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Republic of Congo: Letter of Intent and Technical Memorandum of Understanding

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SUPPLEMENTAL LETTER OF INTENT

Brazzaville, May 27, 2009

The Minister of Economy,
Finance and Budget

To:

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, DC 20431
United States of America

Dear Managing Director:

The Republic of Congo is pursuing a medium-term economic and financial program supported by the IMF under the Poverty Reduction and Growth Facility (PRGF). The program is designed to support balanced growth, low inflation, and fiscal and external sustainability, including through debt relief under the enhanced Initiative for Heavily Indebted Poor Countries (HIPC). This letter supplements the Letter of Intent (and attached Memorandum of Economic and Financial Policies, MEFP) dated November 19, 2008 supporting our PRGF arrangement, which was approved by the Fund's Executive Board on December 8, 2008.

The implementation of our Fund-supported program has proceeded smoothly thus far. Looking ahead, however, we face numerous challenges due to the global financial crisis and the ensuing decline in world oil prices. Indeed, Congo's terms of trade are expected to deteriorate by about 30 percent this year. The decline in world oil prices will lead to a significant drop in the government's oil revenue, with adverse implications for the fiscal position. At the same time, the weakness in global economic activity has reduced demand for some of our key exports, with adverse implications for prospects in the non-oil economy. The difficult environment poses a risk to the smooth implementation of our economic program but we are determined to stay the course, and to take whatever measures are necessary to achieve its broad objectives.

We observed the program's quantitative performance criteria on the non-oil primary fiscal balance through end-December 2008 but breached the zero ceiling on new medium- or long-term non-concessional external debt (Table 1, attached). All of the program's structural performance criteria through end-March 2009 were observed (although three with a delay),

as were the benchmarks (Table 2, attached). Consequently, to complete the first review of the program, we are requesting

- a waiver on the (continuous) zero ceiling on new non-concessional debt, as the Port Authority of Pointe Noire—a state-owned enterprise—contracted a loan from the French Development Agency in March 2009 in an amount of EUR 29 million, as part of a financing package to rehabilitate the Port’s facilities. The government is not providing a guarantee for this loan. Other creditors to this project are expected to include the European Investment Bank (EUR 29 million) and the Central African States Development Bank (EUR 9.1 million). While this loan is on commercial terms (with an estimated grant element of about 11½ percent), the government, its creditors, and development partners (including the World Bank, which has assessed the project and found it viable), believe the project is critical to furthering Congo’s economic development and that it will further strengthen the Port’s profitability, alleviating concerns about its ability to service this external debt. We also request that the program be modified to accommodate the EIB and BDEAC loans, which we expect to be contracted in the period ahead;
- a waiver on the structural performance criterion on the quarterly certification of oil revenue for the third quarter of 2008 by an internationally reputable audit firm, since this measure was observed with a delay, caused by operational difficulties on the part of the international auditor;
- a waiver on the adoption of a new petroleum pricing mechanism, which was not implemented in the envisaged timeframe; and
- a waiver on the adoption of a comprehensive action plan with a timetable to address institutional and procedural deficiencies in the commercialization of Congolese oil. It took additional time and further technical assistance than we envisaged to produce a plan in line with international best practice.

In response to the decline in world oil prices, the 2009 budget envelope—which was passed by Parliament earlier this year—was revised downward, compared with the program that was approved by the Fund’s Executive Board last December. The smaller envelope is to be achieved mainly through lower current spending.

As world oil prices have fallen further since the budget was adopted only a few months ago, we are taking additional actions to consolidate the fiscal position and maintain its consistency with our medium-term objectives under the PRGF arrangement. This further adjustment will come from the projected elimination of fuel subsidies, and savings from using interim-HIPC resources to finance capital expenditures, rather than domestic resources. These adjustments are projected to lower the basic non-oil primary deficit by an additional 3.6 percentage points of non-oil GDP this year.

- In this context, we request that the floor on the quantitative performance criterion on the basic non-oil primary balance be raised at end-June 2009 from a deficit of CFAF 412 billion to a deficit of CFAF 371 billion; and the end-2009 target from a deficit of CFAF 710 billion to a deficit of CFAF 637 billion.
- Over the program period, we will make a concerted effort to ensure steady progress is made toward achieving long-term sustainability. In this context, we will accelerate efforts to mobilize more domestic revenue through reform of the tax system. This reform would aim to eliminate exemptions and loopholes, reduce tax evasion, broaden the tax base, remove nuisance taxes, and ensure that the tax regime contributes to enhancing Congo's international competitiveness. To help with this reform, we have requested technical assistance from the Fund and our development partners. On the expenditure side, we will continue to reduce low priority spending that is not aligned with our Poverty Reduction Strategy; make sure the public investment program is responsive to the evolving fiscal situation; and we expect to generate savings from the reform of the civil service and the unification of the civil service payroll. Taken together, these measures would allow us to sustain the pace of fiscal adjustment needed to ensure long-term sustainability.

