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REPÚBLICA DE ANGOLA  
**MINISTÉRIO DAS FINANÇAS**  
 GABINETE DO MINISTRO

**Dr. Jim Kim**  
**President**  
**World Bank Group**  
**1818 H Street, NW**  
**Washington DC 20433**  
**USA**

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Tuesday, 12<sup>th</sup> of May 2015

**RE: Republic of Angola Letter of Development Policy**

Dear President Kim,

1. The sharp decline in crude oil prices since Jul 2014 has brought uncertainties about the global economic outlook, as evidenced by the downward adjustment to global economic growth forecasts from 3.4 percent in the June 2014 Global Economic Prospects (GEP) to 3 percent in the January 2015 GEP, confirming a global economy still struggling to gain momentum since the financial crisis of 2008. This global context is doubly affecting Angola negatively, as a still oil-dependent economy with nearly 98 percent of its export proceeds and 78 percent of its revenues derived from the oil sector, and as a more and more integrated economy in the global market. In such uncertain external context, the Government of the Republic of Angola (hereinafter, the Government) has taken immediate measures to shore up the economy and protect the poor and vulnerable as revenues projected for 2015 are cut by 35.7 percent, while at the same accelerating medium term reforms to strengthen fiscal management to create the fiscal space to scale up growth-sustaining expenditure to support the diversification of the Angolan economy. This Letter of Development Policy presents the country's recent macroeconomic and fiscal performance and measures that have been taken

to mitigate the expected sharp fall in revenues, the Government medium and long-term development agenda and how the reform program under the Development Policy Financing (DPF)-with the World Bank fits in this agenda, and the monitoring and evaluation system put in place to ensure a smooth implementation of the DPF.

### **Recent Macroeconomic and Fiscal Performance**

2. In the second half of 2014, the World economy was shaken by a sharp fall in oil price by 50 percent and therefore Angolan economy was naturally affected and led to a new reality with oil price expected to remain below \$60 over 2015 and possibly beyond. Real GDP is estimated to have increased by 4.7 percent in 2014 (preliminary figures), down 2.4 percentage points compared to 2013, and 3.3 percentage points compared to the goals of the National Development Plan (NDP) 2013-2017 of 8 percent. The oil sector contracted by 12 percent due to various technical problems, unscheduled maintenance in some fields and essentially due the unexpected oil price drop, while the non-oil sector contracted by 1 percent (preliminary figures). The negative impact on the current account of the decline in oil resulted in a loss of gross reserves of US\$ 3 billion. Should oil price remain at such level over the year, the loss in net international reserves could amount to US\$8 billion, which would correspond to a 28 percent contraction of reserves level reached by the end of 2014 (US\$26.9 billion).

3. In 2014 inflation continued its downward trend to stand at 7.5 percent, 0.2 percent lower than in 2013. However, as depreciation pressure on the kwanza might reverse the downward trend of inflation due to imported inflation. Indeed, the official exchange rate average slightly depreciated over 2014, by 5.29 percent, from KZ/US\$ 97.619 in 2013 to KZ/US\$ 103.069 in 2014. It reached KZ/US\$ 106.3 in February 2015. At the same time, changes in the monetary base and the money supply were aligned with the objective to contain inflation below double digit, with the monetary aggregates M3, M2 and M1 growing respectively at 13.9 percent, 13.9 percent and 16.5 percent between 2013 and 2014.

4. On the fiscal side, revenues were estimated in 2014 to have reached KZ 4,098 million (about US\$41.7 billion), 12.3 percent lower than in 2013, due to the drop in production and oil prices. Oil revenues increased by 22.2 percent to KZ 2,969.8million (about US\$30 billion), while non-oil revenues increased by 13.83 percent to KZ 1,128,230 million (about 11 billion) as a result of ongoing tax administration and tax policy reforms. On the other hand, total expenditures declined by 7.5 percent to reach KZ 5,209,300 million (about US\$47

billion), putting the fiscal deficit on commitment base at KZ 806.6 million (about US\$1.04 billion) in 2014, representing 7 percent of GDP in 2014.

