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**Report No. P7531**

**REPORT AND RECOMMENDATION  
OF THE  
PRESIDENT OF THE  
INTERNATIONAL DEVELOPMENT ASSOCIATION  
TO THE EXECUTIVE DIRECTORS  
ON A  
PROPOSED CREDIT  
OF SDR 360.4 MILLION (US\$450 MILLION EQUIVALENT)  
TO  
THE DEMOCRATIC REPUBLIC OF CONGO  
FOR AN  
ECONOMIC RECOVERY CREDIT**

**May 17, 2002**

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## CURRENCY EQUIVALENT

|                      |   |                      |
|----------------------|---|----------------------|
| Currency Unit        | = | Congolese Franc (FC) |
| US\$1 (Average 2000) | = | CF 50                |
| US\$1 (May 3, 2002)  | = | 320                  |

## WEIGHTS AND MEASURES

Metric System

## GOVERNMENT FISCAL YEAR

January 1 – December 31

## ABBREVIATIONS AND ACRONYMS

|       |                                                                 |
|-------|-----------------------------------------------------------------|
| ADF   | African Development Fund                                        |
| AfDB  | African Development Bank                                        |
| AIDS  | Acquired immune deficiency syndrome                             |
| BIS   | Bank for International Settlements                              |
| DDR   | Demobilization, disarmament and reintegration                   |
| DSA   | Debt sustainability analysis                                    |
| ERC   | Economic Recovery Credit                                        |
| EERP  | Emergency Early Recovery Project                                |
| EMRRP | Emergency Multisector Rehabilitation and Reconstruction Program |
| EU    | European Union                                                  |
| FY    | Fiscal year                                                     |
| GDP   | Gross domestic product                                          |
| HIPC  | Highly indebted poor countries                                  |
| HIV   | Human immunodeficiency virus                                    |
| IBRD  | International Bank for Reconstruction and Development           |
| IDA   | International Development Agency                                |
| IDF   | Institutional Development Fund                                  |
| IMF   | International Monetary Fund                                     |
| MDRP  | Multi-country Demobilization and Reintegration Program          |
| MONUC | United Nations Observer Mission in Congo                        |
| PER   | Public expenditure review                                       |
| PRGF  | Poverty Reduction and Growth Facility (IMF)                     |
| PRSP  | Poverty Reduction Strategy Paper                                |
| SDR   | Special Drawing Rights                                          |
| SMP   | Staff Monitored Program (IMF)                                   |
| TSS   | Transitional Support Strategy                                   |
| UNDP  | United Nations Development Program                              |

|                   |   |                                |
|-------------------|---|--------------------------------|
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| Country Director  | : | Emmanuel Mbi                   |
| Sector Manager    | : | Cadman Atta Mills              |
| Task Team Leaders | : | Brendan Horton, Eric R. Nelson |