We remain optimistic about the medium-term prospects for the Congolese economy and are confident that the fiscal stance, and the allocation of our budgetary resources, provide a strong basis for addressing the current situation. However, if the global financial crisis worsens, we may need to reassess the appropriateness of the fiscal stance, together with Fund staff. This assessment could include analyzing the scope for using some domestic resources, if a fiscal stimulus is needed to support aggregate demand and the achievement of our economic objectives, as elaborated in our Poverty Reduction Strategy and supported under the PRGF arrangement.

We have sufficient domestic resources to finance our ambitious public investment program—which is supportive of economic activity in the non-oil sector—and we will continue to seek foreign financing on highly concessional terms (with a minimum grant element of not less than 50 percent). We will redouble our efforts to strengthen our external debt management and will consult with Fund staff on any external financing issues going forward. We will not contract any new oil-collateralized external debt by or on behalf of the government, which is prohibited under the PRGF arrangement. Finally, in line with our commitments to the Paris Club, we have submitted to the Club a comprehensive report on the current status of our relations with all of our creditors.

We believe that the policies and measures set forth in the November 2008 MEFP continue to be appropriate to achieve the objectives of the program. In line with the Fund's decision to streamline conditionality, we request that the program's structural performance criteria be modified to structural benchmarks. During the implementation of the arrangement, we will consult with Fund staff on the adoption of any measures that may be necessary to achieve the

program objectives, at the initiative of the government, or whenever the Fund staff requests such a consultation.

The government intends to make the contents of this letter and those of the attached Technical Memorandum of Understanding, as well as the staff report accompanying its request for completion of the first review of the program, available to the public and authorizes the Fund to arrange for them to be posted on the Fund's website, subsequent to Executive Board approval of its request.

We can assure you, Managing Director, that the government of the Republic of Congo is determined to fully implement the program supported by the PRGF arrangement, and to move to the completion point under the enhanced HIPC Initiative as soon as possible.

The second review under the PRGF arrangement, based on performance through end-June 2009, is expected to be completed in October/November of this year.

Sincerely yours,

/s/

Pacifique Issoïbeka
Minister of Economy, Finance, and Budget

Attachments (3)

ATTACHMENT I

Table 1. Republic of Congo: Revised Quantitative Targets, 2008-09
(Billions of CFA francs, unless otherwise indicated; cumulative from January)

	End-Dec. 08		End-Mar. 09		End-Jun. 09	End-Sep. 09	End-Dec. 09
	Perf. Criteria	Actual	Indicative Target	Prel.	Perf. Criteria	Indicative Target	Indicative Target
Quantitative targets							
Nonoil primary fiscal balance (floor)	-673	-670	-211	-123	-371	-513	-637
New medium or long-term nonconcessional external debt (including leasing) contracted or guaranteed by the government (ceiling) ^{1, 2, 3}	0	0	0	19	0	0	0
New external debt (including leasing) with an original maturity of less than one year (ceiling) ²	0	0	0	0	0	0	0
New oil-collateralized external debt contracted by or on behalf of the central government (ceiling) ²	0	0	0	0	0	0	0
New nonconcessional external debt with a maturity of more than 1 year contracted or guaranteed by SNPC (ceiling) ²	0	0	0	0	0	0	0
New external arrears on nonreschedulable debt ²	0	0	0	0	0	0	0
New domestic arrears ²	0	0	0	0	0	0	0
Memorandum items							
Oil revenue	2,079	2,118	131	178	300	526	748
Non-oil primary revenue	328	324	93	97	187	279	372

¹ Excluding rescheduling arrangements and disbursements from the IMF; the minimum grant element is set to 50 percent.

² Continuous.

³ The zero ceiling on concessionality does not apply to forthcoming external loans from the European Investment Bank and the Central African States Development Bank, as specified in paragraph 9 of the Technical Memorandum of Understanding.

