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ANGOLA ECONOMIC UPDATE

Economic developments and issues shaping Angola's future



While the non-oil sector is experiencing robust growth, economic developments in 2013 once again highlight Angolan vulnerability to oil-sector performance. The expansion of the non-oil sector together with tax and export competitiveness reforms will help reduce this vulnerability.

Boosting the non-oil sector requires high quality infrastructure. The Public Investment Management system is instrumental in ensuring a high quality of public infrastructure. The Angolan government has made considerable efforts to enhance the quality of the system but challenges remain.

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II. Preface

The Angola Economic Update analyzes recent economic developments in Angola and situates them in a medium-term global context. It evaluates the implications of macroeconomic trends and policy reforms in terms of the government's stated development objectives. Each edition covers a selected topic and includes a Special Focus Section highlighting a subject area of particular importance. The Angola Economic Update is intended for a wide audience, including policymakers, business leaders, international organizations, and the community of analysts and professionals engaged in Angola's evolving economy.

This Second Edition of the Angola Economic Update was prepared by the World Bank's Poverty Reduction and Economic Management Unit in the Africa Region. The team was led by Elisa Gamberoni (Economist) under the supervision of Julio Revilla (Lead Economist) and Soulemane Coulibaly (Lead Economist). The team consisted of Elisa Gamberoni, Sean Lothrop, Gerard Kambou (Global outlook), and Fernando Britos (Analysis of the Public Investment Management System in Angola).

Gregor Binkert (Country Director), Mark Roland Thomas (Sector Manager), and Olivier Godron (Country Program Coordinator) provided overall guidance. The team would like to acknowledge Marco Hernandez (Senior Economist, World Bank), and the peer reviewers Irene Yackovlev (Senior Economist, IMF), Rodrigo Garcia Verdu (Senior Economist, IMF), Raju Singh (Lead Economist, World Bank) for their inputs and comments to the analysis. Partnership with key Angolan policymakers and with the IMF was instrumental in the production of this report.

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For questions and comments relating to this publication, please contact Elisa Gamberoni at egamberoni@worldbank.org.

III. EXECUTIVE SUMMARY

Angola's economy decelerated in 2013 due to the weak performance of the oil sector but the non-oil economy expanded rapidly. Real GDP grew by 4.4 percent, slightly less than the 5.1 percent growth rate estimated in 2012, reflecting lower oil prices and the weak performance of Angola's major trading partners. Non-oil GDP growth reached 6.3 percent in 2013 thanks to the recovery of the agricultural sector from the 2012 drought and investments in electricity sector.

Lower oil revenue and an increase in expenditures, lead to a fiscal deficit for the first time since 2009. Compared to other oil-rich countries in sub-Saharan Africa (SSA) oil revenue makes up an unusually large share of Angola's total revenues. As a result, the Angolan budget is very sensitive to oil-price shocks. Given current oil-price forecasts, a deficit was anticipated during the budget process. However, the deficit was ultimately smaller than policymakers expected due to an oil price higher than forecasted in the 2013 budget and lower execution of capital expenditures. The 2014 budget (adopted in December 2013) is expansionary relative to 2013, with capital expenditures expected to increase by about 3 percentage points of GDP, to about 13 percent of GDP. If fully implemented, the 2014 budget would imply a fiscal deficit of 4.9 percent.

Similarly, lower oil related export earnings and higher imports narrowed the current account surplus. Although Angola continues to run a significant surplus, the current account remains vulnerable to external shocks. Oil exports dominate foreign-exchange earnings, but in 2013 they began to decline as global oil prices fell. The correlation between the current account and fiscal balances magnifies the effect of fluctuations in global oil prices on economic activity in Angola, further highlighting the need to diversify the economy and decouple public finances from the oil sector.

Enhancing export competitiveness and implementing tax related reforms would reduce the co-movement between the current account and the fiscal account balances. Angola has a high level of export product concentration even by the standards of other major oil exporters. Moreover, these exports reach very few destination markets, suggesting that Angolan firms face obstacles that limit their ability to participate in the global economy. Strengthening the export competitiveness of the non-oil sector (including non-oil extractive industries) will help maintaining a stable current account surplus and reduce Angola's exposure to terms-of-trade volatility. On the fiscal side, non-oil tax revenue as a percentage of non-oil GDP has consistently decreased in recent years highlighting the need to reform the tax system in order to reduce the exposure to fluctuations in oil related revenues.

Expanded agricultural output and lower food import prices helped curb the inflation rate to a single digit. Inflation is projected to remain on a downward path as global agriculture price indexes are projected to decrease and domestic agriculture production to continue its recovery from the 2012 drought. Inflationary risks are mainly associated with the planned fiscal expansion, as public spending would not immediately translate into increased supply capacity. For similar reasons, the recent introduction of a new import-tariff schedule could give a one-time boost to inflation. Finally, the recently adopted Oil Foreign Exchange Law, which compels oil companies operating in the country to pay their suppliers through Angolan bank accounts, could generate additional inflationary pressures as increased liquidity could encourage commercial banks to extend credit to higher-risk projects.

The potential negative effects of the new oil foreign exchange law have been warded-off but caution remains imperative. The 2013 data reveal a slowdown in both credit growth and the share of kwanza-denominated loans has increased in line with the government's de-dollarization efforts. However, the observed

deceleration is likely linked to the broader deceleration of economic growth observed in 2013. Moreover, the share of late credit payments has increased.

While the non-oil economy expands, maintaining the observed level of international reserves will help shield the country from potential oil price fluctuations. After reaching a peak in June, net international reserves declined in the last quarter of 2013. Preliminary data suggest a further decline of reserves in February 2014. The decline in reserves is almost fully explained by the transfer of funds from the former Oil for Infrastructure Fund (OIF) to the new sovereign wealth fund, the Fundo Soberano de Angola (FSDEA). However, differently from the former OIF, the FSDEA's funds will not be allocated towards assets which could provide liquidity in case of sudden balance of payments or financial needs (IMF, 2012).

The outlook for 2014 is favorable in light of an expected increase in oil production. A projected 3 percent increase in oil production will more than offset a 2.4 percent reduction in oil prices, and GDP growth is projected to reach 5.4 percent in 2014 and 5.5 percent in 2015. Absent new discoveries, oil production is unlikely to further accelerate GDP growth. Non-oil GDP would thus need to expand rapidly to bring Angola back to the strong performance observed before the 2009 crisis. Refocusing expenditures on capital investment could positively affect Angola's economic outlook, but only if execution capacity can be increased and the quality of public investment can be ensured.

Enhancing Public Investment Management System

Angola's rate of public investment is still low despite the availability of resources and an infrastructure deficit. Investments in basic transportation and public utilities, especially in rural areas, could boost Angola's underperforming agricultural sector, while modernizing Angola's ports and upgrading key overland trade routes could bolster overall economic competitiveness. Yet Angola public investments averaged about 10 percent of GDP in 2013. This is despite Angola's significant historical public savings, a relatively low public debt burden, and an external environment that offers the government good access to concessional financing.

The quality of a country's public infrastructure is determined by the quality of Public Investment Management (PIM) system. Public investment directly impacts the economy by channeling resources into the production of new public capital and indirectly by increasing the returns to private factors of production. The extent to which investment spending is directed to projects with high economic value and the technical efficiency with which those projects are executed affect permanently the returns to investment spending. The cost of a weak PIM system can be measured not just in terms of resources wasted on poorly selected, inefficiently implemented projects, but also as the opportunity cost of failing to enhance the foundation for more robust and enduring economic growth.

The Angolan government has made considerable efforts to enhance the quality of the system but challenges remain. Policymakers have made a number of laudable achievements in this area: The government strengthened the enforcement of rules for budget administration, public investment accounting and oversight, procurement practices, and investment procedures at the subnational level. Particular efforts were made to systematize the processes by which projects were evaluated and selected for inclusion in the PIP. However, the efficiency of public investments, as measured by the ratio of public investment in next period changes in real non-oil GDP, shows a declining trend. A stronger PIM system would ensure that projects financed with public funds are appropriately selected, efficiently implemented, conscientiously monitored or thoroughly evaluated. Additionally, gaps between the financial resources allocated to PIP projects and their practical implementation schedules should be closed by reducing burdensome administrative procedures, which lead to implementation delays.

Consolidating the responsibilities for the core functions of the PIM system and enhancing the oversight power of the central PIM agency could lead to efficiency gains. The process of formulating and implementing the PIP is scattered across line ministries, provincial and municipal governments, and the executive branch while

the National Directorate for Public Investment (NDPI) at the Ministry of Planning and Territorial Development coordinates the inclusion of the projects in the Public Investment Program (PIP). This process is often unmanageably complex further affecting the ability of the NDPI to effectively oversee the process and enforce compliance with its governing legislation. This complexity is compounded by the additional mechanisms used to revise the PIP and incorporate it into the annual budget.

Adopting uniform standards for project formulation and evaluation would generate several advantages. The absence of common guidelines for assessing a proposed project's initial and recurrent spending requirements or for analyzing its economic and social impacts means that each sector ministry relies on its own studies for technical evaluation and cost-benefit analysis. Encouraging steps in this area include a new appraisal and monitoring system piloted by the NDPI and funded by the African Development Bank. If successful, this system could greatly enhance the consistency, predictability and methodological rigor with which project appraisal and monitoring processes are carried out.

Increasing the availability of project-specific information would strengthen the ability of appraising the economic impact of the proposed projects and the coordination efforts among ministries and other public agencies. Absence of data prevents coordinated planning and makes it difficult to integrate complementary projects within the same investment program. It further creates inefficiencies in both design and implementation, leading to higher costs and less impactful projects. While there is now a functioning computerized system for tracking PIP projects, it is not yet integrated with the accounting and tax systems or the systems of the Court of Auditors.

Fostering skilled human capital is critical for improving the entire PIM system. The government is working to build capacity, with training and technical support from the African Development Bank. These efforts in progress should focus on a broader range of public agencies.

The basic structures for sound PIM are in place but further reforms will be necessary to ensure that public investments are appraised accurately, selected and implemented effectively and evaluated thoroughly. To accomplish this, the government should develop consistent methods for monitoring all elements of the PIP at both the national and regional levels. It should also develop a comprehensive framework for medium-term expenditures to ensure regularity and predictability in the implementation of the PIP, and take further steps to bolster the efficiency and effectiveness of public financial management systems. Moreover, it is essential that policymakers learn from previous reform efforts and strive to consolidate new rules for PIM and PFM in simple, comprehensive frameworks.

A priority objective should be the establishment of a standardized system for project appraisal and a standard set of ex post evaluation that can feed into the PIM system. The government may consider establishing an independent project-appraisal unit at the NDPI to objectively assess proposed investment projects according to a single, standard methodology prior to their inclusion in the PIP. The appraisal should be based on a standard system that account for all project costs, including initial capital expenditures and long-term recurrent expenses. Completed projects must be rigorously evaluated against initial projections in order to gauge the accuracy of project appraisal in general, and the methods used to calculate project cost in particular. An independent evaluation unit at the NDPI would be able to apply a standard set of ex post evaluation criteria to all completed projects and ensure that lessons learned from these projects are incorporated into PIM system.

IV. RECENT ECONOMIC DEVELOPMENTS

Trends in GDP Growth and Production Developments

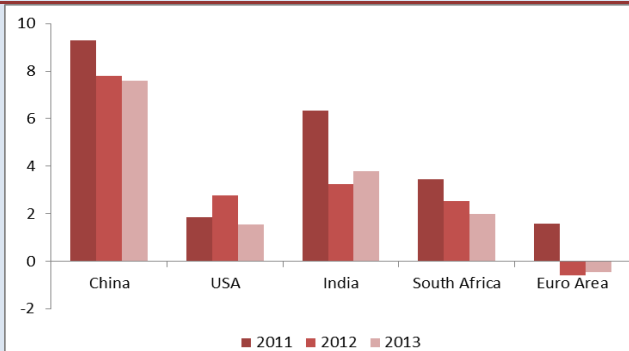
1. Despite a modest deceleration in 2013 Angola's economy appears to be back on track. Real GDP grew by 4.4 percent, slightly less than the 5.1 percent growth rate estimated in 2012 but well above the 2009-2011 average of 3.5 percent. Marginally slower growth in 2013 reflected the stabilization of the oil sector, which accounts for more than 40 percent of Angola's economy. Oil prices rebounded strongly in the wake of the global financial crisis, spiking at an average US\$110.9 per barrel in 2012, but then moderated to US\$107.5 per barrel in 2013 while Angolan oil output in 2013 is estimated to have averaged 1.7 million barrels per day, in line with the performance of the recent years.¹ The observed deceleration can also partially be linked to the weak performance of Angola's major trading partners on their demand for oil exports (Box 1).

Box 1 Recent development on the global economy

Despite signs of pick-up, the global economy grew at the seasonally adjusted annualized rate of 2.4 percent in 2013, similar to 2012, affecting negatively exports growth in Angola. Slowing growth among its major trading partners affected Angola's economy in 2013. China, a major destination for Angola's exports, grew 7.7 percent, similar to 2012 but well below the average 9.6 percent observed during 2009-2011 while weak domestic demand resulted in slowing industrial activity in India. Aggregate euro zone GDP decreased by 0.4 percent, while the United States' economy grew by 1.9 percent in 2013, down from 2.8 percent in the previous year. GDP growth in the Sub-Saharan region strengthened to 4.7 percent in 2013, up from 3.5 percent in 2012, supported by robust domestic demand – notably investment growth. However, in South Africa, a key major trading partner of Angola, structural bottlenecks and tense labor relations combined with low investor confidence and weak external demand kept growth low at 1.9 percent.

Nevertheless, global growth is picking up on account of the recovery in high-income economies. The recovery is strongest in the U.S., despite a recent slowdown due to extremely cold weather, which weighed on household spending, business activity and job creation, with both industrial output and retail sales contracting for the first time in several months in January. However, the underlying impetus remains solid. In the Euro Area GDP growth accelerated to 1.1 percent in Q4, double the pace in Q3, supported by exports. February retail sales and factory orders indicate that consumer and investor confidence has continued to improve. However, growth is well below the rate needed to make a dent in the high unemployment rates, and a continued slide in core inflation is generating concerns about deflation as this could exacerbate debt overhang and weaken demand. In Japan, GDP growth was flat at 1 percent in Q4, mainly due to drags from net exports; but industrial production growth rebounded strongly in January and February, reflecting robust demand. Still, the cyclical recovery could be harder to sustain amid fiscal drags from the VAT hike that took place on April 1 and if progress on structural reforms remains slow.

