

**AFRICAN DEVELOPMENT BANK
AFRICAN DEVELOPMENT FUND**



Democratic Republic of Congo (DRC)

**Eligibility for Supplementary Support Resources under the
Fragile States Facility (FSF)**

Accompanying Note to CSP 2008-2012

REGIONAL CENTER DEPARTMENT (ORCE)

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LIST OF ACRONYMS

ADB	: African Development Bank
ADF	: African Development Fund
BCC	: Central Bank of the Democratic Republic of Congo
BWI	: Bretton Woods Institutions
CDF	: Congolese Franc
CPIA	: Country Policy and Institutional Assessment
CSP	: Country Strategy Paper
DGI	: General Directorate of Taxation
DGRAD	: General Directorate of Public Revenue
DRC	: Democratic Republic of Congo
DSA	: Debt Sustainability Analysis
FSF	: Fragile States Facility
GDP	: Gross Domestic Product
GEP	: Government Economic Programme
GPRSP	: Growth and Poverty Reduction Strategy Paper
HIPC	: Heavily Indebted Poor Countries
IDA	: International Development Association
IMF	: International Monetary Fund
EITI	: Extractive Industries Transparency Initiative
MDG	: Millennium Development Goals
MDRI	: Multilateral Debt Relief Initiative
OFIDA	: Customs and Excise Authority
OGEDEP	: Public Debt Management Agency
OHADA	: Organization for the Harmonization of Business Law in Africa
PAP	: Priority Action Programme
PBA	: Performance-Based Allocation
PRGF	: Poverty Reduction and Growth Facility
RBCSP	: Results-Based Country Strategy Paper
SDR	: Special Drawing Right
UNDP	: United Nations Development Programme

I. INTRODUCTION

1.1 The Boards of Directors will recall that they approved DRC's CSP 2008-2012 on 29 October 2008. On that occasion, a reservation was expressed regarding the country's eligibility for Fragile States Facility (FSF) resources. The Boards noted that although DRC met all first stage selection criteria, the country did not meet one of the second stage criteria concerning debt sustainability owing to the Sino-Congolese Cooperation Agreement which could result in a high level of non-concessional debt. Accordingly, the Boards considered that the Bank had to postpone the decision on DRC's eligibility for FSF until the cooperation agreement between China and DRC was made compatible with the country's external debt sustainability. Management indicated that the Bank will, in collaboration with the IMF and the World Bank, submit to the Boards an assessment showing the country's fulfilment of all second stage FSF eligibility criteria, depending on the outcome of the renegotiation of the Sino-Congolese Cooperation Agreement.

1.2 In light of recent developments, particularly the revision of the Sino-Congolese Agreement and the approval by the IMF in December 2009 of the Poverty Reduction and Growth Facility (PRGF) for DRC, the aim of this Memorandum is to submit to the Boards a revised analysis of DRC's eligibility for FSF resources to enable their use in 2010. The Memorandum includes the following: (i) introduction; (ii) background; (iii) assessment of eligibility for FSF supplementary support; (iv) Bank commitment and use of the proposed resources; and (v) recommendation.

II. BACKGROUND

Overview of Country Situation and Recent Developments

2.1 The security situation in some provinces in the East of the country is still fragile due to armed rebel attacks. Following the resumption of large-scale fighting at the end of August 2008 which displaced more than 250 000 people, DRC and Rwandan troops jointly launched an offensive against the armed militia in January 2009. This helped reduce the intensity of attacks and stabilized the situation to some extent. The historic meeting of the Heads of State of DRC and Rwanda in Goma (DRC) on 6 August 2009 led to a commitment by both Heads of State to guarantee the security of their countries and wipe out armed groups that could jeopardize that security. A dialogue was also initiated between DRC and Uganda when the Heads of State of both countries met in Kasindi (DRC) on 4 March 2009 to restore peace in the border area between the two countries. Although the situation remains fragile, the DRC is in peace with its nine neighbours today because of these efforts to maintain peace.

2.2 Socially, the majority of the population still lack access to basic social services due to the degradation of basic economic infrastructure and macroeconomic instability owing to many years of conflict. More than 71% of the population live below the poverty line. Generally, DRC may not achieve most of the Millennium Development Goals (MDG) by 2015 without vigorous and sustained economic growth. Social indicators are very inadequate: in 2008, life expectancy at birth was 47.7 years; the infant mortality rate (per 1 000) was 115.3 compared to the African average of 83.9; and access to health services (in % of the population) was 17.6% compared to the African average of 38%. The Human Development Index dropped by more than 10% during the last decade, such that DRC was ranked 176th out of 182 countries according to the United Nations Development Programme (UNDP) *Human Development Report 2009*.

2.3 On the economic front, the generally favourable international environment in 2007 foreshadowed encouraging economic prospects for DRC. The real GDP growth rate, which was 6.3% in 2007, was expected to rise to 10% in 2008. Macroeconomic policies in the first half of 2008 were satisfactory. Budgetary accounts showed a modest surplus due to sound internal revenue mobilization and shrewd expenditure management. This situation enabled the Central Bank to control the growth of monetary aggregates while maintaining its key interest rate at 28%. However, in the second half of 2008, this trend was undermined by two negative exogenous shocks, namely:

- The global financial crisis and its recessionary effects on economic activity in the major industrialized and emerging nations. The fall in global demand induced by the financial crisis during the last quarter of 2008 led to a sharp fall in the prices of the country's main export products (copper, cobalt and diamond, which account for 4/5 of exports) and an estimated decline in foreign direct investments from USD 720 million in 2007 to USD 600 million in 2009.
- The resurgence, in September 2008, of conflicts in the East of the country which led to an increase in emergency spending (outside the normal expenditure chain) and further constrained limited budgetary resource allocation.