ATTACHMENT II

Table 2. Structural Benchmarks Under the PRGF Arrangement 2008–09

Measures	Timing	Status
Prepare the 2009 budget consistent with the PRGF program, and using the economic, functional, and administrative classifications.	End-Dec. 2008	Observed
Finalize and adopt the three-year action plan to improve public investment management prepared with assistance from the IMF, World Bank, and the French Cooperation; and publish the plan on the government website.	End-Dec. 2008	Observed
Adopt a new petroleum-pricing regime that will ensure fuel price subsidies are phased out by mid-2011.	End-Mar. 2009	Observed with a delay
Adopt a comprehensive action plan with a timetable to address institutional and procedural deficiencies in the commercialization of Congolese oil, in line with best international practice.	End-Mar. 2009	Observed with a delay
Prepare a medium-term expenditure framework (in consultation with development partners) consistent with the Poverty Reduction Strategy (PRS).	End-June 2009	
Quarterly certification of oil revenue by an internationally reputable audit firm, using the same specifications as for the 2003 certification and with no restrictions on access to information; certification reports to be published on the website of the Ministry of Economy, Finance, and Budget (www.mefb-cg.org). Also, the government will post the audit report on the website, and for each report, a note addressing the comments by the auditors.	Continuous, with a one-quarter lag	Observed with a delay
Repatriation of the oil proceeds (to the Treasury) of oil shipments commercialized by private companies and SNPC on behalf of the government within 45 days after the actual shipment date (according to actual quantities, prices, and shipment dates).	Continuous	Observed
Adoption by the government of the financial sector strategy developed in consultation with Fund staff.	Dec. 2008	Observed
Finalize the strategic study of the oil sector—assisted by Congo's development partners—which will include a critical assessment of the institutions and enterprises, including CORAF.	End-June 2009	In progress
Publication of all invitations to bid and the bids themselves for government procurement contracts above CFAF200 million on the government's website (www.mefb-cg.org).	Continuous	Observed
No recourse to emergency payment and cash advance procedures, except in situations stated in the organic budget law.	Continuous	Observed

ATTACHMENT III

TECHNICAL MEMORANDUM OF UNDERSTANDING

Brazzaville, May 27, 2009

1. This technical memorandum of understanding (TMU) describes the definitions that are intended to clarify the measurement of the quantitative performance criteria and indicators in Table 1 of the supplemental Letter of Intent and the Memorandum of Economic and Financial Policies (MEFP, dated November 19, 2008) covering 2008–11. All quantitative performance criteria and indicators will be evaluated in terms of cumulative flows from December 31, 2008. Also, the TMU specifies the periodicity and deadlines for transmission of data to the staff of the IMF for program monitoring purposes.

I. DEFINITIONS AND COMPUTATION

A. Government

2. Unless otherwise indicated, **government** is defined as the central government of the Republic of Congo and does not include local governments, the central bank, and any public entity with autonomous legal personality (i.e., wholly- or partially-owned state enterprises) not currently covered by the government's consolidated financial operations table (tableau des opérations financières de l'Etat—TOFE).

B. Basic Primary Fiscal Balance

3. The scope of the government's **financial operations table** (TOFE) includes the general budget and the special accounts of the Treasury (including the forestry and road funds) and the government debt management agency (Caisse Congolaise d'Amortissement, CCA).

4. The government's **non-oil basic primary fiscal balance** is defined as total non-oil revenue excluding grants and interest income (on the government's accounts in the central and commercial banks), minus total expenditure (including net credit), which is to exclude transfers to Hydro Congo, interest payments on debt, foreign-financed capital expenditure, and expenditure financed by interim assistance under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative. It is calculated from the budget execution outturn reported every month in the TOFE prepared by the Ministry in charge of finance.

5. The government's **total revenue** is reported in the TOFE on a cash basis. It includes all revenue collected by the Treasury (from tax and customs receipts, oil, services and forestry), whether they result from past, current, or future obligations. Receipts also include those recorded on a gross basis, in special accounts.

6. **Oil revenue** is defined as the government's net proceeds from the sale of oil, including the provision for diversified investments, royalties paid by oil companies, and the government's share of excess and profit oil. It excludes all forms of prepayment and pre-financing. The oil revenue projections take account of the 45 day lag between the date of shipment and the date of receipt of the sale proceeds by the Treasury.

7. **Expenditures** are recorded on a payment order basis. They include current expenditure, domestically-financed capital expenditure, foreign-financed capital expenditure, and net lending. Current expenditures include expenditures on wages, goods and services, common charges, interests on debt (domestic and external), transfers and subsidies, and other current expenditures. Subsidies to the state-owned oil refinery, CORAF, are estimated on the basis of the enterprises income statement.

C. Foreign Debt and External Arrears

8. The definition of **government** used for the various external debt indicators includes government, as defined in paragraph 2, public institutions of an administrative nature (*Etablissements Publics Administratifs*), public institutions of a scientific and/or technical nature, public institutions of a professional nature, public institutions of an industrial and/or commercial nature (*Entreprises Publiques d'Intérêt Commercial*), and local governments, with the sole exception of the national oil company (SNPC)—see paragraph 12 below.

