

Angola

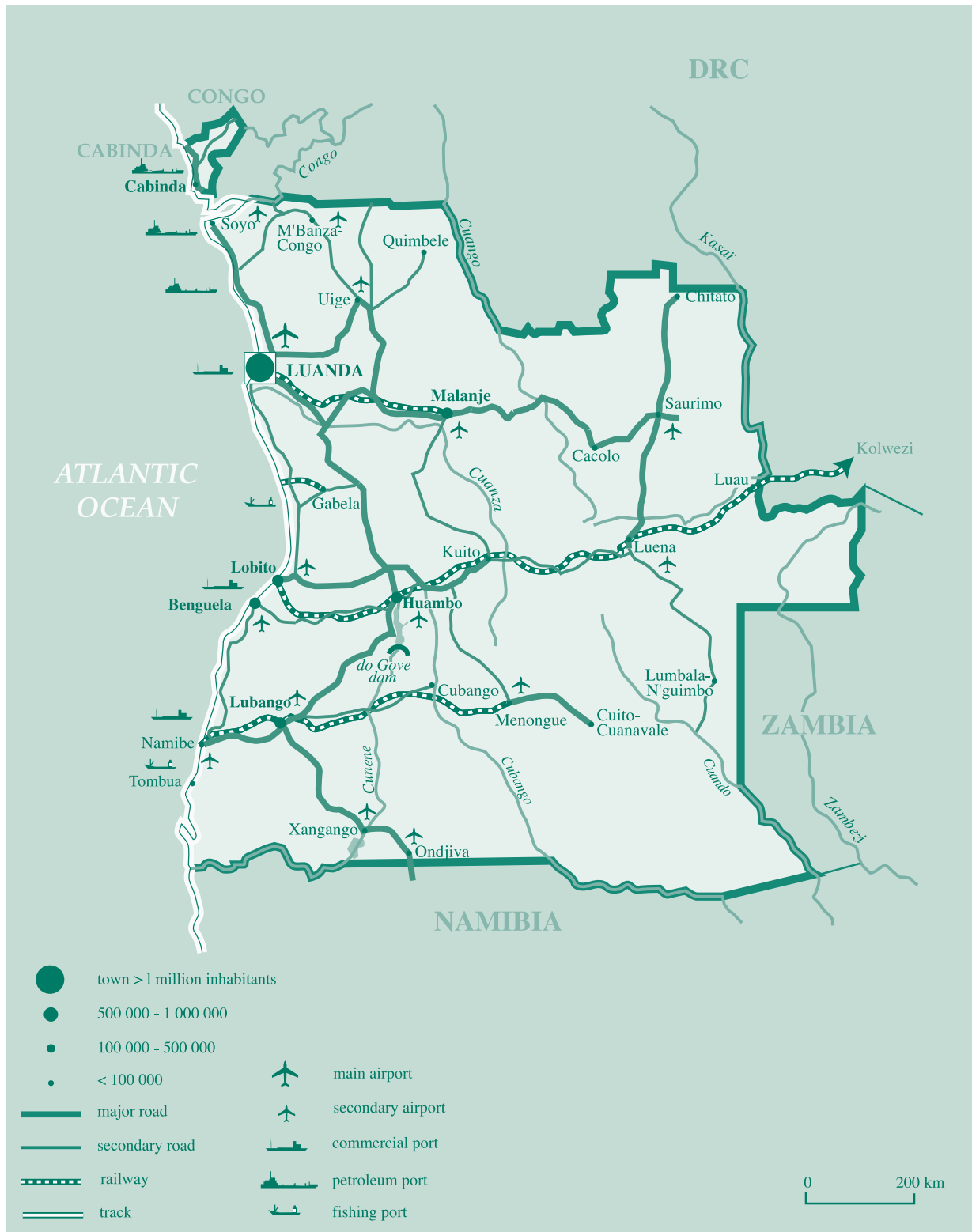
Angola



key figures

• Land area, thousands of km ²	1 247
• Population, thousands (2006)	16 400
• GDP per capita, \$ PPP valuation (2006)	3 438
• Life expectancy (2006)	41.7
• Illiteracy rate (2006)	32.6

Angola



ANGOLA IS EXPERIENCING RAPID and prolonged economic growth, thanks to a boom in commodity prices and rapid development of oil and diamond production. Nevertheless, and despite encouraging signs of recovery in the non-mineral sectors, the lack of structural reform, widespread inefficiency and weak governance are still jeopardising the potential of economic growth to bring about social development.

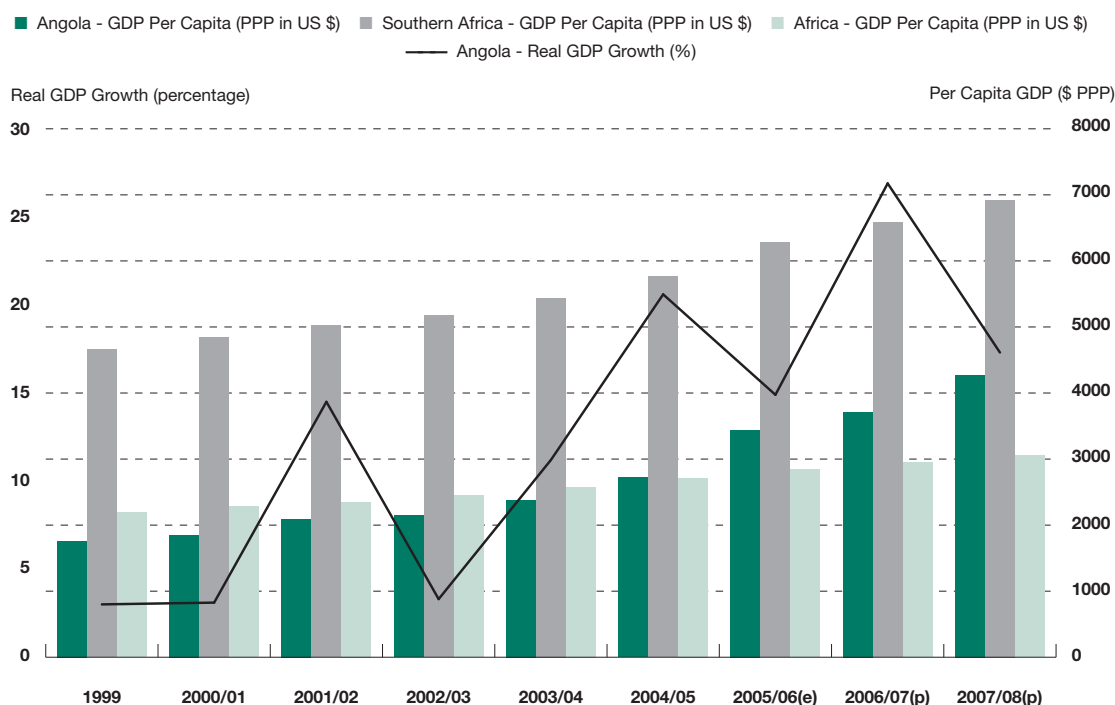
Record-high international oil prices and rapidly growing output from new oil fields sustained real GDP growth, which reached 14.8 per cent in 2006, following 20.6 per cent in 2005, and is expected to remain high at 27 per cent in 2007 and 17.3 per cent in 2008. Angola is exceptionally dependent on oil. Other economic activities account for a negligible share of