These two shocks resulted in a serious deterioration of the macroeconomic situation and rendered public finance management difficult at the end of 2008 and during the first half of 2009.

III. ASSESSMENT OF ELIGIBILITY FOR FSF SUPPLEMENTARY SUPPORT

Meeting First Stage Criteria

3.1 DRC has already met the first stage criteria of eligibility for FSF supplementary financing which are: (i) the country's commitment to strengthening peace and security; and (ii) unmet social and economic needs. The updated situation of these criteria is presented in Annex 1.

Meeting Second Stage Criteria

A. Macroeconomic Environment and Debt Policy

Macroeconomic Situation

3.2 As indicated in paragraph 2.3, the drop in the prices of the main export products as well as the escalation of conflicts in some provinces in the East of the country made macroeconomic management difficult at the end of 2008, leading to an economic downturn in 2009:

- The real GDP growth rate reached 6.1% in 2008 (against a pre-crisis projection of 10%). It was estimated to be 2.7% in 2009 as a result of the slowdown in economic activity, particularly in the manufacturing and mining sectors. Cement and electricity shortages also affected the public works and civil engineering sector.

- After declining in the second half of 2008 because of the fall in world oil and food prices, the inflation rate rose once more at the end of 2008 and early 2009 due notably to public borrowing from the Central Bank. The inflation rate was estimated to be 24.3% at the end of 2009 owing to a strong growth in money supply and a 35% depreciation of the Congolese franc against the US dollar between December 2008 and September 2009.
- Regarding balance of payments, the current account deficit was expected to increase from 0.3% in 2008 to -7.5% in 2009 due to the fall in the prices of the country's main export products.
- After reaching their lowest level in five years (USD 30 million, representing less than one week of import cover) in February 2009 on account of the drop in import earnings, gross international reserves rose to USD 894 million at the end of September (that is 10 weeks of import cover). This increase was a result of assistance given to DRC by external partners to address the effects of the global financial crisis.
- Concerning public finance, the budget balance was expected to decline from -5.8% of GDP in 2008 to -9% in 2009 as a result of the effects of the global financial crisis and poor performance of revenue collection services (the General Directorate of Taxation, the General Directorate of Public Revenue, the Customs and Excise Authority) in domestic resource mobilization during the first half of 2009. However, the Government took measures to ensure the traceability of revenue and reduce their loss rate at each collection point. At the level of customs administration, the customs brigade was strengthened to combat fraud and smuggling, and the pre-shipment system was improved. In the General Directorate of Taxation, the number of taxation centres throughout the country was increased and discretionary exemptions suspended. The Government also made the most of the support from external partners through the improvement of external revenue accounting methods and revenue monitoring by the Ministry of Planning, thus enhancing the visibility of donor operations. According to the IMF, budgetary objectives for the remainder of 2009 could be attained, such that internal revenue mobilization throughout the year should be consistent with the economic programme objectives. With regard to expenditure, the Government took corrective measures to check the increase in expenditure commitments in October 2009. Specifically, the authorities cancelled all commitments for which goods and services had not yet been provided (CDF 68 million). They also stopped all new expenditure commitments from the end of October in accordance with budgetary procedures and reallocated appropriations for discretionary expenditure to settle priority expenditure and finance investments using domestic resources.

3.3 To deal with the crisis, development partners, notably the Bank, the World Bank, the IMF and the European Union, responded urgently. On 6 May 2009, the Bank approved a UA 65 million (or approximately USD 97 million) emergency programme to mitigate the impact of the financial crisis. The World Bank urgently approved a USD 100 million supplementary financial support in February 2009 while the IMF approved financial assistance on 11 March 2009 through the rapid-access component of the Exogenous Shocks Facility worth USD 195 million. The Delegation of the European Commission also granted a

EUR 22.62 million budget support from the European Development Fund (EDF), supplemented by EUR 26 million from the Food Facility, thus bringing its total support to EUR 48.62.

3.4 The macroeconomic objectives for the period July 2009 - June 2012 to be backed by the Poverty Reduction and Growth Facility (PRGF) include: (i) attaining an average growth rate of 5.5% sustained by an upturn in the mining sector and infrastructure reconstruction projects; (ii) reducing the inflation rate to 9% by 2012 by implementing prudent monetary and budgetary policies; (iii) rebuilding gross international reserves to represent approximately 10 weeks of import cover at the end of the programme period.

Debt Policy

3.5 The DRC's external debt situation is unsustainable in the absence of a substantial debt relief under the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI). The total external debt, expressed as a percentage of GDP, was estimated at 106.6% of GDP at end 2008. The attainment of the HIPC completion point which would enable DRC to benefit from total debt cancellation under the Initiative was delayed due to the absence of a programme initiated within the framework of the Poverty Reduction and Growth Facility (PRGF) (one of the preconditions for attaining the completion point).