5. For 2015, real GDP growth was revised downwards from 9.7 percent in the initial 2015 Budget to 6.6 percent, but the economy is still expected to accelerate compared to the growth rate of 4.7 percent recorded in 2014 as daily oil production reaches 1.83 million barrels per day. Indeed, as originally planned, the real economic growth should be led by the oil sector, whose most recent forecasts point to an expansion of 9.8 percent instead of 10.7 percent initially projected. Updated forecasts for growth in the non-oil sector were however significantly revised downward to 5.3 percent, from 8.2 percent registered in 2014.

### **The Government Medium-Term Development Agenda**

6. The higher development objectives set in the NDP 2013-2017 are:

- a) The preservation of national unity and cohesion.
- b) The pursuit of basic initiatives necessary for the development.
- c) The improvement in quality of life.
- d) The insertion of youth in the labor force.
- e) The development of the private sector.
- f) The competitive insertion of Angola in the international context.

7. The decline in oil imposes many challenges in the short and medium term to achieve the main macroeconomic objectives set out in the NDP 2013-2017, which are summarized in the Table below.

**Table 1: Priorities for Fiscal Policy in the NDP 2013-2017**

Sustainability of Public Accounts	Tax Policy Instruments
Ensure that economic growth is realistically consistent with the long-term sustainability of public finances.	On Revenue side: Mobilization of non-oil tax revenues and establishment of a fiscal stabilization fund
Ensure, through the Medium Term Fiscal Framework, fiscal discipline and the sustainability of public finances in the medium term while securing public spending to protect the poor and vulnerable.	On Expenditures side: <ul style="list-style-type: none"> <li>Continue to improve the quality of public expenditure through an effective inter-sectoral allocation process</li> <li>Continue the rationalization efforts of public spending within each sector, with a special focus on the use of subsidies in the economy and other financial support provided by the state to public enterprises</li> </ul>

8. These medium-term strategic areas are underpinning the reform program supported by the World Bank Development Policy Financing operation, through (i) the introduction of fiscal rules for the utilization of the Oil Price Differential Account and the modernization of the tax administration and tax policy; (ii) the enhancement of the efficiency and effectiveness of public investment management; and (iii) the move from untargeted subsidies to targeted cash-transfers and evidence-based policy making.

### **Introducing Fiscal Rules for the Utilization of the Oil Price Differential Account and Modernizing Tax Administration and Tax Policy**

9. Given the volatility of oil revenues that currently 80 percent of total Government revenues, a series of fiscal rules reflecting best practice in public financial management is needed for fiscal stabilization purposes. The economic commission from the Council of Ministers just approved on 27<sup>th</sup> of March the Presidential Decree whose publication will be done soon, establishing the rules of handling and use of the proceeds of the Oil Price Differential Account, underlined by the principles of transparency, good governance and accountability applicable to public finance management. The Oil Price Differential revenue is determined by the difference between the oil return taking into account the market price, and oil revenues projected in the Budget, taking into account the budgetary oil price reference and holding constant the amount of oil production. There can therefore be flow-in and flow-out of the Account depending of the actual level of production and market oil price, with the resources accumulated in the Account to be used for stabilization purposes. As part of the the second DPF reforms, the government will work with the World Bank team to thoroughly review the Presidential Decree, revisit the underlining technical and institutional consideration as needed, and revise accordingly the Presidential Decree. This constitutes the first trigger of next operation. As of now, the new Presidential Decree sets the following conditions of using the Account:

- When financing would raise the debt stock over beyond 60 of GDP;
- When the contraction of financing leads to an excessive debt service or an increased country risk in terms of cost of financing;
- The use of these resources should not, over a 5 years period, lead to an increase of more than 10 percent of recurrent public expenditure, except in circumstances of a State of emergency;