Figure 1: Growth in Angola major trading partners has not fully recovered yet (real GDP per capita growth)



Source: World Bank, WDI and IMFWEQ database

All the key commodity price indices, with the exception of energy, declined significantly in 2013. Particularly relevant for

¹ Oil price and production forecasts are based on estimates by the IMF and the Angolan government.

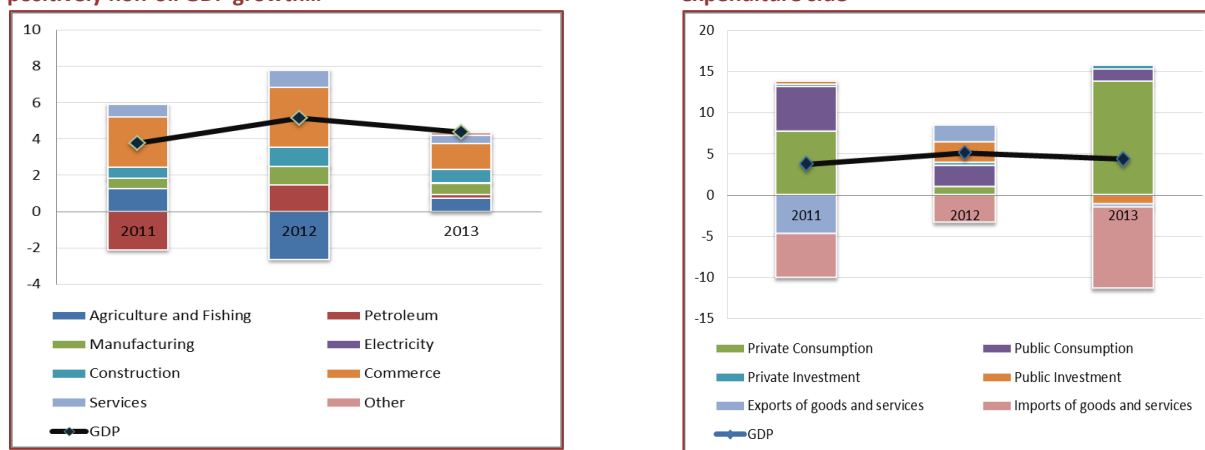
Angola, most agricultural commodity prices continued to weaken: Especially, the grain price index dramatically decreased reflecting the free-fall of maize and rice prices by 36 and 25 percent in just 9 months (from March to December 2013). Given Angola dependence on imported agriculture and food products, the decline in agriculture prices helped curbing Angola' inflation. Crude oil prices instead averaged \$104/barrel (bbl) during 2013, lower than the \$105/bbl average of 2012 also driven by the rapid expansion of unconventional oil production (such as increased Canadian oil from tar sands) which contributed to a build-up of stocks at a time when U.S. oil consumption is moderating and natural gas supplies are increasing rapidly.

Source: World Bank Global Economic Prospect (2014) , IMF WEO database, and World Bank Staff estimates

2. Non-oil GDP growth is accelerating thanks to the expansion of the electricity sector and the recovery of agriculture. Growth in the non-oil economy increased over 2012, reaching 6.3 percent in 2013. Agricultural output rose substantially after a long period of drought, though this appears to be a rebound of the sector that does not reflect an underlying increase in agricultural productivity. Meanwhile, electricity production is estimated to have expanded by 22 percent. This expansion should deliver a permanent boost to economic output. Construction activity also increased, albeit at slower pace than 2012, as public sector investment remained below it 2012 level (Figure 1, left panel).

3. On the expenditure side, consumption drove GDP growth in 2013. Private consumption expanded rapidly (16 percent) in line with the strong performance of the non-oil sector while public consumption grew by 6 percent in real terms. The real investment growth rate decreased by 3.7 percent, in contrast to the average 11.6 percent growth rate observed during 2011-2012 and in line with the observed performance of the oil sector. The observed results are mainly linked to variation in the real growth of public investment: The real growth of public investments increased by 22.6 percent in 2012 and decreased by 8.7 in 2013 (Figure 1) . Despite the substantial increase in total consumption, saving rates still outperformed investment rates, yielding a current account surplus (see the “Balance of Payments” subsection, below).

Figure 1 : The agriculture sector is recovering influencing positively non-oil GDP growth... ... and consumption is driving GDP growth on the expenditure side



Source: Authorities, World Bank, and IMF estimates

4. Medium-term oil production forecast indicates that the economy may have reached a steady-state growth rate. Absent new discoveries, oil production is unlikely to further accelerate GDP growth (see section II). Non-oil GDP would thus need to expand rapidly to bring back Angola on the strong performance observed before the 2009 crisis. Moreover, Angola has demonstrated a high level of dependency on the oil sector to support both capital accumulation and total factor productivity (TFP), which further underscores the importance of economic diversification (see Box 2).

Estimating the long-term productivity of the economy can shed light on its recent evolution and future trajectory. “Growth accounting” measures the contributions of capital, labor and the efficiency with which these two factors are combined to economic growth (TFP). Table 1 summarizes the results of this growth accounting exercise and shows the decomposition of GDP during three different periods: (i) the civil war period (1980-2001); (ii) the immediate postwar period during which oil prices grew rapidly (2002-2008); and (iii) the more recent period of the global financial crisis and the associated drop in oil prices (2009-2011).

Changes in TFP have had a considerable influence on GDP growth in Angola. Between 1980 and 2011 Angola’s GDP grew by an average of 4.6 percent per year. During this period the country’s capital stock grew by 4.2 percent and accounted for 41 percent of GDP growth. Meanwhile, the labor force grew by 3.1 percent and represented 37 percent of GDP growth. The remaining 22 percent of GDP growth is the result of increasing TFP.

Table 1: Total factor productivity (TFP) has been a driving force behind Angola’s economic growth during the past three decades.

(Factors of production, % growth and share of TFP)

	1980-2011		Civil War Period		Peace and Oil Price Boom		Oil Price Bust	
	Growth	Contribution	Growth	Contribution	Growth	Contribution	Growth	Contribution
GDP	4.6%		2%		14%		3%	
Capital	4.2%	41%	5%	133%	1%	5%	6%	95%
Labor	3.1%	37%	3%	103%	3%	12%	4%	65%
TFP	1.0%	22%	-2%	-136%	12%	84%	-2%	-60%

Source: World Bank staff estimates based on data from the WDI and IMF’s World Economic Outlook database.

While it has always been an important factor in Angola, both the impact of changes in TFP and the positive or negative direction of those changes have varied over time. During 1980 and 2001 Angola suffered from the combined impact of a prolonged civil war, volatile oil prices and highly distortive economic policies. Nevertheless, large-scale public investment in infrastructure coupled with private investment in the oil sector boosted the national capital stock by 5 percent, while the labor force grew by 3 percent. However, the damage inflicted by the war and the general deterioration of economic conditions that accompanied it severely undermined the growth of capital and labor, and GDP grew by just 2 percent per year. This reflects the profound impact of negative TFP, as a decline in productive efficiency effectively halved economic growth during the period.

With the advent of peace in 2002 and a sustained boom in global oil prices Angola’s GDP growth rate dramatically increased. Oil prices rose continuously from 2002 until 2008 as the global economy expanded, and Angola’s annual GDP growth rate averaged a remarkable 14 percent. Yet during this period the average annual growth rates of capital and labor were only 1 percent and 3 percent, respectively, and together they accounted for less than one-fifth of GDP growth. Meanwhile, TFP grew at an annual average of 12 percent and represented 84 percent of GDP growth. Changes in Angola’s TFP are closely correlated with oil prices, which in turn might capture higher capacity utilization rate, but they also reflect the impact of peace, improved security and greater political stability, which strengthened economic confidence and encouraged more foreign direct investment (FDI).

GDP growth slowed again during 2009-2011 as the global financial crisis negatively affected oil prices. Large-scale investment, however, continued apace, and Angola’s capital stock grew by 6 percent, its fastest rate of the period. Meanwhile, the growth of the labor force was also strong at 4 percent. But despite the rapid accumulation of capital and labor, GDP grew by only 3 percent, dragged down a full 2 percent by declining TFP. The negative trend in TFP during the period closely followed the drop in oil prices, just as the rapid growth of TFP in the previous period mirrored the rise in oil prices. Angola’s experience over the past decade demonstrates the vulnerability of its economy to changes in oil prices; this indirectly ties Angola’s fate to that of the global economy, as illustrated by the heavy toll of the global financial crisis on international demand for Angola’s chief export.

This exercise reveals the extraordinary importance of TFP to the growth of the Angolan economy. The decomposition of GDP growth from 1980 to 2011 indicates that increases in productive factors have been driven primarily by physical capital accumulation fueled by FDI in the oil sector and by heavy public investment in basic infrastructure. Meanwhile, changes in TFP largely reflect the impact of external shocks, principally volatile oil prices, which can radically enhance or diminish the productivity of capital. This underscores Angola’s urgent need to diversify its economy away from dependence on oil and enhance both its structural resilience to external shocks and its capacity to counter them through remedial policy actions. Finally, the economic importance of TFP highlights the necessity of accelerating progress on structural reforms designed to raise productivity, including measures to strengthen public institutions, improve the business climate and build human capital.

5. An effective economic diversification strategy could raise the long-run growth trajectory of Angola's GDP. Refocusing public expenditures on high-quality infrastructure in the non-oil sector could attract complementary private investment and spur economic growth without destabilizing the government's fiscal stance. As discussed in the previous AEU, investments in basic transportation and public utilities, especially in rural areas, could boost Angola's underperforming agricultural sector, while modernizing Angola's ports² and upgrading key overland trade routes could bolster overall economic competitiveness. Recognizing the country's significant infrastructure deficit the authorities are already allocating additional budgetary resources to support greater public investment with an emphasis on diversification and job creation. The Special Focus Section discusses some of these challenges in the context of the country's public investment management system. However, while increased public investment is essential to diversification, attention should also be devoted to the design and arrangement of Angola's industrial policies. As described in Box 3, below, appropriate reforms to the country's industrial policy framework could enhance growth and speed diversification in the non-oil economy.

Box 3

Out with the Old, Incentivize with the New

Continuously reforming industrial policies to promote growth and diversification

Facilitating growth in the non-oil economy is a key priority of the Angolan government. Angola currently supports the non-oil sector through a number of programs, including *Angola Investe* ("Angola Invests"), which focuses on expanding access to credit among micro, small and medium enterprises, and the more recent *Programa de Aquisição de Produtos Agrícolas* ("Agricultural Products Marketing Program"), which will enable smallholder farmers to consolidate their goods and sell them directly to processors via centralized marketing points, obviating the inefficient current system in which numerous spot transactions are conducted through intermediary traders. Yet despite these efforts, private investment in the non-oil economy has slowed in recent years from a robust growth rate of 10 percent in 2011 to a more modest 7.5 percent in 2013.

The key to effective industrial policy is not only to identify and implement appropriate programs, but also to review and reform existing programs to ensure their continued relevance and consistency with the government's policy objectives. For example, a recent study (Partow, 2012) reviews the current arrangement of industrial policies in Botswana and finds that they are not aligned with the country stated objective of spurring competitiveness. Instead, many are designed to protect uncompetitive industries and prop-up declining sectors; rather than support the development of new economic activities, these policies tend to undermine diversification by skewing the allocation of productive resources toward sectors that are no longer viable, or that never were. It is therefore essential not only to design and advance new programs and policies, but also to regularly review existing ones to ensure that they still accord with the government's objectives and meaningfully advance them.

While the design of specific policies and programs must reflect the unique circumstances of each country, Rodrik (2008) suggests three general principles for maintaining efficient industrial policy frameworks. These include:

- 1) **Strategic collaboration and coordination between the private sector and the government.** This principle has four objectives: (i) to identify the most important bottlenecks to growth and diversification, (ii) to design interventions that will not excessively distort the allocation of productive factors or otherwise undermine their larger goals, (iii) to periodically evaluate the real-world consequences of existing policies, and (iv) to learn from previous mistakes and incorporate these lessons into the design of future policies.
- 2) **Appropriate Incentives:** Fiscal incentives can help to encourage investment, but clear provisions for periodically revisiting and ultimately eliminating these incentives should be established prior to their implementation. Conditionality, "sunset clauses," built-in program reviews, monitoring, benchmarking, and regular evaluation are all vital to ensuring that ineffective or counterproductive policies can be eliminated.
- 3) **Strong Accountability Mechanisms:** Accountability on the part of implementing agencies can be supported by clear

² Recent positive developments in port modernization include the introduction of a new electronic tracking system at the Port of Luanda. The new system, introduced in February 2014, is expected to reduce the time required to clear goods through customs. Additionally, a new port facility is being constructed some 40 km north of the capital at Barra do Dande (EIU, March 7, 2014).

mandates, well-defined responsibilities and periodic reporting on program achievements and policy impacts, both positive and negative.³ Measures to guarantee fiscal transparency and ensure that the government's ongoing dialogue remains open to new entrants are also vital to reinforcing accountability in industrial policy.

Sources: Partow, Zeinab. 2012. Botswana development policy review: an agenda for competitiveness and diversification. Public Expenditure Review. Washington DC: the World Bank;
Rodrik, Dani. 2008. Normalizing Industrial Policy 2008, Growth Commission Working Paper n.3, Washington DC: the World Bank.

6. Angola's sovereign wealth fund-Fundo Soberano de Angola (FSDEA) could present additional opportunities for promoting development in the non-oil sector, but in order to be effective its governing regulations must be strengthened. The SWF was launched in 2012 and remains relatively novel as a policy tool. The fund will finance both domestic and international investment, and its operations will be guided by three overarching objectives: (i) the preservation of capital, (ii) the maximization of returns over the long term, and (iii) the creation of new infrastructure as specified in the investment plan announced in June 2013. Going forward, it will be critical to define the precise circumstances and rules under which the government can draw upon the fund for fiscal stabilization or other approved purposes. It will also be necessary to devise a plan for coordinating the fund's operations with the government's monetary and fiscal policies in order to reinforce its role in maintaining macroeconomic stability. Differently from the former OIF, the FSDEA's funds will not be allocated towards assets which could provide liquidity in case of sudden balance of payments or financial needs (IMF, 2012). This in turn highlights the importance of maintaining high level of reserves for reducing the impact of oil revenue volatility on the economy (see also Box 6).