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**DEMOCRATIC REPUBLIC OF CONGO**  
**ECONOMIC RECOVERY CREDIT**

**TABLE OF CONTENTS**

|                                                                                            |    |
|--------------------------------------------------------------------------------------------|----|
| REPORT AND RECOMMENDATION OF THE PRESIDENT.....                                            | 1  |
| OF THE INTERNATIONAL DEVELOPMENT ASSOCIATION.....                                          | 1  |
| I. INTRODUCTION .....                                                                      | 1  |
| II. COUNTRY BACKGROUND AND RECENT DEVELOPMENTS .....                                       | 1  |
| A. Progress towards peace .....                                                            | 3  |
| B. Economic Reforms .....                                                                  | 4  |
| C. Social Situation.....                                                                   | 6  |
| D. Economic Situation and Prospects .....                                                  | 7  |
| III. EXTERNAL DEBT .....                                                                   | 8  |
| A. Normalization of Relations, Arrears Clearance and Debt Service .....                    | 8  |
| B. The Enhanced HIPC Initiative.....                                                       | 10 |
| IV. DONOR SUPPORT AND FRAMEWORK FOR WORLD BANK ASSISTANCE.....                             | 11 |
| A. Donor Support.....                                                                      | 11 |
| B. IMF Assistance.....                                                                     | 12 |
| C. Framework for World Bank assistance: the Transitional Support Strategy .....            | 13 |
| V. THE PROPOSED CREDIT.....                                                                | 14 |
| A. Objectives and Design.....                                                              | 14 |
| B. Justification for the Proposed Credit.....                                              | 15 |
| C. Features and Content of the Program .....                                               | 16 |
| 1. The Interim PRSP and the Government's Reform Program .....                              | 16 |
| 2. Components of the Program Supported by the Credit .....                                 | 18 |
| 2.1 <i>Improving governance, enabling the private sector and reducing corruption</i> ..... | 18 |
| 2.2 <i>Public enterprise sector reform</i> .....                                           | 22 |
| 2.3 <i>Recovery of the Financial Sector</i> .....                                          | 24 |
| 2.4 <i>Natural Resource Sector</i> .....                                                   | 25 |
| 3. Looking Forward: The Immediate Agenda for Growth and Poverty Reduction .....            | 30 |
| D. Credit Implementation, Monitoring and Disbursement Arrangements .....                   | 30 |
| E. Summary of Conditionalities and Benchmarks .....                                        | 31 |
| F. Environmental Aspects.....                                                              | 32 |
| VI. BENEFITS AND RISKS.....                                                                | 32 |
| A. Benefits.....                                                                           | 32 |
| B. Risks .....                                                                             | 33 |
| VIII. RECOMMENDATION .....                                                                 | 34 |
| ANNEXES .....                                                                              | 35 |
| 1. Timetable of Key processing Events                                                      |    |
| 2. Letter of Development Policy (Government)                                               |    |
| 3. Policy Matrix                                                                           |    |
| 4. Democratic Republic of Congo Social Indicators                                          |    |
| 5. Democratic Republic of Congo at a glance                                                |    |
| 6. Democratic Republic of Congo- Key Economic Indicators                                   |    |
| 7. Country Map                                                                             |    |

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emergency repairs in the city of Kisangani for the rehabilitation of social infrastructures (schools and health centers) and rural roads executed by NGOs using labor-intensive methods. In parallel, and in the context of the above operations, the Bank has provided extensive technical assistance to prepare the reform of the investment and mining codes, to prepare reviews of public expenditures and of the parastatal sector, to deepen work on an I-PRSP, and to prepare for national and regional demobilization, disarmament and reintegration (DDR) programs. These steps are essential prerequisites to further development assistance measures. Key instruments underpinning Bank-re-engagement beyond the EERP, ESRP and other small grants are the proposed Credit and an Emergency Multi-sector Rehabilitation and Reconstruction Program to support rehabilitation in key sectors (Text Box 3). The EMRRP provides a framework and institutions within which donors can coherently work together in order to address the country's most urgent, minimum and non-deferrable rehabilitation needs.

**Box 3: Overview of the Emergency Multi-sector Rehabilitation and Reconstruction Program**

The overall purpose of the proposed EMRRP is to initiate the long-term process of reconstruction and economic rehabilitation. Parallel financing for this project is expected from a number of donors. The program comprises four components: (a) rehabilitation and reconstruction of critical infrastructure (transport, water supply, electricity, and urban infrastructure); (b) agriculture, delivery of social services (education, health, social protection) and community development; (c) development of sector strategies for the medium and long terms, and strengthening of human and institutional capacities; and (d) management, monitoring and evaluation of the implementation of the program and the IDA-supported project.

The proposed program will help prevent the further deterioration of health and loss of life of people by increasing food security, delivering health care and other basic services, restoring water and energy supply services, and improving public health conditions in cities. It will also help lay the groundwork for future policy and institutional reforms and a future investment program for the country's development.

## V. THE PROPOSED CREDIT

### A. Objectives and Design

46. **Objectives.** The main objective of the proposed Economic Recovery Credit (ERC) is to help advance the TSS goals of supporting economic stabilization and supporting structural reforms to lay the basis for recovery within the strategy presented in the Government's I-PRSP. More specifically, the ERC builds on the wide-ranging reforms already undertaken and would support the Government's efforts to pursue policy and structural reforms needed to (a) improve governance and reduce corruption with the objectives of fostering private sector development and increasing the supply of public services; (b) improve public sector financial management, especially regarding public expenditures; (c) continue its reform and restructuring of the public enterprise sector, (d) begin the reform of the financial sector, especially the restructuring of commercial banks; (e) support policy actions in the forestry sector in anticipation of implementation of new regulations; and (f) provide support to urgent special actions within the mining sector that support prospects for fostering restructuring of the sector. These reforms will thus help pave the way for a transformation from an inefficient and concentrated state-controlled economy to one that is market-based and better able to deliver services and to

reduce the extraordinary levels of poverty—accentuated by conflict and the particular needs of demobilized ex-combatants—in the DRC.

