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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 23.6.2003
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Proposal for a

COUNCIL DECISION

on the reallocation to cooperation operations in the Democratic Republic of Congo of payments made by the DRC in respect of special loans and of the proceeds and income from risk capital operations in the DRC under the 2nd, 3rd, 4th, 5th and 6th EDFs

(presented by the Commission)

EXPLANATORY MEMORANDUM

1. The size of the Democratic Republic of Congo's external debt and the international response

External debt is one of the most worrying features of the DRC's economy. As at 31 December 2001, the DRC's debt stock stood at USD 13 279.5 million, equivalent to 1 407.2% of its exports and 226% of GDP. On either scale, the RDC is a severely debt-distressed country.

Moreover, accumulated arrears account for the bulk of the external debt: at 31 December 2001, the DRC had accumulated arrears of USD 10 081.6 million, of which USD 1 932.2 million was owed to multilateral institutions, USD 7 486.4 million was owed to creditors belonging to the Paris Club, including nine EU Member States (Austria, Belgium, France, Germany, Italy, the Netherlands, Spain, Sweden, and the United Kingdom), and USD 663 million was owed to non-Paris Club bilateral creditors and commercial creditors or represented short-term debt.

This extraordinary accumulation of arrears has long represented the major obstacle to renewed involvement by the international financial institutions despite the striking deterioration in socio-economic indicators for the DRC and in its basic infrastructure.

It has taken major efforts by the DRC government and its creditors to overcome this obstacle.

With regard to **multilateral creditors**:

- The **International Monetary Fund** proceeded to wipe off arrears totalling USD 503 million on 12 June 2002 by means of a bridging loan granted by France, Belgium, Sweden and South Africa.

- The **World Bank** proceeded to wipe off arrears of USD 338 million on 3 July 2002 by means of a bridging loan granted by France and Belgium.

- The **African Development Bank** group, facing total arrears of USD 778.5 million, did not have the resources available to provide a bridging loan and had to put together a hybrid repayment/rescheduling scheme with the aid of contributions from other donors. This method had previously been adopted by the World Bank for Bosnia-Herzegovina in 1996. The immediate payment requested from donors in place of the DRC was USD 40 million to wipe off the total arrears to the African Development Fund and USD 76 million for interest payments due to the African Development Bank.

Following the debt discharge of 12 June 2002, the IMF approved a three-year programme worth USD 750 million in the form of a poverty reduction and growth facility. The same day, the World Bank approved an **Economic Recovery Credit** worth USD 450 million to support the Government's work on its economic and structural reform programme.

Following an arrangement with the IMF and World Bank, on 13 September 2002 **Paris Club** creditors reached agreement with the DRC Government on rescheduling the country's external public debt. The agreement covered some USD 8 980 million, of which 16% related to ODA loans. Of the total, arrears on the principal, interest and late-payment interest as at 30 June 2002 accounted for USD 8 490 million, while repayments of the principal and interest due between 1 July 2002 and 30 June 2005 accounted for USD 490 million. The agreement

was concluded on "Naples" terms, i.e. the pre-cutoff-date ODA loans are to be repaid over 40 years, with a grace period of 16 years at a rate of interest at least as advantageous as the concessional rate of the loans; due dates for pre-cutoff-date commercial credits will be treated in such a way as to achieve a 67% reduction, taking into account previous debt treatment arrangements by the Paris Club. The remainder will be rescheduled over 23 years, including a six-year period of grace at market rates of interest. This will result in the immediate cancellation by Paris Club creditors of some USD 4 640 million of the DRC's external debt. These measures will reduce the debt service due to Paris Club creditors between 30 June 2002 and 30 June 2005 from USD 9 090 million to USD 380 million. The remainder represents part of the interest due on the rescheduled amounts and service on the post-cutoff-date debt from 2003.

The settlement of arrears has enabled the international financial institutions to renew assistance to the DRC and has put the country back into consideration for fast-track access to the Heavily Indebted Poor Countries (HIPC) Initiative, which is planned for the end of April. Providing rapid access to the HIPC Initiative is a crucial feature of the international community's strategy to reduce the burden on the DRC's finances and so pave the way for economic recovery and improved social conditions for the DRC population.

2. The Community's response to the debt-relief initiative

At the express request of the Member States, the Commission has already committed itself to participating in international efforts to find a solution to the ADB arrears by contributing a total of EUR 40 million out of the EUR 76 million requested in immediate payments under the scheme proposed by the ADB.

