

## CHAPTER I

### INTRODUCTION

The Centre for Scientific Studies and Research of the *Universidade Católica de Angola* – (UCAN) -- will be publishing an annual report on the Angolan economy, in the context of which the most recent trends will be analysed and a long-range forecast will be prepared of the most likely behaviour of given economic variables. This represents an impartial and objective contribution towards the goals of macroeconomic stability and economic development.

The study of economic behaviour is a routine task in today's world, whether at the initiative of the State Administration, the private sector (firms, banks, etc.), or through the diligence of civil society institutions (including, *inter alia*, university research centers). In the particular case of Angola, having information on hand to analyse the economic situation is a specific imperative, given the enormous constraints the country faces as it strives to coordinate postwar productive activity in such a way as to overcome the lingering economic pressures imposed by the armed conflict and adapt the productive sector to a climate of peace, with a view to reducing unemployment and improving the living conditions of the population.

With the achievement of peace, it is time for the country to return to economic development. Now that the window to war, through which substantial financial resources flowed, has closed, the time has come to attack the economic crisis and to reduce poverty, with a redistribution of the budgeting and financial differentials previously applied towards military expenditure. With many of the world's largest economies currently in recession or periods of low growth, the global economic environment is far from ideal. Added to this are the effects of the terrorist attacks of 11 September 2001, which are reflected in the confidence indicators of many economic agents. The sustained recovery of the world economy and of the countries which dominate it, has not yet occurred and the signals for the first six months of this year are insufficiently strong to predict a change of course and pace. The constant decreases in European and American interest rates indicate that economic growth is proving to be a bigger headache than inflation<sup>1</sup>. This is equally the

case with in the regional context of the SADC (Southern African Development Community). The fast pace of economic integration being pushed by the majority of member countries is clearly incompatible with the internal economic and social weaknesses of many member states. In order to meet this challenge, aggressive and pro-active development strategies and policies are needed, combined with a clearly defined development model to be followed in the future.

The year 2002 may see the close of an economic and political cycle that began with national independence. The economy was dominated by persistent macroeconomic imbalances, by the predominance of oil and diamond revenues and by the inability of the non-mining economy to recover. The political field was marked by the hegemony of war and chronic social problems such as poverty, unemployment, and a large number of internally displaced citizens.

#### 1. Major post-conflict challenges

It is surely not an exaggeration to affirm that, with the end of the war, the country has become a well of problems and a sea of challenges<sup>2</sup>. The expectations of the population are huge, following years of hardship and sacrifice which placed more than two-thirds of the citizens in conditions of poverty and social exclusion.

With the restoration of peace – public good number one, having a social utility probably superior to that of democracy – it is necessary to know how to use it: how to take advantage of the new environment of security and tolerance in order to resolve - or at least mitigate - the problems, and proactively to meet the challenges. The solutions can no longer be only those of the Government. The exercise must be done jointly: The State must not continue to be omnipresent, because that position limits private initiative, the true focus of the market economy, and private economic agents cannot continue systematically to request paternalistic support from the State. The Public Administration cannot continue to be the main obstacle to the activity of the citizens and the fundamental question of ownership must be definitively dealt with.

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the devaluation of the currency of the USA, where it will result in a reduction in the purchasing power of national exports.

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<sup>1</sup>The increase in the price per barrel of oil on world markets following the war against Iraq could have a twofold effect on the Angolan economy: In the immediate future, export receipts and oil taxes will increase, but in the short term, with the fall in the value of the dollar, the increase in the price of oil may not compensate for

<sup>2</sup> Certainly these were always present. However, the fumes of war made them less perceptible, and this justified the establishment of options and priorities. From now on everything must be different, and the great national problems must be resolved rapidly so that people may have hope and their self-confidence may be restored.

The great challenges facing the Angolan economy are many and diverse. Correct ranking and prioritising<sup>3</sup> of these challenges is a necessary part of good development management.

Three of these challenges are of paramount importance.

### 1.1. Guarantee of macroeconomic stabilisation

This is one of the main challenges in the short term. Many studies have been presented on this subject, but it would appear that there are no doubts with respect to the need to stabilise the principal macroeconomic indicators within economically manageable and socially acceptable limits. In the context of these imbalances, the budget deficit and inflation predominate.

The government share of GDP declined by 5.4% in 2002, ending a period of decreasing fiscal deficits begun in 1999, which in 2001 had reached -6.2% of GDP.

With regard to prices, the internal situation has been typified by very high rates of inflation, with the CPI - Consumer Prices Index - having recorded a value of more than 105% in December last year.

