Nudging Fiscal Reforms in Angola

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9th Economic Development Days – May 2023
Vienna University of Economics and Business (WU Wien)

Outline

Nudging Fiscal Reforms in Angola

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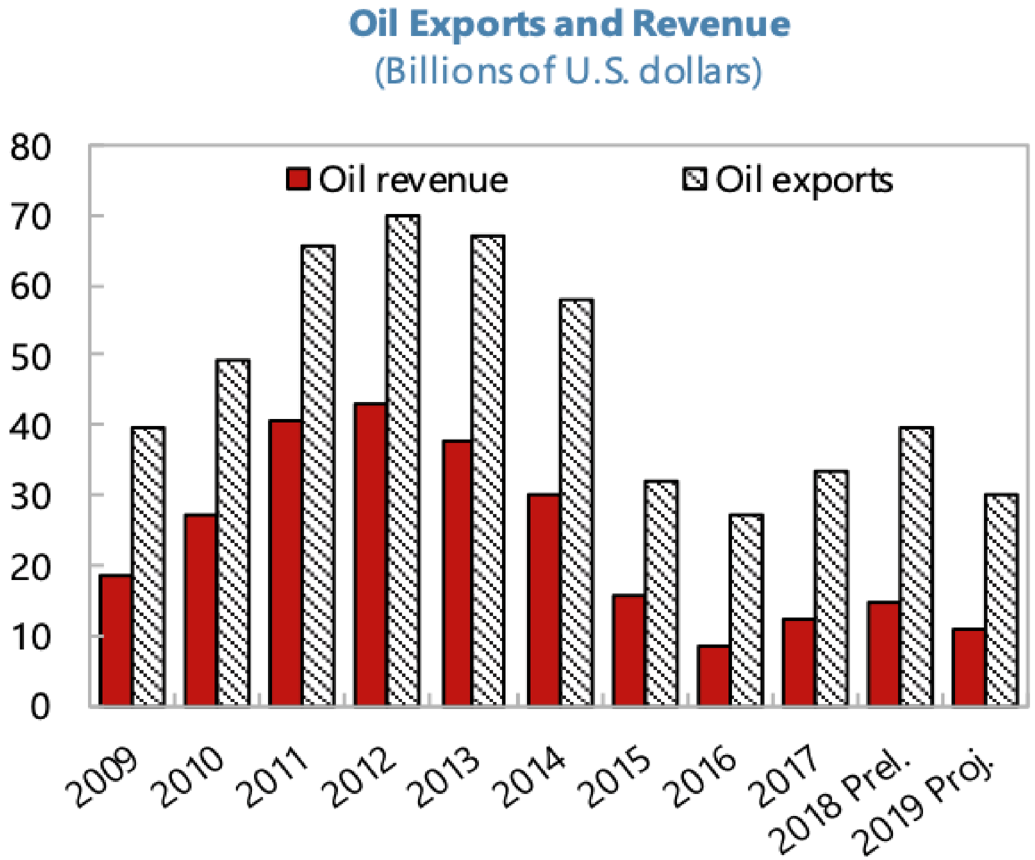
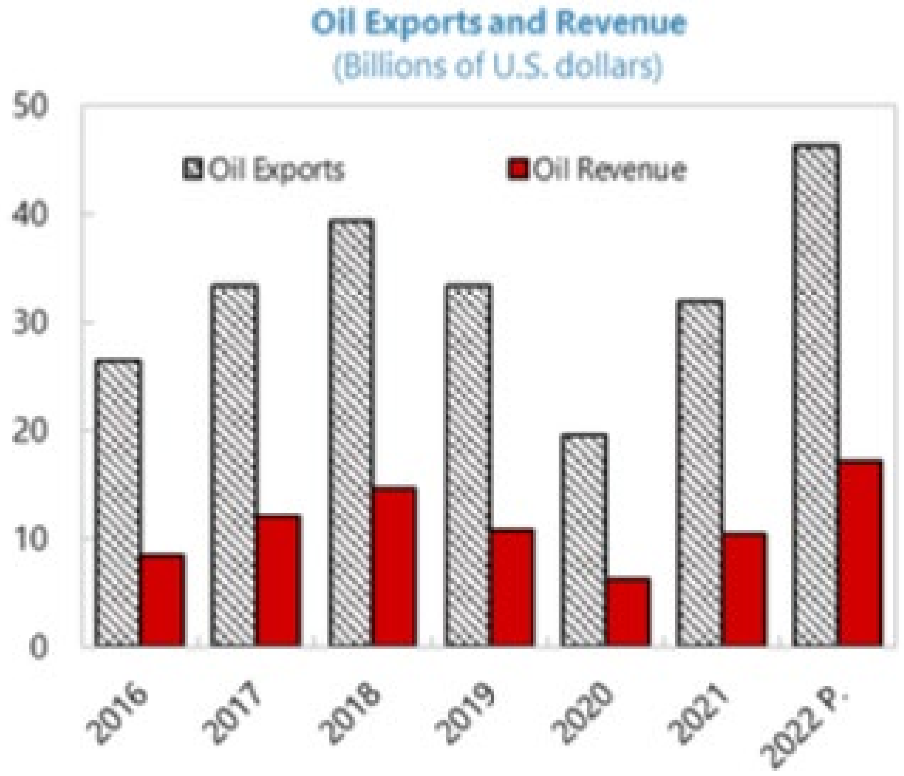
2. Angola Social Economic Outcomes
3. The Need for Improving Social, Human Capital, and Infrastructure Spending
4. The Macroeconomic Policy Challenges – the baseline in 2018/2019:
5. The IMF program of 2018 and Fiscal Reforms – the commitment to reforms
6. Implementing Fiscal Reforms.
7. Tentative conclusions

