Angola: Towards a Medium-Term Macro-Framework

Nicholas Staines
IMF Resident Representative
23/25 Largo Albano Machado
Luanda, Angola
nstaines@imf.org
www.imf.org/luanda
(244) 937-787-670

Infrastructure Partnership for African Development (iPAD)[1]
Luanda, July 24, 2012

The Government has initiated a move towards a medium-term fiscal policy framework and, by extension, a macroeconomic framework. This is of fundamental importance to the macroeconomic policy environment and, as may be appreciated, to those involved in public investment sector, which is the focus of this conference. This presentation is about the motivation behind such a framework and some of its key features.

I. The challenge

The collapse of international oil prices in 2009 triggered a difficult period of economic instability for Angola. But it is fair to say that the economy has been largely stabilized. The large stock of government domestic arrears has been settled and this has supported a recovery of growth in the non-oil sector. The exchange rate is stable and inflation is nearly 10 percent.

Angola is also better placed to face another external shock. Foreign reserves are now higher than before the crisis, whether measured in dollars or in import coverage. Also, the non-oil primary fiscal deficit—non-oil revenues minus non-interest expenditures—is now much lower, or that the stance of fiscal policy is now much tighter. Together, this means that the Government and Central Bank have more room if needed to respond to another crisis.

With this period of instability passed, it is now time to refocus on Angola's medium-term economic challenges. There are many, such as how to diversify growth and how to reduce poverty. But, perhaps simplistically, these could be encapsulated as how best to manage Angola's oil resources. This in turn points to two questions: how much of those resources should be consumed now or invested to support future consumption, and how much investment should be invested in physical capital or set aside in financial assets to generate income for future consumption or provide a buffer against another destabilizing crisis.

A medium-term macroeconomic framework will help address these issues. Its purpose is to help assess what is feasible and the trade-offs. It organizes policy around an anchor and a set of policy rules to guide the economy's evolution to meet the country’s development objectives in a manner that is stable and sustainable.

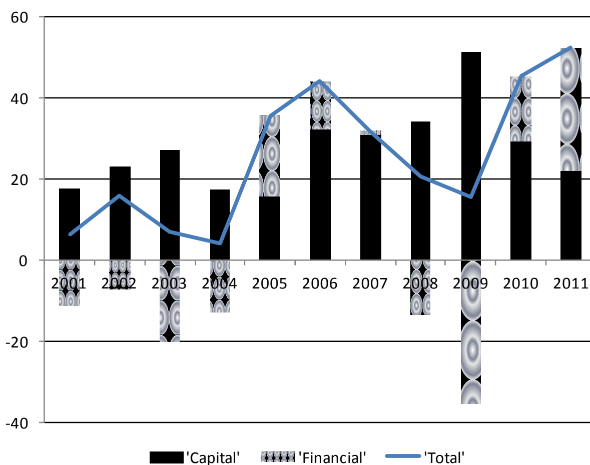
[1] This is a revised version of the presentation delivered at the iPAD conference in Luanda on July 3, 2012. Data are from the Angolan authorities and from IMF staff report on the 2012 Article IV Consultation.

II. Government saving and investment

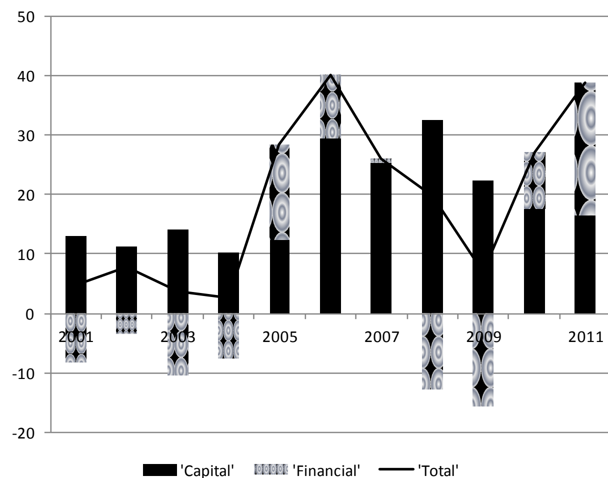
The Government's savings are defined as the balance on the government's current account which equals revenues minus current spending. These savings are then allocated to public capital investment or to the accumulation of financial assets (overall fiscal balance on a cash basis). As the return on capital investment in Angola is currently much higher than on financial assets, the emphasis should be on investing in capital goods rather than in financial assets, but there is also a need to accumulate financial assets.