overall growth and of export revenues, although they contribute more to job creation. Improved performance in banking, construction, retail trade and telecommunications suggests, however, that some impacts from the oil boom are percolating through to the broader economy. Agriculture is also picking up, although output and productivity remain far below potential and the situation is unlikely to improve considerably until infrastructure rehabilitation is completed, markets for key inputs are established and mine clearance is finished.

At the macroeconomic level, despite the progress recorded since the end of the war, transparency of oil

A number of factors are fostering rapid and prolonged economic growth but governance needs improving.

Figure 1 - Real GDP Growth and Per Capita GDP
(\$ PPP at current prices)



Source: IMF and National Institute of Statistics data; estimates (e) and projections (p) based on authors' calculations.

<http://dx.doi.org/10.1787/474756712485>

revenue management remains incomplete, and much remains to be done to align fiscal policy actions with the priorities of poverty eradication. Angola's relationship with the Bretton Woods institutions is poor, and progress in reaching an agreement that would broaden the country's access to international financial markets has stalled as the authorities have gained access to alternative bilateral credit lines. An expansionary fiscal policy continues to place the burden of macroeconomic stabilisation on monetary policy. Although the latter has proven to be very effective in reducing inflation, it has generated adverse consequences in terms of high interest rates, an over-valued domestic currency and uncompetitive domestic prices.

At the microeconomic level, despite the signs of recovery in the private sector, risk taking and entrepreneurship continue to be stifled by high *de jure* and *de facto* barriers to entry, including privileged access to market opportunities and finance for a small number of business people. Some important reforms have been made – for instance, to accelerate the procedures for establishing new companies – but implementation has been delayed in practice by the poor state of the bureaucracy.

Finally, inter-generational considerations give rise to concern. Angola may be experiencing a petroleum boom, but output will soon reach a plateau and then decline quickly. To prepare for this, the authorities should redouble efforts to diversify and increase production by wisely investing current revenues for the benefit of future generations. One way of doing so would be to accelerate land reform, increase allocations to education and health, and improve the efficiency of public spending.

Recent Economic Developments

Developments in the mining sector are driving the currently high rate of GDP growth. In 2006, the growth rate of the oil sector slowed down when compared to 2005, while that of labour-intensive diamond mining strongly increased. Overall, the mining industry is estimated to have expanded at a

somewhat slower rate in 2006 than in 2005, but is expected to accelerate in 2007.

In 2005, the oil sector accounted for more than 56 per cent of GDP, 83.1 per cent of government revenues and 94.1 per cent of exports. In 2006, oil production is estimated to have grown by 15 per cent compared to 26 per cent in 2005. Daily production in offshore fields, mostly in the Congo River basin opposite the Cabinda enclave, averaged 1.4 million barrels a day in 2006 and is expected to peak at 2.6 million barrels in 2010/11. The slower growth was due to maintenance work in a number of fields, including the Girassol field in Block 17, and the slower than anticipated start-up of production on the Dália field. Hence, instead of the initial forecast of 597 million barrels, annual output amounted to 510 million barrels. With reserves now estimated to be between 20 and 22.8 billion barrels, the growth rate of production is expected to accelerate in 2007 and further increase in 2008. In early 2006, oil was produced for the first time from Block 14, while the Benguela, Belize, Lobito and Tomboco fields are expected to produce 200 000 barrels of crude oil per day in 2008. New concessions will be awarded in 2007, and imports of increasingly sophisticated equipment are rising as exploration and exploitation move to ultra-deep fields. In December 2006, Angola officially became a member of the Organisation of Petroleum Exporting Countries. Moreover, new explorations are being undertaken in the field of natural gas, whose potential has not been estimated yet.

The Angolan oil boom has now been under way for a number of years, and reform of the policy environment is more imperative than ever. The government has traditionally intervened in the oil industry through Sonangol, a state-owned enterprise that retains responsibility for regulation and contract negotiations, is sole owner of the fields and has entered into production-sharing agreements with major western oil companies, led by Chevron, Total and ENI, although independent companies, as well as national oil companies from Brazil and China, also play an active and growing role. This combination of Sonangol's various roles has long been criticised for giving rise to conflicts of interest.

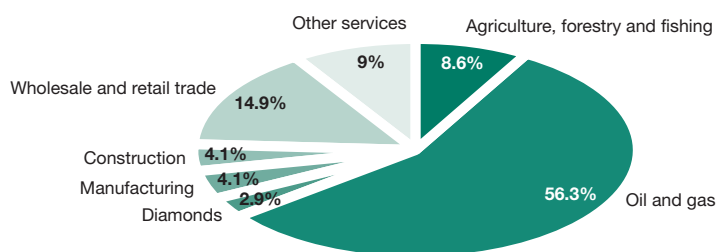
The process of Angolanisation, started in 1982, requires oil companies to staff operations in the country with Angolan workers. The government recently proposed new procurement and employment clauses in the production-sharing agreements aimed at increasing local participation in the industry. This policy attempts to address the fact that the sector has little direct employment impact, creates few direct linkages to other sectors of the economy and relies on imports of capital equipment and specialised services. Nevertheless, there is a risk that foreign oil companies will recruit most of the few highly skilled Angolan workers and crowd out the public administration and the non-oil private sector. Moreover, having reduced inflation, modernised the banking sector and introduced electronic payments and real-time gross settlement of balances, the government has renewed its calls for oil firms to route all industry payments through the domestic banking system. These calls have raised resistance among oil firms, which doubt the capacity of local banks to handle large amounts of money.