Fiscal Policy

7. In 2013 Angola experienced an overall fiscal deficit for the first time since the 2009 crisis. Tax revenues diminished as a share of GDP while expenditures slightly increased, resulting in a deficit equal to 0.6 percent of GDP. This was the first such deficit since 2009, when a steep decline in oil revenues dramatically generated a fiscal deficit of 7.3 percent. Even among oil-rich countries in SSA oil revenue makes up an unusually large share of Angola's total revenues (Figure 2). As a result, the Angolan budget is very sensitive to oil-price shocks (Table 2). Given oil-price forecasts at the time, a deficit was anticipated during the budget process.

Figure 2: Angola has the second-highest ratio of oil revenues to total revenues of any country in SSA...
(% of total public revenue, 2012)

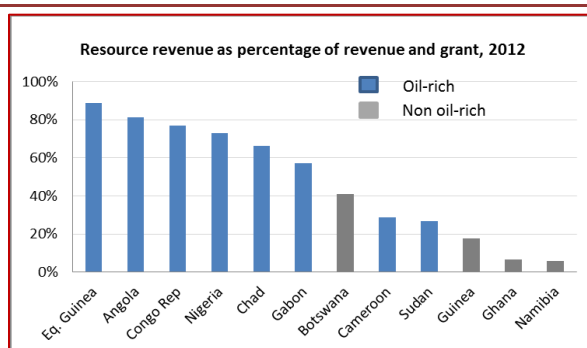


Table 2: ...which means the budget is extremely vulnerable to changes in global oil prices.
(Angola's budget, in US\$ millions and % of GDP)

	2009	2010	2011	2012	2013 ^E
Revenues	2070	3295	4776	5054	4435
Oil	1449	2500	3817	4103	3472
Expenditure	2383	2945	3827	4224	4416
Current	1640	2077	2834	3079	3279
Capital	743	868	993	1144	1137
Overall Balance	-440	261	854	725	-67
% of GDP	-7.3	3.4	8.7	6.6	-0.6
Non oil Overall Balance	-1889	-2240	-2963	-3378	-3539
% Non-oil GDP	-31.5	-29.6	-30.3	-30.8	-30.0

Source: Figure 2: IMF art. IV 2013 and World Bank Staff estimates (Angola). Table 2: Authorities and World Bank Staff estimates.

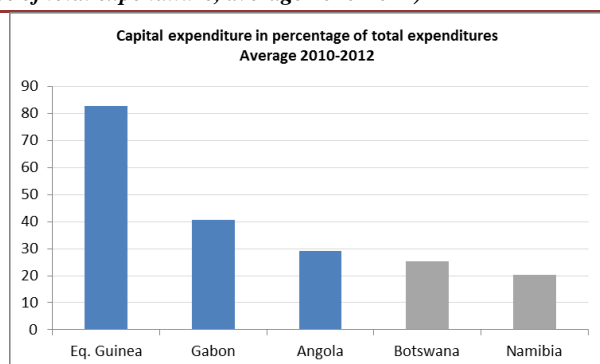
³ Rodrik (2008), for example, suggests following a similar model to that used by a central bank, which sets an inflation target as a metric of sound monetary policy.

8. As was the case in 2009, lower oil revenues are the driving force behind the current fiscal deficit; however, the deficit was ultimately smaller than policymakers expected. Oil production is estimated to have contributed 42 percent of nominal GDP in 2013, down from 46 percent in 2012. Actual oil revenue is estimated to be however higher than budgeted⁴ due to a lower oil price forecast at the budget stage. The 2013 budget anticipated an average price of 96 dollars per barrel, whereas the average price is currently estimated at 107.5 dollars per barrel. Non-oil tax revenue is projected at about 6.7 percent of GDP, roughly the same as in 2012 but lower than the value budgeted in 2013. This likely reflects a delay in the approval of new tax codes. Non-oil tax revenue as a percentage of non-oil GDP has consistently decreased in recent years, dropping from 17 percent in 2008 to 12 percent in 2012. Actual expenditures were lower than budgeted, particularly capital expenditures. As a result the realized fiscal deficit is below the deficit foreseen at budget stage.

9. Current expenditures slightly increased in 2013 and dominate the expenditure side of the budget. Wages and purchase of goods and services are estimated at about 22.8 percent of GDP, rising by about 15 percent in nominal terms. Current expenditures⁵ accounted for 74 percent of total expenditures in 2013, up from 73 percent in 2012. Public investment is estimated to have slightly decreased as a share of GDP. In comparison to other middle-income countries in the region Angola devotes a relatively small share of public expenditures to capital investment (see Figure 3, below, and the Special Focus Section). The ratio of public investments to changes in the next period non-oil GDP has increased in recent years (Figure 4). In other words, one dollar invested by the public sector has had a lower impact on the non-oil economy⁶.

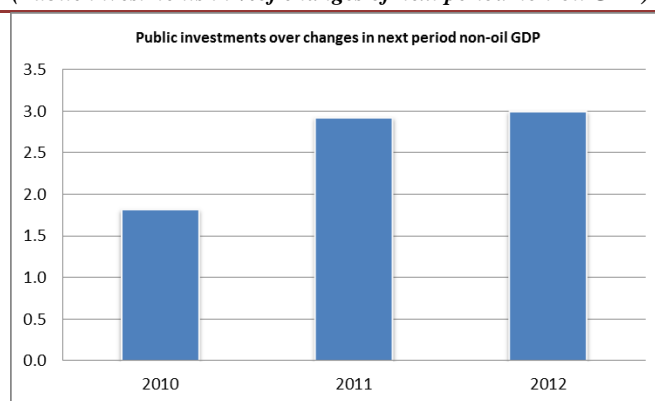
Figure 3: Public investment in Angola is lower than in other oil-rich countries in SSA...

(% of total expenditure, average 2010-2012)



...and public investments are generating a lower level of non-oil GDP.

(Public investments in % of changes of next period non-oil GDP)



Source: IMF art. IV 2013 and World Bank Staff estimates (Angola). Table 2. Authorities and World Bank Staff estimates.

⁴ The 2013 budget estimated oil revenue at 3,281 billion kwanza while we estimate that oil revenues will reach about Kwanza 3,472 billion.

⁵ Excluding interest payment

⁶ The calculation resembles the Incremental Capital Output Ratio (ICOR) indicator, which is defined as the ratio of total investment in next period changes of GDP. As public investments amount to 70 percent of total investments and are mainly directed to the non-oil sector, we use the ratio of public investments to changes in the next period non-oil GDP. Additionally, in Angola the ICOR follows closely movements in the oil prices: it was estimated at 4 in 2010, then fell to 3 in 2011, and reached 3.9 in 2012. The average Angolan ICOR for the period 2009-2011 is estimated at 4, above the average ICOR observed in the same period in Namibia (3.8), similar to the ICOR observed in Gabon (4) and lower than the ICOR registered in Botswana (6). As the ICOR is tied also to the level of development of a country, the Angolan figures are well above the historical values of Botswana (ICOR estimated at 0.9), Chile (2.4), and the Republic of Korea (2.5) when these countries faced the same level of development observed in Angola in 2012 (measured in terms of real GDP per capita).

More Heat than Light

The high cost of energy subsidies and Angola's inefficient electricity sector

Angola devotes a much larger share of its GDP to energy subsidies than do comparable countries, imposing a considerable fiscal burden on the country. In 2012 pre-tax energy subsidies were estimated at 2.5 percent of GDP, well above the median of 0.8 percent for other oil-exporting countries in the region (IMF, 2013). And this does not include the contingent liabilities generated by the state-owned energy company, which were estimated in 2009 at about 1.5 percent of GDP (IMF, 2013). Foregone revenue from fuel taxes is also excluded, and post-tax subsidies in 2012 were estimated at 4 percent of GDP (*ibid.*).

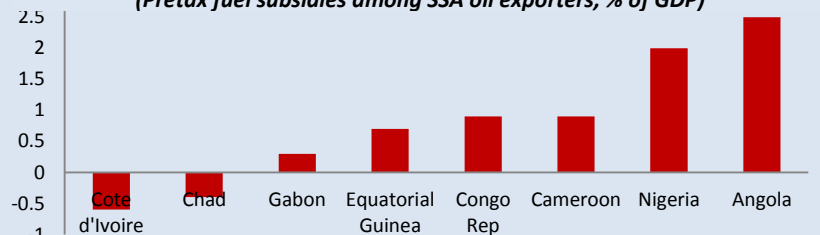
Reducing energy subsidies will require increasing the energy supply. Cross-country analyses show a strong correlation between underpricing and underinvestment in the electricity sector (IMF, 2013). A limited, erratic or otherwise inadequate electricity supply can have a deeply negative impact on economy-wide competitiveness, as electricity is crucial to nearly every activity in a modern economy. Improving energy supply would further increase the public's acceptance of reducing subsidies.

Efficiency is a major issue in Angola's electricity sector.

Energy distribution losses in 2008 (the amount of electricity injected into the distribution network that could not be billed) were estimated slightly below 50 percent of the total energy supply (IMF, 2013). While the government is currently ramping-up investment in an effort to boost generation and expand the electrical grid, public investment in Angola

systematically favors spending on new projects rather than on the maintenance and operations of existing infrastructure (see the Special Focus Section), raising concerns about the long-term sustainability of new capital investment. Nevertheless, constructing new generation and transmission capacity is undeniably important, as insufficient electricity remains among the major constraints cited by Angolan firms in World Bank Enterprise Surveys (Figure 5). Power outages are estimated to cost the average Angolan firm 8.8 percent of its annual revenue.

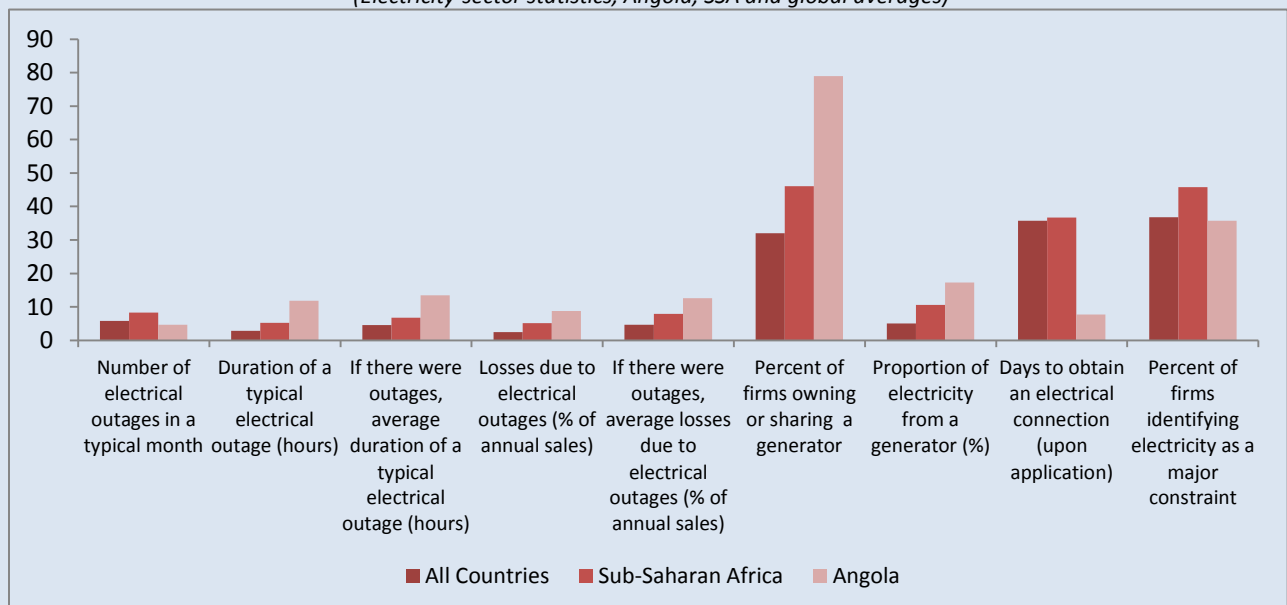
Figure 4: Angola's energy subsidies come at a very high fiscal cost
(Pretax fuel subsidies among SSA oil exporters, % of GDP)



Sources: IMF, 2013

Note. Negative values represent a tax. Pretax data for gasoline, kerosene, and diesel are calculated as the difference between an estimate of cost-recovery price (defined as: the CIF import price plus national "margins and costs") and domestic retail prices.

Figure 5: Angola's electricity sector is highly inefficient
(Electricity-sector statistics, Angola, SSA and global averages)



Source: World Bank 2010 Enterprise Surveys (<http://www.enterprisesurveys.org>)

Expanding the electricity supply will reduce the marginal cost of power, while phasing-out subsidies will still yield a net increase in

electricity tariffs; a targeted subsidy scheme would help ensure that the poor do not bear the brunt of the reforms. The international experience shows that universal energy subsidies are not a pro-poor policy. Poorer households tend to allocate a smaller share of their income to energy products than richer households and are less likely to have access to electrical grids. While this effect varies across countries and energy products (with kerosene subsidies typically being the least regressive), data for Mozambique, Sierra Leone, Zambia, Ghana, Cameroon, and Cote d'Ivoire show that on average the top income quintile receives nearly double the benefits of the bottom quintile. However, while removing subsidies without targeting or compensation mechanisms will have a greater effect on wealthier households, the poor have far less capacity absorb the impact of the price shock. The authorities should begin developing a plan either to phase-out subsidies in a targeted manner that spares the poorest households, or to replace energy subsidies with a more effective pro-poor policy, such as direct cash transfer to low-income households.

Source: IMF Africa Department (2013) *Energy Subsidy Reform in Sub-Saharan Africa Experiences and Lessons*, Washington, D.C.: International Monetary Fund;

World Bank (2012) *Africa's Pulse Vol. 5*, Washington DC: World Bank

The Balance of Payments

10. Although Angola continues to run a significant surplus, the current account remains highly vulnerable to external shocks. Oil exports dominate foreign-exchange earnings, but in 2013 they began to decline as global oil prices fell. Meanwhile, non-oil exports have remained low and largely stagnant, constrained by the limited ability of Angolan producers to access and compete in foreign markets. On the import side increasing demand for both consumer goods and oil-sector-related capital goods outpaced the drop in global food and commodity prices. Strengthening the export competitiveness of the non-oil sector (including non-oil extractive industries) will be vital to maintaining a stable current account surplus and reducing Angola's exposure to terms-of-trade volatility.

11. Declining exports and rising imports have reduced the current account surplus from a high of 12.1 percent of GDP in 2012 to 6.5 percent in 2013. The narrowing of the current account surplus was primarily due to a worsening trade balance. In 2013 real imports of goods and services were estimated to have grown by 10.9 percent, while real export growth contracted by 0.6 percent. In addition, the decline in the current account surplus appears to be the result of lower savings rather than higher investment (Box 5).