This has indeed been the case. Over the past decade, the Government has saved the equivalent of about a quarter of its budgetary oil revenues and invested most of this in capital assets. The trend seems to be upwards and the Government saved the equivalent of about half its oil revenues in the last two years. But this has been mostly because of a large financial investments and the share of capital investment has declined. A similar picture emerges when government savings are measured against non-oil GDP.

Public savings
Percent of oil revenues



Public savings
Percent of non-oil GDP



How do Angola's government savings compare to other Sub-Saharan oil exporters.[2] Angola's government savings were well below the group's average in the few years (2004-08) before the crisis. This was mainly because of Angola's low accumulation of financial assets since, at least measured against non-oil GDP, Angola's government capital investment was comparable to other countries. In the past two years, Angola's government savings have been more comparable to other oil exporters but, as noted above, this has been largely because of the increase in financial investments and public capital investment has fallen behind.

[2] Cameroon, Chad, Republic of Congo, Equatorial Guinea, Gabon and Nigeria

Sub-Saharan oil exporters [1]
Public Savings

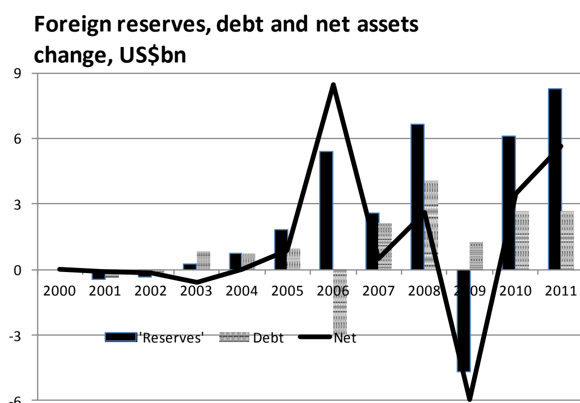
	Average [2]		Angola	
	2004-08	2010-11	2004-08	2010-11
Oil GDP, percent of total GDP	48	45	55	46
Public savings, percent of oil revenues	96	58	27	49
Public capital investment, percent of oil revenues	45	62	26	26
Public financial savings, percent of oil revenues	51	-4	1	23
Public savings, percent of non-oil GDP	45	33	23	33
Public capital investment, percent of non-oil GDP	20	25	22	17
Public financial savings, percent of non-oil GDP	25	7	1	16
Public capital investment, percent of total public spending	34	39	23	24

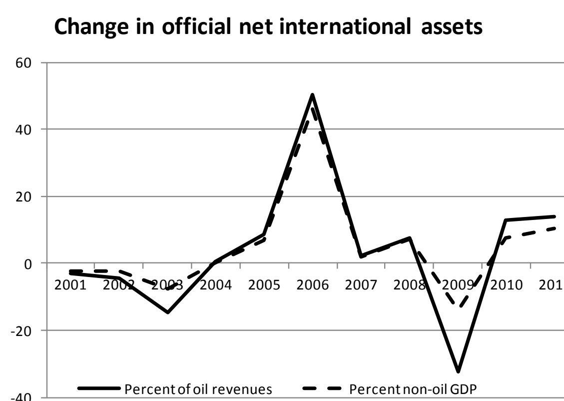
Source: Country authorities and IMF staff reports

[1] Angola, Cameroon, Chad, Republic of Congo, Equatorial Guinea, Gabon, Nigeria

[2] Simple unweighted average across countries, including Angola

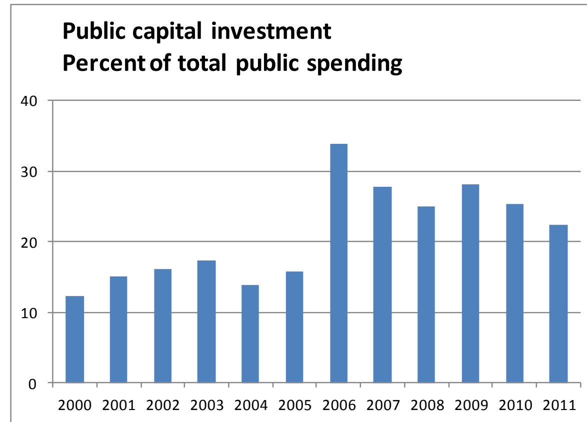
The Government's oil revenues and financial savings contribute towards the accumulation of foreign assets held at the National Bank of Angola. A portion of these foreign assets are sold to the private sector to pay for imports and Angola's stock of official international assets also needs to take into account the accumulation of public foreign debt. Over the past decade, the accumulation of gross foreign reserves and official net international assets has been the equivalent of about 8 and 4 percent of oil revenues respectively.