Diamond mining in extensive kimberlite and alluvial projects is the second-largest source of export revenues

(about 5 per cent of total exports in 2005). Angola is considered to be one of the world's most promising diamond areas, with estimated reserves of 400 million carats of alluvial diamonds and 40 million carats of kimberlite, although detailed geological exploration has started only recently and modern techniques are scarcely in use. Production increased by 16.2 per cent in 2005 and by 41.7 per cent in 2006 as output at the Catoca mine doubled, reaching 10 million carats. This trend is expected to continue, at least in the short term, since 23 new exploration licences were issued to private enterprises in Bié province. To add value to production, the largest polishing and cutting factory in Africa opened in November 2005. The Angola Polishing Diamonds factory – a joint venture between the state diamond company Endiama, the Angolan consortium PROGEM and Lev Leviev Diamonds (LLD), the world's second-largest diamond trading company – employs 400 technicians. As in the case of Sonangol, Endiama combines the roles of regulator and economic operator.

The domestic non-mining economy continued its recovery in 2006, exhibiting growth of 13.8 per cent

Figure 2 - GDP by Sector in 2004/05 (percentage)



Source: Authors' estimates based on National Institute of Statistics data.

<http://dx.doi.org/10.1787/384572172060>

as the dynamism spread from construction and services to agriculture and, to a lesser extent, manufacturing. This positive trend is expected to impact favourably on internal market development and job creation and thus contribute to poverty reduction.

Angola has fertile soil and a climate conducive to agriculture; in fact, at independence the country was

self-sufficient in food production, the largest staple food exporter in sub-Saharan Africa and one of the world's biggest coffee exporters. The civil war exacted a heavy toll on the agricultural sector, especially in the central and northern regions, which were the most affected by fighting. Although production is recovering (the growth rate for the sector over the 2000-04 period has averaged 13.3 per cent and production has increased

by more than 80 per cent since 2000), agriculture accounted for only 8.6 per cent of GDP in 2005, because agricultural production is still hampered by the widespread presence of land mines, infrastructure inadequacy, low productivity, input shortages in general and the absence of storage systems.

Agricultural output grew at a rate of 17 per cent in 2005, but the 2005/06 agricultural season has been below expectations, due to poor rains which have reduced Angola's total cereal production to 742 000 tonnes, a 15 per cent fall compared with the previous season. According to the Famine Early Warning Systems Network (FEWS Net) assessment, households expect drought conditions to reduce their maize crops by 40 to 70 per cent. By contrast, coffee production increased during the 2005/06 growing season, but the road to recovery remains a long one due to high production costs and poor infrastructure. Coffee production had dropped sharply during the civil war, when output of cash crops in general became insignificant.

Angola once had one of Africa's most developed manufacturing industries, but the civil war led to a prolonged phase of negative growth. There are signs, however, that production is picking up in certain industries, as consumers' purchasing power recovers in Luanda and other major urban centres. The sector recorded a cumulative growth rate of 67.4 per cent in real terms for the 2000-04 period, 24.9 per cent in 2005 and 30.7 per cent in 2006. The beverages sector, for instance, grew by 8 per cent in 2005 and is estimated to have grown even more in 2006, benefiting from the national football team's participation in the World Cup. In general, agribusiness is expected to benefit from the recent opening of cold-storage facilities in Luanda and the announcement of a rehabilitation programme for the national cold-storage network. On the negative side, the performance of the only existing petroleum refinery continues to be hampered by persistent bottlenecks, partly associated with the nature of the supply arrangement with Sonangol and distorted incentives that encourage imports of refined petroleum products.

Construction, another booming sector, is leading growth in the non-oil sectors, with physical production

up by 22.14 per cent in the period January-September 2006, following 17 per cent growth in 2005. Progress has been made in rehabilitating transport infrastructure, particularly roads and bridges. Chinese contractors completed major projects such as the Keve bridge and the Luanda-Namibe railway, although completion of the Luanda-Malanje link will be delayed until 2007. In Luanda, on the other hand, a number of Portuguese construction firms completed or announced projects involving residential, hotel and office buildings. All in all, the construction sector expanded by a remarkable 66.2 per cent in 2006, and the hosting of the Africa Cup of Nations football championships in 2010 is expected to sustain growth over the next few years.

The growth rate of the services sector (which accounted for about 15 per cent of GDP in 2005) slowed in 2006, compared to 8.5 per cent in 2005, with the trade sub-sector taking the lead. Telecommunications, and especially mobile telecommunication services, have experienced exceptional growth since 2002, benefiting from the end of the war and the privatisation of the sector. The total number of cell phone subscribers reached 2.6 million at end-2006 (a 44 per cent increase), with the incumbent's market share falling slightly to 81 per cent. The geographical distribution of telecommunication service is extremely asymmetric, with Luanda and other few major towns accounting for more than 85 per cent of the existing connections. The growth potential of the sector is extremely large, considering the low access rate (0.60 per cent), well below that of neighbouring countries such as Namibia (6.86 per cent), South Africa (11.46 per cent) and Botswana (5.64 per cent). The financial sector is continuing on the track of fast post-war development. Ten commercial banks have applied for operating licences, and in 2006 two new banks opened, bringing the number of operating banks to nine. Bank deposits are rising, access to short-term credit is improving, and residential mortgages are increasing, but access to other long-term finance is limited, especially outside Luanda.

The demand structure reflects Angola's historical reliance on oil exports and imports for most consumer

Table 1 - Demand Composition (percentage of GDP)

	1997/98	2004/05	2005/06(e)	2006/07(p)	2007/08(p)
	Percentage of GDP (current prices)		Percentage changes, volume		
Gross capital formation	35.2	7.5	51.9	12.8	13.7
Public	5.9	4.7	80.0	12.0	15.0
Private	29.3	2.8	5.0	15.0	10.0
Consumption	81.1	68.0	21.7	18.1	21.1
Public	28.3	24.1	10.4	8.0	13.2
Private	52.8	43.9	25.6	21.2	23.2
External sector	-16.3	24.5			
Exports	56.2	72.6	9.6	30.1	7.0
Imports	-72.5	-48.0	26.9	14.8	16.1

Source: IMF and National Institute of Statistics data; estimates (e) and projections (p) based on authors' calculations.

<http://dx.doi.org/10.1787/624438874407>

goods. This state of play is expected to continue in 2007 and 2008, with mineral exports continuing to improve the external sector balance and further stimulate growth. The investment component has continued to expand and is estimated to have increased by nearly 52 per cent in 2006. Private investment remains concentrated in the mineral sector, whereas public investment, which expanded at an exceptional rate in 2006, remains focused on infrastructure reconstruction and the social sectors. Growth of both public and private investment is expected to return to more reasonable rates in 2007 and 2008. Private consumption is recovering and accelerating, thanks to increased incomes in Luanda and higher public sector salaries. As a consequence of this growth in investment and consumption, import volumes are expected to grow by 27 per cent in 2006.