9. For the purposes of this memorandum, **debt and concessional loans** are defined as follows:

- As specified in the guidelines adopted by the Executive Board of the IMF,¹ debt will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts

¹ See Executive Board Decision No. 6230-(79/140) as amended by Decisions Nos. 11096-(95/100) and 12274-(00/85).

where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. The debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement, excluding those payments that cover the operation, repair, or maintenance of the property. Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

- Loan concessionality is assessed on the basis of the commercial interest reference rates (CIRRs) established by the OECD. A loan is said to be on concessional terms if, on the date of conclusion of the contract, the ratio of the net present value of the loan, calculated on the basis of the reference interest rates, to its nominal value is less than 50 percent (i.e., a grant element of at least 50 percent). For debts with a maturity exceeding 15 years, the ten-year reference interest rate published by the OECD is used to calculate the grant element. For shorter maturities, the six-month market reference rate is used.
- The concessionality requirement applies not only to the central government, but also covers debt incurred by public enterprises. The sole exception to this concessionality requirement is the projected external loans to the Port Authority of Pointe Noire to support its rehabilitation from the European Investment Bank in an amount up to euro 29 million, and from the Central African States Development Bank in an amount up to euro 9.1 million.

10. The quantitative indicative target with respect to **external debt** apply not only to debt as defined in the above-mentioned guidelines, but also to commitments incurred or guaranteed for which no value has yet been received or on which only partial drawings have been made. However, this does not apply to financing from the IMF or to Treasury bills and bonds issued by the Congolese Treasury in CFA francs on the CEMAC regional market.

11. For **external debt with an initial maturity of less than one year** (a continuous quantitative performance criterion), normal short-term import and export credit are excluded from the scope of the indicator, including the prepayments.

12. The ceiling on any **new nonconcessional external debt with a maturity of more than one year contracted or guaranteed by the SNPC**, with or without government guarantee, will be observed continuously. The SNPC may borrow only to finance investments related to its core activities (research, exploration, production, refining and

distribution of oil, construction of a Brazzaville headquarters, creation and strengthening of its database, etc.). In addition, these investments must be included in the SNPC's investment budget approved by its board of directors. The ceiling on debt does not apply to changes in loan accounts with oilfield partners or to loans with maturities of less than one year.

13. The accumulation by the government of **external payment arrears** is the difference between (i) the gross amount of external debt service payments due (principal and interest, including penalty and/or late interest, as appropriate) and (ii) the amount actually paid during the period under consideration. Under the program, the government commits itself to not accumulate external payment arrears on non-reschedulable debt (that is, debt to Paris Club creditors contracted after the cutoff date and debt to multilateral creditors). Non-accumulation of external payment arrears is an indicator to be continuously observed.

D. Oil-Collateralized External Debt and Oil Prepayments

14. Oil-collateralized external debt is external debt which is contracted by giving an interest in oil. Pre-financing is defined as an oil-collateralized loan which is repaid by the sale of the oil in a different calendar year. New pre-financing by or on behalf of the government is strictly prohibited under the program. The refinancing and/or deferral of the existing stock and/or due dates are permitted but should not give rise to an augmentation of the existing stock of oil-collateralized debt.

15. A prepayment is defined as an advance payment by the purchaser of oil on a specific oil shipment. Prepayment-related operations must be repaid within 6 months but in any case within the calendar year in which they were contracted.

E. Payment Arrears and Domestic Debt

16. Domestic payment arrears of the government are equivalent to the difference over the period under review between the amount of payments authorized and the actual payments made (within 90 days).

II. INFORMATION FOR PROGRAM MONITORING

17. The government will submit the following information to the staff of the IMF through its Resident Representative, and within the time period specified below.

A. Oil Sector

18. Regarding the oil sector, the government will submit the following information to IMF staff within four weeks after the end of the month:

- the monthly data on oil production by oil field, production costs, volume exported, export prices, and the operations of the national oil company (SNPC);

- the breakdown concerning the share of crude oil that accrues to the government, by oil field, distinguishing the type of resource to which this share relates (royalties, profit oil, etc.);
- any change in the tax parameters;
- a breakdown of oil prices;
- a monthly detailed list of shipments commercialized by SNPC on behalf of the government, including information on the type of product, the date of loading, the recipient, the number of barrels and the selling price (in US dollars and CFAF) as well as the date of receipt of the sale proceeds by the Treasury; and
- actual and projected quarterly data to determine the required subsidies in the fuel sector, including prices, quantities, and costs.

