

**FOR
AGENDA**

EBS/95/159
Correction 1

October 17, 1995

The following corrections have been made in EBS/95/159 (9/26/95):

column 1995, line 1: for "139"
read "1,389"

Other Distribution:
Department Heads

Table 3. Angola: Summary of Macroeconomic Program, 1995-96

(Percentage change, except where noted)

	<u>1994</u>	<u>1995</u>	<u>1996</u>
Nominal GDP	2,147	1,389	159
Real GDP	8.2	11.9	6.3
Broad money (end of period)	1,017	505	91
Consumer price index (end of period)	972	547	80
Fiscal balance (percent of GDP)	-23.1	-13.6	-9.6
Current account balance (percent of GDP)	-18.5	-13.3	-8.2

Source: Data provided by the Angolan authorities.

Most discussions between the staff and the authorities centered around issues associated with the speed with which inflation would be reduced, the nature of reforms in public expenditure to be initiated during the first two years of the stabilization effort, and issues involved in the lending of full transparency to government financial operations.

The authorities recognized that the gradual pace of disinflation being targeted under the PES poses risks of failing to engender confidence in their program. The staff urged a more ambitious approach intended to reduce inflation to monthly rates of no more than 1 or 2 percent by the end of the monitoring period. While the authorities recognized the risks, they pointed to a number of factors specific to the Angolan context which, they felt, made a more rapid pace of disinflation impractical at present. They emphasized that the mid-1995 increases in petroleum prices and in government wages would put upward pressure on prices. They argued further that the supply response of the economy is hampered by widespread mining of roads and agricultural fields, dislocation of the population, and destruction of infrastructure. Although the staff understood the authorities' concerns, it urged them to seek opportunities to tighten policies and to reduce the targeted rate of inflation during the course of the program.

The staff argued for greater restraint in both public-sector wages and consumer subsidies than was contained in the PES, arguing that further restraint was needed to promote fiscal sustainability. Although the staff accepted the authorities' explanation of the need for a recovery in public-sector wage rates, it argued strongly for limitations in the programmed increases and for the immediate initiation of a full-scale civil service reform. It also advocated measures to trim consumer subsidies beyond the programmed efforts to raise prices of petroleum products.

While they ultimately scaled back their initial proposal, the authorities argued that substantial increases in government wages were needed to improve morale and retain experienced managers. They were reluctant to implement an immediate cutback in the public sector workforce given the likelihood of weakness in labor demand in the enterprise sector over the short term. Ultimately, however, the Government representatives agreed to initiate planning for civil service reform in 1996. The authorities also preferred to retain remaining Government subsidies for such services as transportation, communications, and housing over the short term in view of the impacts on real incomes of the loss in petroleum subsidies and other programmed adjustment measures.

Considerable discussion was devoted to the requisites of transparency in government financial operations. Until recently, for example, no comprehensive figures were available on the contractual terms and annual service due on the medium- and long-term oil-guaranteed debt. Figures for both interest and principal were lacking for the short-term oil-based debt. Ultimately, however, the staff team received a full account of the medium- and long-term debt. The short-term debt will be fully accounted for as soon as an inventory is completed.

Discussions on the details of a new mechanism to lend transparency to Government financial operations in the petroleum market were also protracted, partly because of disagreements among Government, the central bank, and the oil company on the importance to be attached to their respective interests in the transactions involved.

1. Fiscal policy

Fiscal consolidation between 1994 and 1996 is to stem primarily from large reductions in subsidies and military expenditures. These savings would be only partly offset by the increases in current and capital expenditures for the reconstruction and resettlement effort, as well as in government wages, amounting to about 2.5 percent of GDP (Table 4).

a. Expenditures

In support of the peace process, outlays of US\$1.2 billion are programmed over two years for demobilization, the creation of a unified army, removal of land mines, reconstruction of transport and communication lines, and the rehabilitation of social infrastructure at the community level. At the same time, new measures are being implemented to reduce spending in other areas. Defense expenditures are programmed to fall from 21 percent of GDP in 1994 to 11 percent in 1995. The decline represents the net impact of a reduction in expenditures on military goods and services, on the one hand, and an increase in the cost of maintaining a peacetime army, on the other. The latter costs will be swollen by a "global integration" strategy agreed during peace negotiations of combining the entire UNITA forces with the government army for as much as two years before beginning a