In terms of its debt to the European Community, at 31 December 2002 the DRC had accumulated arrears of EUR 124.2 million, of which EUR 24.3 was owed to the ordinary section and EUR 99.9 million to the special section; these figures are projected to rise to EUR 26.7 million and EUR 109.3 million by 31 December 2003. The breakdown by country and by EDF as at 30 June 2003 is shown in the following table.

Projected DRC arrears as at 30 June 2003 (Special Section)						
Breakdown by Member State (estimate)						
	Yaoundé 1	**Yaoundé 2**	**Lomé 1**	**Lomé 2**	**Lomé 3**	**Total (EUR)**
Germany	2 248 267.24	3 991 965.71	2 357 703.97	20 921 111.26	484 053.96	30 003 102.14
France	2 248 267.24	3 991 965.71	2 357 703.97	18 927 910.83	437 937.07	27 963 784.82
Italy	912 089.46	1 878 642.89	1 090 267.73	8 497 328.14	233 754.67	12 612 082.89
Belgium	629 142.00	1 069 899.76	567 847.78	4 361 062.59	73 544.30	6 701 496.43
Netherlands	601 845.89	1 069 899.76	722 302.37	5 470 061.33	104 855.24	7 968 964.59
Luxembourg	17 975.49	32 494.14	18 171.13	149 864.69	3 467.44	221 972.89
UK			1 699 000.55	13 307 984.81	307 908.25	15 314 893.61
Ireland			54 513.39	442 100.85	10 228.93	506 843.17
Denmark			218 053.55	1 850 828.97	38 592.55	2 107 475.07
Greece				1 004 093.45	23 041.11	1 027 134.56
Spain					123 787.44	123 787.44
Portugal					16 383.63	16 383.63
Total	6 657 587.32	12 034 867.97	9 085 564.44	74 932 346.92	1 857 554.59	104 567 921.24

As in the case of other creditors, the DRC's accumulated arrears to the European Community, whether they be on direct EIB loans, on loans administered by the EIB on behalf of the Commission (loans on risk capital) or on those which the EIB recovers on behalf of the

Commission (special loans), require appropriate treatment and an agreement between the national authorities, the EIB and the Commission, otherwise the country will not have fulfilled the conditions required to reach the 'decision point'.

With regard to loans from its own resources, the EIB has already called on the Member States' guarantees and obtained authorisation from them to suspend recovery of the debt until 31 December 2003. A longer-term solution needs to be devised by then.

With regard to loans from EDF resources, the Commission, which is committed to maintaining the Community's status as preferred multilateral creditor, did not consider it appropriate to suggest simply cancelling or possibly rescheduling the arrears.

Negotiations were therefore begun with the DRC Government, which agreed to use envelope A of its 9th EDF allocation up to the amount of the arrears to the European Community on special loans and risk capital at the date of the decision point. This operation will be funded from the Community's contribution to the HIPC Initiative.

3. Reconstruction requirements and the need to make a success of the transition to democracy

At the Consultative Group's meeting in Paris in December 2002, the World Bank presented an agenda for donors, which provides an initial outline of financing requirements for launching an emergency rehabilitation and reconstruction programme.

This USD 1 741 million programme is confined to the area under government control, i.e. only about a third of the national territory. The objective is to tackle the immediate problems of agriculture and food security, rehabilitation and reconstruction of basic infrastructure, social services and capacity building. The Consultative Group concluded that only 75% of the requirements presented were covered by pledges from the various donors for the period 2002-2005.

However, while careful financial management in 2002 enabled the Government to achieve a small primary surplus, it is highly improbable that this can be maintained when the budget, which has so far been very conservative, has to cover the new needs arising from the extension of Government action to the whole of the country. Moreover, the economy, bled dry and impoverished as it is by years of war, is not capable of providing a tax base sufficient to cover the new needs which will arise over the next few years. World Bank estimates suggest that Government tax revenue will not exceed USD 900 million in 2005. While this is 2.7 times the figure for 2001, it will have to fund a conservative increase in public expenditure to cover new needs over the same period.

Moreover, the estimate takes into account neither the financial implications of thoroughgoing reform of the Congolese civil service nor the social costs of restructuring public enterprises. Initial estimates put the social plan for the civil service alone at a possible USD 160 million.