III. Investing in the future

Angola's known oil reserves are large but are also finite, so that difficult choices need to be made. At current rates and without further discoveries, the flow of oil could last several decades. But Angola would need more than several decades of high growth just to catch up with income levels currently enjoyed in OECD countries. The size of these reserves and the scale of production could obviously increase, but this would not essentially change the issue.



Angola has an urgent need to raise the living standards of its people, as indicated by the high poverty rates. Protecting the most vulnerable is correctly a key government priority and about a third of the budget is allocated towards social priorities. But the surest way to reduce poverty on a sustainable basis is through sustained economic growth in the non-oil sector to support higher income and consumption in the future. This requires capital investment. But for much of the decade, the share of Angola's budget allocated to public capital investment has been low compared to other Sub-Saharan oil exporters.

Public investment—especially in infrastructure, education and health—needs to be scaled up to support growth. But budgetary resources are limited and public funds used for current consumption also mean lower resources available for capital investment or accumulating financial assets. Shifting public resources away from current consumption would be difficult but probably unavoidable.

Some additional fiscal space could be obtained by shifting the burden of financing future investment more towards those who are currently benefiting from the oil resources. For example, revenues collected from the non-oil sector, at about 19 percent of non-oil GDP, are relatively low and there is room to raise revenues from this sector. To put this in perspective, revenues in Sub-Saharan countries that lack resource revenues have averaged about 24 percent of GDP over the past 5 years. Similarly, the Government's spending on current items–such as salaries, goods and services and on subsidies and transfers—consumes the larger portion of the budget, possibly providing scope for savings. In particular, subsidies and transfers are nearly as large as its capital investment program and there may be room to reduce the large fuel subsidies while targeting them more closely towards the vulnerable segments of the population.

Budgetary resources can also be augmented through public borrowing, domestic or external. But care needs to be taken not to crowd out the private sector's access to financing and not to mortgage the future.

Even if resources were available for higher public investment, there are limits on the scale and pace of the increase. Until capital investment can be scaled up, government savings may need to

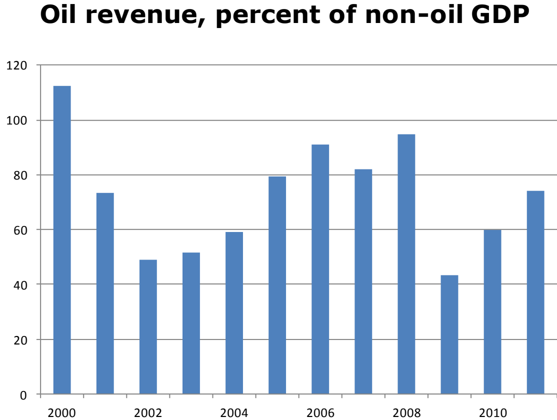
be invested in a capital investment fund with foreign financial assets to protect the payment of imports needed for capital investment and perhaps with maturities geared to the timing of the capital investments.

The economy can only absorb so much public capital investment. Existing infrastructure bottlenecks will first need to be addressed. A large and rapid increase in investment can boost growth, but it can also be destabilizing. Depending on how the investment program is financed and implemented, it has the potential to raise prices, eat into foreign reserves, or squeeze out the private sector. Too large or rapid a build-up of investment can be costly and reduce the benefits to the economy.

There are also important institutional constraints to scaling up public investment. For Angola to get good value for its money, the public investment program has to be carefully managed, often with a long time horizon to completion. Projects have to be identified, assessed, selected and then prioritized. Project implementation and related expenditures need to be closely monitored and supervised. This is a very demanding task and doing it well can slow down project implementation. But bypassing this process can also be very costly and reduce the benefits going to the economy.

