Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 22-Oct-2019| Report No: PIDC26266

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Angola	P168336	Second Angola Growth and Inclusion Development Policy Financing Operation (P168336)	P166564
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
AFRICA	Jul 09, 2020	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Ministry of Finance	Ministry of Finance		

Proposed Development Objective(s)

The development objective is to support the Government of Angola to achieve more sustainable and inclusive growth, through (i) a macro-financial and institutional environment that is conducive to private-sector led growth; and (ii) financial and social inclusion.

Financing (in US$, Millions)

SUMMARY

Total Financing	500.00

DETAILS

Total World Bank Group Financing	500.00
World Bank Lending	500.00

Decision

The review did authorize the preparation to continue

B. Introduction and Context

The government is pursuing an ambitious economic reform agenda to rebalance the economy away from its dependency on oil towards a more inclusive growth model. The administration has delivered on several key reforms since taking office in 2017 the more recent being a privatization law, the setup of a one-stop window for investors to improve the business climate, and the establishment of a social protection registry to protect the most vulnerable from the reforms. Macroeconomic stability has been largely restored and maintained through a more flexible exchange rate regime, restrictive monetary policy, and fiscal consolidation. The reform program is supported by a three-year Extended Arrangement Under the Extended Fund Facility (EFF) from the IMF (US$3.7bn) and a programmatic series of Development Policy Financing (DPF) from the World Bank (US$1.5 billion in three operations).

The policy response since late 2017 has been adequate and effective in reducing domestic imbalances. The BNA adopted a restrictive monetary policy to anchor inflation and to offset the impact of the exchange rate depreciation. Even though, the BNA has cut interest rate by a total of 250 basis points this year, reserve requirement in local currency, a more powerful monetary policy tool, was raised from 17 to 22 percent in October. Inflation remains high but has continued to decelerate from 18.6 percent at end-2018 to 16.3 percent in November 2019. Fiscal consolidation has turned fiscal deficits since 2014 into a budget surplus of 2 percent of GDP in 2018. Weak economic activity and limited exchange rate pass-through have kept inflation in check, despite a one-off electricity tariff increase in July and VAT implementation in October. Real interest rates are approaching positive territory after negative readings during the past two years.

Overall, these reforms have boosted investor confidence, but an increase in investment and growth has not yet materialized as these reforms take time to show results. Volatile oil prices and a large decrease in oil production have resulted in three consecutive years of recession. Despite extensive reforms in the oil sector, including the restructuring of the national oil company Sonangol, oil production levels continued to decline in 2019. Oil production fell further in 2019, averaging [1,388] tbbl/day[1] (well below the production cap under the OPEC agreement (1,481 tbbl/day), reflecting the maturation of oil fields and low investments in previous years. Business confidence in the non-oil sector remains low as the economy is adjusting to the government's economic stabilization program.

Relationship to CPF

The DPF series reflects the priorities and objectives of the 2018 Performance and Learning Review (PLR), which updates and extends the Country Partnership Strategy (CPS) FY14–FY16 through FY19[2]. The policy areas of the DPF series are expected to contribute to both focus areas of the CPS; complement investment lending under the CPS; and create the policy underpinnings that can, together with the International Finance Corporation (IFC), harness private sector opportunities. A new Country Partnership Framework (CPF) is under the final stages of preparation and has informed this operation as well.

C. Proposed Development Objective(s)

The proposed operation supports the Government of Angola (GoA) to maintain macroeconomic stability and to lay the foundations for private sector-led economic diversification to create a more inclusive growth model. Angola is the second largest oil-producing country in Sub-Saharan Africa (SSA). Over-dependence on oil has made growth and macroeconomic management highly vulnerable to external shocks, and the economic structure very concentrated on oil and dependent on imports. Until recently, Angola has relied on the oil industry and high oil prices to drive economic growth and to rebuild a large part of its infrastructure. This growth, however, generated very few jobs, especially for the young cohorts of the population. The challenge for Angola is to make growth inclusive and less dependent on oil. Prospects of persistently low oil prices and potentially diminishing oil reserves over the longer term make the call for economic diversification and inclusion even more pressing.

[1] Based on OEPC's Monthly Oil Report, direct sources.
[2] PLR: Report No. 125072, dated 04/25/2018. CPS: Report No. 76225, date 09/26/2013.

This operation is the second Development Policy Financing (DPF) in a series of three. The operation is organized around two pillars, each including several policy areas. DPF2 maintains the same pillars and policy areas as DPF1

- **Pillar 1: Strengthening the macro-financial and institutional environment**. Policy areas are: strengthening debt and natural resource management for fiscal sustainability (1.1); strengthening financial sector resilience (1.2); strengthening management and commercial viability of SOEs (1.3); supporting pricing and subsidy reform for financial sustainability and effective service provision (1.4); and leveling the playing field for private investment (1.5).
- **Pillar 2**: **Protecting the poor and vulnerable.** Policy areas are: protecting the poor and vulnerable from shocks (2.1); and increasing access to finance (2.2).

Key Results

This operation aims to achieve better outcomes in fiscal policy including fiscal pressures from SOEs, financial sector stability, larger private sector participation and better protection and livelihood for the poor. This will be measured by a set of 10 indicators.