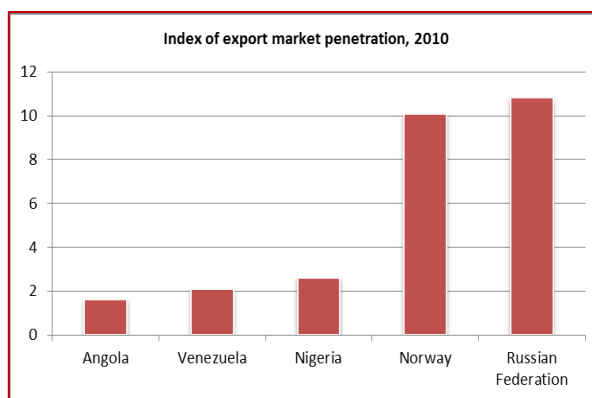
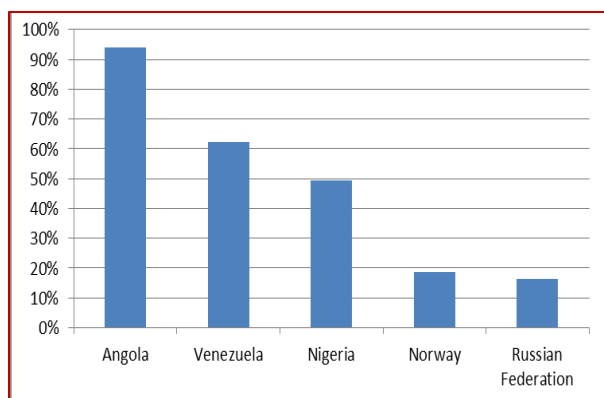
12. The drop in exports was a direct result of falling oil prices. In 2013 oil exports accounted for about 97 percent of total good exports, underscoring the extreme sensitivity of the trade balance to shocks in the global oil market. Meanwhile, exports of goods, services and non-oil commodities remain stable, reflecting also the limited ability of Angolan producers to access foreign markets. Angola has a high export product concentration even by the standards of other major oil exporters. Moreover, these exports reach very few destination markets, suggesting that Angolan firms face obstacles that limit their ability to participate in the global economy (Figure 6).

Figure 6: Export concentration in Angola is high even when compared to other major oil exporters...
(Export-product concentration index, 2012)⁷

...and its exports reach only a small share of the available markets.
(Export-market penetration index, 2010)⁸

⁷ The export product concentration index measures the dispersion of trade value across an exporter's products. A country with a preponderance of trade value concentrated in very few products will have an index value close to 1 (Source: Trade Indicator, WITS database).

⁸ The index of export market penetration measures the extent to which a country's exports reach already proven markets. It is calculated as the number of countries to which the reporter exports a particular product divided by the number of countries that report importing the product that year (Source: Trade Indicator, WITS database).

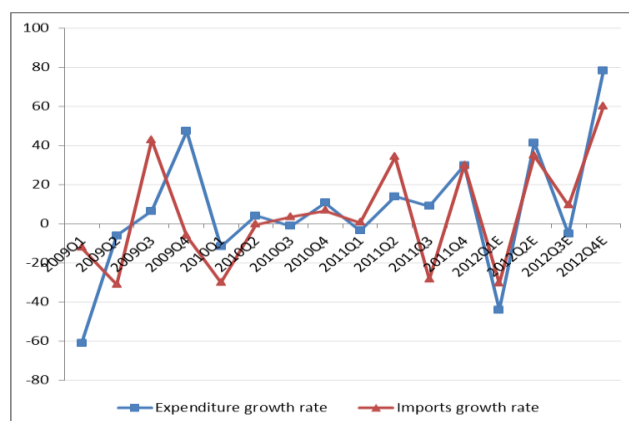


Source: Trade Indicator, WITS database

Note: Mirror data have been used to compute the trade indicators for Angola. Includes exports of oil

13. The growth of good imports appears to closely follow the trend of total public expenditure (Figure 7). This partly reflects the predominance of current expenditures in the budget, particularly wages and procurement. Current expenditures are generally focused on consumer goods (either directly via procurement or indirectly via wages) and consumer goods in 2012 still accounted for more than half of all goods imports. Moreover, due to low agricultural productivity and a small domestic manufacturing sector, strong demand for consumer goods and basic commodities is largely met by increased imports. Agricultural imports have risen from around 13 percent of total imports in 2008 to almost 22 percent in 2012, accelerated by a drought that reduced domestic agricultural output. Estimates for 2013 sketch a similar picture, with nominal import growth of goods (estimated at 3 percent) in line a slight increase in current expenditures.

Figure 7 : Trends in imports mirror trends in fiscal expenditures.
(% growth rates of imports and expenditures, 2009-2012)



Source: INE, BCA, World Bank Staff estimates.

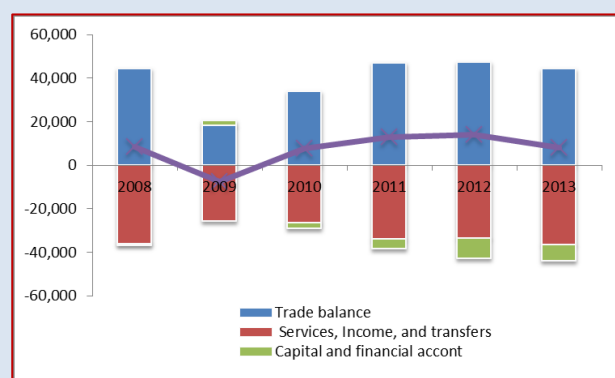
Box 5

The balance of payments and the tradeoff between national savings and public investment

Understanding the structure of the BoP can provide valuable perspective on a country's relationship with the global economy. The BoP is particularly useful for understanding the transmission channels through which shocks in international markets can impact the domestic economy, but it also illustrates the country's aggregate decision regarding the trade-off between current and future consumption. Approaching the BoP from the former perspective highlights Angola's vulnerability to global oil and food markets, while the latter situates

Angola's strong current account surpluses in the context of its low rates of public investment.

Figure 8: The trade balance dominates the balance of payments.
(Decomposition of current and capital accounts, 2008-2013)



(Balance of payments, US\$ billions)				
	2010	2011	2012	2013(e)
Current Account	7.5	13	14	8
Trade Balance	33.9	47.1	47.4	44.3
Services Balance	-17.9	-22.9	-21.3	-25.3
Income Balance	-8.1	-9.7	-10.4	-10.7
Transfers Balance	-0.4	-1.4	-1.8	-0.4
Capital and Financial Account	-2.8	-4.5	-9.3	-7.6
Direct Investments	-4.6	-5.1	-9.6	-6.4
Portfolio Investment	0.1	-1.5	1.8	-3.7
Other investment (including Public External financing)	2.1	1.1	-1.5	2.5
Financing	-4.8	-8.6	-4.5	-0.3

Note: (e) = estimate.

Source: Authorities and World Bank staff estimates.

While Angola's financial markets continue to develop, the trade balance exerts a larger influence on the BoP than the capital account. Cross-border portfolio capital flows remain relatively limited due to the small size of the domestic bond and equity markets. FDI represents the largest share of incoming capital, followed by foreign bank loans and purchases of sovereign debt by foreign investors. But while these inflows of foreign capital are important for spurring domestic economic activity and financing the budget, net capital inflows have totaled just 3.5-8 percent of GDP over the past 4 years, well below the trade surplus, which is generally around 20 percent of GDP (Error! Reference source not found.). FDI is primarily focused on the oil sector, though FDI in the manufacturing and agricultural sectors is currently on the rise (see Section III: Economic Outlook and Risks). Medium and long-term loans from foreign banks to Angolan state-owned enterprises are another major source of capital inflows.

The current account balance can also be viewed as the difference between aggregate savings and investment. This analytical framework not only helps to identify the channels through which external shocks are transmitted to the domestic economy, but it can also shed light on important tradeoffs between current and future consumption. If an economy consumes and invests more than it produces or receives in income and transfers, it finances the difference by borrowing from overseas by running a current account deficit. This deficit is sustainable if borrowing is used to finance investments that boost productivity and generate a sufficient increase in national income to finance the country's debt burden. Angola, however, is one of only a handful of countries in the region that have regularly registered a current account surplus, allowing it to lend more money overseas than it borrows. But whereas other oil-rich developing countries—Gabon and Nigeria, for example—have cut into their current account surpluses to achieve public investment levels of more than 25 percent of GDP, public investment in Angola has remained much lower at around 10 percent of GDP.

Figure 9: Angola has maintained a large current account surplus, with domestic savings generally exceeding domestic investment.
(Savings-investment gap, % of GDP)

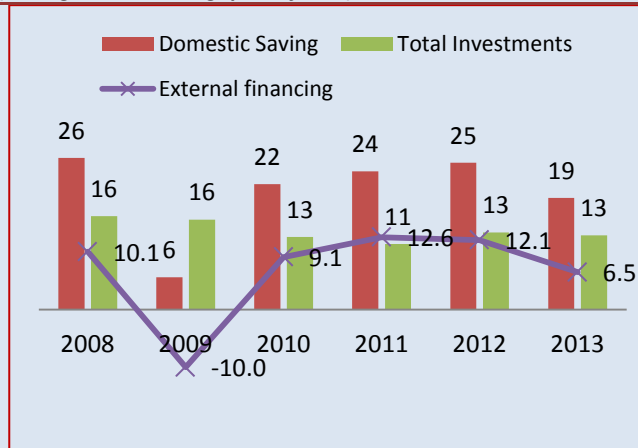
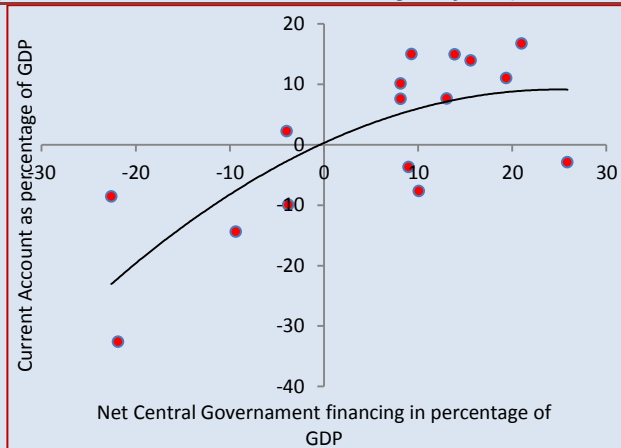


Figure 10: Angola's current account and fiscal balances are highly correlated, as both are closely linked to global oil prices.
(Current account balance and net lending, % of GDP)



Source: World Bank staff estimates.

While a large current account surplus can help to insulate the economy from external shocks, it also represents a missed opportunity to raise Angola's growth trajectory through investment in critical infrastructure. Angola's vast inflows of foreign capital can be used to build the foundation for a more diverse and productive economy. This is particularly true in the public administration, where relatively modest investments in institutional capacity and business-climate reform can attract complementary private investment and unlock the vast growth potential of Angola's non-oil economy. Infrastructure investment is also critical, though it should be accompanied by key structural reforms in public investment management, which are detailed in the Special Focus Section.

Because Angola's investment rate remains low by international standards—even falling further in the wake of the global financial crisis—fluctuations in Angola's current account have been accompanied by dramatic changes in national savings. Angola's savings rate plunged from almost 26 percent of GDP in 2008 to around 6 percent in 2009. Savings have since recovered, but at 19 percent of GDP in 2013 they remain below their pre-crisis levels (Figure 9). This recovery during 2009-2012 was primarily driven by an increase in public savings as the government returned the budget to a surplus. Angola's private savings rate has yet to recover to pre-crisis levels: in 2008 private investments amounted to 16.6 percent of GDP against 10.3 percent in 2013.

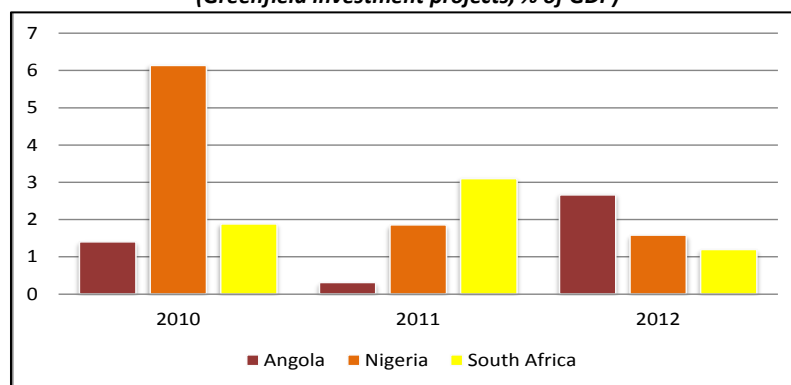
The volatility of public savings highlights another key transmission channel through which fluctuations in global oil prices impact the Angolan economy—the highly procyclical nature of the national budget. With oil revenues accounting for 80 percent of all public revenue Angola's fiscal balance is also driven by fluctuations in global oil prices, which means it is closely linked to the current account balance (Figure 10). The correlation between the current account and fiscal balances⁹ magnifies the effect of fluctuations in global oil prices on economic activity in Angola, further highlighting the need to diversify the economy and decouple public finances from the oil sector.

14. Despite its negative net inward FDI position¹⁰ greenfield investment projects increased rapidly in 2012. FDI trends in Angola are largely influenced by the behavior of oil companies, and the repatriation of oil profits resulted in a net inward FDI position of -9 percent of GDP in 2012. Yet this obscures the fact that greenfield investment was more than four times higher than its 2010-2011 average and comparable to the rates observed in Nigeria and South Africa (

15.

16. Figure 11).

Figure 11: New investment is on the rise in Angola.
(Greenfield investment projects, % of GDP)



Source: UNCTAD World Investment Report, 2013 and World Bank, WDI database

17. By the end of 2013 international reserves had returned to their 2012 levels. After reaching a peak in June, net international reserves declined in July and again in December. This was due to an accelerated budget execution rate in the second quarter of the fiscal year and its impact on imports. In the

⁹ The correlation coefficient between the government's fiscal balance (cash basis) and the current account over the period 2008-2012 is about 0.8.

¹⁰ A country's inward FDI position is the size of FDI inflows as a share of GDP; it measures the country's relative success in attracting global FDI. If repatriated profits are subtracted from inward FDI, the difference is the *net* inward FDI position.