Macroeconomic Policies

Fiscal Policy

In recent years, efforts to reduce inflation and improve public finances have been broadly successful, and these gains were further consolidated in 2006, when the inflation rate approached the target of 10 per cent and the fiscal balance remained soundly positive. Nevertheless, the sustainability of the policy mix remains a cause for concern, unless structural reforms are

implemented. In fact, the country's success in curbing inflation is largely due to expensive exchange-rate operations, which sterilise the huge amounts of foreign currency injected in the economy, while fiscal policy remains extremely expansionary, generating strong inflationary pressure. The concern arises from the fact that this policy seems to be sustainable only as long as oil prices (and revenues) remain high.

Some improvements have been made in enhancing budgetary oversight over most off-budget expenditures, such as the quasi-fiscal operations carried out by Sonangol on behalf of the government and the central bank's operating deficit. Nonetheless, the country still has no medium-term expenditure framework allowing for countercyclical expenditure planning, and the budget design does not seem to take into serious consideration the limited absorption capacity of the public administration. Unfortunately, the combination of high oil prices, reduced leverage of the international financial institutions with respect to new financing opportunities for the country and the upcoming legislative and presidential elections make any serious change in the policy mix rather unlikely in the short term.

Despite some improvements on the revenue side, a great deal more progress is needed to achieve full transparency concerning the expenditure side and oil revenues (especially concerning Sonangol's quasi-fiscal operations). Angola remains an observer to the Extractive

Industries Transparency Initiative, arguing that full membership requires a set of implementation measures that exceed the country's current capacity. For the time being, data on oil production and exports are published on the website of the Ministry of Finance and the financial statements of Sonangol for fiscal years 2003 and 2004 have been audited by international firms, although the latest audit reports have not yet been published. Revenue collection in the expanding diamond industry remains opaque.

Despite the conservative oil price adopted, the government had to revise the 2006 budget to take account of higher oil prices (\$56 per barrel instead of the initial forecast of \$45), lower oil production and weaker GDP growth. Oil revenues, although increasing, were also revised downwards, from 31 to almost 28.5 per cent of GDP. The government maintained its basic public spending priorities, as the oil revenue windfall made it possible to more than double budgeted expenditures. The largest bill is for the social sectors,

Table 2 - Public Finances (percentage of GDP)

	1997/98	2002/03	2003/04	2004/05	2005/06(e)	2006/07(p)	2007/08(p)
Total revenue and grants^a	26.3	37.9	36.9	38.0	35.4	34.8	32.7
Tax revenue	6.6	7.8	6.8	5.7	5.8	5.8	6.1
Oil revenue	19.2	28.9	29.3	31.0	28.5	27.8	25.4
Total expenditure and net lending^a	55.3	44.9	35.8	30.1	30.0	28.5	28.9
Current expenditure	34.4	37.5	30.6	25.4	23.3	21.9	21.9
<i>Excluding interest</i>	27.6	35.2	28.3	23.5	21.9	20.1	20.6
Wages and salaries	9.1	12.4	10.3	8.6	8.8	8.2	8.4
Interest	6.8	2.3	2.3	1.9	1.4	1.8	1.4
Capital expenditure	5.8	7.4	4.4	4.7	6.7	6.5	7.0
Primary balance	-22.3	-4.6	3.4	9.8	6.8	8.1	5.2
Overall balance	-29.0	-7.0	1.1	7.9	5.4	6.3	3.8

a. Only major items are reported

Source: IMF and Ministry of Finance data; estimates (e) and projections (p) based on authors' calculations.

<http://dx.doi.org/10.1787/837655487055>

which attracted more than 30 per cent of total expenditures, as against 29 per cent of total spending in 2005. Nevertheless, taking into account the weak absorption capacity of the public administration, it seems highly unlikely that the government's over-ambitious expenditure plan will be executed.

The trend of current expenditure, which decreased in terms of GDP share, is characterised by an increase in public wages and new recruitment, and a decrease in goods and services expenditure, while subsidies to fuel, water and electricity were maintained and accounted for 3.8 per cent of GDP in 2006. The 2006 budget marked a significant change in the composition of expenditure, with the share of capital expenditure in overall budgeted spending increasing considerably, but not as much as foreseen by the government. Capital expenditure is estimated at 6.7 per cent of GDP in 2006, corresponding to an increase of 80 per cent in real

terms over 2005. This level should be maintained in 2007 and 2008.

Overall, fiscal year 2006 is expected to close with a substantial surplus of 5.4 per cent, although the fiscal position is deteriorating with respect to 2005. The fiscal balance is expected to improve marginally in 2007 and to deteriorate again in 2008, due to a probable decrease in oil prices and hence in government revenue.

The 2007 budget as announced by the government in December 2006 is based on the assumption of an international oil price of \$50 for Angolan crude, and includes expenditure commitments for 1.8 trillion kwanzas (equivalent to a 32 per cent real increase). Although expansionary, the fiscal policy seems more reasonable than in 2006, taking more into consideration the limited absorption capacity of the economy. This, and in particular the forecast 12 per cent decrease in

net investment, should be considered a step towards the improvement of public expenditure efficiency. The social sectors are expected to receive 28.1 per cent of fiscal outlays, while the share of defence and security should fall further to 12.7 per cent as the country consolidates reconciliation. The budget is supposed to generate 260 000 new jobs in 2007 and 403 000 in 2008. The impact of the expenditure increase on the fiscal balance is expected to be offset by larger than budgeted oil receipts. However, this might not be the case in 2008, when oil revenue is expected to decrease sharply, leading to a deterioration of the fiscal balance.

Monetary Policy

Owing to an effective monetary policy, the inflation rate has been decreasing dramatically since 2003, with the annual rate declining from 98 per cent in that year to 43.5 per cent in 2004 and 23 per cent in 2005. Despite a slight increase at the end of the year, mostly fuelled by a spike in transport prices, inflation fell to about 10 per cent in 2006, almost achieving the government target. It is expected to stabilise at around 9 per cent in 2007 and 2008.

This result has been achieved thanks to the *ex ante* stabilisation strategy of Banco Nacional de Angola (BNA), which has been purchasing kwanzas with dollars (derived either from oil receipts or from loans backed by promises of future oil receipts) to stabilise the kwanza's nominal exchange rate against the dollar and dampen the inflationary pressures caused by substantial public expenditures. In the first half of 2006, the BNA sold \$2.755 billion, twice as much as in the corresponding period in 2005, but still below the amount forecast because of the low absorption capacity of the economy. In consequence of this strategy, the nominal value of the kwanza has been stable against the dollar since the last big nominal appreciation of the exchange rate (7.8 per cent) in November 2005, while the real effective exchange rate has continued to appreciate. Real appreciation was 40 per cent between 2004 and 2005. While this strategy keeps down the prices of imports, which represent 90 per cent of domestically consumed goods, it damages the competitiveness of domestically

produced goods, thus working against the diversification of production.