D. Concept Description

The 2nd Angola Growth and Inclusion Development Policy Financing supports the following prior actions:

Prior Action 1: To improve fiscal sustainability and the management of natural resources, the GoA has submitted to the National Assembly the law for the establishment of the oil revenue fund with the dual objective of fiscal stabilization and long-term investment.

Prior Action 2: In order to improve the regulatory and legal framework for banking supervision and resolution, the GoA has submitted to the Assembly a revised FIL.

Prior Action 3: In order to strengthen performance, accountability and transparency of the SOE sector and attract private investments, the GoA has (i) published the first aggregated SOE report with financial and operational performance indicators; (ii) approved a privatization program; and (iii) adopted PPPs regulations in line with good international practices.

Prior Action 4: The GoA implements (i) a market-based pricing formula for quantifying fuel subsidies and for setting fuel price ceilings; (ii) approves the methodology for establishing revenue requirements for water and electricity utilities; and (iii) transfers full authority to set and enforce revenue requirements for electricity and water utilities to IRSEA, the water and electricity sector regulator.

Prior Action 5: In order to develop and implement an effective competition policy framework, the ARC, has (i) adopted secondary legislation to develop the enforcement tools for protecting markets from non-competitive behavior, and the GoA (ii) has revised legislation to phase out price control mechanisms that may distort competition.

Prior Action 6: In order to mitigate the short-term impact of the subsidy and tariff reform, the GoA has set up a poverty-targeted cash transfer using the *Cadastro Único*.

Prior Action 7: In order to strengthen and modernize the national payments system, the GoA has (i) submitted a new payments system and services law and the BNA has passed (ii) the implementing regulations of the new law which includes the activation of the National Payments Council (NPC).

E. Poverty and Social Impacts and Environmental Aspects

Poverty and Social Impacts

The main distributional and poverty impacts of this DPF series will come from fuel prices and utility tariffs adjustment and the roll-out of the cash transfer program. A full-fledged analysis of the distributional impacts of the fuel price and tariff adjustment and cash transfers will be carried out during the period of implementation of the DPF2. The analysis will be based on the full dataset of the new household survey data *Inquérito sobre Despesas, Receitas, e Emprego de Angola* (IDREA), conducted by the National Statistics Institute (INE) between March 2018 and March 2019. The PSIA will have three stages, one for assessing the impact of the (i) fuel subsidy reform; (ii) one for assessing the impact of electricity subsidy reform; and (iii) an analysis of the distributional impact of combined fuel and electricity subsidy reform.

The distributional/poverty impacts of the fuel price and tariff adjustment will take into account both direct and indirect impacts. Direct impacts are those associated with the loss in purchasing power due to an increase in the tariffs. Tariff increases can also produce indirect impacts on the consumer prices of other goods and services produced using electricity or fuels as inputs. When the price producers pay for inputs rises, the price of goods and services produced using that input may, under certain assumptions, also rise, creating an "indirect" burden on households. An Input-Output matrix for Angola for the year 2015 will be used to assess those indirect effects[3].

There are potentially poverty-reducing effects that could arise from leveling the playing field for private investment and removing barriers for foreign investors as well as anti-competitive practices. Moving from a market structure dominated by incumbent operators to a competitive one could have welfare-improving effects through prices, wages of the employed, and job creation. Going forward, these effects can only be verified and quantified once the specifics of the reforms become clearer.

Improved access to finance has been found to support growth and income equality. Modern development theory sees the lack of access to finance as a critical mechanism for generating persistent income inequality and slower growth (Demirguc-Kunt and Levine 2008). Small enterprises and poor households face much greater obstacles in their ability to access finance all around the world but more so in developing countries like Angola. The difficult access to the banking system by the poor occurs because banks focus on areas that offer economies of scale. In other words, the spread of formal banking services rises with income. Reforms to expand mobile payments will have a positive impact on vulnerable groups by expanding financial services in these areas and by reducing transactions costs (e.g. traveling costs) through electronic systems. This allows accounts to be maintained at relatively low costs to savers and borrowers located in these underserved areas.

Environmental Impacts

Actions supported by this operation are not likely to have major negative effects on the environment, forests, and natural resources. Actions and reforms under pillar 1 (Strengthening the macro-financial and institutional environment) are likely to have some environmental impacts. Tariff and subsidy reforms can contribute to the reduction in use of water, energy and fuel and, in turn contribute to better fiscal savings, reduce greenhouse gas emissions and increased opportunities of investment in technologies and renewable energy. On the other hand, such reforms may result in price increases, leading to an increase in the use of traditional fuels such as wood (for domestic use), thus causing more pressure in renewable natural resources and in the ability of the ecosystems to provide goods and services. These impacts will be mitigated by keeping unchanged the price of kerosene, which is used for lighting and cooking by the poorer households;

3 [1] The IO matrix for Angola will be accessed from the website: http://worldmrio.com/countrywise/

and by the cash transfer program that will compensate vulnerable households up to a doubling of their expenditure in fuel and public transportation. Protecting the poor and vulnerable from shocks and increasing access to finance addressed under pillar 2 are not expected to have any direct or indirect environmental impacts or risks.

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APPROVAL

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