3.6 Discussions between DRC and IMF for a PRGF-backed arrangement have been impeded since 2008 by the implications of the Sino-Congolese Cooperation Agreement signed in April 2008 between DRC and a Chinese consortium, which intends to carry out huge investments in the mining sector worth USD 3.2 billion and infrastructure worth USD 6 billion in two phases over the period 2009-2017. In 2008, IMF and World Bank staff assessed the implications of the said cooperation agreement for debt sustainability. In their view, the financing package of the agreement resulted in a concessionality element of about 15% that could jeopardize debt sustainability and hence the country's access to debt relief under the HIPC Initiative and MDRI (see Annex III for a review of the Sino-Congolese Cooperation Agreement).

3.7 Therefore, the IMF and World Bank considered it necessary to review the terms of the Cooperation Agreement to: (i) cancel the State's guarantee for the mining component which should be treated as a commercial project; (ii) cancel for the time being phase II of the infrastructure component worth USD 3 billion and consider it by the end of the first phase of the infrastructure component; and (iii) increase the concessionality element of the financing package under the Agreement.

3.8 Drawing conclusions from this situation, on 24 October 2009, the authorities and their Chinese partners signed the amendments to the Sino-Congolese Cooperation Agreement, including the withdrawal of the Government's guarantee on the mining component and the cancellation of the second phase of the infrastructure component (deferred to a later period). Following the revision of the Agreement, the debt sustainability analysis (DSA) by the IMF and the World Bank concluded that although the infrastructure financing guaranteed by the State will significantly increase the country's external debt service indicators over the medium term, its impact on debt sustainability over the long term will not be very significant. The grant element under the new financial clause of the Agreement is estimated to be between 42% and 46% which is acceptable for debt sustainability. However, it was noted that, in the absence of debt relief, the related indicators would be high.

3.9 After this analysis, the Paris Club met on 25 November 2009. This enabled the IMF Executive Board to consider and approve on 11 December 2009 a three-year PRGF-backed arrangement worth USD 551 million and an additional interim assistance of about USD 72.68 million under the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative to reduce DRC's debt service payments to the IMF. The PRGF will enable the country to make progress towards attaining the HIPCI completion point in 2010¹ and to benefit from complete debt cancellation under the enhanced HIPC Initiative and MDRI².

3.10 Concerning commercial debt contracted within the framework of the London Club, the Government intends to conclude the discussions for cancellation of its debt under a debt buyback programme backed by the World Bank. It will seek to obtain debt relief from its creditors other than those of the Paris Club under conditions comparable to those obtained from the Paris Club.

3.11 The Government plans to strengthen external and internal debt management as part of its medium-term economic programme (2009-2012) to limit the risks of debt overhang. To that end, the Government acknowledges that only the Minister of Finance is empowered to commit the State regarding public debt at the central, provincial and local levels. External and internal debt management will be centralized at the Public Debt Management Agency (OGEDep) which will publish a half-yearly statistical bulletin as well as quarterly public debt service projections.

B. Public Finance Management

3.12 To increase priority spending under the State budget, DRC is making efforts to improve the functioning of its public finance management system with the support of development partners. Concerning revenue, the challenge is to mobilize internal revenue to support the country's reconstruction efforts. Despite the improvements made, revenue collection services are still unable to mobilize all expected internal revenue, considering the fiscal capacity of the country's economy. Thus, the Government initiated various reforms, in particular: (1) modernization of tax management structures with a view to instituting the value-added tax (VAT), the bill of which has been tabled before the National Assembly; (2) introduction of the new Customs Code, the bill of which is being finalized by the Government; and (3) building of the capacity of taxation services staff. Emphasis is laid on broadening the tax base by rationalizing and eliminating exemptions in the Investment Code, Mining Code and Forestry Code over the long term. The Government has also strengthened the structure responsible for major taxpayers in the General Directorate of Taxation in order to improve the collection of taxes and levies from mining companies, in particular. The introduction in 2012 of a single rate VAT will help eliminate various discretionary taxes. To ease tax reform management, the Government intends to set up taxation centres throughout the country. Concerning customs administration, the objective of reforms is to reduce fraud and processing time frames, and improve the assessment of the value of goods. Priorities in this domain also include the monitoring of mining exports, the setting up of one-stop shops in customs posts, the modernization of information management and the introduction of an individual taxpayer identifier.

¹ DRC was admitted to the decision point on 23 July 2003.

² For information on the completion point enablers, see *DRC: Exceptional Extension of Interim Period under the Enhanced HIPC Initiative* (Ref. ADB/BD/WP/2009/07-ADF/BD/WP/2009/04).

3.13 Poor planning of budgetary spending is a key contributory factor in weak fiscal discipline. To improve budgetary planning and programming, the preparation of Medium-Term Expenditure Frameworks (MTEF) for the 2009 fiscal year was launched and an MTEF Steering Committee set up in the Ministry of the Budget with representatives from the priority sectors³. MTEF will help establish a link between planning, programming and the State budget, and promote the introduction of results-based management.

3.14 The weaknesses of the public finance management system also affect expenditure execution. The security situation in some provinces in the East of the country was a major source of significant fiscal slippage which led to a reduction in the budget earmarked for other priority spending, in particular reconstruction and support to poverty alleviation. In 2008 and early 2009, the security situation resulted in an increase in emergency spending outside the normal expenditure chain procedure. Such spending was not regularized *a posteriori* within the time frame specified by the instruments in force. The Government intends to reduce recourse to this emergency procedure. The stabilization of the security situation in provinces in the East of the country and normalization of relations with neighbouring countries should help it achieve this goal. However, disarming and rehabilitating ex-combatants remain major challenges with significant budgetary implications.