External Position

Following the introduction of a revised six-level tariff structure in early 2005, the simple average Most Favoured Nation applied import duty stood at 7.4 per cent in 2005. Rules of origin are relatively simple, although the full implementation of Angola's integration into the Southern African Development Community (SADC) Trade Protocol would add to their complexity. Angola has made very little use of bilateral schemes with the United States and the European Union under the Generalised System of Preferences (GSP).

The trade balance has continued to improve, thanks to high oil prices coupled with increased production, which boosted export earnings in 2006. Oil and diamond exports, which together amount to 99 per cent of total exports, are estimated to have risen in volume by 13 per cent in 2006. Over the projection period, export volumes are expected to rise dramatically, by an estimated 31 per cent in real terms in 2007 and 8 per cent in 2008, due to expanded crude oil production, offsetting the decrease in oil prices which is expected for 2007. The increase in households' disposable income, coupled with the growth in oil production and the boom in the construction sector, is expected to lead in turn to an increase in imports, particularly of cement and capital goods, which are projected to grow by 16 and 17 per cent per year in real terms in 2007 and 2008.

In the first half of 2006, freight forwarders' shipment data indicate that the United States remains the largest export destination (33 per cent), followed by China (25 per cent). The European Union remains relatively marginal for exports, while it accounts for roughly half of imports. Portugal is the largest source country, with imports from this country totalling EUR 1.098 billion in the 11 months to November 2006 (a 52 per cent rise over the same period in 2005). The growth of imports from Brazil to Angola has also been dramatic (60 per cent at the end of 2006, to reach \$836 million). China's 2005 exports to Angola stood at \$370 million, an increase of 91 per cent.

Table 3 - **Current Account** (percentage of GDP)

	1998	2003	2004	2005	2006(e)	2007(p)	2008(p)
Trade balance	22.4	28.9	38.6	44.9	41.4	41.6	36.1
Exports of goods (f.o.b.)	54.3	68.2	68.1	71.3	64.8	63.1	57.6
Imports of goods (f.o.b.)	32.0	39.3	29.5	26.4	23.4	21.5	21.5
Services	-38.6	-22.4	-22.6	-20.4	-18.3	-17.3	-17.4
Factor income	-14.9	-12.4	-12.5	-11.8	-8.7	-11.4	-16.8
Current transfers	2.3	0.7	0.0	0.1	0.1	0.0	0.0
Current account balance	-28.8	-5.1	3.5	12.8	14.5	12.9	2.0

Source: IMF and Banco Nacional de Angola data; estimates (e) and projections (p) based on authors' calculations.

<http://dx.doi.org/10.1787/661783765870>

The current account balance has been positive since 2004, and its improvement was consolidated in 2006, when the current account surplus expanded from 12.8 per cent of GDP to 14.4 per cent. This result is wholly attributable to the trade surplus, which largely offsets the persistent deficit in the factor income account. The latter, highly correlated with the performance of exports, is estimated at 8.7 per cent in 2006, down from 11.8 per cent in 2005. It is expected to worsen in 2007 and 2008, however, as foreign oil companies remit increasing profits to their headquarters following the increase in oil production.

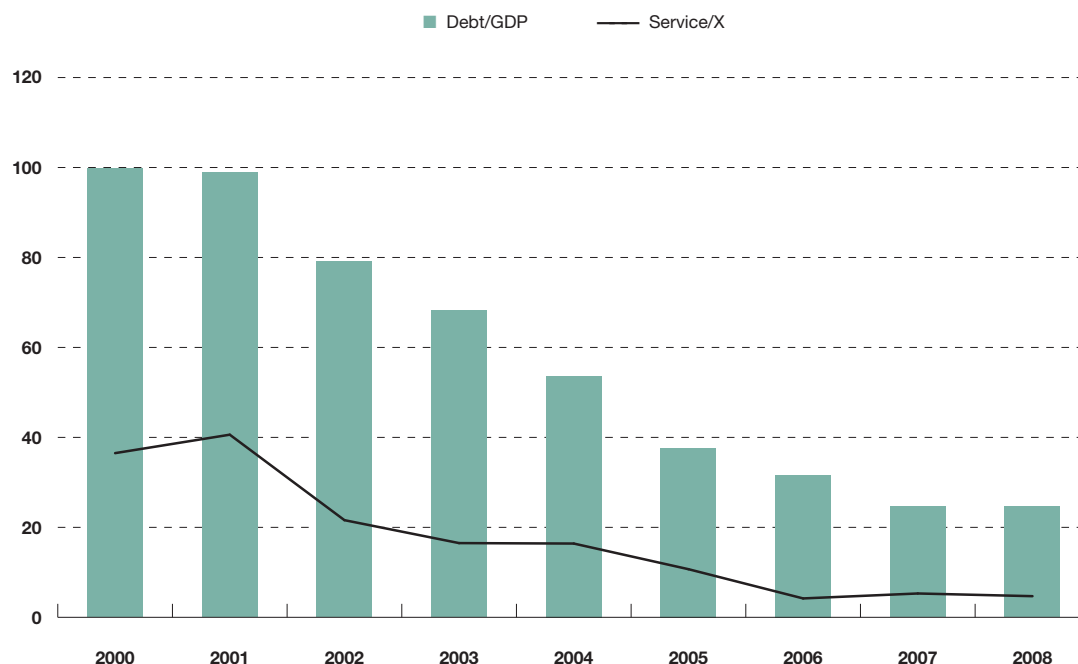
Together with Nigeria, Angola was Africa's largest recipient of foreign direct investment (FDI) flows over the 2003-05 period, owing to its mineral wealth. Rising investment in the country is due to high oil prices, together with promising reserves prospects. In 2006, a number of new licences for nine blocks were granted, and the creation of five new blocks was authorised. Also in the natural resources sector, the world's largest mining company, BHP Billiton, invested in nine diamond projects and is interested in investing in base metals.

Although FDI flows remain small in the rest of the economy, new opportunities continue to emerge. In agriculture and food processing, for instance, Israeli and other investors are exploiting pent-up demand for fresh fruit and vegetables in peri-urban areas, at prices considerably lower than those of imported food. In banking, the Portuguese banks Banco Internacional de Crédito (BIC) and Banco Comercial Portugues (BCP Millennium) expanded their branch networks,

the Russian bank Vneshtorgbank and local partners constituted Banco VTB África and ten additional licences have been requested. As for FDI outflows, the government acquired the absolute majority of shares in the cement industry from Portugal's Cimpor in September 2006. In November, Sonangol took full control of the Luanda refinery from Total, in anticipation of a major investment, possibly in partnership with Asian investors.