1. Angola Political & Economic Context

A dependency on one product……

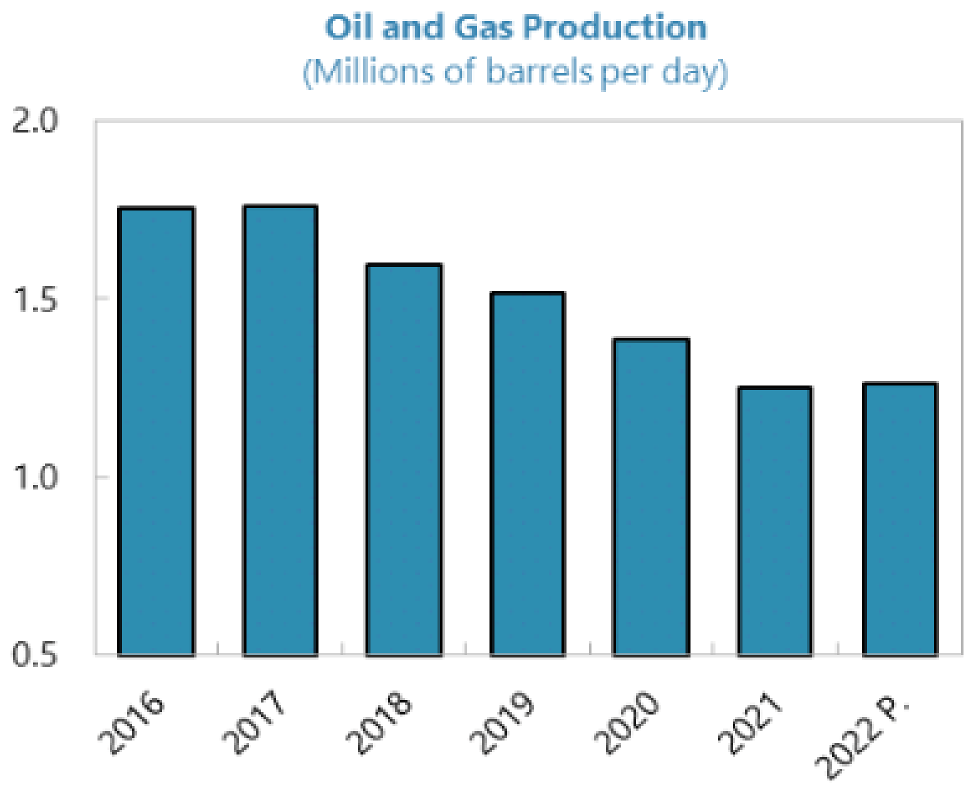




Source: IMF & Angolan authorities & IMF staff calculations

1. Angola Political & Economic Context

Oil production is declining……



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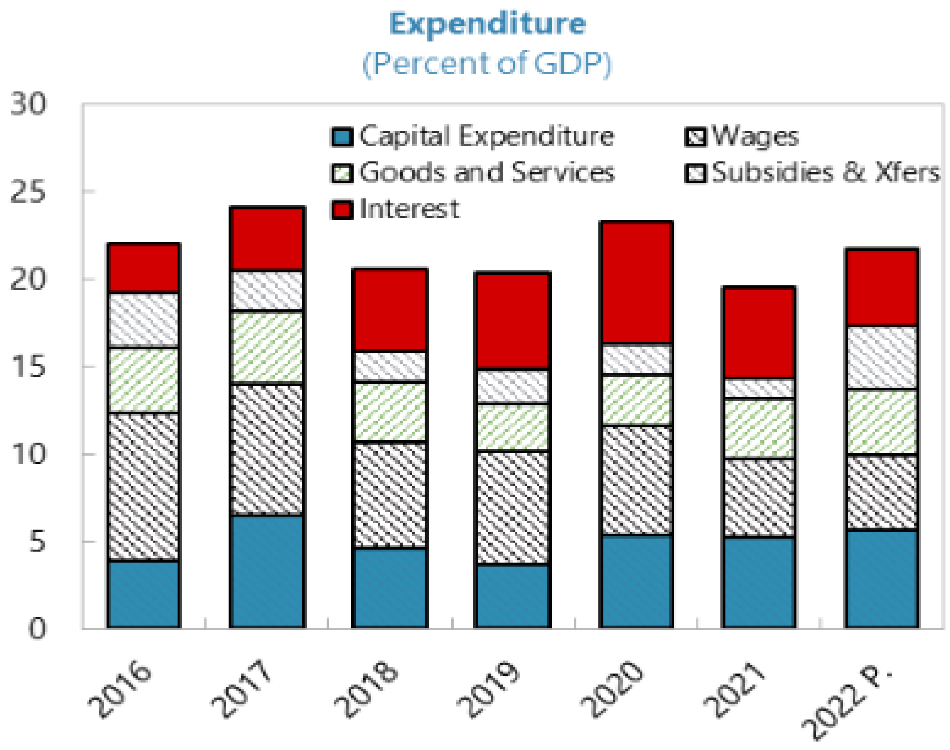
1. Angola Political & Economic Context

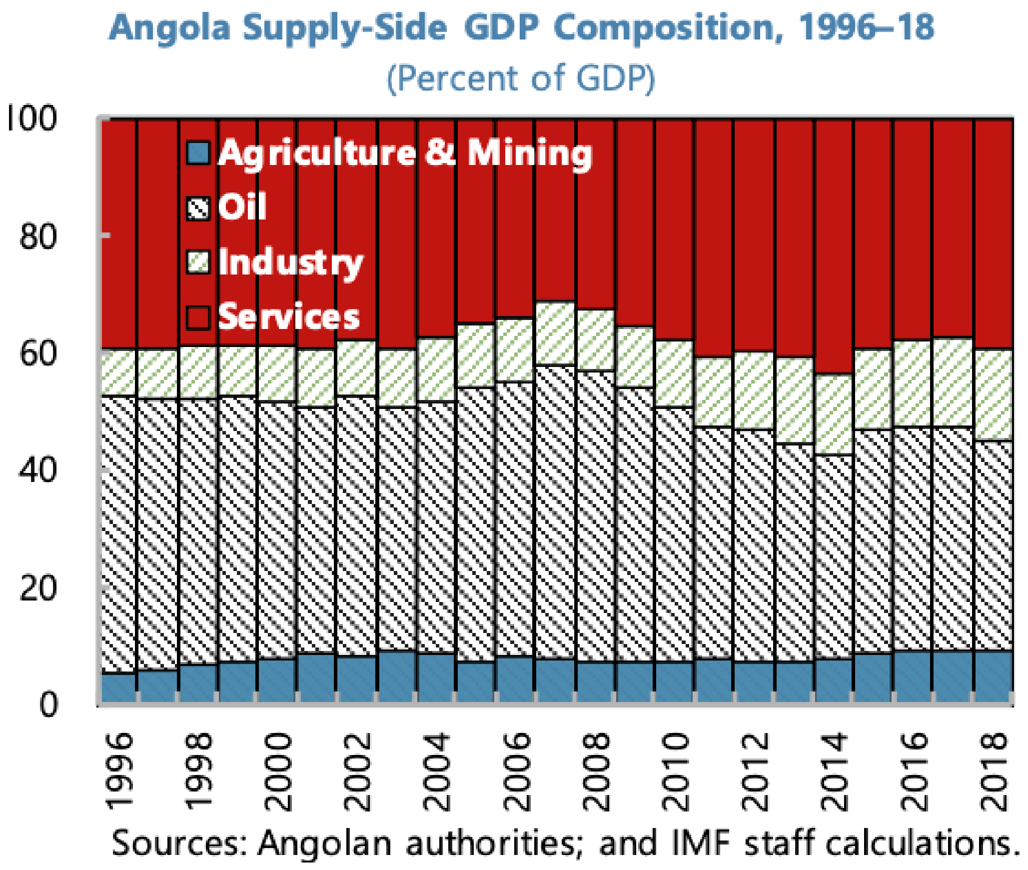
…….much is spent debt service & subsidies