3.15 Decentralization also raises major issues with regard to the budget in terms of public finance management capacity of provinces. The Government has undertaken to transfer 40% of national revenue as well as responsibilities for the implementation of social programmes to provinces. Considering constraints in this area, Government has slowed down the rate of implementation of decentralization pending the enactment of the organic law on public finance and the building of managerial capacity in provinces.

C. Transparency of Public Accounts

3.16 The existence of a large number of accounts opened by the State at BCC and in commercial banks has limited the transparency of Government operations and promoted fiscal indiscipline in recent years. Although significant progress is yet to be made in this domain, remarkable efforts are being made to improve budget preparation, execution and control in accordance with international standards. In this respect, it is necessary to establish double-entry bookkeeping. The Government intends to complete the introduction of this system in the Treasury Department at the end of 2009 and to establish it in revenue collection services to ensure the recording of accounting operations during the different phases of budget execution. Double-entry bookkeeping will help improve the monitoring of financial flows from the commitment phase up to the payment phase. The publication of periodic summary financial statements stemming from double-entry bookkeeping will ease control and supervision, thanks to the generation of accounting entries with their respective counterparts. The finance law governing State accounting and budgetary operations as well as revenue and expenditure nomenclatures is also under revision. Although the presentation of budgetary monitoring reports has been considerably enhanced to strengthen the traceability of expenditure, major efforts are still to be made. Cash plans reconciled with commitment plans are produced and published on the web sites of the Ministries of Finance and of the Budget, respectively.

3.17 In 2008, the Government commissioned an audit of all public accounts as well as emergency spending. An inter-ministerial decree was issued in December 2008 to specify the

³ Health, Education, Agriculture and Rural Development, Road Infrastructure.

scope of application of emergency spending and regularize the said spending. So far, the Government has applied the new procedures in a successful and transparent manner, and all emergency spending payments have been carried out in accordance with the law enacted in December 2008. It is envisaged that the financial statements and audit reports of the Central Bank of Congo (BCC) will be published no later than six months following the end of the fiscal year⁴.

3.18 The Government intends to implement other actions to improve economic governance in general in order to ensure greater transparency of public accounts. Already, the Government publishes partnership contracts between State-owned and private enterprises, including related financial and tax details two months after they have been signed. It intends to set up an independent anti-corruption body by June 2010. The Government also plans to improve the system and quality of statistics in order to generate reliable macroeconomic, social and demographic data. Furthermore, the authorities will implement the action plan of the Extractive Industries Transparency Initiative (EITI) to enhance transparency in the mining sector and its impact on tax revenue.

3.19 As indicated earlier, although significant progress is yet to be made, remarkable efforts are being put into improving public finance management and the transparency of public accounts. Progress in this domain is essential for preserving priority pro-poor spending in key social sectors. The pace of implementing public finance management reforms is often slowed down by constraints related to weak institutional capacity of public administration. Since a PRGF-backed arrangement was approved by the IMF on 11 December 2009, the expected increase in the financial and technical assistance of DRC's partners should help accelerate the implementation of the Public Finance Management Action Plan which will be adopted at the end of March 2010. The thrust of this plan focuses on five pillars: (i) modernization of the legal framework, including the adoption of the organic law on public finance and the Procurement Code; (ii) improvement of the annual budget preparation process, on the basis of a medium-term expenditure framework; (iii) streamlining of budget execution and cash management to help monitor expenditures; (iv) strengthening of the computerization of budget execution reports; and (v) intensification of *ex-ante* and *a posteriori* budget controls.

3.20 The restructuring and recapitalization of the Central Bank of Congo (BCC) is another important structural reform included in the PRGF-backed 2009-2012 medium-term economic programme. It is expected to have positive impacts on the improvement of public finance management and transparency. The Government's objective is to strengthen BCC's independence and operational capacity, while consolidating its financial resources. In 2009, BCC adopted a three-year strategic plan to improve its governance and strengthen its capacity in carrying out its monetary policy implementation and financial system supervision missions. In parallel, the Government will implement the Central Bank recapitalization process which will be completed in 2011.

3.21 In light of the foregoing analysis, DRC has met the second stage criteria and is therefore eligible for the resources of the supplementary support window under the Fragile States Facility.

⁴ The audit report on BCC financial statements for the 2008 fiscal year was published in June 2009.

IV. BANK COMMITMENT AND USE OF RESOURCES

4.1 **Government's strategy:** DRC has a Growth and Poverty Reduction Strategy Paper (GPRSP) covering the period 2006-2008 which hinges on five pillars: (i) promote good governance and strengthen peace through institution building; (ii) consolidate macroeconomic stability and growth; (iii) improve access to social services and reduce vulnerability; (iv) fight against HIV/AIDS; and (v) support community development. The Government has extended the GPRSP to December 2010 through a Priority Action Programme (PAP) 2009-2010 to help prepare a second generation PRSP for the period 2011-2015. A relay document which constitutes a transition between the emergency and sustainable development phases, PAP focuses the public investments envisaged by the Government and development partners on the abovementioned strategic thrusts. It outlines the measures and projects to be implemented by the Government in order to stabilize the security situation in the East of the country and mitigate the effects of the global financial and food crisis on macroeconomic outputs so as to continue to improve the socio-economic conditions of the Congolese people.

4.2 **Bank strategy:** the Bank's 2008-2012 strategy is based on the following pillars: (i) good governance support (transparency in public resource management and improvement of the business environment); and (ii) pro-poor growth support (electrification, sanitation and access to drinking water, basic urban and rural infrastructure, and transport). The private sector would get involved in the growth sectors (mining, SME, energy).