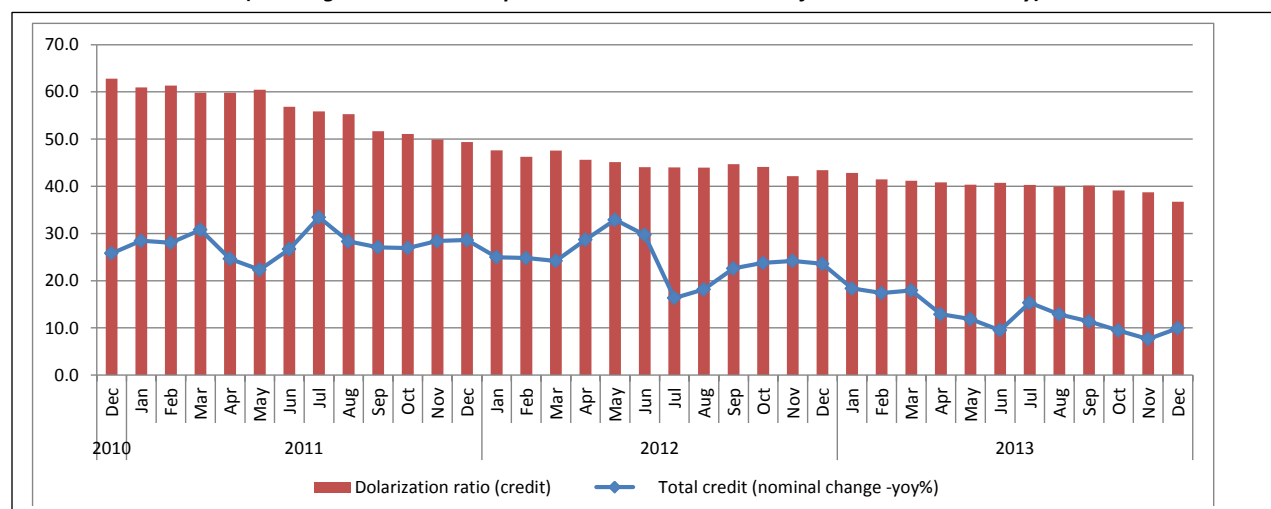
last quarter of 2013 international reserves declined by 8 percent, mirroring a similar decrease in the government's foreign-exchange deposits at the central bank. International reserves play a pivotal role in shielding Angola's economy from oil-price fluctuations.

Monetary Policy

18. Angola maintains a managed exchange-rate regime through its central bank, the Banco Nacional de Angola (BNA). The BNA currently uses an auction system with a predefined calendar, which allows commercial banks to bid on foreign exchange. Since 2010 the exchange rate has fluctuated within a band of 90 to 97.4 kwanza per US dollar. In an attempt to increase the flexibility of the exchange-rate regime while keeping inflation low the government adopted an updated monetary framework in January 2012. The new monetary framework introduced the concept of "reference interest rate" as a key policy indicator.¹¹ In addition, the "permanent liquidity facility" is intended to absorb banks's overnight liquidity and is set at a spread around the BNA rate. Since its introduction the BNA has cut the policy rate four times, in January 2012, January 2013, August 2013 and November 2013. As a result the interest rate now stands at 9.25 percent, the lowest level since the rate was introduced in 2011 at 10.5 percent.

19. The growth of private-sector credit from commercial banks slowed in 2013, but the share of kwanza-denominated loans has increased due to the government's de-dollarization efforts. Between December 2012 and December 2013 private-sector credit grew by 10 percent, down sharply from the 24 percent observed in 2011-2012 in line with lower economic growth. In December 2013 just 36.7 of total credits were in foreign currency compared to 43.4 percent in 2012.

Figure 12: Commercial bank credit to the economy has slowed, but kwanza-denominated loans now comprise the majority.
(% change in credit to the private sector and the share of loans in local currency)



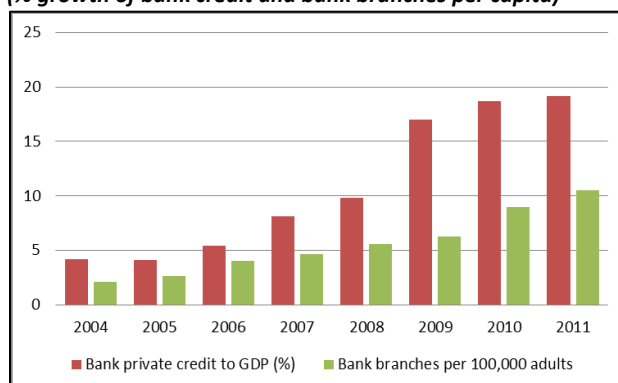
Source: BCA and World Bank Saff estimates

20. Profitability indicators have deteriorated, and despite recent improvements both the depth and extent of financial inclusion are below the average for middle-income countries. Late payments on credits, titles and interest as a share of overall credit to the private sector rose from 5.7 percent in

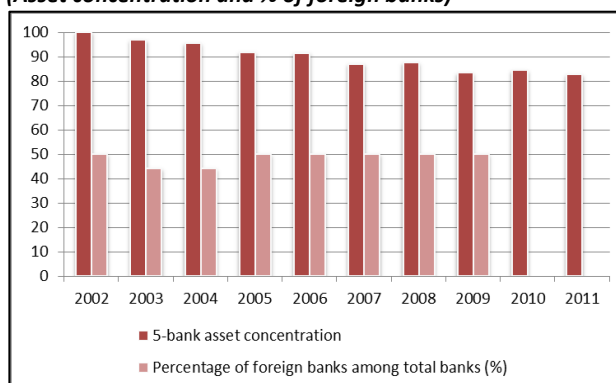
¹¹ The establishment of the Monetary Policy Committee (MPC) was accompanied by an expansion in monetary policy instruments. In particular, the BNA is now able to augment the management of the domestic money supply with instruments including reserve requirements, currency exchanges, and an expanded array of open market operations (including the buying and selling on the secondary market of Treasury bonds and central bank securities). The BNA has also improved its financial monitoring capacity and crisis preparedness and regularly publishes a financial stability report. In May 2012 the BNA created the Financial Stability Committee (COMEF) to monitor evolving conditions and risks in the financial market (Source: Angola Economic Update 1).

December 2011 to 8.3 percent in December 2012 and reached 10.2 percent in 2013.. Indicators of the depth, inclusion and competitiveness of the financial sector all showed positive trends, yet they remain well below the average for middle income countries (Figure 13Error! Reference source not found.). Progress has also been made in expanding financial inclusion, but according to the World Bank's Global Financial Inclusion Database (Findex) the rural bancarization rate¹² is just 33.8 percent and 56.7 percent in urban areas.

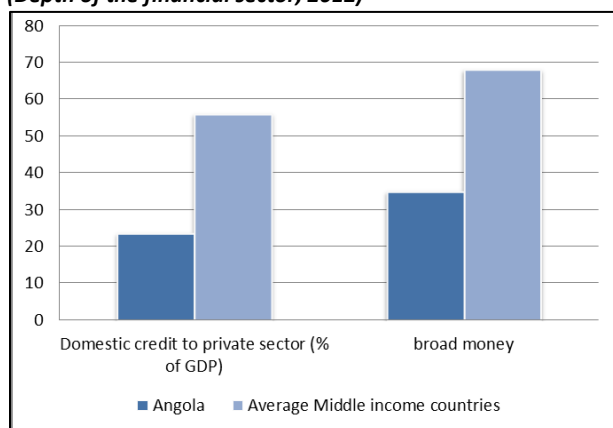
Figure 13: Angola's financial sector continues to develop...
(% growth of bank credit and bank branches per capita)



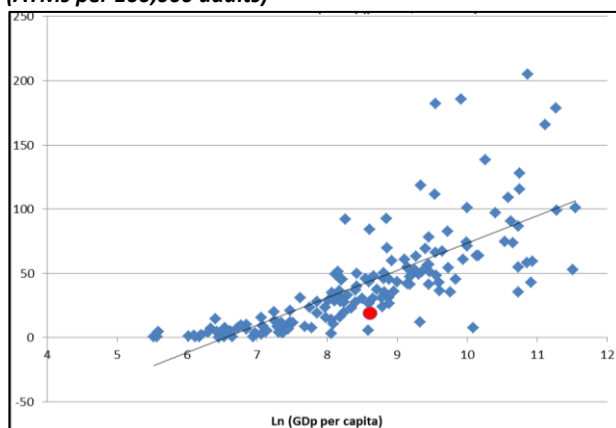
...and competition has started to pick up...
(Asset concentration and % of foreign banks)



...but the sector is less deep than the average for other middle income countries....
(Depth of the financial sector, 2012)



...and financial infrastructure is limited for a country with Angola's GDP per capita.
(ATMs per 100,000 adults)



Source: Authors based on World Bank, WDI and global financial inclusion databases

21. Micro, small and medium enterprises (MSMEs) face especially serious obstacles to obtaining credit. As discussed in detail in the previous AEU, larger and older firms are systematically more able to access credit than their smaller, younger counterparts. Similarly, foreign-owned firms and firms located in Luanda are less credit-constrained than domestic firms and firm based outside the capital.¹³ To expand access to credit among MSMEs the government has launched *Angola Investe*, a program that assists these firms by guaranteeing up to 70 percent of the value of a small-business loan. In 2013 the program partially insured 187 loans with a total value of 32.5 billion kwanza. The major sectors benefitting from the program included transportation and mining (51 percent), agriculture (13 percent) and construction (6 percent).¹⁴ The program appears to be successful thus far, and it may significantly

¹² In this context, the “bancarization rate” refers to the share of the population with an account at a formal financial institution.

¹³ See World Bank. 2013. *Angola Economic Update*. Issue 1 (March). Washington DC: The World Bank

¹⁴ <http://www.portaldeangola.com/2013/12/governo-aprova-mais-de-180-projetos-no-ambito-do-angola-investe/>

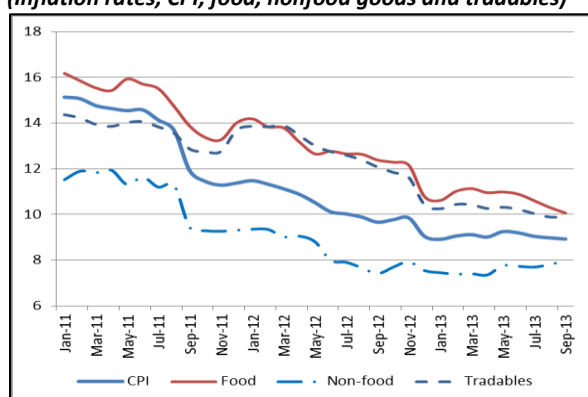
bolster growth among MSMEs, provided that potential moral hazard problems on the part of both borrowers and lenders are detected and prevented and that the program can be extended to firms outside the capital.

22. The new oil Foreign Exchange Law mentioned above presents both opportunities and challenges for the banking sector. The law aims at decreasing financial dollarization by compelling oil companies operating in the country to pay their suppliers in domestic currency through Angolan bank accounts. The law is expected to help deepen financial intermediation and boost credit in local currency. However, a rapid increase in domestic bank liquidity might encourage loans with excessive risk, which could threaten the inflation rate or even destabilize the banking sector. The 2013 data reveal a slowdown in credit growth, which might however reflect the broader deceleration of economic growth observed in 2013. Caution remains imperative over the near term. As the new law is expected to increase the volume of operations undertaken by commercial banks, the BNA has worked to strengthen its supervisory role by establishing a prudential supervision department to monitor the financial system's overall stability, and a consumer-protection department to defend the interests of lenders. The BCA has also introduced a series of regulations requiring banks to reinforce their corporate structure and internal auditing systems.

23. Despite the ongoing decline of Angola's inflation rate the inflation differential with key trading partners has caused the REER to appreciate, negatively affecting the competitiveness of the export sector. Inflation continues on its downward path, driven by falling international food prices. The average inflation rate is estimated at 8.8 percent in 2013 mirroring the declining trend of global food prices (Figure 16). As food imports are a major component of Angola's consumption basket, consumer-price inflation is highly sensitive to changes in global food prices and exchange-rate fluctuations. In September of 2013 the year-on-year inflation rate of Angola's key trading partners was estimated at about 2.9 percent, while the country's own inflation rate was at 8.9 percent. The inflation differential was not offset by nominal currency depreciation, and it continues to put upward pressure on the REER, diminishing the export competitiveness of Angolan firms.

Figure 14: Inflation is declining as global food prices remain low...

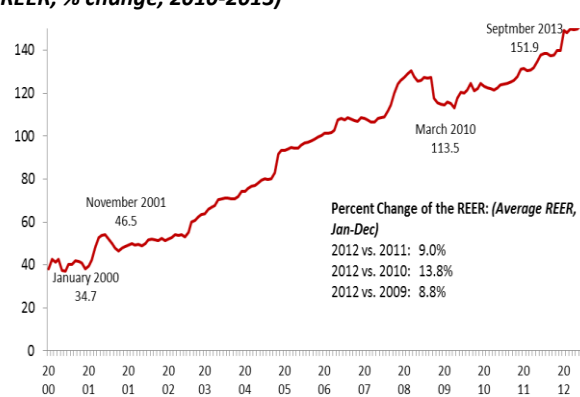
(Inflation rates, CPI, food, nonfood goods and tradables)



Source: INE

...yet the inflation differential is causing the REER to appreciate.

(REER, % change, 2010-2013)



Source: World Bank estimates based on BNA, Eurostat, and IFS

V. ECONOMIC OUTLOOK AND RISKS

Angola and the Global Economy

24. The global economic outlook is for a gradual strengthening of the global recovery with emerging market growth expected to remain stable but subdued in the near term, which could affect the demand for Angola's exports. Global GDP growth is projected to strengthen from 2.4 percent in 2013 to 3.0 percent this year and 3.4 percent in 2015. Led by the U.S., growth in high-income economies is expected to rise from 1.3 percent in 2013 to 2.1 percent in 2014 and 2.4 percent in 2016, as consumer demand and investment spending firm. Growth is projected to strengthen in India in 2014, supported by a rebound in domestic demand and improved conditions in key export markets. Growth will remain subdued in South Africa under the combined effect of policy tightening and infrastructure bottlenecks. China has set its growth target at 7.5 percent for 2014, and a rebalancing of growth drivers toward more reliance on demand and less on investment is expected to take place in the next several years. Growth in developing countries is expected to rise moderately from 4.8 percent in 2013 to 5.0 percent in 2014, reflecting in part capacity constraints but also tighter external financial conditions.

