new cycle of accumulating arrears vis-à-vis the Bank Group. This support will help the country meet all its completion point triggers and reach the completion point.

5.3 The Boards of Directors are invited to:

(i) Approve an increase in the limit of interim debt relief to Democratic Republic of Congo from 40 percent to 50 percent;

(ii) Approve an extension of the period for provision of interim debt relief to DRC to December 2010; and

(iii) Approve US$241.8 million of additional resources, in nominal terms, required for the extended interim debt relief. Similarly to the precedent cases, there is no additional cost to the DRC HIPC special Fund (Bank Group) and the HIPC Trust Fund.

Annex-I

Democratic Republic of the Congo: Progress on Status of Triggers for Reaching the Floating Completion Point

(As of end August 2008)

Triggers	Progress Status
1. PRSP Completion of a full PRSP through a participatory process and its implementation for one year, duly documented in the DRC's annual progress report, and confirmed as satisfactory by a joint staff advisory note (JSAN).	**Ongoing**. The full PRSP was completed through a participatory process, and adopted by the Government in July 2006. The newly elected Government endorsed it in March 2007. The PRSP and the JSAN were presented to the Bank Board in May 2007. The Government made the PRSP its document of reference and used it extensively to elaborate its Program 2007-2011. The PRSP progress report at end-June 2008 is being finalized.
2. Macroeconomic stability Continued maintenance of macroeconomic stability after reaching the decision point, as evidenced by satisfactory performance under a program supported by an arrangement under the IMF's PRGF.	**Mixed.** Inflation increased considerably at end-August 2008 compared to 2007 due mainly to higher food and oil prices. Annualized inflation reached 32.68 % against 9.96% in 2007 and an end of year objective of 23.50 %. On a monthly basis, inflation slowed down in July (3.47%) and in August (1.06%), compared to June (4.62%). On the foreign exchange market, the Congolese franc stabilized vis-à-vis the dollar to around CDF 555/ 1USD since February 2008. Compared to December 2007 it depreciated by 10.1% after reaching CDF 559.65 at end August 2008. Treasury account recorded a surplus at end August 2008, but with a deficit the last two months due overall to weaknesses in public financial management, and to some overspending mainly for security. An IMF mission was conducted in September 2008 to assess the implementation of the SMP and continue discussions on a new PRGF arrangement. Discussions with authorities should include PFM aspects, the Budget 2009 under preparation, and the China deal.
3. Use of budgetary savings resulting from enhanced HIPC Initiative-related debt service relief during the interim period for poverty-related expenditures in accordance with the I-PRSP, with supporting documentation satisfactory to the staffs of IDA and the IMF.	**Ongoing**. An external audit of the HIPC account to assess the use of budgetary savings from the enhanced HIPC Initiative account has been completed in June 2007. Findings were mixed; however recommendations for improvement have been made.
4. Public expenditure management (a) Implementation of a modernized budget-execution system, providing information from commitment to payment, and allowing for the monitoring of arrears;	**Ongoing.** (a) The budget-execution system is improving but very slowly. A reporting mechanism is in place within the public finance management system, the *Chaine de la dépense*. General budget execution reports (*États de suivi budgétaire - ESB*) are produced but not on a regular basis and their quality is yet to improve. However, delays in producing ESB harmonized with the State financial operations table (*Tableau des opérations financières de l'État - TOFE*) are considerable. Sectoral budget execution reports are prepared by line ministries and sent to Ministry of Budget but are not exhaustive to be used by the latter. Treasury accounts produced monthly are as well not yet exhaustive and reliable.

