Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 21-Mar-2019 | Report No: PIDC25497
## BASIC INFORMATION

### A. Basic Project Data

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<td>Angola</td>
<td>P166564</td>
<td>Angola Growth and Inclusion DPF (P166564)</td>
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**Proposed Development Objective(s)**

The Operation will 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**

<table>
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<th>Total World Bank Group Financing</th>
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Decision
B. Introduction and Context

Country Context

The proposed Development Policy Financing (DPF) series supports the Government of Angola’s (GoA) efforts to maintain macroeconomic stability and lay the foundations for private-sector led economic diversification. The proposed operation is the first in a programmatic series of three IBRD loans. This first single tranche operation, in the amount of US$500 million, is organized around two pillars: (i) laying the foundation for sustainable growth and (ii) promoting social and financial inclusion and effective public service delivery.

The Angolan economy is at a significant juncture. The current growth model based on oil wealth is nearly exhausted and has not delivered inclusive growth and shared prosperity. In addition, over-dependence on oil has made growth and macroeconomic management highly vulnerable to external shocks. The challenge for the new Administration of President João Lourenço, the first new leader in almost four decades and in office since September 2017, is to lay the foundations for a new growth model that is more open and 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. Within this context, Angola faces two broad policy challenges that need to be urgently addressed:

- Angola needs institutions that support more sustainable and less volatile growth. The sharp and prolonged decline in oil prices since mid-2014 has reduced oil revenues and caused GDP growth to contract over the past three years. The current account deficit stood at 8.8 percent of GDP in 2015, large fiscal deficits have been recorded since 2014, public debt has doubled over the last three years. There is also an urgent need to safeguard financial system stability as the undercapitalization of a systemically important state-owned bank, the loss of direct U.S. dollar correspondent banking relationship, and non-performing loans are inhibiting the banking sector’s ability to provide needed credit for the private sector, especially for small and medium enterprises. Inflation escalated in 2016, reaching a peak of 40 percent in December 2016, before retrenching to 18 percent in February 2019.

- Angola needs a more inclusive growth model that promotes private-sector led diversification and protects the poor and vulnerable. Up to now, Angola has relied on the oil industry and high oil prices to drive economic growth and to rebuild a large part of its infrastructure, which was destroyed during the long Civil War (1975-2002). Inequality remains high, with a Gini coefficient of 0.43 in 2016. In the 2015, Angola ranked 150 (out of 188) in terms of Human Development Indicators. The Human Capital Index (HCI) is at 0.36 and performs below income comparators and the Sub-Saharan Africa’s average at all levels. In 2016, about 30 percent of the Angolan population remained below the international poverty line (at $1.90/ day and 55 percent if $3.1/day is considered). Investment in human capital, effective institutions and a favorable business environment are critical for economic diversification and job creation.

The new Administration is aware of these challenges and has started to implement much needed reforms. Decisive steps have been taken towards restoring macro-stability and the medium-term National Development Plan (2018-2022) lays out a road map towards a more diversified and inclusive growth model that is open to supporting a young and growing population. The new Administration has also shown willingness to tackle entrenched interest and has
undertaken several critical reforms, including the passage of laws for greater private sector investment and transparency. The new Administration is advancing plans to open up important sectors to competition, including through privatizations of large-scale state-owned enterprises. Macro-economic policies have been adjusted to reflect market realities and address imbalances; these include greater exchange rate flexibility; the modernization of monetary policy; plans to reform and better target subsidies; more effective management of natural resource wealth through the creation of a Sovereign Wealth fund with the dual objective of fiscal-stabilization and long-term saving; and a commitment to restructure state-owned banks. The proposed DPF series intends to support Angola in its ambitious and urgent reform strategy.

The macroeconomic framework in Angola is sustainable over the medium term and adequate for the proposed operation. The depreciation of the currency and the removal of FX restrictions has allowed the current account to reach equilibrium and brought the real effective exchange rate close to fundamentals. The adoption of a market-based exchange rate will allow the exchange rate to respond to oil price fluctuations, bearing most of the adjustment in the future. Domestic equilibrium has not yet been achieved as inflation and debt levels are still high. However, the policy response since late 2017–anchored in the PEM – has been adequate and effective in reducing these imbalances. If implemented successfully, the PEM is expected to strengthen fiscal and debt sustainability, reduce inflation, and improve financial sector stability over the medium term. The economic diversification agenda–backed by the NDP 2018-22–will be instrumental to enhance private sector-led growth and competitiveness over the medium term, which will help reduce the volatility and pro-cyclicality from commodity dependency and support macroeconomic stability.