25. Growth in Angola is expected to accelerate on the strength of a rebounding oil sector as growth in high-income countries recovers and oil price remain stable (Box 6). A projected 3 percent increase in oil production will more than offset a 2.4 percent reduction in oil prices, and GDP growth is projected to reach 5.4 percent in 2014 and 5.5 percent in 2015. These figures are based on the assumption that oil production will increase by an additional 3 percent as a result of gains in extraction efficiency. Further increases in oil production are regarded as an upside risk. Sonangol, the state-owned enterprise that oversees oil production in Angola, expects the sector to produce 2 million barrels per day by 2015, in which case GDP growth in 2015 could potentially reach 8 percent. However, the AEU uses a more conservative forecast to hedge against unexpected technical problems in oil extraction, as have occurred in the past. Public investment is expected to drive non-oil GDP growth. Major projects include the rehabilitation of secondary and tertiary roads, the building of new energy-generation and distribution capacity, and the development of new irrigation systems to spur agriculture productivity. The service sector, including hotels and restaurants, is also expected to contribute to the growth of non-oil GDP.¹⁵

26. Downward risks to these projections include slower growth among Angola major trading partners. China's GDP growth slowed to an 18-month low in the first quarter of 2014 from the previous year, coming in at 7.4 percent year-on-year, beating expectations, but lower than 7.7 percent in the fourth quarter of 2013. Growth in fixed investment slowed and exports and imports contracted. Slower growth in China and other emerging markets would translate into lower demand for commodities. Additional downside risks to the global outlook include those arising from China's high debt levels and geo-political tensions. China's commitment to improve resource allocation and increase the role of market forces in the economy has been reflected in major reforms since November 2013. But rebalancing, which the government intends to accompany with measures to slow credit, will be challenging. Any "hard landing" could have substantial spillovers to economies within the East Asia region, and to commodity exporters in Sub-Saharan Africa. Geo-political tensions (as in Crimea) also pose tail risks, and could have substantial confidence impacts that cut into global spending and activity, and cause dislocations in global financial markets.

¹⁵ According to recent report, for example, Accor Group, a French hotel group, plans to build 30 new hotels in Kenya, South Africa, Angola, Nigeria, Ghana, Algeria and Morocco to boost its total room network to 22,000 (EIU, March 11, 2014).

Box 6 Commodities Prices Outlook

Commodities prices are expected to remain low in 2014 under the combined effect of weak demand and increased supply. Metal prices are projected to decline an additional 1.7 percent in 2014 as new supplies are expected to come on board. Similarly, precious metals are expected to decline more than 13 percent in 2014 as institutional investors increasingly consider them less attractive “safe haven” alternatives. Agricultural prices are projected to decline a further 2.5 percent in 2014 under the assumption that the existing improved crop conditions will continue for the rest of the year. Specifically, prices of food and beverages are expected to fall by 3.7 and 2.0 percent respectively.

Oil prices are expected to remain broadly stable, averaging \$103/bbl in 2014 just 1 percent lower than the 2013 average. After reaching \$100/bbl in early 2011 for the first time since the 2008 financial crisis, crude oil prices have fluctuated within a remarkable tight band around \$105bbl. The period 2011-13 has been one of the least volatile 3-year periods of the recent history of the oil market. Nominal oil prices are expected to average \$103/bbl during 2014 (down from \$104/bbl in 2013) and decline to \$100/bbl in 2015. In the longer term, prices in real terms are expected to fall, due to growing supplies of unconventional oil, efficiency gains, and (less so) substitution away from oil. The key assumption underpinning these projections reflects the upper-end cost of developing additional oil capacity from Canadian oil sands, currently estimated at \$80/bbl in constant 2014 dollars.

World demand for crude oil is expected to grow at less than 1.5 percent annually over the projection period, with all the growth coming from non-OECD countries, as has been the case in recent years. Consumption growth in OECD economies will continue to be subdued by slow economic growth and efficiency improvements in vehicle transport induced by high prices—including a switch to hybrid, natural gas, and electrically powered transport. Pressure to reduce emissions due to environmental concerns is expected to dampen demand growth at the global level. On the supply side, non-OPEC oil production is expected to continue its upward climb, as high prices have prompted increased use of innovative exploration techniques (including deep-water offshore drilling and extraction of shale liquids) and the implementation of new extractive technologies to increase the output from existing wells. Last, prices of natural gas (in the U.S.) and coal are expected to remain low relative to crude oil as well as European and Japanese natural gas prices. Some convergence in prices is expected to take place but its speed will depend on several factors, including the development of unconventional oil supplies outside the U.S., the construction of LNG facilities and gas pipelines, relocation of energy intensive industries to the U.S., substitution by coal, and policies.

27. In 2014 Angola fiscal deficit is expected to equal to about 0.9 percent of GDP, well below the 5 percent projected in the government’s 2014 budget. The difference is due to the differences in the forecasts for oil prices and oil production, with the latter based on the average for recent years. On the expenditure side, current spending is projected to increase at the same pace observed in 2013. Capital investment is expected to gradually increase and reach about 10 percent of GDP in 2014. The AEU projects a narrower current account deficit due to a combination of higher-than-expected oil prices compared to the 2014 budget assumption and the anticipated under-execution of the capital budget.

28. Refocusing expenditures on capital investment could positively affect Angola’s economic outlook, but only if execution capacity can be increased and the quality of public investment can be ensured. The state of Angola’s public investment management system is detailed in the following section. The country’s infrastructure deficit and historically low rates of public investment indicate that a sustained increase in the capital budget is necessary to raise its growth trajectory, and public investment reforms could greatly increase the impact of additional capital spending.

29. There have also been important recent developments in fiscal and trade policies. A new round of tax reforms is currently being discussed at the National Assembly, and the authorities are reportedly working on a plan to reduce energy subsidies.¹⁶ While the details of any forthcoming changes in tax and subsidy policies are not yet known, if properly designed these reforms could both enhance the

¹⁶ EIU December 2016

efficiency of public expenditure and lessen Angola's fiscal dependence on the oil sector. Finally, in March 2013 a new import-tariff schedule¹⁷ was introduced. This tariff schedule is expected to increase revenues by raising custom duties on selected agricultural goods and raw materials, but it may negatively affect GDP growth and/or put upward pressure on inflation as domestic producers will need to adjust to new import prices and higher tariffs could potentially raise the costs of intermediate inputs.

30. Despite higher tariffs on certain goods imports are expected to growth in 2014, driven by the government's planned fiscal expansion. Projections for 2014 suggest a reduction in the current account surplus as the growth of imports is expected to outpace the growth of exports. As oil prices decline further, blunting the impact of rising production, exports are projected to reach about 52.7 percent of GDP in 2014. The new tariff schedule is not expected to substantially discourage imports in 2014, but it may lessen the projected decrease in inflation.

31. Inflation is expected to continue on its downward path. The average inflation rate is projected to slide to 7.7 percent in 2014, as agriculture prices declines. Inflationary risks are mainly associated with the planned fiscal expansion, as new investment will not immediately translate into increased supply. For similar reasons the recent introduction of a new import-tariff schedule could give a one-time boost to inflation as discussed above. The recent Oil Foreign Exchange Law could generate additional inflationary pressures as increasing liquidity could encourage commercial banks to extend credit to higher-risk projects.

¹⁷ Angola's new customs tariff is expected to increase tax revenues by around 23 billion kwanzas per year, according to Angolan news agency Angop. Citing official figures, the agency said that the figure was a 10 percent increase on customs taxes provided by the previous tariff list, which came into effect in 2007. <http://www.macauhub.com.mo/en/2014/03/04/angola%E2%80%99s-new-customs-tariff-expected-to-increase-tax-revenues/>

VI. SPECIAL FOCUS SECTION: ENHANCING PUBLIC INVESTMENT MANAGEMENT

Introduction

32. Angola has reached a critical turning point in its development, and public investment management (PIM) will play a pivotal role in the country's future. Angola's infrastructure deficit is a binding constraint on economic growth, inhibiting diversification and discouraging private investment outside the natural-resource sector. In this context the current influx of oil revenues presents policymakers with an enormous opportunity, as the responsible investment of resource rents could enable the country build the public capital necessary to permanently raise its growth trajectory. Realizing this opportunity will require the government to overcome a number of serious macroeconomic challenges, including the distortive impact of extractive industries and the country's growing reliance on volatile commodity exports, as well as addressing persistent structural weaknesses in the legal and administrative framework of the PIM system.

33. In order to effectively leverage its oil reserves and build a foundation for sustainable, broad-based growth the government must transform its finite stock of natural wealth into reproducible physical and human capital. Angola's rate of public investment is low by the standards of comparable countries and, establishing the conditions for enduring growth in the real sector will require a sustained expansion of public investment—the first stages of which are already underway. However, the long-term success of these efforts will depend on the efficiency and integrity of PIM systems. If the government cannot ensure an adequate rate of return on public investment, it runs the risk that increased spending will be ineffective or even counterproductive.

34. The Angolan government has made considerable efforts to enhance the quality of PIM and leverage investment spending to advance the country's growth and poverty-reduction objectives. Policymakers have made a number of laudable achievements in this area, including stronger enforcement of rules for budget administration, public investment accounting and oversight, procurement practices, and investment procedures and the current administration is committed to continuing the PIM reform process. Yet previous reform efforts have yielded mixed results, and the Angolan PIM system is not yet strong enough to ensure that projects financed with public funds are appropriately selected, efficiently implemented, conscientiously monitored or thoroughly evaluated.

35. In this context, the following Special Focus Section examines recent developments in PIM reform and highlights areas in which more remains to be done in order to maximize the value of increased public investment. This analysis and its conclusions are designed to support the authorities' PIM reform agenda and advance the ongoing dialogue between the government, its development partners, and the many domestic and international stakeholders concerned with this critical area of development policy.

Expanding Public Investment and Enhancing Investment Quality

36. The quality of a country's public infrastructure exerts enormous influence over the growth

and competitiveness of its economy. Public investment directly impacts the economy by channeling resources into the production of new public capital, but it also spurs growth indirectly by increasing the returns to private factors of production.¹⁸ The former effect is immediate but temporary; as the implementation of a new investment project commences, it generates a boost in employment and demand in construction and other sectors that contribute to the project, but once the project has been completed those dynamics largely run their course. The latter, by contrast, produces a lasting impact on private-sector competitiveness and accelerates the long-term development of the economy. As the stock of infrastructure grows, access to transportation and utility networks expand, reducing the cost of doing business and opening up new opportunities for private investment, employment and income generation.

37. It is important to distinguish between the public and private economic effects of infrastructure investment. The direct impact of public investment is essentially automatic and depends largely on the level of investment spending, while the indirect impact is conditional on the economic value of the resulting infrastructure and has only a limited connection to the amount spent. The indirect effect of public investment on competitiveness and long-term growth is indeed determined by the quality of PIM—the extent to which investment spending is directed to projects with high economic value and the technical efficiency with which those projects are executed. Consequently, increasing the quality of PIM can permanently enhance the marginal returns to investment spending, and boosting investment levels in the context of an increasingly efficient PIM system can greatly magnify the impact of fiscal policy on economic growth. Conversely, the cost of a weak PIM system can be measured not just in terms of resources wasted on poorly selected, inefficiently implemented projects, but also as the opportunity cost of failing to enhance the foundation for more robust and enduring economic growth.

38. Addressing Angola’s unique development challenges will require a combination of expanded public investment spending and improved investment quality. The private sector is growing rapidly on the strength of a rising oil sector, but this growth model is inherently unsustainable, and as noted above the time horizon for oil extraction is relatively short. Meanwhile, private-sector growth outside the extractive industries is below potential (See section II).

39. Although a more robust and diverse private sector is critical to the country’s development, increasing public investment spending offers important immediate advantages. Greater investment can help shore-up employment and combat poverty while alleviating critical infrastructure bottlenecks.¹⁹ In addition, the increasing importance of the oil industry may be distorting the growth of the broader economy and damaging the competitiveness of the non-resource sectors.. In this context further expanding public investment can accomplish key short-term policy objectives, but enhancing the efficiency of the investment process could greatly advance the governments long-term development goals.

40. Thanks to an improving external climate Angola now has sufficient fiscal space to increase public investment without destabilizing the public finances. Although external funding was significantly disrupted by the global financial and euro-zone crises, the stabilization of international capital markets currently offers the government good access to concessional financing. Despite an extremely aggressive increase in investment spending could generate downside risks arising from commodity-price shocks,²⁰ Angola’s significant historical public savings and a relatively low public debt burden—currently equal to around 26.5 percent of GDP—place Angola in a comfortable position to increase investment spending over the medium term.

¹⁸ See Barro (1990) and Tanzi and Zee (1997).

¹⁹ See AfDB (2012) and IMF (2012).

²⁰ See Richmond, Yackovlev and Yang (2013).

41. However, expanding public investment without adequate attention to investment quality may have profoundly counterproductive consequences. A growing body of research illustrates the critical link between institutional quality and the economic impact of public investment. Substantial investment in economic infrastructure is widely regarded as a prerequisite for sustainable long-term growth.²¹ But increasing the volume of public investment spending in a context of weak financial controls and limited oversight can result in resources being squandered on poorly executed, low-quality projects with minimal effects on the country's macroeconomic trajectory. The relationship between PIM quality and growth is so strong that in many developing countries investing in the investment process is among the most productive uses of public resources.²² This is especially the case in resource-rich developing countries, where the nature of public revenues introduces additional budgetary volatility and increases the urgency of effective measures to ensure transparency and accountability in the management of public finances.²³

42. Consequently, strengthening PIM systems is an essential prerequisite for expanded investment spending. An important first step is to review the overall processes by which public investment projects are proposed, evaluated, approved and implemented. According to the frequently cited work of Rajaram et al. (2010), effective there are eight components of an effective PIM system. These include (i) preliminary guidance and screening, (ii) formal project appraisal, (iii) appraisal review, (iv) project selection and budgeting, (v) implementation, (vi) project adjustment, (vii) completion and operation, and (viii) ex-post evaluation. In an ideal PIM system these functions would be clearly organized and allocated to various ministries and other public agencies. However, in practice this is not always the case, and convoluted inter-institutional relationships are a major cause of weak PIM.

The Structure of the Angolan PIM System

43. In Angola, the fragmented division of responsibilities for the core functions of the PIM system and the limited oversight power of the central PIM agency greatly reduce the efficiency of investment spending. Public investment projects are consolidated in a multiyear investment plan known as the Public Investment Program (PIP), which is administered by the National Directorate for Public Investment (NDPI) at the Ministry of Planning and Territorial Development. The PIP is the product of a reform process designed to rationalize public investment—which had previously been largely uncoordinated, with projects approved, financed and implemented on an ad hoc basis—but to date these reforms have produced uneven, and sometimes counterproductive, outcomes.