The external debt burden continued to ease, following the trend of recent years. At end-2004, Angola's debt amounted to \$10.6 billion (including arrears and overdue interest), which corresponds to 53.6 per cent of GDP, down from 99 per cent in 2001. In 2005, although the external debt stock increased slightly when Sonangol contracted a new \$3 billion oil-backed commercial loan, the IMF and World Bank estimate that the debt-to-GDP ratio fell below 38 per cent. Thanks to the high GDP growth rate, this downward trend is expected to continue for the next two years, stabilising at 24.6 per cent in 2007/08. A quarter of the outstanding stock of external debt consists of arrears, nearly all owed to the Paris Club. Imports are increasingly being financed by new credit lines provided either by Paris Club members that have signed bilateral debt renegotiation agreements (such as Germany, Spain and Portugal) or by non-OECD countries such as Brazil, Israel, Russia and China. In addition, Angola seems to have reached agreement on a supplementary multi-billion dollar facility from China, although official information on its terms is not available. Access to trade credits from a wider variety of sources has helped to sustain reconstruction efforts

Figure 3 - Stock of Total External Debt (percentage of GDP) and Debt Service (percentage of exports of goods and services)



Source: IMF.

<http://dx.doi.org/10.1787/617054383372>

115

and give the treasury some operational autonomy. It is more difficult to gauge the risks that such new loans entail for debt sustainability and creditworthiness.

Similarly, it is hard to predict whether a home-grown reform programme that takes into account some of the IMF's recommendations will provide a sufficient basis for successful conclusion of ongoing negotiations with the Paris Club. After three decades of external intervention, Angola's government is sensitive to close monitoring by the international community.

Structural Issues

Recent Developments

The transformation of Angola into a functioning market economy is a long process that has not been facilitated by the circumstances of the country's post-conflict transition. Still, the pace of structural reforms is disappointing. Hindrances to private sector

development, including egregious examples of rent-seeking behaviour, limit the potential benefits of the current economic boom. Moreover, the persistence of inefficiency in the public sector and of abuses of market power by state-owned enterprises in various sectors has impeded fiscal consolidation, shifting the burden of macroeconomic management to monetary and exchange rate policies.

International rankings such as *Doing Business* and the Transparency International index confirm that major bottlenecks due to endemic corruption, outdated regulations and rent-seeking behaviour frustrate entrepreneurial efforts, thus hampering the creation of new job opportunities. Angola ranks 156th out of 175 countries in the 2007 *Doing Business* classification, losing one place with respect to 2006. Although the time required to open a business has been drastically reduced since 2004 – falling from a year to 30 days, thanks to the creation of a one-stop window for business creation – barriers to entry remain high as the regulatory burden is heavy and the privilege of venturing into

promising new business sectors is reserved to a small number of businesses thought to have strong political influence. According to the 2006 World Economic Forum ranking, Angola is the least competitive out of 125 economies. Decentralisation, meant to improve delivery of public services, remains incomplete, as administrative tasks have been transferred to lower levels of government without a corresponding delegation of spending or taxation authority.

Since 2003, the authorities have introduced an array of new legislative measures that have gone in the right direction but not fully borne fruit in the absence of accompanying normative and institutional measures. In fact, since 2005, the pace of structural reforms has slowed. A competition bill was drafted in 2004 but has not yet been transmitted to parliament. Concerns regarding the status and success of the privatisation process had led the authorities to suspend it in 2001. To reactivate this process, a confidential diagnosis presented to the authorities in 2006 includes proposals to draft specific laws to cover public enterprises and holders of public service concessions. In the meanwhile, empire-building and prestige-seeking seem to abound in the strategies of state-owned enterprises.

The national airline TAAG embarked on a major investment drive in view of a long-needed overhaul of its ageing fleet. The \$150 million syndicated loan that a pool of local banks secured towards the acquisition of six new aircraft was rightly seen as a sign of the country's financial maturity. Unfortunately, TAAG is still on the International Air Transport Association (IATA) list of carriers showing a sub-standard safety record, and its pilots have failed so far to obtain flying certification for the new aircraft, which were delivered on the day of Angola's 31st anniversary. Sonangol and, most recently, Endiama have decided to expand their airline business.

In financial markets, the dollarisation of the economy remains a cause for concern. Nonetheless, the return of price stability, the entry of new banks, the opening of a substantial number of new branches in Luanda and the provinces, and the availability of withdrawal facilities have combined to overcome

households' reluctance to place their savings in formal financial institutions. As a result, total bank deposits increased by 23.9 per cent in real terms in the first half of 2006. Although the stock of commercial credit increased by just 1.38 per cent over the same period, the liquidation of treasury liabilities released resources for the productive sectors and credit to private firms increased by 42.2 per cent.

A new development bank, Banco de Desenvolvimento de Angola (BDA), started operations in late 2006 and will receive 5 per cent of oil revenues. A similar initiative is the Fundo Nacional de Desenvolvimento (FND), which will disburse up to \$300 million per year at concessional terms. The FND will be managed by BDA and be funded partly through oil and diamond extraction levies. The experience of the Fundo de Desenvolvimento Económico e Social (FDES), which managed to disburse only a fifth of its budget (also drawn from oil revenues) to support investment in the private sector, illustrates one of the challenges facing these new institutions.

Inefficiencies in thermal generation facilities and delays in completing the Capanda dam and hydroelectric plant still plague energy infrastructure. Brownouts and power cuts have become even more frequent as the economy accelerates, and less than 20 per cent of the population has access to electricity. In Luanda, the number of households connected to the grid is as low as 131 500, one major obstacle to the increase of capacity and investment being the low tariffs applied to electricity. Nevertheless, thanks to massive government and Chinese investments, electricity generation is expected to grow by 42 per cent in 2007/08. In fact, a huge number of projects are to be financed by a new Chinese credit line of \$5 billion, including the Apanda-N'Dalatando power line (2007), a new power line from the Cambambe dam to Luanda (2007), a series of electricity distribution and transformation centres (end-2006), a power line from Quifangondo to Caxito (2007) and a \$70 million project to electrify Luanda's suburban areas. In the meanwhile, government wishes to increase hydroelectric potential: the Cambambe dam, in Malange province, is expected to increase production by 260 MW from

2007 and the start-up of two new turbines should bring the dam's output to its full capacity of 530 MW by July.