(b) adoption and implementation of a double-entry Government accounting system and a new chart of accounts; and (c) production of quarterly budget execution reports using economic, administrative, and functional classifications.	(b) The double-entry system is being implemented. The staff have been trained, equipment purchased, and software developed. Additional efforts are needed for the staff to master the new system; (c) A new classification has been adopted. The budgetary reports are produced using economic, administrative, and functional classifications, but with a lag of 2-3 months.
5. Governance and service delivery in priority sectors (a) Completion of a budget-tracking exercise on health, education, rural development and infrastructure expenditure, consisting of (i) monitoring the execution of poverty-related public expenditure; (ii) evaluation by user groups of the quality of related public services, and (iii) evaluation by service-providers of constraints to effective provision; and (b) Adoption and implementation of a new procurement code and key implementing decrees.	**Partially done**. (a) (i) The treasury monitors poverty-related public expenditures in all sectors, using the new budget classifications. (ii) Evaluation by user groups of health clinics and schools was conducted through an Institutional and Governance Review (2005). (iii) Evaluation by service providers in education and health was conducted through an Institutional and Governance Review (2005). (b) The draft procurement code was adopted in April 2006. The application laws were validated in October 2006. The final version of the code and the laws need to be adopted by the Council of Ministers, then by Parliament. The consultant tasked with preparing a national procurement strategy and a program of capacity reinforcement has issued a preliminary report. The last step is to put in place institutions compatible with the new code, and to make them operational.
6. Social and rural sectors Adoption of sectoral development strategies and related implementation plans for health, education and rural development, which are satisfactory to IDA.	**Partially done.** The country's health status report was issued in May 2005. Health sector strategy was completed in March 2006 based on the findings of this report. In the field of education, the Government finalized, in September 2004, the Status Report on the National Education System, which assesses the sector's constraints, and adopted a draft action plan for the Education for All (EFA) Initiative. The education sector strategy was drafted in the second quarter of 2006. An agriculture sector review was completed in May 2006, while the rural development strategy is under preparation.
7. Debt management Installation and full activation of a computerized debt-recording system, covering public and publicly-guaranteed debt that can (a) produce monthly debt-service projections, and incorporate actual disbursement and debt-service payment execution data; (b) produce advance monthly debt-service projections that will be published quarterly; and (c) support the centralization of debt information into a single center.	**Partially done.** A public debt management software (DMFAS / SYGADE) was installed, and the public external debt outstanding was recorded. The implementation program, including the training of the relevant staff on debt management is now complete although OGEDEP is still not producing or publishing the debt service required statistics, in particular projections. A Prime Minister decree strengthening the role of OGEDEP as the single debt information center has been signed on February 2008 and a related action plan validated by the Minister of Finance on May 2008.
Source: World Bank PREM team with information from DRC authorities	

Annex-II

IMF Executive Board Concludes 2007 Article IV Consultation with the Democratic Republic of the Congo

On September 05, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Democratic Republic of the Congo (DRC).

Background

The DRC has made significant economic and political progress since 2001, after years of conflict and political instability. Adoption of prudent macroeconomic policies resulted in rapid disinflation and the stabilization of the exchange rate. The implementation of structural reforms made the economy more open, removed major price distortions, and strengthened macroeconomic policy management. These, combined with improved confidence fostered by progress on the political and security fronts—including the formation of a transition government of national unity in 2002—helped increase investment and renew growth.

However, economic performance weakened starting in 2005, as the government's focus turned to the drafting of a new constitution and the preparation for general elections**.** In 2006, large money financed government overspending, primarily for security and the elections, resulted in the Congo franc to depreciate by 15 percent against the US dollar, 12-month inflation to rise to 18.2 percent, and gross international reserves to decline to US$150 million (3 weeks of imports). Real GDP growth, which had picked up to 6.5 percent in 2004-05 slowed to 5 percent in 2006 because of weak manufacturing production and a drop in diamond exports. Major reforms suffered delays, including those in the mining sector, public enterprises, the civil service, the social sectors, customs administration, and the central bank.

The first democratic elections in four decades were successfully held in 2006, bringing to an end the mandate of the transitional government and leading to the formation of a new government in February 2007.

The new government has taken steps to reestablish macroeconomic discipline. Strong revenue collection and expenditure restraint reduced net bank credit to the government. This tightened liquidity conditions and contributed to a decline in base money. Consequently, since last May, the Congo franc has appreciated by 12 percent, annualized inflation declined to 12 percent and international reserves increased to US$190 million. Preliminary data indicate that real GDP could grow by 6½ percent in 2007. However, the DRC accumulated external arrears vis-à-vis bilateral creditors, and its external debt remains unsustainable.

Despite recent improvement, risks to macroeconomic stability remain high. In particular, the 2007 budget promulgated last July is very expansionary. It calls for a very large increase in domestically financed spending, including on wages, which is unlikely to be matched by a commensurate increase in revenue.

Executive Board Assessment

The Executive Board commended the authorities of the Democratic Republic of the Congo (DRC) for the successful completion of the first democratic elections in four decades, and encouraged the new government to work with all parties to improve security and bring peace to all the country's provinces.