44. Following elections in 2008 the government began a far-reaching reorganization of its economic governance structures, including the institutional framework for PIM. This effort continued following the adoption of a new Angolan Constitution in 2010. It involved the creation of substantial restructuring of a number of major economic policy institutions, such as the Ministry of Finance, the Ministry of Economic Coordination, and the Court of Accounts. During this period the formal institutional responsibilities for PIM were in a state of flux, and the reshuffling of staff and shifting of administrative burdens appears to have inadvertently slowed the process of economic decision-making.²⁴

45. The PIM reform process involved several successive rounds of legislation; although

²¹ While the precise nature of the relationship between infrastructure and growth remains the subject of some debate, there is strong cross-country evidence that the contribution of infrastructure to GDP typically exceeds its cost. See Esfahani and Ramirez (2003).

²² See, e.g., Dabla-Norris et al. (2010) and Ody et al. (2006).

²³ See, e.g., Berg et al. (2012), Arezki et al. (2012) and Collier and Venables (2008).

²⁴ Jensen and Paolo (2011).

intended to modernize the PIM system, these revisions to the legal framework also added to its complexity. The public investment system is currently regulated by Presidential Decree 31/10, which governs the approval, preparation, implementation and monitoring of the PIP, and by Decree 24/10, which covers budget execution and financial reporting. The PIP is also informed by Presidential Decree 320/11, which sets forth the annual rules for implementing the budget, and by the Budget Law, which establishes the geographic distribution of projects included in the PIP.

46. The current structure of the PIM system attempts to strike a balance between the administrative centralization of investment processes and local control over investment priorities and project design. The PIP establishes the criteria for preparing public investment projects and determines the basis for the selection of projects to fund. Line ministries, provincial and municipal governments propose investment projects, and the NDPI coordinates the inclusion of the projects in the PIP. The executive branch also contributes to the formulation of the program. Once a project is integrated into the PIP the budget-allocation process starts. The selection of projects and their integration into the PIP is conditioned by the availability of specific funding and sector priorities, which are set by each line ministry and provincial or municipal government.

47. This process, though well intentioned, creates contradictory outcomes. In principle the roles and procedures described above should streamline the public investment system through the use of consistent processes for all projects, enhance the impact of completed investments by allowing for greater coordination between public agencies, and leverage project-specific knowledge by preserving the autonomy of local and technically specialized agencies. In practice, however, the process of formulating, revising and implementing the PIP is often unmanageably complex, and the NDPI's limited ability to effectively oversee the process and enforce compliance with its governing legislation reduces the efficiency of the PIM system. This complexity is compounded by the additional mechanisms used to revise the PIP and incorporate it into the annual budget.

48. In an effort to allow for greater flexibility and responsiveness in the PIP the government established a routine amendment process, the Annual Programming Adjustment (APA). The APA for the coming year is prepared during the first year of operation and is approved when the PIP is approved. It is prepared between July and September of each year through the following process. First, a new adjustment program based on the current one is created. Line ministries and other government agencies responsible for year-end project implementation are identified, and a period of commissioning, negotiation and arbitration with sector stakeholders commences. Once this process is complete the APA is sent to the National Assembly for validation and approval, after which the PIP and APA enter into force on January 1st of the following year. While the APA mechanism should allow for important revisions and updates to the PIP, the actual process significantly increases both the administrative burden on the agencies involved and the ambiguity and uncertainty imposed by a highly complicated PIM process.

Box 7: The Institutions Responsible for Public Investment Planning in Angola

The *Ministry of Planning*, *Ministry of Finance*, *Ministerial Departments*, *Provincial Governments*, *Municipal Governments* and the *Executive Branch* are each responsible for different elements involved in the process of formulating the PIP.

The *Ministry of Planning* is responsible for:

- Preparing guidelines for the PIP and APA;
- Developing and disseminating project appraisal and evaluation methodologies;
- Determining national projects to be included in the portfolio;
- Ensuring the compatibility of programs with the goals of relevant national development strategies;
- Preparing the PIP; and
- Monitoring and evaluating the implementation of the PIP.

The *Ministry of Finance* is responsible for:

- Setting spending limits for proposed public investments;
- Integrating the PIP with the General Budget; and
- Overseeing the financial implementation of PIP.

Ministerial Departments and *Provincial Governments* are responsible for:

- Conducting studies of programs and projects submitted for inclusion in the PIP;
- Formulating and submitting provincial or sector-specific project portfolios;
- Selecting and prioritizing projects included in each portfolio; and
- Monitoring the implementation of provincial and sector-specific PIP portfolios.

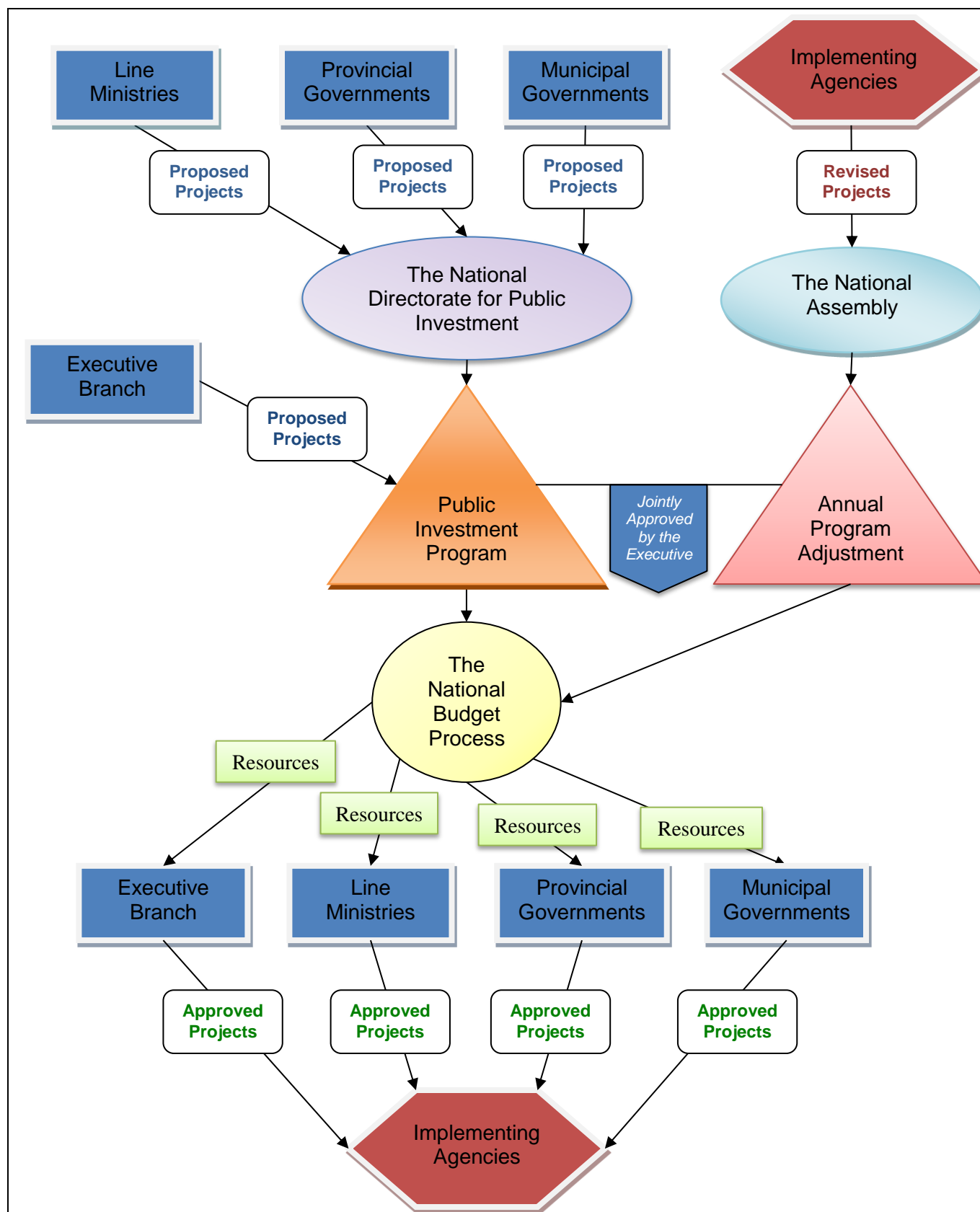
Municipal Governments are responsible for:

- Carrying out studies, programs and projects prepared at the municipal level;
- Determining the eligibility of municipal projects;
- Including proposed municipal projects in provincial budgets; and
- Supporting the implementation of municipal investment projects.

The *Executive Branch* is responsible for:

- Approving the PIP;
- Approving the APA; and
- Independently introducing Executive-Branch projects to the PIP.

Figure 15: The Angolan Public Investment Process



Source: Authors

49. The PIP articulates its long-, medium- and short-term goals through the Budget Law. The PIP's long-term goals are designed to accord with the country's overarching growth strategy, while its medium-term goals align with the National Directorate of Planning's Table of Medium-Term Expenditure Plans, the Sectoral and Provincial Development Plan, the National Plan for Regional Development and other strategic plans. Short-term goals are established in line with the government's current Action Plans, Annual Plans and Contingency Plans. Despite this multiplicity of public-sector plans, the strategic approach of the PIP is broadly effective in coordinating the objectives of the numerous investment projects proposed by public agencies operating in different sectors and at different levels of government. However, it is not sufficient to ensure the technical efficiency of the projects selected for inclusion in the PIP.

PIM Reform and Remaining Systemic Weaknesses

50. Since the mid-2000s the Angolan government has pursued a series of policy reforms and institutional restructuring efforts designed to reinforce the efficiency and integrity of PIM, and the structure of the PIM system described above is in part a reflection of these efforts. The government strengthened the enforcement of rules for budget administration, public investment accounting and oversight, procurement practices, and investment procedures at the subnational level. Particular efforts were made to systematize the processes by which projects were evaluated and selected for inclusion in the PIP. While considerable progress has been made in this and other areas of PIM, significant challenges remain.

51. The financial management of the public investment process has been substantially strengthened, and the government continues to pursue important reforms. Angola's 2012 *African Economic Outlook* country report summarizes the recent progress made in this area:

Angola is improving its financial management tools, and has several programs in place to enhance transparency and control over expenses. It has introduced quarterly financial plans for line ministries' outlays to ensure that only budget-approved projects are implemented. The government started to publish regular quarterly budget execution reports in 2011, with the 2010 final budget accounts being published with less than a year of delay. National accounts are audited by Ernst & Young, which is also supporting the government on improving budget execution efficiency and transparency. The Government is implementing a complete overhaul of project budgeting, appraisal and monitoring capacity to increase and achieve enhanced development outcomes. During 2011, the government undertook a restructuring of the Ministry of Economy, and created a new Institute for Public Enterprises to strengthen oversight of public enterprises and create a new regulatory framework. Public enterprises are now required to supply quarterly reports to the Institute and to produce externally audited annual accounts that are made public. (AEO 2012)

52. While these developments are encouraging, it is still too early to determine their ultimate impact on the financial oversight of public investment, an area in which promising reforms have previously failed to yield the intended results. Nevertheless, the government's demonstrated commitment to the reform process is reason for optimism, and many current reforms are expressly designed to address weaknesses identified in analyses of the post-2010 PIM framework. One particularly important example is the project appraisal and monitoring system. The 2010 reforms did not update public investment appraisal and monitoring procedures, which was cited by critics as a key flaw in the

PIM system.²⁵ However, in 2013 a new appraisal and monitoring system funded by the African Development Bank was piloted by the NDPI. If successful, this system could greatly enhance the consistency, predictability and methodological rigor with which project appraisal and monitoring processes are carried out.

53. Notwithstanding the government's reform efforts, important challenges remain in a number of key areas. Project design standards are often superficial, and there is no common set of rules and methods for all projects. This creates a degree of unpredictability regarding the time and cost required for implementation, leading to delays and cost overruns. Relatedly, the lack of uniform standards for project formulation and evaluation—such as common guidelines for assessing a proposed project's initial and recurrent spending requirements or for analyzing its economic and social impacts—means that each sector ministry relies on its own studies for technical evaluation and cost-benefit accounting. The lack of common rules and procedures also prevents consistent multi-stage evaluation for individual projects. While the pilot appraisal and monitoring system described above is designed, in part, to address these issues, at present the absence of uniform analytical methods is a major liability of the PIM system.

54. The project formulation and *a priori* assessment processes are further compromised by the limited availability of essential economic data and project-specific information. Angola suffers from considerable gaps in basic economic statistics, as well as in the data recorded by the Central Bank. This inhibits the ability of ministries and other public agencies to accurately appraise the economic impact of their proposed projects and leads to a suboptimal allocation of investment resources. Meanwhile, the inadequate sharing of information about the projects being planned by different agencies prevents coordinated planning and makes it difficult to integrate complementary projects within the same investment program. This creates inefficiencies in both design and implementation, leading to higher costs and less impactful projects. While there is now a functioning computerized system for tracking PIP projects, it is not yet integrated with the accounting and tax systems or the systems of the Court of Auditors.

55. One specific area in which the lack of uniform PIM systems compromises investment quality is investments by public enterprises and public-private partnerships. Public enterprises are autonomous and not subject to assessment by the NDPI, but their investment projects are underwritten by the government and are fundamentally similar to other forms of public investment. The proposal formulation, *a priori* assessment, operational monitoring and *ex post* evaluation of projects implemented by public enterprises are of highly uneven technical quality. While there are established processes for *ex post* evaluation, there is no system for monitoring of the project's ongoing operations. Finally, projects funded through public-private partnership (PPP) agreements are not subject to the same evaluation system as projects funded directly by the government, and so the performance of PPP projects cannot be compared to that of projects financed entirely with public funds. While the recently created Institute for Public Enterprises may—and should—adopt an evaluation system consistent with that used by the NDPI, at present PPP projects remain compromised by the inconsistency that pervades the broader PIM system.

56. Human-capital constraints create an additional obstacle to effective project formulation and assessment, and weaknesses in administrative capacity affect all aspects of the PIM system. The government is working to build the capacity of its staff, with training and technical support from the African Development Bank, but these efforts are still nascent and focused on a narrow range of public agencies. The general lack of sophisticated human capital impairs the functioning of the entire PIM system; it also hinders communication between policymakers and technical specialists and between the state and its financing institutions, both foreign and domestic.