Source: IMF & Angolan authorities & IMF staff calculations

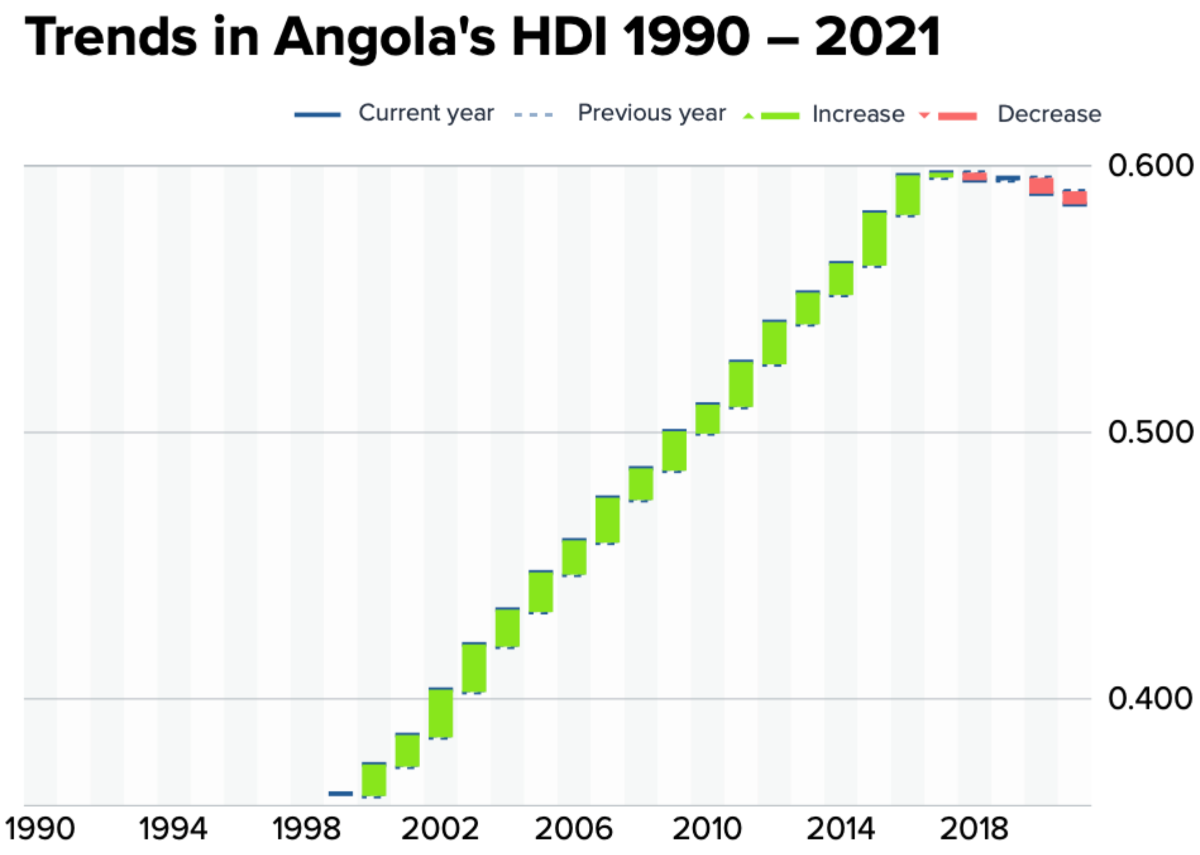
1. Angola Political & Economic Context

….other than oil, mostly services…



2. Angola: Social Economic Outcomes

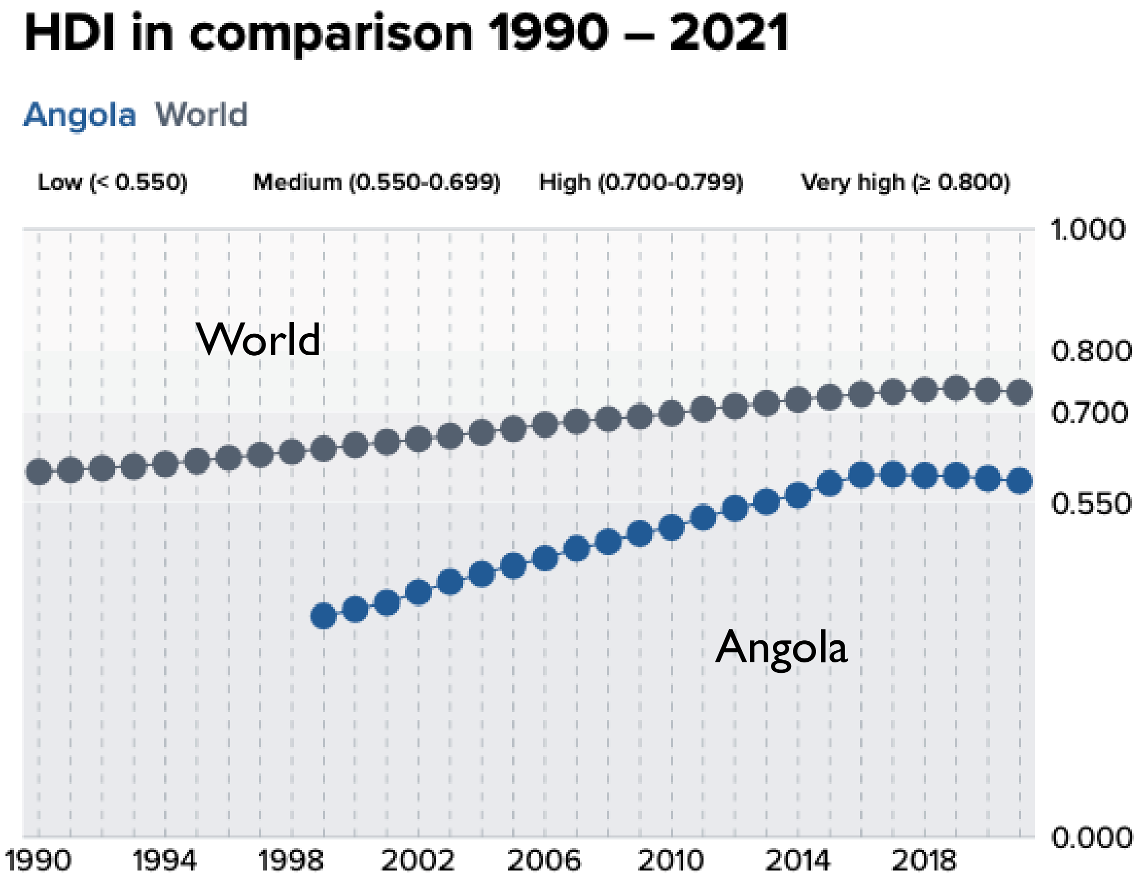
…. Peace in Angola improved social & economic conditions for Angolans…



Source: UNDP

2. Angola: Social Economic Outcomes

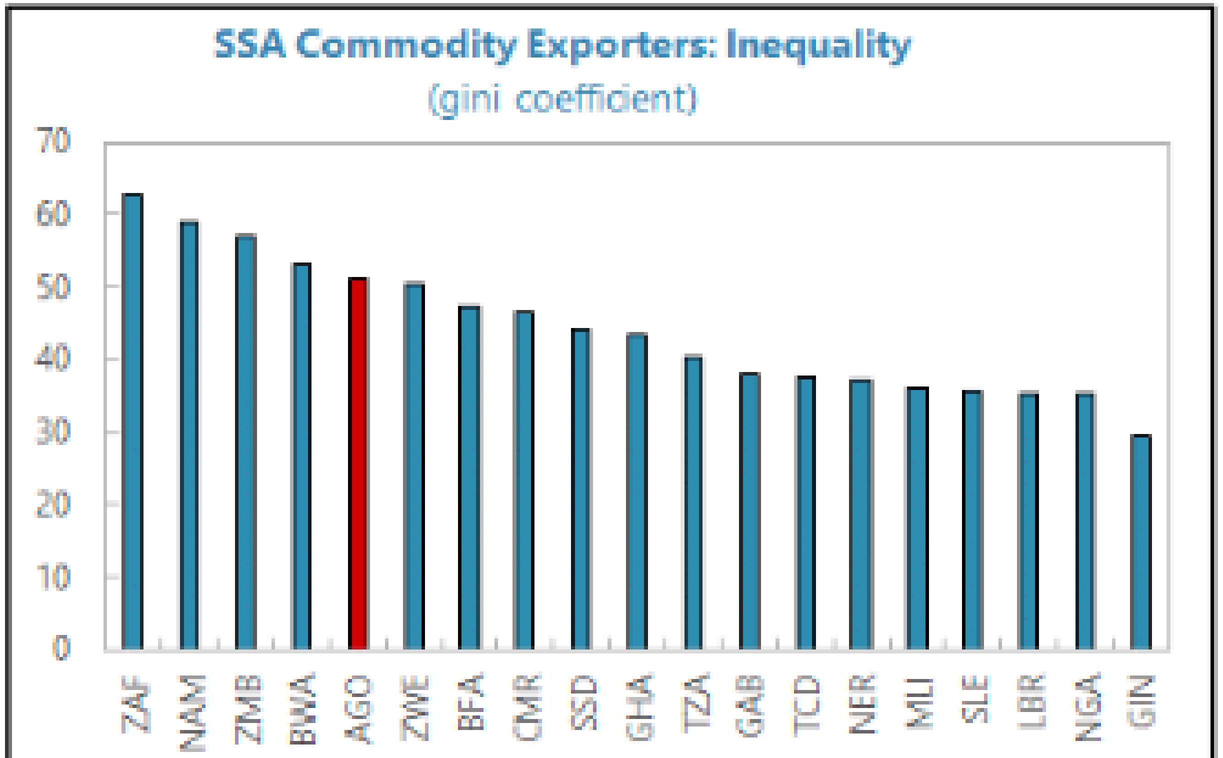
…. Angola caught with the the World's average…. but since 2014 a decline of living standards has set in… increasing again the gap with the rest of the world ……