Price control is one of the essentials of macroeconomic stabilisation, it being beyond question that:

- The reduction of inflation in the short term is an essential task on which the creation of conditions for the sustainability of equilibrium between the different futures markets depends;
- With inflation stabilised, salary increases will take place in accordance with productivity gains and not indexation to monetary variables, which adversely affects the competitiveness in the real economy;
- With inflation stabilised, interest rates will reflect true conditions of supply and demand of money, making possible the rational allocation of credit and serving to attract savings;
- With inflation stabilised, the allocation of resources and investment decisions will be ruled by criteria of economic rationality and

not by speculative motives or reasons of influence.

### 1.2. National economic structure

It is now commonplace to affirm that the internal economic structure is "in tatters", with a dominating State<sup>4</sup> and an underdeveloped non-mineral private sector. The domestic private economy is dominated by informal rural and urban activities, which are practically unaffected by official economic policy. The mining economy reigns supreme: with its own exchange system and a functioning logic based on the dollar, it is exempt from the payment of customs duties at the same time that it is the nation's number one importer of goods. These costs are passed on to the rest of the economy. The maximum expression of this divorce is seen in the low volume of national employment which this key sector creates.<sup>5</sup> Still, the oil and mining sector plays an important role as the exclusive supplier of foreign exchange<sup>6</sup> and a major payer of income tax to the State.

To summarise: The domestic economic circuit consists of four agents, namely the State, possessor and appointed governor, the mining economy as the External Bank of the country, the informal economy with increasing expression<sup>7</sup> and the formal economy<sup>8</sup> with no favours from the State and late in being recognized as potentially the most important economic actor of the country. Among these four agents, economic relations are very tenuous, even nonexistent, between some of them. When one considers that the domestic structure of production is overwhelmingly concentrated in a small coastal strip of the country, one has a clear image of the important structural disarticulations that exist in Angola.

<sup>4</sup>It is still the biggest holder of fixed assets, with a budget expenditure in the mid 1990's representing around 60% of GDP and external debt in the name of the State to the extent of practically 100%.

<sup>5</sup>The mining economy employs no more than 40,000 Angolans (10,000 in the petroleum sector, 28,000 in the diamond sector and 2000 in the remaining sectors).

<sup>6</sup>On average, in the past decade, more than 90% of total export receipts.

<sup>7</sup>Probably accounting for 35% of the GDP, 59% of jobs and 55% of aggregate family income (Fion de Vieter - "A Produção do Setor Microempresarial Urbano em Angola" [Production of the Urban Micro Entrepreneurial Sector in Angola], Principia-UNDP, May 2002).

<sup>8</sup>In the decade of the 1990s the GDP of manufacturing industry did not exceed on average 3.5% of the total GDP of the country, a clear symptom of a process of acute de-industrialisation.

<sup>3</sup>The establishment of a collective preference function.

The exaggerated weight of the State on the economy<sup>9</sup> certainly has a negative effect on the process of economic growth. A reduction in its size and a restructuring of its functioning organics<sup>10</sup> is thus necessary, even while one of the key features under consideration in a process of sustainable economic development is the formation of an Administration for that development.

### 1.3 Poverty Reduction

The results of the survey of family expenditure and receipts of the INE - National Institute of Statistics - indicate a worsening of extreme poverty between 1995 and 2000: parameterised in individual terms, the respective rate increased from 13.4% to 26.3%. In terms of family aggregates, the deterioration was even more acute, increasing from 11.3% to 24.7%. The following information again shows the probable deterioration in the distribution of income during those years:

YEARS	Extremely poor	Extremely poor individuals	Moderately poor	Moderately poor individuals	NNPfc per capita
1995	11.3	13.4	49.5	56.6	306.0
2000	24.7	26.3	38.5	41.9	418.1

Source: INE, Inquérito às receitas e despesas familiares [Survey of family income and expenditure, 2000/2001]

Notes: the poverty indices are expressed as a percentage and refer to family aggregates and individuals; the values of Net National Product refer to US\$ per capita

The apparently contradictory evolutions between average per capita income and the poverty indicators are curious:

- Although the average income generated by the economy improved considerably – by more than 100 dollars in five years – extreme poverty worsened substantially;
- The reduction in moderate poverty was not an indicator of an upward trend, i.e., the result of an increased non-poor headcount, but of a downward trend, i.e., by an increase in the extremely poor class: non-poor household and individual numbers declined during the years analysed, from 39.2% to 36.8% and from 33% to 31.8%, respectively.