²⁵ *Ibid.*

57. Serious systemic flaws in the preparation, implementation and monitoring of projects contribute to the low execution rate of public investment expenditures. In 2012 the PIP recorded a financial execution rate of 67 percent, down from 74.9 percent in 2011. This due in part to the persistent discrepancy between the financial resources allocated to PIP projects and their practical implementation schedules and in part to implementation delays caused by burdensome administrative procedures, which are also partially responsible for the government's low overall execution rate for public spending.

Building a Stronger PIM System in Angola

58. The basic structures for sound PIM are now in place, but further reforms will be necessary to ensure that public investments are appraised accurately, selected efficiently, implemented effectively and evaluated thoroughly. To accomplish this, the government must develop consistent methods for monitoring all elements of the PIP at both the national and regional levels. It must also develop a comprehensive framework for medium-term expenditures to ensure regularity and predictability in the implementation of the PIP, and take further steps to bolster the efficiency and effectiveness of public financial management systems. Moreover, it is essential that policymakers learn from previous reform efforts and strive to consolidate new rules for PIM and PFM in simple, comprehensive frameworks. New rules would also help ensure that structural changes are permanent and that the system is viable in the long term.

59. While these challenges are considerable, there is clear evidence that the government has the necessary political will to advance the PIM reform agenda. The authorities recognize the importance, in general terms, of project formulation and *a priori* assessment to assure that resources are allocated in ways that maximize their economic growth and welfare impact.

60. The establishment of a standardized system for project appraisal that clearly articulates criteria for determining a project's expected return should be regarded as a priority objective. The multiple, incompatible methods currently used by different government entities introduce a substantial degree of uncertainty into cost-benefit calculations for individual projects and make it difficult to compare projects to one another based on their expected rate of return. In order to ensure impartiality the government should consider establishing an independent project-appraisal unit at the NDPI to objectively assess proposed investment projects according to a single, standard methodology prior to their inclusion in the PIP.

61. Accurate project appraisal must include a formal system for accounting all project costs, both in terms of initial capital expenditures and long-term recurrent expenses. Policymakers often tend to focus on the upfront cost of establishing a project rather than the cost of maintaining and operating that project over time. The NDPI should therefore adopt a standard, comprehensive accounting method for determining the present discounted value of recurrent project costs and mandate its use in all project proposals.

62. The PIM system also suffers from a lack of credible ex post evaluation. Maintaining an effective PIM system requires continuously working to improve the efficiency of PIM processes. Completed projects must be rigorously evaluated against initial projections in order to gauge the accuracy of project appraisal in general, and the methods used to calculate project cost in particular. An independent evaluation unit at the NDPI would be able to apply a standard set of ex post evaluation criteria to all completed projects and ensure that lessons learned from these projects are incorporated into PIM system.

63. Finally, an important area for further scrutiny is the exceptional latitude afforded to the Executive Branch in proposing and approving investment projects. Unlike the other entities charged with proposing projects—the line ministries and provincial and municipal governments—the Executive Branch does not submit its proposals to the NDPI. Instead, it incorporates proposed projects directly into the PIP, which it is then tasked with approving. Consequently, the Executive Branch effectively has nearly complete discretion over its own projects and is not beholden to any other government agency. There are both potential advantages and disadvantages associated with this degree of autonomy. However, the lack of thorough ex post project appraisal makes it difficult to determine whether Executive Branch projects are implemented more or less efficiently than projects proposed and approved through the standard PIM system.

VII. ANNEXES



Annex 1: Angola Main Economic Indicators, 2009-2015

	2009	2010	2011	2012	2013 ^E	2014 ^F	2015 ^F
Real economy (percent change, except where noted)							
Real GDP	2.4	3.4	3.8	5.1	4.4	5.4	5.5
Oil sector	-5.1	-3.0	-5.6	4.3	0.6	3.0	3.0
Non-oil sector	8.1	7.6	9.4	5.5	6.3	6.6	6.7
Nominal GDP	-5.2	26.6	28.9	12.2	7.6	9.2	8.9
GDP deflator	-7.4	22.4	24.2	6.7	3.1	3.6	3.2
Consumer prices (period average)	13.7	14.5	13.5	10.3	8.8	7.7	7.7
Consumer prices (end of period)	14.0	15.3	11.4	9.0	7.7	8.0	7.5
GDP (billions of USD)	75.6	82.5	104.0	114.9	122.2	131.4	141.2
GDP (billions of AOA)	5988	7578	9767	10959	11787	12871	14013
Non-oil GDP (billions of AOA)	3326	4182	5135	5948	6849	7843	9000
Central government (percent of GDP)							
Revenues and grants	34.6	43.5	48.9	46.1	37.6	38.5	36.9
Of which: Oil revenues	24.2	33.0	39.1	37.4	29.5	30.3	27.7
Total expenditures	39.8	38.9	39.2	38.5	37.5	38.5	39.0
Current expenditures	27.4	27.4	29.0	28.1	27.8	28.3	28.9
Capital expenditures	12.4	11.5	10.2	10.4	9.6	10.2	10.1
Primary balance	-5.2	4.6	9.7	7.6	0.2	0.0	-2.1
Interest payments	2.1	1.2	1.0	1.0	0.7	1.0	0.8
Overall balance	-7.3	3.4	8.7	6.6	-0.6	-1.0	-2.9
Non-oil overall balance	-31.5	-29.6	-30.3	-30.8	-30.0	-31.3	-30.6
Balance of payments (Billions of USD, except where noted)							
Exports of goods	40.9	50.6	67.3	71.1	68.8	69.2	68.1
Of which: Oil exports	39.4	48.6	64.5	68.9	66.5	66.7	65.6
Imports of goods	22.7	16.7	20.2	23.7	24.5	26.2	28.1
Trade balance	18.3	33.9	47.1	47.4	44.3	42.9	40.1
Export prices (percent change)	-20.8	25.5	42.1	2.2	-3.2	-2.5	-4.4
Import Prices (percent change)	-22.7	9.6	14.6	2.9	-2.4	-0.2	0.2
Terms of trade (percent change)	2.3	14.5	24.0	-0.6	-0.9	-2.4	-4.7
Current account balance	-7.5	7.5	13.1	13.9	8.0	7.5	2.6
(as a percentage of GDP)	-10.0	9.1	12.6	12.1	6.5	5.7	1.8
Net international reserves (NIR)	12.6	17.3	26.1	30.6	30.9	31.2	32.3
(as a percentage of GDP)	16.7	21.0	25.1	26.7	25.3	23.8	22.9
NIR in months of imports	3.61	5.87	7.13	8.02	7.35	7.12	7.11
Exchange rate							
Exchange rate (period average, AOA/USD)	79.26	91.90	93.90	95.41	96.45	97.95	99.26
Exchange rate (end of period, AOA/USD)	88.74	92.36	95.28	95.83	97.62	98.41	99.99
Nominal exchange rate change	5.6	16.0	2.2	1.6	1.1	1.5	1.3
USD: United States dollar, AOA: Angolan kwanza							
E: estimates, F: forecasts							

Annex 2: Angola – Gross Domestic Product

Real Gross Domestic product by sector (Annual growth rates)	2009	2010	2011	2012	2013 ^E	2014 ^F	2015 ^F
Agriculture and Fishing	27.7	5.9	11.4	-22.5	8.6	6.6	6.7
Extractive Industry	-4.4	-3.5	-5.5	4.1	1.0	2.9	3.0
<i>Petroleum</i>	-5.1	-3.0	-5.6	4.3	0.6	3.0	3.0
<i>Other</i>	4.6	-10.3	-3.3	0.3	6.6	2.6	2.8
Manufacturing	5.3	10.7	8.4	14.0	8.0	8.0	8.0
Electricity	21.3	10.9	15.0	10.4	22.4	14.8	25.8
Construction	23.7	16.1	6.8	11.7	7.6	7.6	7.6
Commerce	-1.5	8.8	12.3	13.4	5.4	6.8	6.9
Services	6.0	4.5	8.2	11.0	5.0	5.9	6.0
Import Duties	3.2	4.2	3.9	0.0	0.0	0.0	0.0
GDP	2.4	3.4	3.8	5.1	4.4	5.4	5.5
<u>Notes:</u>							
<i>Non-oil GDP</i>	8.1	7.6	9.4	5.5	6.3	6.6	6.7
<i>GDP without extractive industry</i>	8.3	8.7	10.0	5.8	6.3	6.7	6.8
E: estimates, F: forecasts							

Annex 3: Angola: Fiscal operations of the central government, 2009-2015

(Percent of GDP)

	2009	2010	2011	2012	2013 ^E	2014 ^F	2015 ^F
Revenues and grants	34.6	43.5	48.9	46.1	37.6	38.5	36.9
Tax revenues	33.2	40.8	46.4	44.0	36.2	37.5	36.2
Oil revenues	24.2	33.0	39.1	37.4	29.45	30.26	27.7
Non-oil revenues	9.0	7.8	7.3	6.6	6.7	7.2	8.5
Of which: Income taxes	3.3	3.2	3.3	3.0	3.3	3.9	5.2
Non-tax revenues	1.3	2.6	2.5	2.1	1.4	1.0	0.7
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditures	39.8	38.9	39.2	38.5	37.5	38.5	39.0
Current expenditures	27.4	27.4	29.0	28.1	27.8	28.3	28.9
Wages	11.1	9.4	9.0	9.4	10.2	10.9	11.7
Good and services	6.4	8.2	10.6	11.8	12.5	12.4	12.2
Transfers	9.9	9.7	9.5	6.9	5.1	5.0	4.9
Capital expenditures	12.4	11.5	10.2	10.4	9.6	10.2	10.1
Primary Balance	-5.2	4.6	9.7	7.6	0.2	0.0	-2.1
Interest payments	2.1	1.2	1.0	1.0	0.7	1.0	0.8
Domestic	1.5	0.4	0.6	0.6	0.4	0.5	0.6
External	0.6	0.8	0.4	0.3	0.3	0.5	0.3
Overall Balance	-7.3	3.4	8.7	6.6	-0.6	-1.0	-2.9
Change in total payments arrears (net)	-0.3	0.0	1.6	2.6	-0.2	0.0	0.0
Domestic	0.3	0.0	1.6	2.6	-0.2	0.0	0.0
External	-0.6	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance (cash basis)	-7.6	3.4	10.3	9.3	-0.7	-1.0	-2.9
Financing	7.6	-3.4	-10.3	-9.3	0.7	1.0	2.9
External financing (net)	2.1	2.5	1.1	-1.3	0.7	2.1	1.9
Domestic financing (net)	5.5	-6.0	-11.4	-7.9	0.0	-1.1	1.0
Bank credit (net credit to government)	11.0	-3.9	-5.2	-3.9	1.6	-1.7	-2.2
<i>Net central government claims on the Central Bank</i>	<i>10.7</i>	<i>-3.3</i>	<i>-4.3</i>	<i>-3.5</i>	<i>1.2</i>	<i>-0.3</i>	<i>-1.0</i>
<i>Net central gov claims on deposit commercial banks</i>	<i>0.3</i>	<i>-0.5</i>	<i>-0.9</i>	<i>-0.4</i>	<i>0.4</i>	<i>-1.3</i>	<i>-1.2</i>
Non-Monetary Sector	-5.5	-2.1	-6.2	-4.0	-1.6	0.6	3.2
Notes:							
Non-oil overall balance	-31.5	-29.6	-30.3	-30.8	-30.0	-31.3	-30.6
Non-oil primary balance	✓ -1763	✓ -2150	✓ -2868	✓ -3272	✓ -3453	-3897	-4177
per cent on GDP	-29.4	-28.4	-29.4	-29.9	-29.3	-30.3	-29.8
per cent on non-oil GDP	-53.0	-51.4	-55.9	-55.0	-50.4	-49.7	-46.4
E: estimates, F: forecasts							

Annex 4: Angola: Balance of Payments, 2009-2015

(Millions of USD)

	2009	2010	2011	2012	2013 ^E	2014 ^F	2015 ^F
Current account	-7548	7526	13084	13873	7956	7470	2577
Trade balance	18288	33928	47082	47376	44324	42929	40062
Exports	40948	50594	67310	71093	68834	69154	68124
Oil crude	39391	48630	64473	68871	66451	66704	65621
Refined oil products and gas	532	722	1013	845	915	935	927
Diamonds	842	967	1181	1112	1176	1230	1291
Others	183	275	643	265	291	284	285
Imports	22660	16667	20228	23717	24510	26226	28062
Oil products	4326	3159	3383	4040	4322	4625	4949
Agriculture products and food	3185	2774	3785	5249	4506	4821	5159
Others	15149	10734	13060	14429	15682	16779	17954
Services	-18643	-17877	-22938	-21339	-25340	-25605	-25642
Exports	623	856	732	780	688	859	888
Imports	19266	18733	23670	22119	26027	26464	26529
Income	-6823	-8087	-9698	-10402	-10665	-9464	-11425
Credit (net receipts)	131	134	209	260	281	287	287
Debit (net payments)	6954	8221	9907	10662	10946	9750	11712
Transfers	-371	-438	-1362	-1762	-363	-390	-418
Of which: workers' remittances	-397	-395	-231	-358	-383	-410	-438
Capital and financial account	2261	-2752	-4457	-9325	-7644	-7167	-1486
Short and long term Private C&F account	150	-4421	-5597	-7828	-10138	-9918	-4237
a) Foreign Direct Investment (FDI)	2199	-4567	-5116	-9639	-6441	-5299	-4157
From Which:							
Reinvestment	2743	3325	3978	4269	4356	3812	4978
b) Medium, long and short term private capital	-2049	146	-1548	1811	-3697	-4619	-80
Public External financing	1523	2092	1140	-1497	2494	2751	2751
Borrowing	1719	2433	2689	2284	1494	1751	1751
Disbursements	4579	5702	5959	4019	5220	5220	5220
Amortization	-2860	-3270	-3270	-1735	-3726	-3469	-3469
Government deposits abroad (Escrow account flows)	-196	-341	-1549	-3781	1000	1000	1000
Errors and omissions	589	-424	0	0	0	0	0
Overall Balance	-5287	4774	8627	4548	313	303	1091
Financing	5287	-4774	-8627	-4548	-313	-303	-1091
Net international reserves	4878	-4705	-8758	-4548	-313	-303	-1091
Exceptional financing	409	-69	130	0	0	0	0
<u>Notes:</u>							
Exports as % of GDP	54	61	65	62	56	53	48
Trade balance (percent of GDP)	24	41	45	41	36	33	28
Current account (percent of GDP)	-10	9	13	12	7	6	2
Stock of Net international reserves (percent of GDP)	17	21	25	27	25	24	23
Capital and financial balance as % of GDP	3	-3	-4	-8	-6	-5	-1
E: estimates, F: forecasts							

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