4.3 **Bank portfolio:** the Bank's active portfolio (excluding multinational and private sector operations) comprises eleven (11) operations involving ten (10) projects and one (1) study totalling UA 358.17 million. In the private sector, the Bank approved an operation for a total of USD 100 million for a copper and cobalt project in Katanga Province in September 2007. In January 2008, it contributed the sum of USD 1.1 million and USD 0.650 million in technical assistance for the establishment of Advans Bank Congo (ABC). A USD 1.05 million increase in the Bank's share in the capital of Advans Bank was approved in December 2009.

4.4 **Portfolio performance:** according to the 2009 portfolio review, the overall performance was considered as fairly satisfactory with an aggregate score of 1.87. The portfolio, whose disbursement rate for active projects in the public sector was 36.74% in mid-January 2010, is facing problems such as poor preparation and design of the first projects approved during the early post-crisis period, lack of mastery of Bank rules, poor monitoring of project implementation and difficulties in releasing Government's counterpart contribution to project financing. The portfolio review helped prepare and monitor with the authorities a portfolio improvement plan which is in the implementation phase.

Resources Allocated Under the 2008-2012 Strategy

4.5 **ADF 11 – Performance-based allocation (PBA):** the amount allocated to DRC under ADF 11 (2008-2010) PBA in 2009 was UA 187.06 million. The following projects were financed (see table in Annex II): the Inga Site development study (multinational operation, UA 4 million); the study on the rail/road bridge between DRC and Congo (multinational operation, UA 1 million); the NELSAP Interconnection Project (multinational operation, UA 9.22 million); and the Emergency Programme to Mitigate the Impact of the Financial Crisis (UA 65 million). The following projects will be financed in 2010: the

Electricity Infrastructure Rehabilitation and Extension Project (UA 8.84 million); the Central Government Human Resource Development Project (UA 20 million); the Decentralization Support Project (UA 10 million); and the Rural and Semi-urban Drinking Water Supply Project (DWSS, UA 69 million).

4.6 **The Bank's response to the food crisis in Africa (RFCA):** in June 2009, the Bank allocated UA 5.3 million to DRC as part of its short-term response to the food crisis. These resources, which were disbursed from the non-committed resources of the Agricultural and Rural Sector Rehabilitation Support Project (PARSAR) and the Agricultural and Rural Sector Rehabilitation Project in the Katanga and Kasai Provinces (PRESAR), were used to finance the procurement of inputs and small implements to ensure greater food security.

4.7 **FSF - Targeted support:** in view of the huge capacity building needs in DRC, the Bank's support is necessary to develop knowledge and build human and technical capacity through economic and sector work (ESW), project feasibility studies, targeted technical support and secondments. DRC is currently eligible for Window III of the FSF (i.e. targeted support) totalling USD 2 million. At least an additional USD 2 million is envisaged in 2010, thus increasing the amount to USD 4 million. Part of these resources will be used to finance institutional capacity building in public finance and macroeconomic policy management. In September 2009, DRC submitted requests to the Bank in that regard, as well as applications for conducting prospective studies for the preparation of the new GPRSP and the decentralization study. The terms and conditions of this assistance are being considered by the Fragile States Unit.

4.8 **Financing of private sector and multinational operations:** during ADF 11, the Bank will, through the ADF window, continue to support private sector development, particularly the micro-finance and mining sectors. Concerning multinational operations, the operations involving DRC benefitted from ADF regional resource allocation which helped finance the Inga hydroelectric site development study, the study on the rail/road bridge between Kinshasa and Brazzaville, the African Programme on Onchocerciasis Control, and the Nile Equatorial Lakes Countries Electricity Grid Interconnection Project.

4.9 **Assistance under the HIPC Initiative:** in January 2009, DRC benefitted from: (i) an increase in the debt relief ceiling, during the interim period, from 40% to 50%; and (ii) the extension of the interim period for the grant of debt relief to December 2010⁵.

Use of Supplementary Support Resources (Window I)

4.10 In 2010, the Bank intends to finance an electricity infrastructure rehabilitation project for a total UA 69 million. It plans to use UA 60 million from the resources of Window I of the FSF to finance this project which is in line with operational priorities for the use of such resources whose framework prioritizes the rehabilitation and reconstruction of basic infrastructure, among other things. The proposed project is also consistent with the priorities of the second pillar of the Bank's 2008-2012 strategy. Accordingly, the Electricity Infrastructure Rehabilitation Project will be prepared and submitted to the Boards of Directors for approval, in accordance with the FSF Window I framework.

⁵ For further information, see *DRC: Exceptional Extension of Interim Period under the Enhanced HIPC Initiative* (Ref. ADB/BD/WP/2009/07-ADF/BD/WP/2009/04).

V. RECOMMENDATION

The Boards of Directors are requested to approve DRC's eligibility for Window I of the FSF as stipulated in the "Operational Framework of the Fragile States Facility". This recommendation is based on the assessment of progress achieved by the country in implementing its public finance stabilization programme, as well as its efforts to stabilize the political and institutional environment, within the context of a fragile State with significantly reduced institutional and administrative capacity, and unmet social needs.