Access to Drinking Water and Sanitation

Angola has abundant water resources, but existing hydraulic infrastructure is largely inadequate, having been traditionally confined to the production of energy. Moreover, households' access is severely deficient, as the available infrastructure was destroyed or damaged during the civil war and little or no investment has been made to cope with massive rural-to-urban migration.

In urban areas, installed capacity is estimated, on average, at 40 litres per capita per day, for per capita consumption of 20 litres per day. In peri-urban areas, however, where most of the poor and most vulnerable population groups live, consumption falls as low as 5 litres per capita per day. Water utilities, where they exist, encounter major financial difficulties, due to inadequate tariff systems, a huge proportion of unaccounted-for water (between 50 and 60 per cent) and very poor collection ratios. This situation, together with the poor skills of available staff, leads to continuing degradation of the existing infrastructure. Households rely on fountains, standpipes and truck tank systems for their water supply.

In the capital city, water is provided by Empresa Provincial de Aguas de Luanda (EPAL) and, in informal settlements, by informal private operators. Water sold by private truck tanks is much more expensive (\$10/m³ as against less than \$0.50/m³). EPAL maintains 100 000 connections, thus providing water to fewer than 1 million people through home connections or a pre-paid fountain system. Considering the overall population of Luanda (close to 5 million) and the obsolescence of the hydraulic network, which dates back to the Portuguese period, the service provided is plainly inadequate. The network, measuring 570 kilometres, needs considerable investment, in terms of both length and capacity, and water quality controls should be introduced. However, the extension of the network to peri-urban areas would require an urbanisation plan, which does not exist.

In rural areas, safe water sources are in most cases standpipes – generally boreholes with hand pumps – where water is free of charge. Up to 50 per cent of all standpipes are out of order, however, due to lack of spare parts and of maintenance in general. This situation obliges most people to rely on a seasonal supply of surface water, which they must often travel considerable distances to collect. It is important to stress that this broad picture masks huge inequalities between provinces, due to the extent to which different areas were hit by the war, to the presence of national and international NGOs, and to the different management models chosen by each province.

Since the secondary legislation (regulatory framework) attached to the 2002 Water Law is still waiting for approval by the government, each province can still choose its own management model for the water system. At central level, all water affairs are under the responsibility of the Ministry of Water and Electricity, which plays the role of regulatory authority, whereas technical support and operational supervision for the provincial departments is handled by the National Water Directorate (Departamento Nacional de Agua). In turn, provincial agencies create local units at town and community level (*brigadas das aguas* and *grupos de agua e saneamento*). This design, associated with the more general process of decentralisation, is only partially implemented, however, as local units are either inexistent or not officially recognised by the central government. Where the budget is concerned, the system also remains mostly centralised, with central and provincial governments allocating funds to local units.

Data collection and processing in Angola remain very poor. It is therefore very difficult to have reliable quantitative estimates of access to safe water and sanitation. At the national level, the 2001 UNICEF Multiple Indicator Cluster Survey sets the percentage of population with access to safe water at 62 per cent and to sanitation at 59 per cent, but these figures are widely believed to overestimate access. A later estimate, produced by UNICEF in 2002, suggests that just 34 per cent of the urban population has access to safe water, this figure rising to 39 per cent for rural areas. This picture places Angola among the worst performers

in Africa, despite its higher than average GDP per capita.

Sanitation is even more neglected. Only 59 per cent of the urban population has access to sanitation, whereas in rural areas this percentage falls to 26 per cent. Even in urban areas, the high population density and the concentration of human and non-human waste can produce dramatic health emergencies, such as the cholera epidemic that afflicted Luanda and other major towns in 2006. Besides Luanda, only four cities have waterborne sewage systems, and in all cases these serve only very central areas covering 17 per cent of the urban population.

As part of a Water and Sanitation Development Strategy, the government has identified the needs and deficiencies of the current system and formulated an ambitious 14-year programme to develop the sector. The strategy, which would require investment of up to \$3 billion, calls for a 70 per cent increase in improved water production and the construction of 927 fountains and 1 060 wells. As for sanitation, the government's objective is to reach an access rate of 85 per cent in urban areas and 65 per cent in rural areas by 2016. Considering the magnitude of the financial and institutional efforts required and the slow pace of improvements recorded so far, however, it is unlikely that Angola will achieve the Millennium Development Goal (MDG) of reducing by half the percentage of people not having access to safe water and sanitation.

The Water Law provides for the creation of water utilities (*empresas de agua*) for water treatment and distribution at provincial level. Although the target is to create one *empresa* per province by 2010, only a few small urban centres have already created their water companies, apart from EPAL in Luanda. The World Bank's Urban Rehabilitation and Environment Project for Benguela and Lobito Province (PRUALB) led to the establishment of such companies for the cities of Lobito and Benguela, and in Soyo and Caxito private companies owned by Angolans were given licences to operate the water system, with the assets remaining the property of the state. As a matter of fact, although the huge investments required for the rehabilitation and

construction of infrastructure constitute a major disincentive for private companies to enter the sector, the Water Law provides for the entry of private operators, specifying the rights and duties associated with grants and licences, as well as the terms under which they can be delivered.

Since the central government provides only 50 per cent of EPAL's overall financing, other sources of technical and financial support are clearly needed for expanding the system. With only a limited role foreseen for the private sector, external donor support will continue to be important in Luanda and elsewhere. The main external partners are China (construction and rehabilitation of infrastructure), Brazil (construction of water treatment facilities and technical assistance) and the European Commission (technical assistance). Since 2003, the Portuguese co-operation agency has been assisting in the restructuring and modernisation of EPAL, providing technical assistance and capacity building.

Political Context and Human Resources Development

Long in gestation, the presidential elections – initially scheduled for September 2006 and now unlikely to be held before mid-2008 – are supposed to constitute a milestone in national reconciliation and the consolidation of democratic institutions. The basic procedures are now in place following the establishment of a national electoral commission, completion of the electoral census and of the corresponding voter registry, and the courts' ruling that President Eduardo dos Santos can serve three consecutive terms of office. Reasons for the delays of the process include abundant technical problems (to name just one, the size of Angola's population is unknown), friction within the ruling Movimento Popular de Libertação de Angola (MPLA) and the difficulty in building the necessary trust between the MPLA and opposition parties. Although the MPLA seems sure to remain in power, in each of the opposition parties there are separate fringes that, despite the authorities' efforts to co-opt them, may refuse to acknowledge the verdict of polls and stir up ethnic

tensions. In fact, the peace agreement reached in mid-2006 with the secessionist movement in Cabinda (Frente para a Libertação do Enclave de Cabinda – FLEC), which would include the appointment of new vice-ministers in some areas, was quickly denounced by some FLEC leaders who were excluded from the deal.