Source: UNDP

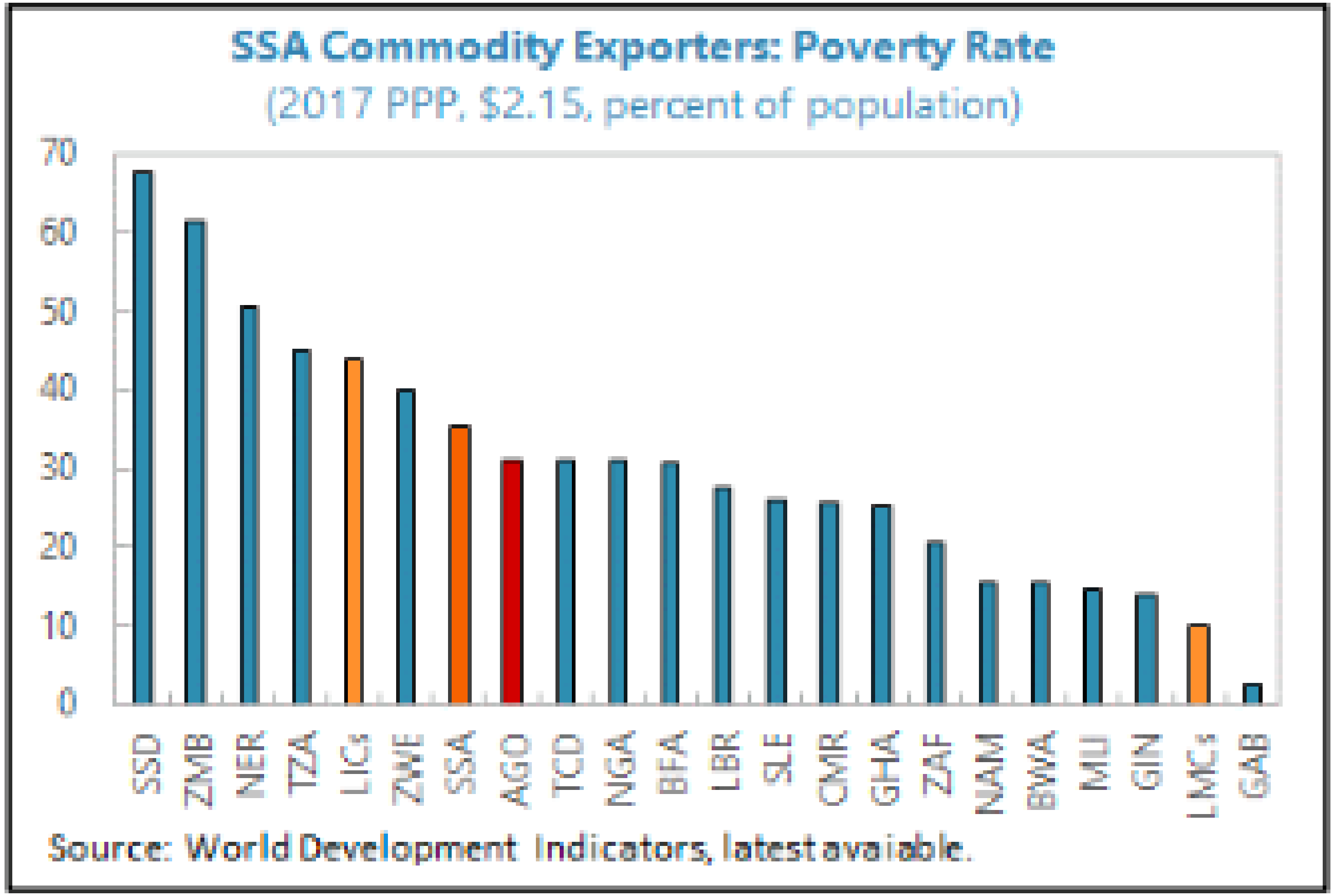
2. Angola: Social Economic Outcomes

…. Inequality and poverty rates are high compared to its peers…



Source: World Development Indicators, latest avaiable.

2. Angola: Social Economic Outcomes



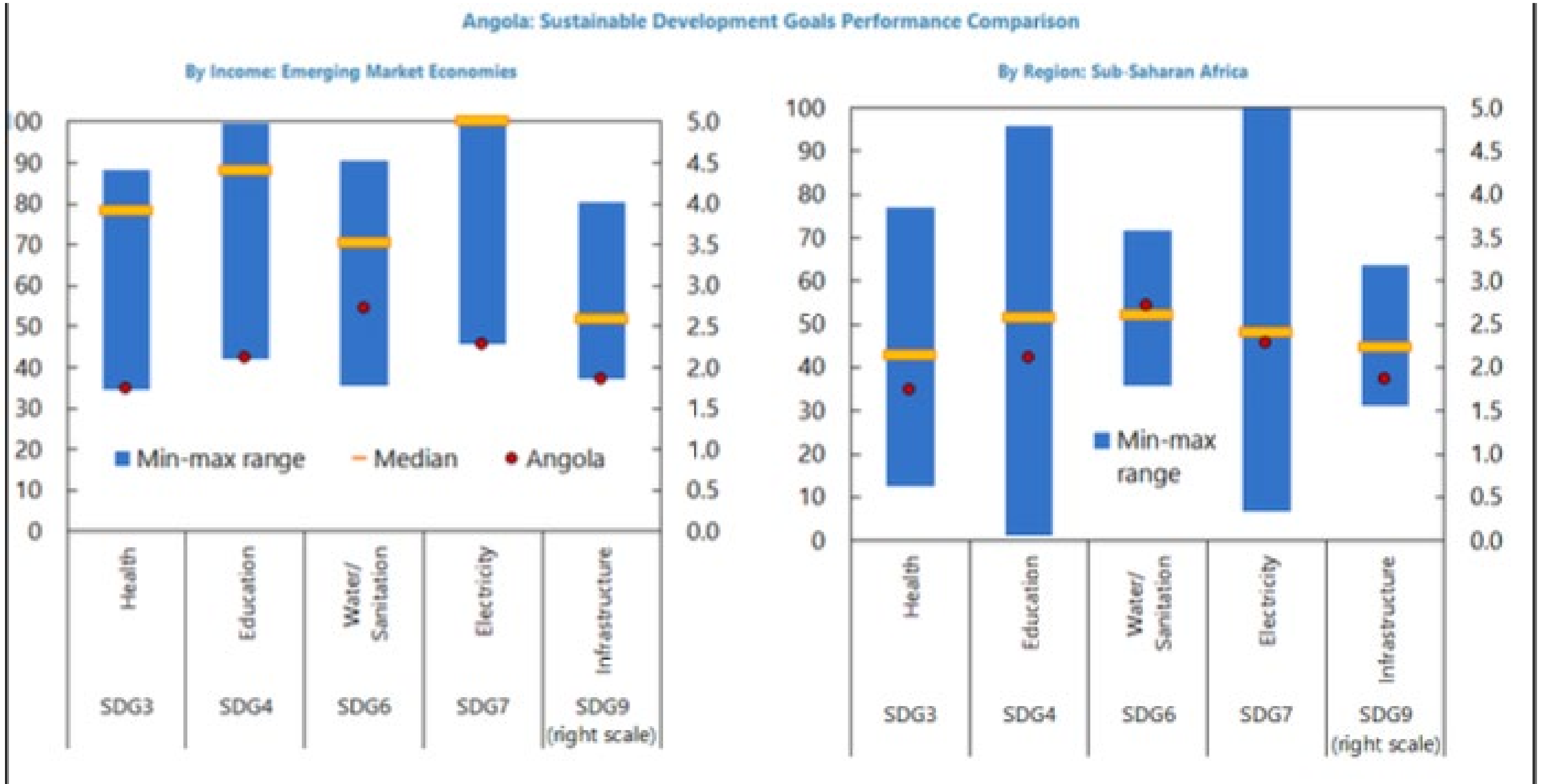
2. Angola: Social Economic Outcomes

Underlying these relatively high poverty and inequality levels are **large development gaps.**

In considering **progress toward the SDGs**, Angola lags relative to median SSA and emerging market (EM) peers across most categories but is much closer to SSA than EM peers.