Annex I: Update of First Stage Criteria for DRC – Supplementary Support Window

Criterion	Justification
<p><i>Commitment to strengthen peace and security</i></p>	<ul style="list-style-type: none"> • Political dialogue: the Government put in place on 5 February 2007 following the presidential elections held in October 2006, led by Prime Minister Antoine Gizenga, was reshuffled on 9 October 2008 with the appointment of Mr Adolphe Muzito, former Minister of the Budget in the Gizenga Government, as Prime Minister. The former coalition comprising the President’s party (the People Party for Reconstruction and Democracy - Parti du peuple pour la reconstruction et la démocratie), the Prime Minister’s party (the Unified Lumumba Party - Parti Lumumbiste Unifié) and the Union of Mobutu Democrats (Union des démocrates mobutistes - UDEMO) is still effective because through this appointment, the agreement concluded between these main political parties soon after the elections is still being adhered to. • Peace agreements: peace initiatives have been taken at the national and sub-regional levels such as the AMANI (meaning <i>peace</i> in Swahili) process of January 2008 which led to the signing of the Goma (DRC) Peace Agreements between the rebels of the National Congress for the Defense of the People (Congrès National pour la Défence du Peuple - CNDP) and the DRC Armed Forces (FARDC). However, recurrent tensions led to the resumption of war in 2008. Following an agreement between DRC and Rwanda’s political and security officials in early January 2009, the situation has somewhat stabilized with reduced large-scale fighting. The political context has been marked by the historic meeting between the Heads of State of DRC and Rwanda in Goma (DRC) on 6 August 2009 during which they undertook to guarantee the security of their countries and wipe out armed groups that could jeopardize that security. A dialogue was also initiated between DRC and Uganda with the meeting of the two Heads of State in Kasindi (DRC) on 4 March 2009 to restore peace in the border area between the two countries. Although the situation remains fragile, DRC is today in peace with its nine neighbours.
<p><i>Unmet social and economic needs</i></p>	<p>Most social and economic needs are yet to be met in DRC. Indeed, the socioeconomic situation is characterized by:</p> <ul style="list-style-type: none"> (i) Very low per capita income: since independence, DRC has suffered a series of economic crises which worsened during the armed conflict years. Per capita GDP fell from USD 380 in 1960 to USD 80 in 2000 and approximately USD 150 in 2008. (ii) Very weak human development and delay in attaining most MDGs despite the country’s huge natural resources: the majority of the population still lack access to basic social services due to the degradation of basic economic infrastructure and macroeconomic instability following many years of conflict. More than 71% of the population live below the poverty line. In general, DRC may not achieve most of the Millennium Development Goals (MDGs) by 2015 without a vigorous and sustained economic growth. Social indicators are very inadequate: in 2008, life expectancy at birth was 47.7 years; the infant mortality rate (per 1 000) was 115.3 compared to the African average of 83.9; and access to health services (in % of the population) was 17.6% compared to the African average of 38%. The Human Development Index dropped by more than 10% during the last decade to the extent that, according to the United Nations Development Programme (UNDP) <i>Human Development Report 2009</i>, DRC was ranked 176th out of 182 countries.

Annex II: Indicative Programming by Source of Financing**(UA million)**

Operation	Year	ADF 11 – Performance- based allocation	FSF	Total
Programme to Mitigate the Impacts of the Financial Crisis	2009	65		65
Central Administration Human Resources Development Project	2010	20		20
Decentralization Support Project	2010	10		10
Electricity Infrastructure Rehabilitation and Extension	2010	8.84	60 (Supplementary Support Window I)	68.84
Inga Site Development Study (multinational operation) *	2008	4		4
Rural and Semi-urban DWSS	2010	69		69
Study on the Rail/Road Bridge between DRC and Congo (multinational operation) *	2008	1		1
NELSAP Interconnection Project (multinational operation) *	2008	9.22		9.22
TOTAL		187.06	60	247.06

* The amounts included in the table for multinational operations represent the country's contribution from its performance-based allocation.

ANNEX III: Sino-Congolese Cooperation Agreement

In April 2008, DRC authorities signed a cooperation agreement with a Chinese consortium to finance an important investment programme in the mining and infrastructure sectors. The agreement includes a mining component totalling USD 3.2 billion and a public infrastructure component for USD 6 billion, to be implemented in two phases of USD 3 billion each over the period 2009-2017.

The agreement provides for the setting up of a joint venture, SICOMINES, between the State mining company, GECAMINES, and a group of Chinese companies. According to the terms of the agreement, DRC would receive basic infrastructure (roads, ports, airports, schools, hospitals, etc.) and in exchange cede rights to SICOMINES for the exploitation of mineral resources. The net operating profits of the joint venture would be distributed at a rate of 32% for GECAMINES and 68% for the Chinese consortium.

According to the terms of the initial cooperation agreement, the Congolese State guaranteed loans for the mining and public infrastructure components, or made a commitment to service the debt from public revenue allocated for that purpose. IMF and World Bank staff estimated the concessionality element of the loan arrangement under the cooperation agreement to be approximately 15%.

While acknowledging the potential importance of investments in public infrastructure projects for the country's growth and poverty reduction, the IMF and the World Bank were of the view that the loan arrangement under the cooperation agreement had a negative impact on debt sustainability and jeopardized the country's chances of obtaining debt relief under the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative, the Multilateral Debt Relief Initiative (MDRI), and development assistance from other donors. The terms of the cooperation agreement also raised doubts about the preferred creditor status enjoyed in principle by international financial institutions.