In a post-conflict environment, it is very difficult for civil society organisations to exercise critical surveillance over governments' deeds, and Angola clearly is no exception. The MPLA extends its control over state resources to the media, including radio stations and the press, while the number of people displaced during the hostilities who have not yet regained their homes is estimated to be 450 000.

Despite the progress achieved since the end of the civil war, progress towards good governance is slow and corruption remains endemic. Transparency International has ranked Angola at 142nd on the Corruption Perception Index. Although small improvements towards democratisation have been recorded, the parliament does hardly anything to check the government's actions and counter balance the overwhelming power of the presidential elite. In February 2006, Angola ratified the United Nations Convention against Corruption, which now requires domestic legislation to be implemented.

Indicators of living standards are of poor quality and often rather outdated. The last household spending survey, covering only 8 provinces out of 16, dates back to 2001, and the last household living conditions survey was conducted in 2002. The latter, which is believed to be more reliable than the former, sets the urban share of the population as among the highest in Africa. Rapid urbanisation has had a number of negative consequences, from the deterioration of living conditions in overcrowded urban and peri-urban areas to the abandonment of the countryside and, in consequence, of many agricultural activities. Since the population in rural areas is mainly composed of children and the elderly, food insecurity is an issue (in early 2006, an estimated 800 000 people experienced food shortages before the main harvest). With the progressive withdrawal of emergency NGOs and the World Food

Programme, government has had to take responsibility for responding to food crises, which it seems to be doing rather effectively.

The poverty rate was estimated at 68 per cent in 2000/01, with 28 per cent of the national population living in extreme poverty. Inequality in income distribution is among the highest in the world (62 per cent), and it is on the rise. In Luanda, the striking wealth of a small minority stands in sharp contrast to the harsh poverty of the large majority, a phenomenon that is certainly a root cause of widespread frustration and a rising crime rate. Although Angola enjoys one of the highest rates of per capita GDP growth in the world, there are few indications that the country will achieve any of the MDGs by 2015. This predicament underscores the responsibility of the government and the private sector, domestic and foreign, to do more to foster human development together with growth. Implementation of the interim Poverty Reduction Strategy Paper (drafted in 2004 and never formally approved) would support the social sectors, which still receive a very small share of the national budget.

Despite the end of the war, the living conditions of the Angolan population have been deteriorating in recent years, life expectancy is only 40 years (UNFPA, 2005) and health indicators are among the worst in the world. The under-five child mortality rate rose from 250 per thousand in 2001 to 260 per thousand in 2004, the second highest rate in the world, while maternal mortality (1 400 to 1 700 per 100 000 births) also remains very high because of the very low rate of assisted deliveries, which decreased from 24 per cent in 2001 to 22.5 per cent in 2003. The incidence of malaria, which is one of the most frequent causes of child and maternal death, increased in the 2000-03 period, afflicting 22 per cent of the population as against 16 per cent in 2000. Other major causes of death are diarrhoea and respiratory diseases. Vaccination coverage for infants is rather low, ranging from 75 per cent for tetanus to 46 per cent for polio, and 43 per cent of routine Expanded Programme on Immunisation (EPI) vaccinations are financed by the government (UNICEF, *The State of the World's Children 2006*). Another indication of the progressive deterioration of the living

conditions of Angolans, especially in urban areas, is the severe cholera epidemic that struck Luanda and other towns in 2006 in 10 of the 16 provinces, the illness having been transmitted through contaminated water. The epidemic affected 56 213 people between February and October, and caused more than 2 300 deaths.

Many obstacles hamper progress in health services quality and delivery. These include the low priority given to primary health care by the government, insufficient numbers of qualified staff, inefficient co-ordination mechanisms between different levels of the public administration and with other sectors (as well as donors), and inefficient management structures. The Ministry of Health is still to approve a national policy and a medium-term strategy that could provide guidance on tackling vertical programmes.

HIV/AIDS prevalence is officially one of the lowest in the region (2.7 per cent according to 2005 local estimates) owing to the country's isolation during the years of war. However, the lack of statistical information and poor quality of surveillance centres suggest that actual HIV/AIDS prevalence might be much higher. Moreover, it seems that the national rate masks large regional disparities: border areas, where international mobility is easier, exhibit prevalence rates as high as 10.4 per cent (e.g. Cunene province). Hence, the increased openness of the country, due to political stabilisation and peace, could cause an increase in the national rate, especially when one considers that the population has limited knowledge of the illness and its transmission channels.

On the positive side, some progress has been recorded in education. Since the end of the war in 2002, government efforts to increase school enrolment – through the construction and rehabilitation of schools and the recruitment and training of teachers – have led to a measurable increase in enrolment rates. Since 2003, the government has continued the recruitment campaign, and the number of teachers at the primary level is estimated to be around 80 000. In 2006, a reform of the public education system was finally implemented nationwide, after an initial experiment with a pilot project started in 2003 in 5 per cent of

schools. The main innovations brought about by the reform include the restructuring of the school system with the creation of a compulsory primary school of six years (*ensino primario*), updating of the curriculum and teaching methods (using a child-centred methodology), and a maximum pupil/teacher ratio of 35.

The demand for education exceeds supply and is rising. The evidence for this is a gross enrolment rate above 100 per cent, whereas net enrolment remains very low (around 50 per cent in 2003), at least when compared to other African countries. Access remains problematic for many Angolan children, as only 22 per cent of children enter primary school at age six. The reasons for this are manyfold. Since the system is decentralised, access to schooling and the quality of teaching are not uniform, and in general rural areas suffer from a lack of financial resources, resulting in fewer schools and less well-trained teachers. In particular, the expansion of the education system has been more rapid in the littoral area, which accounted for more than 60 per cent of primary pupils, as against almost 39 per cent in the central areas in 2004. The quality of teaching, although superior in urban areas, remains very poor. Nevertheless, the social context is crucial for educational achievement, and living conditions are often worse in peri-urban areas than in rural areas – hence the low levels of learning achievement recorded in some areas of Luanda. Finally, although schooling is supposed to be free of charge, in most cases families are obliged to pay a fee to the teacher in order to let the child attend school, and learning materials are rarely provided for free. The result of all this is very low achievement rates (30.6 per cent in 2003), high repetition rates (26.3 per cent in 2003) and high dropout rates. In its Poverty Reduction Strategy Paper, the government has set ambitious objectives, although the budget share allocated to the education sector still remains inadequate (7.14 per cent in the 2005 budget).