Relationship to CPF

The DPF series reflects the priorities and objectives of the proposed FY20-25 Country Partnership Framework (CPF), which is under preparation. Key focus areas of the CPF aim to strengthen governance and institutions for an inclusive economic and social model which is more diversified and less reliant on oil revenues; foster private sector investments for sustainable private sector-led growth; and protect and strengthen human capital through social protection, the provision of basic services, and investing in education and health.

The policy areas of the DPF series will contribute to all three focus areas of the CPF, complement investment lending under the CPF, and create the policy underpinnings that can, together with IFC, harness private sector opportunities. For example, the DPF support for a Medium-term Debt Strategy and the establishment of an Oil Revenue Differential Financial Reserve aligns to the CPF objective to improve fiscal management and reduce pro-cyclicality of fiscal expenditures, and builds on an Oil Price Differential Account ASA (P159791). Support to strengthen the management and commercial viability of SOEs—including pricing and subsidy reform for financial sustainability and effective service provision of providers, increase access to finance, and improve the competition framework reflect CPF objectives to improve the enabling environment and increase private sector-led growth, especially in sectors that have previously been dominated by SOEs. This relates closely with ongoing ASA including the country economic memorandum CEM (P162993) and the joint WB and IFC country private sector diagnostic CPSP (P167838 and IFC AS), the subsidy reform project (P168918), business environment RAS, information and communication technology ICT and energy sector analytics, as well as lending for smallholder and commercial agriculture, which is expected to catalyze IFC support for private sector investments in agribusiness.

The agenda on financial and social inclusion and improved service delivery under DPF Pillar 2 is aligned with the CPF objective on strengthening human capital through social protection and the provision of basic services. It relates to the WB projects in social protection and health, including a local development project and a planned social safety net project.
C. Proposed Development Objective(s)

The series’ Program Development Objectives (PDOs) are to support the government 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. The reforms under the two objectives mutually reinforce each other and are expected to make the country more resilient to shocks, raise investor confidence, and foster fiscal sustainability and private-sector-led growth over the medium-term.

Key Results
Specific expected results by the end of the DPF series (by the end of 2020, that is one year after this operation) revolve around the following:

**Pillar 1 --- Strengthening the macro-financial and institutional environment.**

- Number of quarterly fiscal accounts published per calendar year, with lags no longer than 45 days for each quarter. Baseline (2018): 0. Target (2021): 4.
- Share of the total deposit accounts insured by a Deposit Guarantee Fund. Baseline (2018): 0%. Target (2021): 90%.
- Government transfers to SOEs (operational subsidies, capital transfers) as a share of GDP. Baseline (2017): 5%. Target (2021): 2%.
- Number of enforcement decisions issued by the Competition Regulation Authority (ARC). Baseline (2018): 0. Target (2021): 3.

**Pillar 2 --- Protecting the poor and vulnerable.**

- Number of poor households registered and receiving cash transfers in the Cadastro Único. Baseline (2018): 0. Target (2021): 800,000.

D. Project Description

The operation is organized around two pillars, each including several policy areas:

**Pillar 1: Strengthening the macro-financial and institutional environment.** Policy areas include: strengthening debt and natural resource management for fiscal sustainability; strengthening financial sector resilience;
strengthening management and commercial viability of SOEs; supporting pricing and subsidy reform for financial sustainability and effective service provision; and leveling the playing field for private investment.

**Pillar 2: Protecting the poor and vulnerable.** Policy areas include: protecting the poor and vulnerable from shocks; and increasing access to finance.

The proposed DPF is fully aligned with the government’s priorities and reflects the World Bank’s current engagement in Angola. The DPF builds on extensive policy dialogue structured around analytical work, including the recent Angola systematic country diagnostic (SCD), technical assistance, and other current and prospective World Bank engagements.

The IMF approved a three-year Extended Fund Facility (EFF) with Angola on December 7, 2018. The IMF program will provide financing for US$ 3.7 billion, of which US$ 990.7 million was made available for immediate disbursement. The program supports the implementation of Angola’s macroeconomic reform plan (PEM), including fiscal consolidation, increased exchange rate flexibility, and financial sector stability. Other pillars of the program include enabling a better business environment; updating the AML/CFT legal framework; and improving governance. The EFF includes conditionalities on public debt and the transparency of debt statistics. The EFF further envisages close collaboration with the World Bank on subsidies reforms, including on mitigating social protection measures.