B. Government Finance

19. Regarding government finance, the government will submit the following information to IMF staff:

- A table on government fiscal operations (TOFE) and its annexes. The annexed tables include (i) the breakdown of oil revenue in value terms with the corresponding notes on computation, (ii) excess oil trends and any bonus payments, (iii) the breakdown of tax and non-tax revenue, and central government expenditure, particularly transfers and common charges; and (iv) a report on the amounts of and rationales for emergency payment and cash advance procedures. The provisional TOFE and its annexes will be reported monthly within four weeks from the end of the month, whereas the final TOFE and its annexes will be reported within six weeks from the end of each month.
- Monthly data on the prices and taxation of petroleum products. These data will include: (i) the price structure in effect during the month; (ii) the details of computation of the price structure, (f.o.b. Mediterranean price) at retail prices, including the border impact prices, taxes, transit costs, economic adjustments, ex-refinery prices (for CORAF and imports), entry distribution prices, margins and fees, transport costs and losses, financing expenses, and insurance; (iii) amounts released for sale; and (iv) a breakdown of the tax revenue from oil products—customs duties and value-added tax—and direct/indirect subsidies incurred by the budget. These data will be reported within four weeks from the end of the month.
- The Treasury balance to monitor expenditures. It will include the amount of commitments, payment orders, and payments, for both current and capital

expenditure. It will be produced on a quarterly basis, and submitted to Fund staff no later than four weeks after the end of each quarter.

- Data on implementation of the public investment program, including the breakdown relating to financing sources. If the data on the execution of investments financed with foreign grants and loans are not available on schedule, a linear estimate of execution in comparison with annual forecasts will be used. These data will be reported on a quarterly basis within four weeks from the end of the quarter.
- Complete monthly data on domestic financing of the budget (net bank credit to, and net non-bank credit to the government). These data will be reported monthly within four weeks from the end of the month.
- The table used to monitor the expenditure process will list the amount of commitments, payment orders, and payments, for both operating and capital expenditures. It will be produced on a quarterly basis, and submitted to Fund staff no later than four weeks after the end of the quarter.
- A quarterly table for monitoring poverty reduction expenditures, based on the pro-poor sectors defined in the poverty reduction strategy paper—basic health care and education; infrastructure and rural integration; water and electricity; disarmament, demobilization and reintegration; social protection, and agriculture). The quarterly tables will be submitted within four weeks of the end of the quarter.
- A monthly table of prepayments, which will also indicate the nature of the expenditures (current transfers, investment, etc.) and the justification for the need to use the prepayment option.

C. Monetary Sector

20. The government will submit on a monthly basis, within four weeks of the end of the month, the following preliminary information:

- data on net bank credit to the government;
- the consolidated balance sheet of the monetary institutions, the central bank survey, and the commercial banks survey;
- the integrated monetary survey;
- the table of lending and deposit rates; and
- the usual banking supervision indicators for banks and non-bank financial institutions, where necessary.

21. The final data for the integrated monetary survey will be transmitted within six weeks of the end of the month.

D. Balance of Payments

22. The government will submit the following information to IMF staff:

- any revised balance of payments data (including services, private transfers, official transfers, and transactions for the capital and financial account) as soon as the data are revised; and
- foreign trade statistics (volume and price) prepared by the national statistics agency within three months of the end of the reporting month.

E. Debt

23. The government will submit the following to the staff of the IMF within four weeks of the end of the month:

- data on the stock, accumulation, and payment of domestic arrears;
- data on the stock, accumulation, and payment of external payment arrears;
- a breakdown of estimated domestic and external public debt service, service due, and actual payments, including breakdowns of principal and interest and by creditor;
- the list and amounts of new external debt incurred or guaranteed by the government, including detailed information on the terms and conditions (currency, interest rate, grace period, and maturity) stated in the original agreement; and
- actual disbursements of foreign financial assistance (project and non-project), including new borrowing and any external debt relief granted by foreign creditors (CCA tables).

F. Real Sector

24. The government will submit the following to the staff of the IMF:

- monthly itemized consumer price indices, within four weeks of the end of the month;
- any revision of the national accounts; and

- any other indicators and statistical data used to track overall economic developments, including information on activity in the forestry sector and wood-processing industry, as well as the short-term economic bulletins prepared monthly.

G. Structural Reforms and Other Data

25. The government will submit the following information to the IMF staff:
- a monthly detailed table concerning the implementation of structural measures under the program;
 - any study or official report on the economy of the Republic of Congo, within two weeks of its publication; and
 - any decision, order, law, decree, ordinance, or circular having economic or financial implications for the program, within two weeks from the time it is published, or, at the latest, from its entry into force.