This includes, especially, the **critical areas of health, education, water and sanitation, electricity, and roads**, where Angola performs toward the bottom of EMs and, in the case of education, health, and roads, below the median SSA performers.

2. Angola: Social Economic Outcomes



Source: Source: IMF staff calculations using Sachs, J., Kroll, C., Lafortune, G., Fuller, G., Woelm, F. (2021). The Decade of Action for the Sustainable Development Goals: Sustainable Development Report 2021. Cambridge: Cambridge University Press.

Note: SDG3, SDG4, and SDG6 are the indexes ranging from 0 to 100 (left scale); SDG7 is the access to electricity as percentage of population (left scale); and SDG9 is the 2018 World Bank's Logistics Performance Index's Quality of Trade and Transport Infrastructure Component Score ranging from 1 to 5 (right scale), (available from: http://lpi.worldbank.org/international/global).

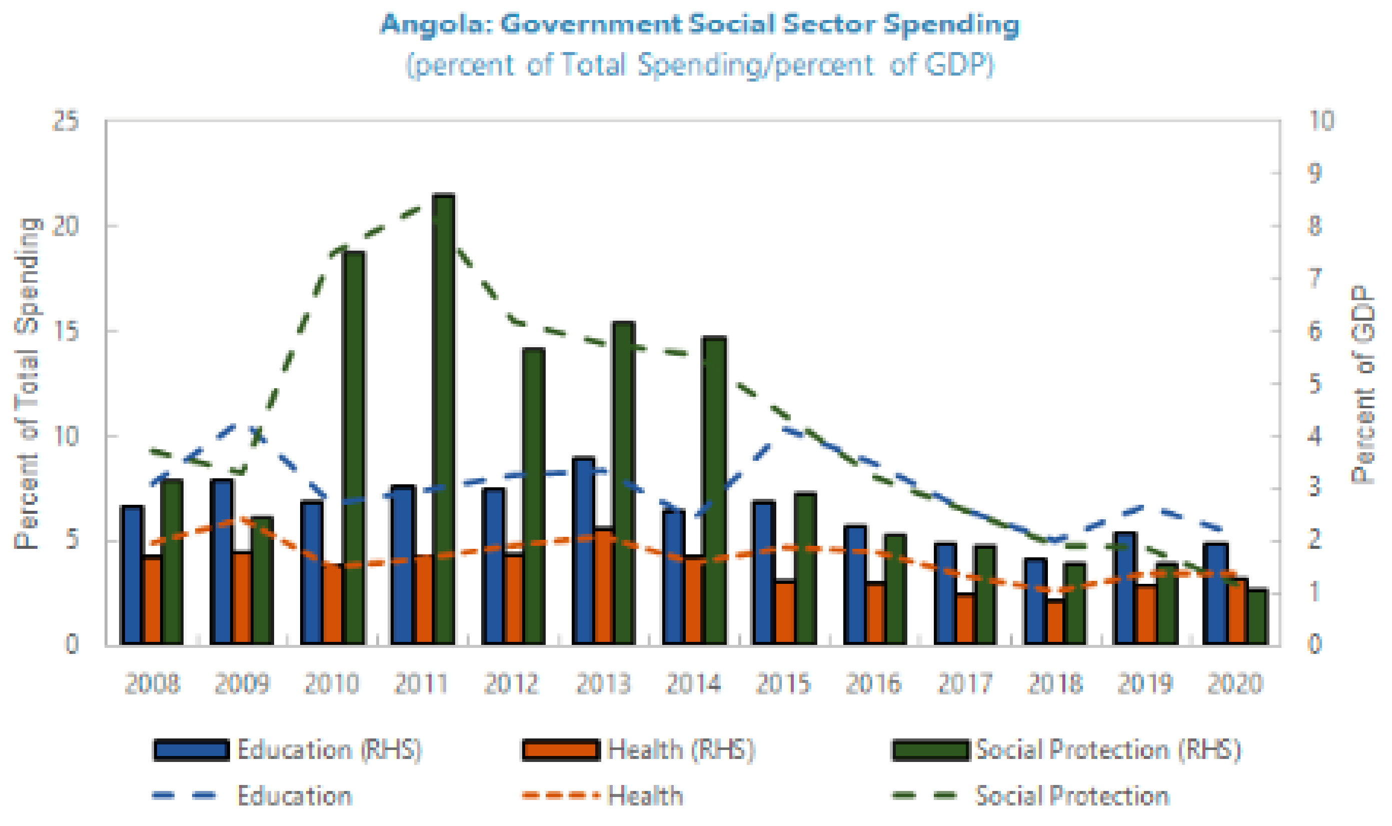
3. The Need for Improving Social, Human Capital, and Infrastructure Spending

Angola's social and human capital spending has historically been low and inefficient. Social spending on public health and education has largely declined since the mid-2010s (as shares of GDP and total expenditure) - increasing the gap, including with peers.

Education expenditure and efficiency lag peers. As a share of total government expenditure, education spending significantly lags SSA and EMDE peers and fell in the runup to the pandemic, with spending biased toward tertiary education. In terms of efficiency, teacher-student ratios historically lagged EMDEs (although they are roughly in line with SSA peers) and appear to have had little relationship to outcomes. Teacher-student ratios are also low relative to primary and secondary school net enrollment, and net primary school enrollment has significantly lagged peers.