47. **Design.** The Credit, in an amount of US\$450 million equivalent, will be used as follows. The **first tranche**, in an amount of about US\$410 million, would be made available at effectiveness. Of this, at the request of the Congolese authorities, about US\$330 million would be used to reimburse directly the creditors who had extended a bridge loan used to clear the DRC's arrears to IBRD and IDA; the remainder of the tranche after settlement with the bridge financiers (about US\$80 million) would also be made available at effectiveness and would be deposited into a special deposit account opened in U.S. dollars and held in the name of the Ministry of Finance at the Central Bank of Congo. These resources would be used to finance imports, except those on a negative list, as specified in Schedule 1 of the Credit Agreement. The use of the funds deposited by IDA in the deposit account of the Central Bank will be subject to annual audits by auditors acceptable to IDA.

48. **Two subsequent floating tranches** would aim at buttressing initial, critical and sensitive actions related to the natural resource sector. The **forestry sector tranche**, about US\$15 million equivalent, would be released after implementation of specific actions, acceptable to IDA and pertaining to urgently needed safeguard actions and reforms in the forestry sector as described in paragraphs 90-95. Disbursement of this tranche would be made in U.S. dollars into the Ministry of Finance deposit account in the Central Bank of Congo, and would be subject to that account's use and audit requirements.

49. The **mining sector tranche**, about US\$25 million equivalent, would be released after implementation of specific actions, acceptable to IDA and pertaining to the mining sector and the restructuring of Gécamines, the country's largest mining company, as described in paragraphs 101-104. Disbursement of this tranche would also be made in U.S. dollars into the deposit account opened in the Central Bank of Congo, and would be used to finance imports, except those on a negative list, as specified in Schedule 1 of the Credit Agreement. The authorities intend to use the counterpart funds to finance redundancies at Gécamines in accordance with the plan set forth in paragraphs 101-104. The use of the funds deposited by IDA in the deposit account and the corresponding counterpart funds will be subject to annual audits by auditors acceptable to IDA.

## **B. Justification for the Proposed Credit**

50. The DRC is well endowed with natural resources. However, years of mismanagement and conflict have resulted in a secular decline in per capita income, which is now less than US\$90 per year, or \$ 0.25 per day. Moreover, over 70 percent of the population now lives on less than one dollar per day. Since the early 1990s, the DRC has accumulated arrears on its external debt of some US\$9.5 billion, which is about 75 percent of total outstanding and disbursed debt.

51. As described in Section II, social disruption and civil strife have been a fact of life for many years. Following the civil conflict leading to the overthrow and departure of

public sector banks as non-viable. The identified private sector banks are currently under liquidation. A further four financial institutions have submitted restructuring plans to COREBAC and are operating under a special restructuring regime. The new laws on banking and on credit unions (February 2002) strengthen the legal environment for financial institutions and provide greater independence to the supervisory authority.

83. The new Central Bank (BCC) charter, which assures the independence of the Central Bank as regards the conduct of monetary and exchange policy, was promulgated in May 2002. A financial audit of central bank operations, financed using the resources of the IDA-grant-funded ERRP, was launched in late April 2002 and is expected to be completed by the end of September. A corrective action plan will then be prepared on the basis of this audit, by the end of December 2002.

84. **Looking forward**, the recovery of the financial sector is essential to private sector recovery and growth. The Government intends to place the three public sector banks identified as non-viable into liquidation by September 2002, and to limit government shareholding in banks to under 20 percent. Liquidations and restructuring, however, are only a necessary first step. An overall financial sector strategy under development is to be adopted by end-June 2003. It will encompass legal, regulatory, and accounting reforms, as well as a coherent strategy for other sub-sectors of the financial system, including credit unions, microfinance, insurance, and specialized financial institutions. As a next step in the bank-restructuring program, further audits will help to determine more clearly the status of remaining banks. By September 2002 these audits will permit the authorities to identify any ongoing banks which must be liquidated, and which are to be privatized or restructured, including the conditions under this can be done. The corresponding action plans will be ready by end-December 2002. The greatest constraint to the implementation of this plan are the social liabilities on the balance sheets of banks to be liquidated, and the high costs of restructuring and recapitalizing the surviving banks which may be beyond the means of the current stockholders.