On the political front, the setting-up of a transitional Government in Kinshasa in accordance with the agreements concluded under the Inter-Congolese Dialogue in Pretoria on 6 March 2003 will lead to the holding of elections throughout the country within a maximum of 36 months under the agreement. The elections will mark the culmination of transition, and should establish the legitimacy of the elected Government and its institutions. This is regarded as crucial to restoring the rule of law and consolidating peace and stability in the country and throughout the Great Lakes region. This principle was reiterated by the Council (General Affairs and External Relations) on 27 January 2003, which publicly committed itself to

assisting the transition to free and transparent elections by the deadlines laid down in the Pretoria Agreement.

A conservative estimate by the United Nations in 1996 put the costs of the electoral process at USD 225 million. No new estimate has been made since then, but the war can only have increased the costs.

4. The Commission's current resources for reconstruction and the transition to democracy

Bilateral cooperation between the Community and the Democratic Republic of Congo was suspended from 1992 to January 2002 when a national indicative programme costing EUR 120 million was signed. That amount combined the existing balances from the 6th and 7th EDFs and a reduced allocation of EUR 25.7 million under the 8th EDF.

In fact, while aid was suspended, the country was never informed of the allocation it was originally expected to receive under the 8th EDF, which was some EUR 180 to 200 million. As a result of the needs arising in other spheres, notably the HIPC initiative, this was gradually reduced to EUR 25.7 million. Over the period of the suspension, the country was denied not only programmable funds but also access to stabex and sysmin funds and the Structural Adjustment Facility.

Its reduced allocation and the lack of performance indicators led to the programmable part of its allocation for the 9th EDF (EUR 171 million in envelope A) being the same as that for the 7th EDF in nominal terms.

To date, 85% of the NIP signed in January 2002 has been committed under the emergency rehabilitation and reconstruction programme. Commitment of the other 15% is planned for the third quarter of 2003.

The agreement reached with the DRC authorities on using EUR 105 million from envelope A of the NIP under the 9th EDF to wipe off the arrears to the Community will dramatically reduce the Commission's ability to tackle the political imperatives for transition; these imperatives, confirmed by the Ministry of Foreign Affairs, include support for holding the elections, demobilisation of the army and reform of the civil service.

There is no way of increasing envelope A under the 9th EDF until after the mid-term review covering all ACP countries, which is scheduled for late 2004/mid-2005. No indicative amounts for the priority operations referred to above can be set before then.

Article 7(1) of the Internal Agreement on the 9th EDF, which governs payments made to the EIB in respect of special loans granted to the ACP States and the proceeds and income from risk capital operations undertaken under previous EDFs, stipulates that such payments are credited to the Member States unless the Council decides, **on a proposal from the Commission**, to place them in reserve or **to allocate them for other purposes**.

It is therefore planned to propose that **arrears paid on** the debt to the Community, rather than accruing to the Member States, be **managed** by the Commission **to finance operations of benefit to the DRC in line with the guidelines adopted by the Council (General Affairs and External Relations)**.

5. Moral hazard

Overall, the moral hazard is slight because of the multilateral context in which the operation is proposed (the HIPC Initiative), and because of the special efforts and practical commitments made by the DRC in order to reach the decision point.

However, there is also little moral hazard because: (1) there is no automatic link between the operation to pay the DRC's arrears from the 9th EDF allocation and the return of the sums paid, and (2) under the internal agreement, this operation can only be undertaken if the Council unanimously decides on a proposal from the Commission that it should.

In addition, the Commission has indicated that the proposed operation to redirect the payments is a one-off, an exception to the normal administration of special loan repayments and income from risk capital operations conducted in ACP States under the EDF.

The exception is justified on the grounds of: (1) the DRC's position as an HIPC that satisfies the conditions set by the multilateral framework for the Initiative and is close to the decision point at which it will qualify for interim debt relief; (2) the country's post-conflict situation and the extent of the destruction caused by the conflict; (3) the reduced allocation of EUR 26 million which the DRC received under the 8th EDF, and (4) the Council's stated desire to support the transition process.