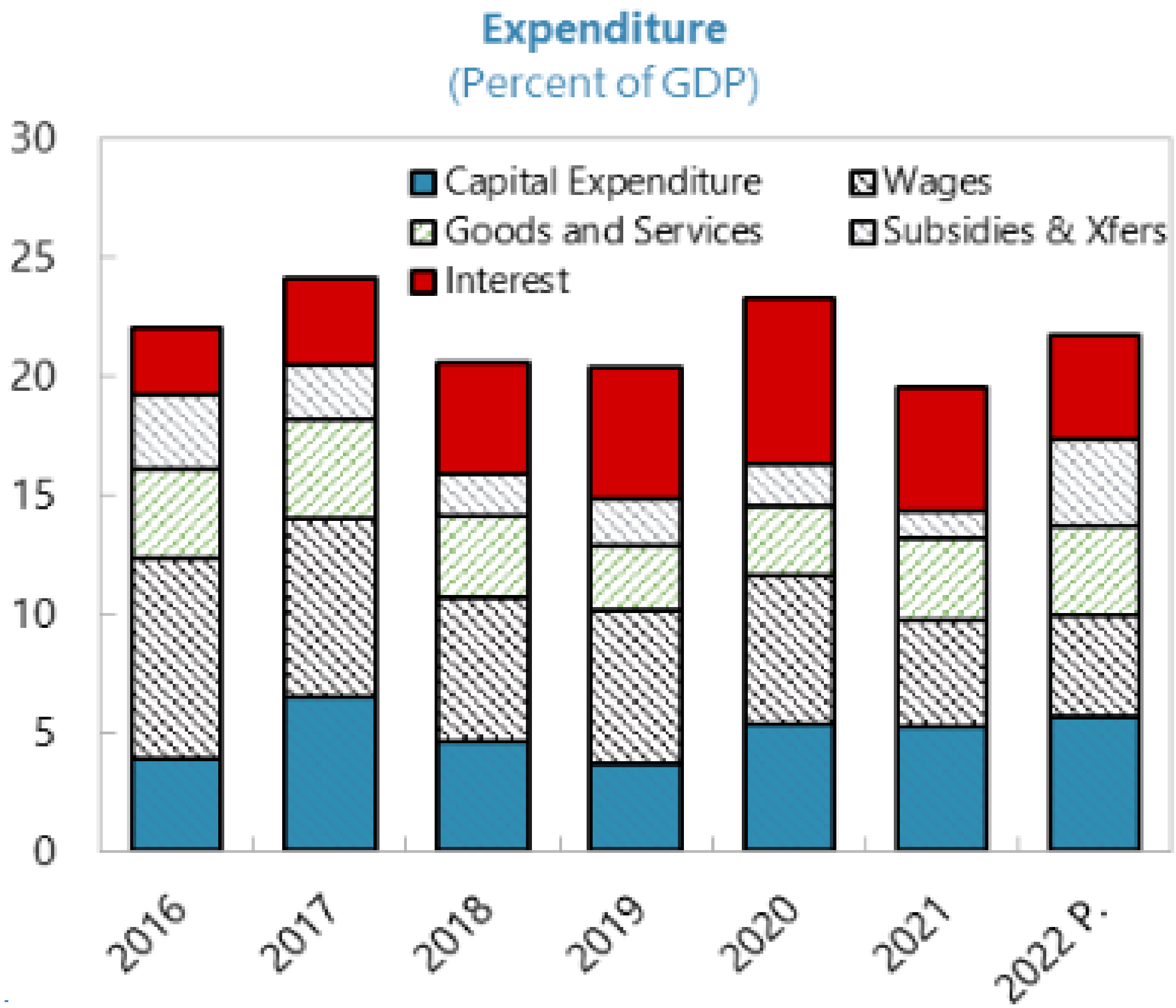
Spending on health is low and inefficient. Angola's public health expenditure as a share of GDP and total spending are low relative to SSAs and EMDEs. Moreover, public health spending as a share of GDP and expenditure has been on a downward trend since the early 2010s, excluding an uptick around the pandemic, with weak budget execution as well. Health spending efficiency in Angola is, in turn, also low, with weak health outcomes across a variety of individual areas.

3. The Need for Improving Social, Human Capital, and Infrastructure Spending



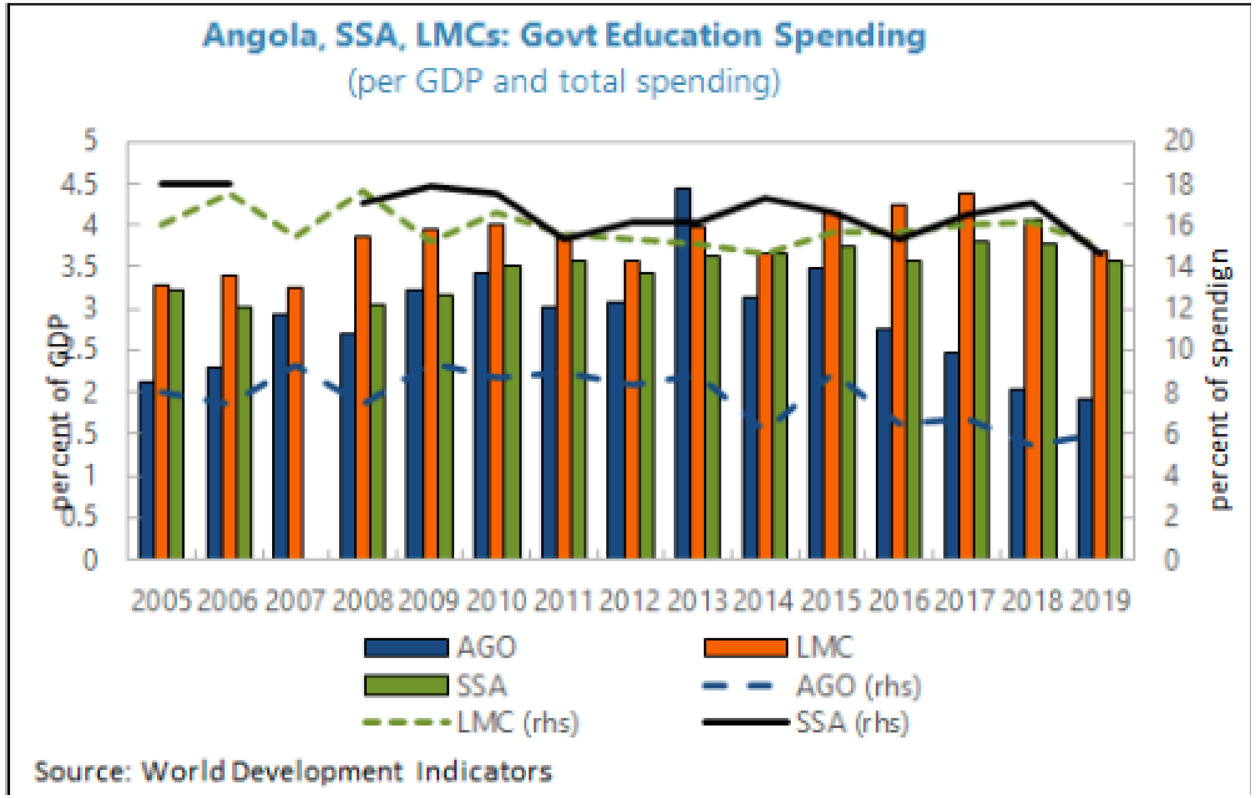
Note: Social protection expenditures include spending on fuel subsidies.
Source: BOOST, authorities data and staff estimate.

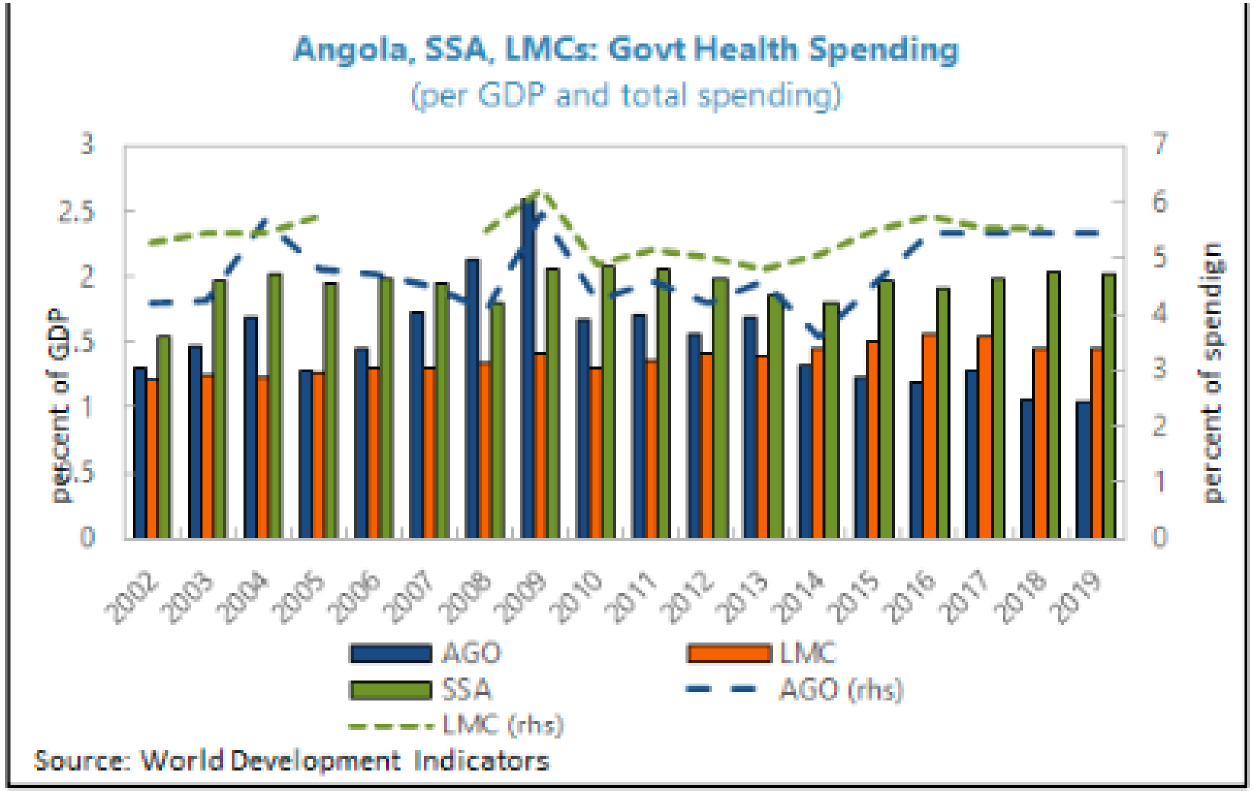
3. The Need for Improving Social, Human Capital, and Infrastructure Spending