Directors noted that the generally prudent macroeconomic policies implemented by the new government have contributed to some encouraging results, with improved fiscal position, reduced inflation, strengthened international reserves, and an appreciation of the Congo franc. They regretted, however, the recent spending pressures in the wake of the expansionary 2007 budget and the delays in structural reforms. Against this background, and with continuing security concerns, Directors considered that the economic situation remains challenging. They called for early actions to further strengthen fiscal discipline, improve governance, and carry forward structural reforms to lay the basis for sustained growth and progress toward the MDGs. Directors stressed that the 2007 program monitored by Fund staff (SMP) provides an opportunity to establish credibility for good economic management and pave the way for a medium-term program that could be supported by a PRGF arrangement. In this context, Directors noted that, under the SMP, all quantitative benchmarks for end-June and several structural benchmarks have been met. Strong leadership will be important to build a broad consensus for the needed reforms and ensure their effective implementation. While also underscoring the importance of strong implementation, some Directors called on the authorities and the staff to work towards early consideration of a new PRGF-supported program.

Directors stressed that the implementation of the 2007 budget, as promulgated, would put macroeconomic stability at risk. Optimistic revenue projections and a concomitant expansion of spending would likely lead to a new cycle of widening fiscal deficit, rapid money expansion, depreciation of the currency, and rising inflation. Directors also noted that the large increase in the wage bill would undermine fiscal sustainability and crowd out pro-poor spending. They encouraged the authorities to take the necessary measures for meeting the fiscal objectives of the 2007 SMP, and noted their assurances on the implementation of a Treasury cash-flow plan consistent with the SMP.

Directors stressed the need for the government to continue avoiding central bank financing of fiscal deficits, as this has helped improve macroeconomic stability. They considered improving public financial management (PFM) critical in this regard, and more generally, underscored its importance for enhancing the efficiency and credibility of the budget process. Directors called for reforms to strengthen tax administration and revenue collection, rationalize expenditure procedures and improve expenditure prioritization, better track pro-poor spending, and establish an affordable and efficient civil service. Directors noted the authorities' planned devolution of government revenue to the provinces. They encouraged the authorities to proceed cautiously, in line with the devolution of spending responsibilities and taking into account PFM capacity building requirements in the provinces.

Directors noted that monetary policy should remain tight to reduce inflation. This requires strengthening monetary policy management and enhancing the central bank's credibility and independence. Reinforcing financial sector supervision is also needed to strengthen the banking system and deepen financial intermediation.

Directors noted that the floating exchange rate regime is appropriate for the DRC and has served the country well. They encouraged the authorities to limit interventions to smoothing short-term fluctuations, and achieving the central bank's international reserve target. Directors encouraged the authorities to lift the remaining exchange restriction and multiple currency practice.

To promote growth and reduce poverty, Directors emphasized that the medium-term policy agenda should include bold strategies to combat corruption—especially in the natural resources sector—privatize public enterprises, strengthen the judiciary, and reduce the regulatory burden on business. In that regard, Directors called for the effective implementation of the relevant laws to fight corruption, money laundering, and the financing of terrorism. They welcomed the authorities' intention to meet the requirements of the Extractive Industries Transparency Initiative. Progress in these areas will be essential to mobilize donor support.

Directors emphasized that rural sector development and increased investment in human capital—health and education—will be critical in addressing entrenched poverty. In this regard, Directors encouraged the authorities to proceed with the costing of the proposed pro-poor programs and the development of mechanisms to monitor the effectiveness of the programs.

Directors noted that the DRC's external debt is unsustainable. They encouraged the authorities to quickly establish a track record for prudent policies and reforms to help advance toward qualifying for debt relief under the enhanced Heavily Indebted Poor Country and Multilateral Debt Relief initiatives. Directors underscored the need for prudent debt policy and strengthened debt management capacity.

Annex-III

DRC's Interim Period – HIPC Debt Relief Implementation

(Amounts in NPV terms, in US$)

Year	Debt relief	Cumulative	As % of total debt relief
2003	1,217,172	1,217,172	0.1%
2004	84,573,448	85,790,620	6.3%
2005	93,363,186	179,153,806	13.1%
2006	101,645,669	280,799,476	20.5%
2007	101,305,021	382,104,497	27.9%
2008	100,566,533	482,671,029	35.2%
2009	98,726,086	581,397,115	42.4%
2010	96,888,120	678,285,235	49.4%
2011	47,948,843	726,234,078	52.9%