**E. Implementation**

Institutional and Implementation Arrangements

**MOF will be responsible for collecting and monitoring information related to program implementation and progress towards the achievement of the results.** MOF will be responsible for coordinating necessary actions among the agencies involved in the reform program supported by this DPF series. The World Bank has worked closely with MOF and line ministries in order to define results indicators that are clearly spelled out and measurable, giving preference to those that are collected on a regular basis in order to avoid an additional reporting burden. For example, some indicators are included in the NDP, which has a robust results framework that is closely monitored by MEP. Other indicators are already being regularly produced by the BNA, supported by Bank TA and other operations, or will also be produced to comply with structural benchmarks as well as data reporting requirements for IMF EFF.

**F. Poverty and Social Impacts and Environmental Aspects**

Poverty and Social Impacts

Overall, the proposed DPO supports policy and institutional changes that are likely to have poverty-reducing effects in the medium- to long-term. Yet, there will also be distributional effects in the short-run that should be addressed. Reforms to improve oversight and privatization of SOEs as well as reforms on fuel, electricity, and water tariffs are likely to improve the fiscal position of the government and to improve macro-stability and economic growth in the medium to long-term. In turn, this could help prevent economic crisis-induced increases in poverty. Policy reforms regarding fuel, electricity, and water tariffs are expected to have the largest direct and indirect impact among the proposed changes, increasing poverty in the short-run. Targeted cash transfers under the planned social safety net project (P169779) explicitly seek to tackle adverse impacts of the tariff reforms. These are likely to have poverty-reducing effects, depending on several factors, including targeting, size and duration of the transfers, and coverage. Reforms seeking to improve access to finance could have positive impacts on poverty. Reforms aimed at improving competition and introducing a higher level of foreign
investment could also help decrease poverty through the channels of prices, wages of the employed, and potential job creation.

The fuel, electricity, and water tariff are expected to contribute to poverty reduction and have positive distributional impacts in the medium to long-term. In the short-run, they are likely to have negative distributional effects. Tariff structure adjustments will increase available fiscal space, and consequently may have welfare-improving effects in the medium- to long-run. The tariff reform could also allow the fuel, electricity, and water providers to become more financially sustainable and to use additional revenue to expand and improve access, mainly to underserved rural areas. Previous analyses carried out by the World Bank (2016) and the IMF (2015) on the fuel subsidies reform had pointed out that the latter have mainly benefitted the rich. Similar studies by IMF and by the WB indicated that this is also the case in Mozambique. Fuel subsidies were benefiting those in the top income quintiles as well as people, i.e. truck drivers, from the neighboring countries. A recent IMF study (IMF, 2012) confirmed this finding for most developing countries. Yet, the World Bank study on Angola, carried out in 2016 (WB, 2016) concluded that through direct (lower household consumption) and indirect (higher prices of goods and services due to higher fuel expenditures) effects, the poverty headcount rate was likely to increase due to the envisioned fuel tariff reform. A similarly careful analysis would be necessary for the electricity and water tariffs using the same household consumption survey (IBEP, 2008). If a newer household dataset became available in time for the analysis (the most recent household survey should become available mid-2019), the team would be able to include welfare comparisons over time and study the impact on poverty given that a large part of the subsidies was subsequently reduced in the past years.