Source: IMF & Angolan authorities & IMF staff calculations

3. The Need for Improving Social, Human Capital, and Infrastructure Spending





Source: IMF & Angolan authorities & IMF staff calculations

3. The Need for Improving Social, Human Capital, and Infrastructure Spending

What is needed in Angola to close the gap in meeting Sustainable Development Goals by 2030?

- Education: 8.3% of GDP annually up to 2030
- Health: 5.7% annually of GDP up to 2030
- Sanitation: 2.1% annually of GDP up to 2030
- Electricity: 4.2% annually of GDP up to 2030
- Roads (access): 3.5% annually of GDP up to 2030
- **In total**: **20.8 % annually of GDP up to 2030**

Source: IMF Selected Issues Paper, February 7th, 2023.

3. The Need for Improving Social, Human Capital, and Infrastructure Spending

How to finance what is needed?

- Non-oil taxes: 2.4% (VAT, excise etc.) of GDP;
- Energy (oil) subsidy reduction/elimination: 1.2-1.7% of GDP;
- Improving expenditure quality: 0.5% of GDP;
- Other ? About 15 + % of GDP.

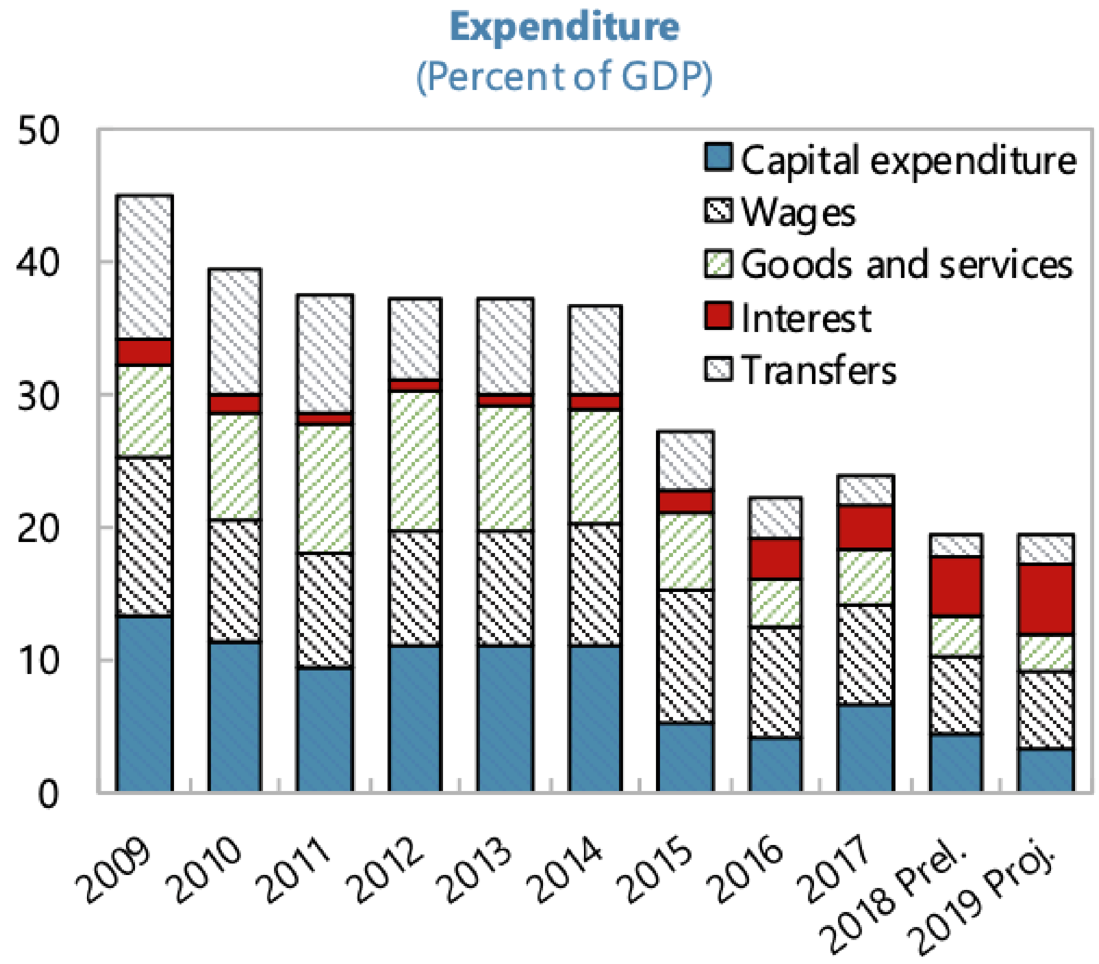
Source: IMF Selected Issues Paper, February 7th, 2023.

4. The Macroeconomic Policy Challenges – the baseline in 2018/2019

The problem as it was perceived in 2018/2019 - post-elections 2017:

- Economic growth was stagnant and social outcomes considered non-satisfactory;
- No macroeconomic stability (fiscal deficit), inflation running at 30%
- debt service reaching about 50-60% of the annual budget
- payment arrears of more than 5% of GDP (= 20-25% of the budget),
- exchange rate distortions (parallel market offering up to 150 to 20% better rates)
- bad public services/bad governance - low expenditure quality /corruption perception/ bad business climate
- no economic diversification

4. The Macroeconomic Policy Challenges – the baseline in 2018/2019



Source: IMF & Angolan authorities & IMF staff calculations

4. The Macroeconomic Policy Challenges – the baseline in 2018/2019

Angola: Clearance of Payments Arrears Accumulated up to End-2017

(Percent of revised GDP, unless otherwise indicated)

	2018	2019	2020	2021	Total
TOTAL[1]	**1.4**	**2.2**	**0.8**	**0.7**	**5.9**
SIGFE	0.4	1.3	0.0	0.0	1.9
NON-SIGFE[2]	1.0	0.9	0.8	0.7	4.0
***Memorandum Items*:**					
Percent SIGFE	20	80	0	0	100
Percent NON-SIGFE	25	25	25	25	100

Sources: Angolan authorities; and IMF staff estimates and projections.

[1] Gross amounts, i.e., not netting out claims that could be deemed invalid by the certification.