85. One of the most urgent priorities in restoring the health of the financial sector is to re-establish the fungibility of base money so that banks are able to convert free reserves at the Central Bank into banknotes. The inability of banks to provide cash to their customers has resulted in the discounting of checks, hampered regional commerce and exacerbated financial disintermediation. The IMF has made a number of recommendations and offered technical assistance to the BCC to address this issue.

## 2.4 Natural Resource Sector

86. **Context and development objectives.** Congo contains vast mineral and forestry resources. In the past these have been abused, underused, and used to fuel a sad legacy of more than a century of abuses of human rights as well as recent armed conflict in the Great Lakes region. Recovery of the sector must be accompanied by transformation to modern best practices if the Congo is to escape the "curse of natural resources."

87. The DRC has 60 million hectares of natural hardwood forest, which provides a source of revenue and a way of life for the 35 million rural population of the country.

Present production is only 1 percent of the 6-10 million cubic meters sustainable annual harvest. Taxes on export rights were only US\$91,000 in 2001; exploitation rights netted US\$5,381 against a potential of US\$60-360 million if all concessions were attributed in a competitive market. If properly exploited, the sector would produce 60,000 jobs and gross revenues of US\$1 billion, 30 percent of which could flow directly to local communities, improving rural life and encouraging sustainable forestry.

88. The DRC has significant exploitable reserves of copper, cobalt, diamonds and other minerals. Annual production of diamonds (including artisanal alluvial diamonds and the production of the parastatal MIBA) has fallen from 26 million carats in 1988 to 16 million carats today. Production of copper has fallen from 475,000 MT to 25,000 MT. The parastatal firm Gécamines was once the world's first producer of cobalt and a leading producer of copper, as well as the country's first provider of foreign exchange (more than US\$1 billion per year, about three quarters of the total), 40 percent of the government's revenues, and 7 percent of employment. Today Gécamines is bankrupt. In contrast, private investors have been flocking to the DRC despite (or, in some instances documented in the press and by the Security Council, in response to) the current distressed environment<sup>12</sup>.

89. The **objective** of Government policy in the natural resource sector is quickly to rehabilitate and/or develop production in the country in an economically, environmentally and socially sustainable way, and to ensure that development of the natural resource sector contributes to growth, development and poverty reduction rather than to the wealth of a privileged elite. Specific elements of the government's strategy include:

- Improving transparency and good governance in the management of mineral and forest resources;
- Establishing a legal and regulatory framework conducive to responsible private investment, in order to contribute to resumption of growth in the natural resource sector and in industries that utilize natural resources;
- Increasing participation of local communities in forest management and direct access to forest revenues; and
- Addressing the immediate constraints of the largest mining company, Gécamines.

*(a) Forestry*

90. **Current activities.** A new Forestry Code, recently drafted by the Ministry with World Bank assistance and submitted to the Interministerial Committee on Economy and Finance for its approval and formal submission in April 2002, will improve rural life and encourage sustainable forestry. It assimilates international best practices. The Code states that 30 percent of fiscal revenues (estimated to amount to US\$60-360 million) will flow directly to local communities, which will also be given the right to manage directly their own forests. Large-scale logging concessions will be awarded through a transparent

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<sup>12</sup> Indeed, the Government's program, supported by the Bank calls for an evaluation of existing mining claims once a new Mining Code is in place, with a view to annul those that were illegal.

market-based mechanism that discourages speculative holding of property while encouraging private sector investment and operation, and which increases revenues accruing to Government and local communities. Sustainable forest management will become advantageous to local communities under this code. This promotes effective enforcement in practice of the forest management plan that is a mandatory part of the contract. This new code will also rationalize taxation in the forestry sector by reducing the number of taxes (currently exceeding 60) and the number of authorized tax collection agencies (currently 8 in number). The new code is expected to be adopted in June 2002, and its implementing regulations by end-December 2002.