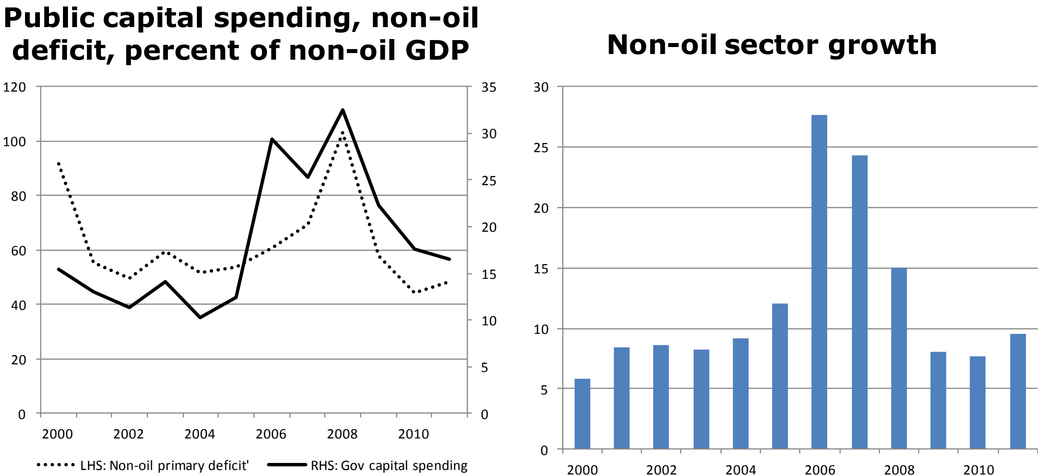
IV. Reducing volatility

Another reason to accumulate financial assets is to provide a buffer against oil revenue volatility. The budget's resource envelope is heavily reliant on oil revenues and, as illustrated in the accompanying chart, is vulnerable to the variability of these revenues. This variability stems mostly from movements in international oil prices and oil production that are outside the Government's control. But uncertainties in the institutional setting for managing oil revenues have also caused some variability.



Government spending, especially capital investment, have also been closely linked to the resource envelope and hence oil revenues. The same is true for the non-oil primary balance which, as mentioned above, is a good measure of the fiscal policy stance. In other words, fiscal policy has been pro-cyclical, transmitting volatility in the oil sector through to the rest of the economy. And this showed itself very clearly over the course of the recent crisis: fiscal policy was expansionary as oil revenues increased before and up to 2008 and turned contractionary as oil revenues then shrank during the crisis. The outcome was to transmit the volatility in the oil sector to the non-oil sector, with damaging consequences for the latter.

A key objective of the fiscal framework is to delink the non-oil sector from the oil sector so as to shield the economy from oil sector volatility. This can be done by smoothing the stance of fiscal policy supported by accumulating or drawing-down buffer stocks of foreign financial assets held in a stabilization fund to protect import payments. In other words, the idea is to smooth, say, capital spending or the non-oil primary deficit, saving resources when oil revenues are high and drawing down on these savings when oil revenues are low. This requires the Government to set aside liquid financial assets.



V. Towards a medium-term framework

The purpose of a medium-term macroeconomic framework is to help assess what is feasible and the nature of the trade-offs. Its purpose is also to provide a set of policy rules to guide the economy's evolution to meet the national development objectives, in a sustainable manner while also maintaining stability. The shape of framework will in some part be driven by the projections of Angola’s dependency on oil, the time horizon of this dependency, and the access to other funding.

There are three key decisions that need to be taken. The first concerns the appropriate fiscal anchor which will be the indicator that provides the basis for fiscal policy. There are several possibilities, such as the current account, the overall balance or the non-oil primary balance.

Each has quite different implications for fiscal policy. The IMF's own preference and the one used in the SBA program is the non-oil primary balance as a share of non-oil GDP.

The second key decision concerns the fiscal policy rule which outlines how the fiscal anchor should evolve and respond to shocks. Any policy rule has to start off with an element of fiscal smoothing and balancing the needs of the present versus the aspirations of the future. But the future is uncertain and some flexibility can be incorporated, for example, by allowing an adjustment in the fiscal policy anchor in response to a sustained change in oil prices. Other variants on policy rules could be to have ceilings on how fast or how far public expenditure can change. And there is also a discussion of whether the fiscal policy anchor should be defined in structural terms, after extracting its cyclical component.

The third key decision relates to the nature of the oil resource funds. These resources can be put into one fund or several. In either case, it would be important at least conceptually to distinguish the purpose of the resources, the type of financial investments and the rules regulating access to those resources when needed. A stabilization fund would be used to provide protection during a crisis and would need to contain highly liquid resources. Resources in a capital investment fund specifically targeted to protect investment projects over a medium-term horizon could perhaps be less liquid and with longer maturities. Resources could also be placed in a wealth fund invested in long-term assets to generate income for future consumption.

Conclusion

To close off, Angola is embarking on a significant transformation of its macroeconomic policy environment. It will make policy making more predictable, the economy more stable and growth more sustainable. If sustained, this will make an important contribution to improving the business environment, including for those in the private sector involved in public investment projects.