[2] Includes 0.2 percent of GDP in claims that the authorities identified to be owed to non-residents.

5. The IMF Program, end 2018 to end 2021 – the Commitment to Reforms

The intention or the underlying agreement (taken from the Chairman's statement at the occasion of the IMF Board approval in December 2018 of a credit/program arrangement - under the Extended Fund Facility - amounting to ultimately to about $4.5 billion):

- Fiscal consolidation is a core element of the program.
- The authorities' plan is to increase non-oil revenue (VAT),
- eliminating energy subsidies and clearing domestic arrears.
- Protecting the poor and most vulnerable is an important element of the program (In this regard, the sequencing of reforms and putting in place off-setting measures will be important).
- Strengthening public financial management will improve the allocation of scarce public resources and strengthen policy formulation and implementation.
- Put public debt on a downward trajectory and create space for much needed infrastructure and social spending.

5. The IMF Program, end 2018 to end 2021 – the Commitment to Reforms

Structural reforms were geared at:

- diversifying the economy,
- reduce fiscal risks, and
- foster private sector development, including restructuring state-owned enterprises and improving the business climate,
- strengthening economic governance, and continuing to fight corruption

Source: IMF & Angolan authorities & IMF staff calculations

5. The IMF Program, end 2018 to end 2021 – the Commitment to Reforms

The IMF technical assistance – funded by the EU – executed by the IMF's Fiscal Affairs Department (FAD) supported "capacity building" (CD) for fiscal reforms aimed at improving public financial management and governance by:

- **adopting a *Fiscal Rules Law* (anchoring fiscal policies) – called in Angola "Public Finance Sustainability Law"**
- introducing the **medium-term perspective to budgeting** as an element to fight fiscal volatility and manage better resources
- **anticipating risks** (debt) = smoothing the fiscal path;
- **obtain better expenditure quality** through improved planning, especially for public investment management, and
- improving the **consistency and comprehensiveness of fiscal reporting**.

5. The IMF Program, end 2018 to end 2021 – the Commitment to Reforms

Typical requirements for such reforms (seen from the IMF angle):

- Government: Ownership, political will
- IMF: Capacity Development (CD) strategy: demand driven.

The commitment and range of policy reform content is regularly renewed or updated during the course of “program implementation” In the “Memorandum of Economic and Financial Policies”, which forms an annex to the “Letter of Intent” (which is an annex to the Staff Report).

6. Implementing Fiscal Reforms

The FAD executed PFM project aimed at:

The Law: Formulation and adoption of a ***Fiscal Rules' Law***; (legitimacy and political will/consensus)

The Law - Law on Public Finance Sustainability (LPFS) - **establishes new fiscal instruments and the medium-term view**:

- establishing a debt (stock) and fiscal deficit (flow) anchor (limit)
- introduction of a Medium-term Fiscal Framework (MTFF) and Fiscal Strategy Report,
- a Medium-term Expenditure Framework (MTEF),
- enhanced transparency/accountability rules

A Public Investment Diagnostic: A Public Financial Management Assessment (PIMA)

to identify with more clarity reforms needs and structure possible ways going forward or agree on selective entry points (on where to reform first go).

6. Implementing Fiscal Reforms

What has been achieved so far, since September 2019?

The Law on Public Finance Sustainability (Fiscal Rules Law - LPFS) was approved (almost unanimously) on the last day of the 2020 summer parliament session, August 6th, but got only issued on October 30th, 2020.

A draft MTFF got elaborated and an initial Fiscal Strategy Paper (2nd half 2020) -since then further refined but never published.

A first fiscal execution report got prepared aligned with the demands of the (LPFS) – issued in Summer 2021 but since then discontinued;

Work on an MTEF got initiated in Fall 2021 (demand driven) but stopped in early 2022 – so far, the Ministry of Finance/the budget department has been hesitant to involve other sector Ministries in this exercise (bottom-up dimension).

6. Implementing Fiscal Reforms

What has been achieved so far, since September 2019? – continued

A Public Investment Management Assessment was finalized by May 2020 but negotiations about details/feedback of the report took to May 2021 – delaying per definition any follow-up.

6. Implementing Fiscal Reforms

Hesitation to implement the Law on Public Finance Sustainability

- Issuing the law on October 30th (deliberate delay) implied that the Budget 2021 could not be guided by the LPFS.

- In May 2021, an argument was made to delay the implementation of the law, considering that national elections - back then – were likely to happen in August 2022, complicating further decision making

- In addition, a 5-year Development Plan is traditionally elaborated for the incoming new Government (informing /guiding 5-year economic/social development mandate). Political managers perceived the LPFS as undue constraint on the new Development Plan

As a result, the election and the Development Plan hindered the political support for advancing the implementation of the law and work on its respective instruments.

In the meantime, the IMF program expired by end of 2021 (8 months prior to the elections), reducing the IMF leverage.

6. Implementing Fiscal Reforms

Hesitation to implement the Law on Public Finance Sustainability

The law is now meant to be fully applied as of the budget preparation for the year 2024, and the end of the technical assistance project. The expectation is that the Fiscal Strategy Report (summarizing the medium-term fiscal parameters and risks) is being published by end May 2023, a month later than the law stipulates.

Monitoring of the law is improving but no report has yet been published.

The MTEF elaboration TA (CD) work might be continued in 2023/2024.

There is no new development plan yet.

In 2025 the law is supposed to be assessed concerning its effectiveness or appropriateness.

7. Implementing Fiscal Reforms – tentative conclusions

Why such a lengthy and apparently complex process to implement the reforms ?

Political economy of such (fiscal) reforms: binding discretion about expenditure decisions across the government.

Yet: these reform decisions are made with incomplete information on both sides and therefore require learning/adjustment for both and imply uncertainty about the process and the outcome:

- No one **understands upfront fully what such a reform buys into or implies**, and what is required or how it changes the political economy of the given status quo. Although there are accounts available on experience made (for reference) which could inform, each case is different.
- The **IMF has a fairly solid analytical understanding of the macroeconomic situation** of the country, what might have caused the status quo and what likely drives the economy for the coming year (economic parameters) but the IMF (or others) **does not have a systemic understanding of the political economy** in the country or the political economy of reforms steps. Of course, the team is "formulating informed guesses". Would it be worth-wile to understand better the political interests ?

7. Implementing Fiscal Reforms – tentative conclusions

Why such a lengthy and apparently hesitant process to implement the reforms ? - continued

- To simplify, the de-facto working assumption is that the Minister of Finance's signature under the **Letter of Intent** represents the **government political will**. The Letter of Intent or a Memorandum of Economic & Financial Policies is the country's Economic Policy Declaration, the expression of the government's will - typically designed for the next 12 months plus. Such a letter or statement is rolled-over every 6 months (review intervals), adjusted /updated. Yet, "political will" is apparently more – or a more complex issue - than the letter of Intent.

- The **country's authorities understand** or reveal **increasingly the implication of the reforms** they have agreed to, as they work on them (feedback, resistance, arbitrage of interests etc.); stakeholders learn about or begin to understand better the reform (Law for Public Finance Sustainability, subsidy reform, etc.). The IMF learns (or is alerted) about questions on the "political will" as the country is not implementing or advancing certain reforms or measures and asks the "why": why is not happening what the country has committed to in the Letter of Intent. The remedy is typically to buy more time and adjust the approach towards reform – time-wise and sequence- wise, sometimes delivery-wise. The governance of TA (CD) delivery might need to be retooled to avoid implementation issues and align expectations?

- **There is always a good reason why things do not happen as envisaged** (uncertainty or lack of full information, competition with other (conflicting) goals, surprises). Both sides have to maintain a "certain flexibility" and adjust (adjusting as a result of learning) or manage expectations. Typically, joint implementation reviews help. The IMF should consider these.

Thank you

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