Conclusion

For the reasons given above, the Commission proposes that the Council adopt the attached Decision.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to the Partnership Agreement between the members of the African, Caribbean and Pacific Group of States of the one part, and the European Community and its Member States, of the other part, signed in Cotonou on 23 June 2000,[1]

Having regard to the Internal Agreement of 12 September 2000 between Representatives of the Governments of the Member States, meeting within the Council, on the Financing and Administration of Community Aid under the Financial Protocol to the Partnership Agreement between the African, Caribbean and Pacific States and the European Community and its Member States signed in Cotonou (Benin) on 23 June 2000 and the allocation of financial assistance for the Overseas Countries and Territories to which Part Four of the EC Treaty applies, and in particular Article 7(1) thereof, [2]

Having regard to the proposal from the Commission drafted in agreement with the European Investment Bank,

Whereas:

(1) In its conclusions of 27 January 2003 regarding the Democratic Republic of Congo, the Council (General Affairs and External Relations) stated that it was prepared to assist the transition to free and transparent elections by the deadlines laid down in the Pretoria Agreement and reaffirmed its willingness to support the transition, as soon as its institutions were in place, with projects by the European Union and its Member States designed in particular to promote aid to the population, the strengthening of State structures, the economic reconstruction of the country and disarmament, demobilisation, reintegration, repatriation and resettlement (DDRRR).

(2) The DRC received a reduced allocation of EUR 25.7 million under the 8th EDF.

(3) The funds allocated to the DRC under the 9th EDF are insufficient to enable the Community to cover the cost of the commitments made by the Council in the name of the European Union,

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1 OJ L 317, 15.12.2000, p. 3.
2 OJ L 317, 15.12.2000, p. 355.

HAS ADOPTED THIS DECISION:

Article 1

An additional allocation in the form of a grant equivalent to EUR 105 million shall be allotted to the Commission for the implementation of operations to be conducted in the Democratic Republic of Congo to ensure the country's democratic transition to free and transparent elections, to strengthen State structures, to contribute to the reconstruction of the country and to set up a programme of demobilisation and reintegration of former combatants.

Article 2

The amount of the additional allocation referred to in Article 1 shall constitute a ceiling.

Article 3

The additional allocation referred to in Article 1 shall be financed by the debt service payments relating to risk capital and special loans granted under the Yaoundé I[3] and II[4] Conventions and the First[5], Second[6] and Third[7] Lomé Conventions which are to be made to the European Investment Bank by the Democratic Republic of Congo.

Article 4

The Member States shall authorise the EIB to transfer the sums received from the Democratic Republic of Congo directly to an account opened in the name of the Commission, after deduction of any commission due to the Bank on such operations. Any interest accruing on the amount transferred into the account will be capitalised. At the end of a period of four years from the date on which the account is opened, the account will be closed and the balance returned to the EIB, which will refund it to the Member States.

Article 5

A maximum amount of 5% of the additional allocation, after deduction of any commission due to the Bank on such operations, shall be intended to cover the administrative costs of management of the additional allocation by the Commission.

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3 Convention of Yaoundé I between the European Community and its Member States and the Associated African and Malgache Countries, 1963 (OJ 93, 11.6.1964, p. 1431).

4 Convention of Yaoundé II between the European Community and its Member States and the Associated African and Malgache Countries, 1969 (OJ L 282, 28.12.1970).

5 First Lomé Convention between the European Community and the African, Caribbean and Pacific States (ACP), 1975, (OJ L 25, 30.01.1976).

6 Second Lomé Convention between the European Community and the African, Caribbean and Pacific States (ACP), 1980, (OJ L 347, 22.12.1980).

7 Third Lomé Convention between the European Community and the African, Caribbean and Pacific States (ACP), 1985, (OJ L 86, 31.03.1986).

Article 6

The Commission shall implement the financial resources allocated to the Democratic Republic of Congo under the additional allocation under centralised management in accordance with Article 14 of the Financial Regulation for the 9th EDF.

Article 7

The procedures for deciding on financing from the additional allocation governed by this Decision shall be those set out in Articles 24 to 27 of the Internal Agreement.

Article 8

The Commission shall be authorised to approve the breakdown of the additional allocation according to the types of operation referred to in Article 1 after consulting the EDF Committee, which shall give its opinion in accordance with Article 27 of the Internal Agreement.

The Commission shall be authorised to approve a different breakdown of the allocation without requesting the EDF Committee's opinion in advance if the changes do not exceed 20% of the total additional allocation.

Article 9

This Decision shall enter into force on the day of its publication. It shall apply for the same period as the Internal Agreement between representatives of the Governments of the Member States, meeting within the Council, on the financing and administration of Community aid.

This Decision is addressed to the Member States.

Done at Brussels,

For the Council
The President