91. The government has scheduled publication in May 2002 in its official gazette a Ministerial Decree (*Arrêté*)<sup>13</sup> establishing a moratorium on the issuance of all new allocations, extensions or renewal of forestry concessions (including new *autorisation de prospection*, *lettre d'intention*, and *garantie d'approvisionnement* or the transformation of one such form into another) until the publication in the official gazette of the implementation decree establishing new rules of adjudication within the context of the new forestry code.

92. By June 2002, the Government intends to conclude a review of concession contracts under the old code in order to eliminate those that have expired or have not complied with the terms and conditions (particularly payment of taxes and installation of capacity) that the old code required. While political opposition to the measures taken is likely, the Government has moved swiftly and boldly: by April 20, 2002, 143 contracts covering 23.4 million hectares (out of 40 million hectares in 263 concessions under review) had been annulled by decree.

93. Immediate steps need to be taken to prevent speculative trading of long-term logging rights on the forest in the period required first for legislative review and approval and then introduction of implementation regulations for the new code to come into effect. The contracts not yet annulled are largely held by speculators in the expectation that the new regulations will greatly increase the value of their holdings. In April 2002 the Ministry of Environment, with the concurrence of the Ministry of Finance, has decreed a 350-fold increase in the annual area fee (tax) on all existing contracts from US\$0.000143 to US\$0.50 per hectare to discourage speculative holding by those not engaged in revenue-generating activity.

94. The Ministry of Environment and Ministry of Finance are undertaking a detailed review of the results of 2001 forest tax collections. This will be completed by June 2002. The recommendations of a planned study of taxation of the sector based upon this review will influence the regulatory texts implementing the code.

95. These reforms, with immediate effects on government revenue and on supporting community dynamics and self-reliance of the poor in forest areas—key elements of the I-PRSP—would be supported by the forest sector floating tranche of ERC. This

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<sup>13</sup> This decree is satisfactory in form and substance to the Association.



US\$15 million tranche would be released upon submission for parliamentary approval of new forestry code satisfactory to IDA.

(b) *Mining*

96. Economic reform of the mining sector is underway. The authorities are pursuing a strategy composed of three elements: (a) revision of the legal and regulatory framework; (b) establishment of key institutional arrangements for the restructuring and privatization of state owned mining enterprises; and (c) addressing the immediate crisis of Gécamines through a study proposing strategies for the company's restructuring, and putting in place voluntary program of separation for redundant, unpaid workers that will effectively begin the restructuring process.

97. **Revision of the legal and regulatory framework.** In 2001, the diamond sector was liberalized. A diamond export monopoly granted a few years earlier was abolished and purchasers and private trading posts may now operate without restriction in mining production zones. Looking forward, as of 2002 the authorities are putting in place the procedures for certification of origin required to adhere to the Kimberley Accord on conflict diamonds; this should significantly enhance revenues from the sale of gem quality stones.

98. A new mining code was submitted into Parliament and is currently under discussion; promulgation is expected in May 2002 notwithstanding substantial opposition to reform on the part of certain national and foreign interests. The government has been pursuing its mining sector reforms in a consultative manner. For the last three years, mining conferences have been held to bring together foreign investors and other stakeholders. The conference held in April 2002 focused on further measures the government can take to attract responsible private investors interested in the long run development of the sector.

99. Following the adoption of new mining code, a new mining cadastre is to be created by Presidential Decree in May 2002. A review of existing mining titles in light of the new code will have been undertaken and a final list of valid titles expected to be published by the end of 2002. New mining regulations (*règlement minier*) based on the new code would be published by end-2002.

100. **The restructuring and privatization of state-owned mining enterprises.** The creation of a level playing field for mining investment in the DRC and the quick rehabilitation of production require the immediate restructuring of state-owned mining enterprises, especially Gécamines. This would entail the sale of a substantial part of their assets, as well as the creation of a social safety net to assist redundant workers, the transfer of social assets to municipalities, and the design of a program to handle environmental activities. To this end, Government is seeking future World Bank technical and financial assistance to reform, for a mining rehabilitation project currently under preparation.