The State's guarantee for mining component loans was withdrawn from the agreement amended on 24 October 2009. The second phase of the public infrastructure component worth USD 3 billion, which would be implemented during the period 2014-2017, was also withdrawn from the amended cooperation agreement. The investment of USD 3.2 billion in the mining project was to be financed by an interest-free loan amounting to USD 1.1 billion as well as a USD 2.1 billion loan at an interest rate of 6.1%. The investment of USD 3 billion in public infrastructure would be financed by a series of loans for individual projects on the basis of a 4.4% interest rate.

The operating profits which would be generated from 2013 will be used to repay loans to mining and public infrastructure projects.

The concessionality element of infrastructure financing guaranteed by the State is now estimated to be between 42% and 46% (depending on whether the USD 250 million signature bonus to be paid by the Chinese consortium is considered or not).

Annex IV: Statement at the Conclusion of an IMF Staff Visit to the Democratic Republic of Congo

Press Release No. 09/399
11 November 2009

An International Monetary Fund (IMF) mission led by Mr Brian Ames visited the Democratic Republic of Congo between 27 October and 10 November 2009 to review recent economic developments and their impact on the authorities' economic programme, including the draft 2010 budget presently being considered by Parliament. The mission met with the President of the Senate, Léon Kengo; the Prime Minister, Adolphe Muzito; the Minister of Finance, Athanase Matenda; the Minister of Budget, Michel Lokola; the Central Bank Governor, Jean-Claude Masangu and other senior government officials. The mission also participated in outreach activities with the Economic and Financial Committees (ECOFIN) of the National Assembly and the Senate on the 2010 budget.

The mission discussed how the recent acceleration in inflation and depreciation of the exchange rate beginning in late August affected the Government's economic programme for 2009 and the macroeconomic and revenue assumptions underpinning the draft 2010 budget submitted to Parliament in September. It reached understanding with the Government on a revised framework that was consistent with its objectives of high growth, low inflation, increased foreign exchange reserves, and poverty reduction.

Mr Brian Ames issued the following statement in Kinshasa:

"The main objective of the mission was to discuss how recent economic developments affected the Government's economic programme for 2009 and the draft 2010 budget presently before Parliament. Economic growth is projected to be 2.7 percent in 2009 owing to the effects of the global financial crisis on the domestic economy. After declining during May-August, inflation picked up in September-October in response to the increase in money supply and the depreciation of the Congolese franc, which depreciated by 35 percent against the U.S. dollar between December 2008 and September 2009. Gross international reserves rose from a historic low of USD 25 million in February to USD 894 million at end-September (10 weeks of non aid import cover) following the disbursement of emergency assistance from the IMF and other development partners, the disbursement of the first tranche of the signature bonus under the Sino-Congolese Cooperation Agreement, and the recent general and special allocations of special drawing rights (SDRs) from the IMF to member countries.

Against this backdrop, the authorities implemented their 2009 economic programme satisfactorily through end-September, with government revenues and expenditure in line with projections. However, lack of timely coordination between the Treasury and the Central Bank impeded liquidity management, resulting in excess liquidity in the economy. The mission welcomes the recent tightening of monetary policy, which should help moderate inflation, and the efforts being undertaken to improve coordination in liquidity forecasting through weekly, rather than monthly, coordination meetings.

With regard to the draft 2010 budget, while these recent developments will have an impact on the nominal value of projected revenues and proposed expenditure credits, they would not have an impact in real terms if the composition of spending remains the same. The authorities indicated that while they were open to revising the macroeconomic framework underpinning the budget, their economic and social priorities and policies for 2010 would remain the same. The mission's discussions with the two ECOFINs took place in the context of a technical workshop, focusing on changes in key macroeconomic assumptions and their likely impact on revenues, expenditure, and financing of the 2010 budget. The mission appreciated the exchange, particularly its focus on assessing the risks and uncertainties going forward.

The mission congratulated the authorities on the recent revisions to the Sino-Congolese Cooperation Agreement that made it consistent with debt sustainability. Although the government-guaranteed infrastructure financing would significantly increase the country's external debt burden indicators over the medium term, the IMF and World Bank staff did not believe it would have a major impact on debt sustainability over the long term. Nevertheless, in the absence of debt relief, the country's debt indicators would continue to indicate a high level of debt distress. On this basis, IMF staff expect to request financing assurances from Paris Club creditors regarding the rescheduling of the DRC's official debt. If all goes well, IMF Board consideration of the authorities' request for a new three-year arrangement under the Poverty Reduction and Growth Facility could follow shortly thereafter.

The mission would like to thank the authorities for their warm hospitality and excellent cooperation during the visit."