- Give priority to capital expenditures in the utilization of the Account, except when the tax revenue covers less than half of structural current expenditure (such as salaries and minimum operating expenditure) and non-negotiable debt service.
10. The Stabilization Fund needs to be complemented with increased non-oil tax revenues. The Ongoing Tax Administration and Tax Policy reforms are done in this spirit. These measures include:
- The integration of Tax and Custom Administrations through the creation of the AGT, whose Board of Directors has already appointed and working to fully operationalize the new structure;
  - A number of tax codes were modernized, namely the Industrial Tax Code (approved by Law no. 19/14, of 22 October 2014); the Personal Income Tax Code (approved by Law no. 18/14, of 22 October 2014); the Tax on Invested Capital Code (approved by Presidential Decree Law no. 2/14, of 20 October 2014); the Stamp Duty Code (approved by Presidential Decree Law no. 3/14, of 21 October 2014). Together with the introduction of other significant changes in the various Angolan taxes, these laws revoke all legislation previously in force that contradicts the new tax codes.
11. These reforms effort will continue with introduction in the coming years of a full-fledged Value Added Tax. Some preparatory are currently under way to identify the modalities to effectively introducing this tax. For the next DPF operation, the reforms will focus on the implementation of institutional and operational measures to make the AGT fully functional by December 30, 2015: (1) AGT organizational structure completed and management of all departments fully staffed; (2) New Strategic Plan and Implementation Plan for AGT approved by both the AGT Board and Minister of Finance; (3) New dedicated Code of Ethics completed and applied to entire staff at AGT; and (4) New Management Unit reporting directly to the Chair of the AGT Board established to coordinate implementation of strategic cultural and operational integration between tax and customs administrations as well as change management. By December 30, 2015, we will also continue major operational business process reengineering and staff training to support implementation of new tax laws: (1) Complete the pilot phase of updating registration database for the group of corporate sector; (2) Expand the taxpayer base through a mix of new operational initiatives, e.g., create mobile teams and task force to reach hard-to-tax groups of taxpayers and those located outside of Luanda; (3) Develop new tax forms as commensurate to the revised tax laws; (4)

Introduce e-filing, make it compulsory to large taxpayers; (5) Update and improve Strategic Plan and Manual for tax audit; and (5) Continue training on new tax codes.

### **Enhancing the Efficiency and Effectiveness of Public Investment**

12. The objective of the Government of Angola is to build an integral Public Investment Management (PIM) system that improves coordination in the National Directorate of Public Investments (NDPI) and ensures that projects financed with public funds are linked to strategic priorities appropriately formulated, appraised and selected, efficiently implemented and monitored comprehensively. Stronger PIM will help with improving value for money by enhancing the efficiency and effectiveness of public investment. To achieve that objective, the Government is focusing on the following activities (i) updating the legal and regulatory framework, (ii) improving the Public Investment Plans (PIP) and the IT system helping to handle it (SIPIP), (iii) better coordination and linkage of the SIPIP to other relevant software systems in other public administrations such as the Financial Management System of the Ministry of Finance (SIGFE) and the IT system of the Procurement Authority (IGTC), and (iv) promoting skilled human capital for PIM.

13. To improve the Medium Term Fiscal Framework under which investment projects are articulated, the Government is also reinforcing the macroeconomic projection tool that is used to project the country's macroeconomic framework, using the richest set of national account statistics recently released by the National Institute of Statistics (INE), with the support of the World Bank technical assistance. The Government ambitions to develop a statistical system with more frequent household surveys that will allow to better identify needs, set objectives, and monitor progress of implemented policies. The National Strategy for Statistical Development (ENDE-2015-2025) was approved during the month of February 2015 by the Council of Ministers. The set of surveys that are planned to take place in the next decade, and their respective budget allocations, will be carried out according to the published version of the ENDE-2015-2025. A main component of the national statistical system is the survey "Inquerito de Despesas e Receitas e Emprego da Populacao-2015" (IDRE-2015) (Population, Budget, Income, and Employment Survey -2015) that is planned to be fielded in 2015. Once the IDRE-2015 is completed, its data and the data from the 2014 national census will be used to prepare poverty maps which can assist the Government in better targeting its anti-poverty and social programs.