Improving the current social protection system by introducing one that consists of cash instead of in-kind transfers is to be welcomed and is more likely to tackle the adverse impact of the fuel, electricity, and water tariff reform than the current system in place (Cartão Kikuia). The poverty-reducing effect of the envisioned cash transfer will crucially depend on the exact size of transfers, targeting, transparency of allocation mechanisms, as well as other practical considerations. The current system in place, Cartão Kikuia, had multiple problems serving the poor as a recent WB (2016) illustrated. The main problems consisted of (i) too low transfers, (ii) non-transparent targeting, as well as the (iii) in-kind nature of the transfers. Latter consists of vouchers to be redeemed in so-called Kikuia stores or to be used for a set of products that can be purchased with the card. The main problems being: (i) available stores are concentrated in the capital city, (ii) the supply of products in existing stores is low, (iii) there are reported technical problems in card recognition, and (iv) budget allocations to the program did not materialize consistently. All of the above explains why most beneficiaries are not able to use the 10,000 kwanza theoretically available on the card. The latter amount is far below the 60,000 (close to $200) needed to effectively reduce poverty – because family size is currently not taken into account. Hence, planning for transfer amounts to compensate for the average expected subsidy-removal loss in income among the two bottom quintiles and hence increase coverage are to be welcomed. Going forward, it will also be crucial to clearly communicate eligibility criteria through social and traditional media and municipalities, as well as improving targeting mechanisms. Setting up the social registry (Cadastro Único) is a step in the right direction. Depending on the start date of the new social safety net program and availability of the most recent household survey (mid-2019), the poverty-reducing effect of the cash transfers could be studied.

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.
Environmental Aspects

Angola’s legal environmental framework is in place; however, further efforts are needed to strengthen the administrative capacity and implementation framework to manage environmental risks. The Environment Framework Law (EFL)\(^1\), and relevant subsequent decrees, establish the general conditions for public consultations, enforcement, prevention and control of pollution; it also lays out requirements for prior environmental assessment. In Angola, the National Institute for Environmental Management (approved by Presidential Decree No. 11/11) is responsible for implementing and monitoring environmental policies. Other duties include mainstreaming environmental policies into sectoral policies; and establishing and maintaining environmental management systems. The Fund for the Environment approved by Presidential Decree No. 09/11 has been established as a financial mechanism to support management of the environment at the national level.

The institutional and regulatory system for environmental management appears to be in place, however, government capacity to handle and manage potential environmental risks associated with Prior action #3; Prior Action #4 and Prior Action #5 is weak. The Ministry of Environment is conscious of these limitations and a recent analytical study carried out by the World Bank in 2018 in Angola discusses challenges and opportunities for strengthening environmental and social management capacity in Angola. Prior actions to be implemented under this DPF which relate to SOE reform, utility tariff reform and creating investment opportunities are likely to have environmental effects, and hence need to receive scrutiny and close supervision.

G. Risks and Mitigation

The overall risk associated with the proposed DPF is assessed as high. Most of the reforms supported by the operation form part of the PEM and the NDP and benefit from strong ownership of the government. The most relevant risks are related to macroeconomic, institutional capacity categories and stakeholder risks.

Macroeconomic risks arise from the uncertainty in the external outlook and domestic developments. A sharp decline in oil prices, a stronger than expected reduction in oil production and tighter global financing conditions could dampen growth prospects and increase the need for additional fiscal consolidation. This may lead to a re-orientation of reform and spending priorities away from social services. Mitigating factors include the government’s commitment to macroeconomic stability, which is supported by the IMF EEF program. A significant increase in oil prices may also lessen reform momentum in the short-term, but long-term prospects of declining oil production provide strong incentives to pursue a less-oil dependent growth model.

Angola’s institutional capacity to implement some of the supported reforms will require some strengthening. As most measures supported by the DPF called for fundamental managerial and administrative reforms, it will be critical that implementation capacity is strengthened in step. The approach of the DPF series to support all prior actions with TA and/or investment operations is expected to help mitigate this risk. The Technical Committee of prior action-specific focal points is also expected to facilitate DPF-supported reform areas.

Stakeholder risks arise from potential resistance to reform from vested interest. Lessons from the 2010 DPF highlight the importance to consider the political constraints to development in Angola. The execution of the program fell short in

\(^1\) Lei de Bases do Ambiente: No.5/98, of June 19, 1998.
areas where the expected measures called for fundamental managerial and administrative reforms, or where policies required strong political support to overcome vested interest, such as with the consolidation of the social sector programs or the introduction of automatic adjustments to fuel prices. While these risks still exist, they are mitigated by political support for reforms at the highest level as well as coordination with other IFIs, such as the IMF and the EU. Prospects that MFD-enabling reforms supported by the operation, such as improvements to business climate, SOE reform and tariff reform, may unlock significant private financing, which may also help lessen resistance from vested interests. To mitigate any adverse impacts related to subsidies and the new safety net reform, the government has started to work on a multi-stakeholder communication strategy. The proposed operation also supports a phased approach to the elimination of subsidies by supporting the establishment of the registry of beneficiaries first so that a cash transfer program can effectively target the most vulnerable.

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