Annex V: Development Indicators

Congo (DRC) - Development Indicators				
Social indicators	Congo (DRC)		Africa	Developing Countries
	1990	2008 *		
Area (000 Km ²)	2 345		30 323	80 976
Total population (million)	37.0	64.3	985.7	5 523.4
Population growth (annual %)	3.7	2.7	2.3	1.4
Life expectancy at birth, total (years)	47.8	47.7	54.5	65.7
Infant mortality rate (per 1 000)	114.4	115.3	83.9	53.1
Physicians (per 100 000 people)	6.9	10.2	39.6	78.0
Births attended by trained health personnel (%)	...	74.0	55.0	39.0
Child immunization against measles (% children aged 12-23 months)	37.0	79.0	83.0	76.0
Gross enrolment ratio in primary school (%)	70.0	105.9	75.9	106.0
Ratio of girls/boys in primary school (%)	61.9	92.5	68.0	100.0
Illiteracy rate (% of population >15 years)	...	...	38.0	26.6
Access to safe water (% of population)	43.0	48.2	68.0	62.0
Access to health services (% of population)	15.0	17.6	38.0	33.0
Human Development Index (Rank among 179 countries)	...	...	...	...
Human Poverty Index (HPI-1) (% of population)	...	39.3	3.3	...
Congo (DRC)				
Macroeconomic indicators	2000	2007	2008	2009**
GNI, Atlas method (current USD)	80	140	150	...
GDP (current USD million)	4 335	10 423	12 644	11 855
Real GDP growth (annual %)	-6.2	6.3	6.1	2.7
Real GDP growth per capita (annual %)	-8.5	3.4	3.2	0.0
Gross domestic investment (% of GDP)	3.4	18.2	17.7	16.2
Inflation (annual %)	550.0	16.7	27.6	24.3
Budget balance (% of GDP)	-6.0	-0.3	-5.8	-9.0
Trade, External Debt & Financial Flows	2000	2007	2008	2009**
Change in volume of exports (%)	-6.1	75.0	-3.9	-21.3
Change in volume of imports (%)	38.8	69.0	15.8	-10.4
Change in terms of trade	-4.6	1.1	45.1	-1.9
Trade balance (USD million)	242.4	207.8	1189.2	374.9
Trade balance (% of GDP)	5.6	2.0	9.4	3.2
Current account balance (USD million)	-172.7	-191.1	32.9	-884.7
Current account balance (% of GDP)	-4.0	-1.8	0.3	-7.5
Debt servicing (% of exports)	83.6	9.6	8.4	16.1
Total external debt (% of GDP)	290.9	101.0	106.6	116.6
Total net financial flows (USD million)	191.8	1143.8	...	...
Net official development assistance (USD million)	177.1	1216.5	...	...
Net direct investments (USD million)	23.4	720.0	...	...
International reserves (import months)	...	0.3	0.1	0.2
Private sector and infrastructure development	2000	2006	2007	2008
Time required to start a business	...	155	155	155
Investor Protection Index (0-10)	...	3.3	3.3	3.3
Fixed telephone subscribers (per 1 000 people)	0.2	0.2	0.1	0.6
Internet users (per 1 000 people)	0.3	72.6	105.4	144.2
Tarred roads (% of total roads)	...	...	...	...
Railway, Goods transported (million tonnes/km)	513.0	...	...	...

Source: Department of Statistics - ADB, from national and international sources.

* Most recent year.

** forecast

Last update: October 2009

Annex VI: Table of Ongoing Public Sector Operations (in UA million, 15 January 2010)

#	PROJECTS BY SECTOR	ADF Window	Approval Date	Signature Date	Effectiveness Date	Closure Date	Approved Amount	Disbursed Amount	Disbur. Rate (%)
1	Agricultural Sector Rehabilitation Support Project in Bas-Congo and Bandundu Provinces (PARSAR)	LOAN GRANT	19/05/2004	25/05/2004	04/02/2005	31/03/2011	18.00 7.00	5.615 2.699	31.20 38.56
2	Agricultural and Rural Sector Rehabilitation Project in Katanga, Kasai Oriental, and Kasai Occidental Provinces (PRESAR)	GRANT	12/12/2005	02/02/2006	02/02/2006	31/01/2013	35.00	16.313	46.61
3	Agricultural Sector Study (ESA)	GRANT	28/06/2006	11/10/2006	11/10/2006	31/12/2009	1.85	0.562	30.36
SUBTOTAL AGRICULTURE SECTOR							61.85	25.19	40.73
4	Nsele-Lufimi and Kwango-Kenge Roads Rehabilitation Project	GRANT	19/12/2005	29/12/2005	29/12/2005	31/01/2010	52.45	13.348	25.45
5	Inga Hydroelectric Power Plants and Kinshasa Network Rehabilitation and Reinforcement Project (PMEDE)	GRANT	18/12/2007	10/04/2008	10/04/2008	31/12/2014	35.70	0	0
6	Semi-urban Drinking Water Supply and Sanitation Project (PEASU)	GRANT	06/06/2007	09/08/2007	09/08/2007	31/07/2012	70.00	2.146	3.07
SUBTOTAL INFRASTRUCTURE SECTOR							158.150	15.49	11.8
7	Health I. Orientale Province Health Development Master Plan Support Project (PAPDDS)	LOAN GRANT	17/03/2004	25/05/2004	16/03/2005	30/09/2010	20.00 5.00	1.673 0.845	8.36 16.89
8	Education Sector Support Project (PASE)	GRANT	17/03/2004	25/05/2004	25/05/2004	31/12/2009	5.23	4.558	87.16
9	Post-conflict Socio-economic Reintegration Support Project (PARSEC)	GRANT	24/07/2007	09/08/2007	09/08/2007	31/12/2009	15.00	0.394	2.63
SUBTOTAL SOCIAL SECTOR							45.23	7.470	16.51
10	Multi-sector Socio-Economic Rehabilitation Project (PMURIS)	LOAN	20/12/2002	04/06/2003	03/02/2004	31/12/2009	27.00	18.102	67.04
11	Programme to Mitigate the Impact of the Financial Crisis	GRANT	06/05/2009	13/05/2009	23/07/2009	31/07/2010	65.00	65.000	100.00
SUBTOTAL MULTISECTOR							92.00	83.102	90.33
GRAND TOTAL							357.230	131.255	36.74