## **Moving from Untargeted Fuel Price Subsidies to Targeted Cash-Transfers**

14. Besides being fiscally costly, fuel subsidies are inefficient and inequitable. They crowd out growth-enhancing spending, create incentives to smuggling, effectively financing low-cost fuel consumption in neighboring countries. In addition, they provide rent seeking opportunities and raise governance challenges. During the last quarter of 2014, the Government raised fuel prices for the first time in four years. The prices for gasoline and diesel increased by 25 percent, while liquified petroleum gas (LPG) increased by 21.6 percent, kerosene by 34.6 percent, heavy fuels by 100 percent, and asphalt by 18.8 percent. In December 2014, the Government raised the prices of gasoline and diesel further by 20 percent. In addition, the prices of light and heavy fuel oils, as well as the price of asphalt, were liberalized and are now to be determined by the market.

15. The Cartao Kikuia is pilot cash transfer program that is part of the Poverty Reduction Program “Combate da Pobreza”. The program has already enrolled 50,000 families, 99 percent of which are headed by females. Our Government is planning to gradually reduce these fuel subsidies, and create by the same occasion some fiscal space to scale up better targeted social expenditure through cash transfer programs. The program plan is to enroll 90,000 more families in 2015. The Cartao Kikuia program is an unconditional cash transfer program that transfers 10,000 Kwz (approximately US\$100) per household per month. Beneficiary households must meet at least one requirement of a list of criteria that includes:

- Household is female headed
- Household has at least one member with a disability
- Household has at least one member who is a former combatant or a war veteran
- Household has at least one member who is a senior citizen or has a chronic disease
- Household has at least one malnourished child
- Household has a high dependency ratio
- Household has at least one orphan child.

16. While Cartão Kikuia transfers are likely better targeted to the poor than untargeted fuel price subsidies, there is likely considerable room for improving its targeting system. Currently, we establish quotas for the number of beneficiaries for each province in the country. These provincial quotas were computed via the estimation of the proportion of households meeting the criteria above with the 2008/09 IBEP household surveys. These

proportions were then applied to the total provincial population count of the 2014 national census. The provincial governors (who are not elected but are appointed by the president) then decide how to distribute their provincial quotas of Kikuia beneficiaries across their municipalities. Municipal administrators are then responsible to distribute their municipal quotas among their several comunas, and comuna administrators are then put in charge of distributing their comuna quotas among resident households. Nevertheless, while setting the quotas well can contribute to good targeting, they do not tell the whole story since quotas account for only a portion of the gain focus of the selection system currently used. In other words, much of the focus gain is due or the merits of the local system of selection of families to be registered, or use the registration information for the selection of families to be benefited. Therefore, we hoping to get the support of the World Bank though TA on these other factors that contribute to good targeting systems. As part of the reform program of next DPF operation, we will prepare with the assistance of the Bank team a poverty map combining the data from the 2014 National Census and the 2008-09 IBEP survey, and use the poverty map to assess the targeting of the Cartão Kikuia resources, as well as the allocation of the main other poverty reduction programs. The Ministry of Finance is also planning to centralize all social programs in a single register to facilitate monitoring and evaluation. Currently, various social programs are scattered across various ministries (e.g. Ministry of Social Affairs, Ministry of Commerce and Ministry of Veteran Affairs among others). The World Bank DPF will provide the TA needed to develop and implement a Cadastro Unico of all social programs.

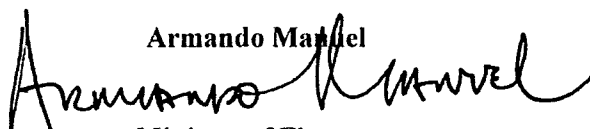
### **Project Monitoring and Evaluation**

17. The Ministry of Finance is the main counterpart for implementation of the DPF series. To facilitate coordination of reforms the Government has established the following Technical Team to work closely with the World Bank Team on both the loan and the Guarantee component:

- João Boa Francisco Quipipa
- Angélica Eugénia Calembe Paquete
- Bantu Anfaná Teixeira dos Santos
- Manuel António Freire



18. The Ministry of Finance will also regularly collect key monitoring and evaluation indicators needed to assess progress toward the expected results of reforms planned under DPF series.

  
Armando Manuel  
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