<sup>9</sup>From another standpoint, probably more penalising for the economy, it could be said that the excess weighting of the State is in its complex bureaucracy and in the lack of efficiency of the services it provides to citizens and companies.

<sup>10</sup> The number of Ministries, Vice Ministries, organisations, etc., should be urgently re-equationed.

There can only be one conclusion: The deterioration of the situation among the citizens is not due to a lack of economic growth<sup>11</sup>, but a substantial worsening of the distribution of national income.

Taking as a reference the poverty line fixed in the Relative Development Index (RDI),

- Poor..... US\$ 51.2/month
- Extremely poor ..... US\$ 22.8/month

a distribution of the value of the Net National Product at factor cost (NNPfc) per capita of 2000 (US\$ 418.1) was attempted, taking as a basis for the calculation the upper limits of the income classes of the IDR.

the results of which are as follows:

- non-poor..... US\$ 278.96/annum
- poor..... US\$ 614.4/annum
- extremely poor... US\$ 273.6/annum

#### DISTRIBUTION OF INCOME IN AFRICA - 1986-1997

Percentage of income drawn by population groups

COUNTRIES	10% +rich	20% +rich	10% +poor	20% +poor
Lesotho	43.4	60.1	0.9	2.8
Mozambique	31.7	46.5	2.5	6.5
South Africa	45.9	64.8	1.1	2.9
Swaziland	50.2	64.4	1	2.7
Tanzania	30	45.5	2.9	6.8
Zambia	39.2	54.8	1.6	4.2
Zimbabwe	46.9	62.3	1.8	4
Guinea-Bissau	42.3	58.9	0.5	2.1
B. Faso	39.5	55	2.2	5.5
Burundi	26.6	41.6	3.4	7.9
CAR	47.7	65	0.7	2
Côte d'Ivoire	28.8	44.3	3.1	7.1
Ghana	26.1	41.7	3.6	8.4

SOURCE: African Development Indicators 2002, World Bank

We have here an economic paradox, with the annual income of the poor higher than that of the non-poor. The reasons for this include:

<sup>11</sup>Here is a specific case of economic growth with increasing under-development so abundantly referred to in the development economics literature. In Angola it is sufficient for an oil well to commence activities in order for the total GDP to increase by the direct and exclusive effect of the increase in the production of oil. The essential point about these economic effects is that benefits are derived from them by countries which are already developed and rich: Development takes place at the expense of under-development in Angola. If the assumptions on which the process of distribution of oil income is based are not substantially modified the perverse effects of the oil economy on the economy as a whole and on Angolan society will intensify, thus emphasising the already considerable social differences even further, and putting national reconciliation at risk.

- The known deficiencies of calculation of the aggregates of the National Accounts;
- Problems establishing lines of poverty and of absolute poverty;
- Such a distribution must necessarily assume that a very restricted group of citizens exists, whose living standard does not depend on remuneration obtained in the process of normal production. Their sources of finance of consumption and savings are other than domestic production. If this were not the case, the limits of poverty of the RDI would be meaningless<sup>12</sup>.

If we consider the average point of each income class of the RDI<sup>13</sup> for the same level of NNPFc per capita, the results are as follows:

- Non-poor..... US\$ 615.04/annum
- Poor..... US\$ 445.20/annum
- Extremely poor ..... US\$ 136.80/annum

values that are more acceptable from the standpoint of economic logic. The distribution indicated by these values shows that the non-poor earned 4.5 times more than the extremely poor, that the poor earned 3.25 times more than the extremely poor and that the income of the non-poor is only 1.38 times higher than that of the poor. While this distribution is more logical in terms of national income (itself very meagre) it still does not conceal the existence of a very restricted group of select citizens holding enormous personal fortunes, the origins of which are not included in standard GNP accounting.<sup>14</sup>

The labor income in the formal sector of the country for all classes is low and, to a certain extent, relatively level. The difference is found in the weighting of unofficial income (internal and external) and relates in particular to the groups situated at the top of the social pyramid, whose income is inaccessible to a progressive system of taxes, because it is concealed.

<sup>12</sup> A more extreme conclusion is that the poor cannot even attain the higher limits in the respective classes of income of the RDI, otherwise the non-poor would be as poor as the rest, i.e., the country does not have any rich citizens.

<sup>13</sup> Extreme poor (0-\$22.8) and poor (\$23-\$51.2), whose average points are, respectively, \$11.4 and \$37.1.

<sup>14</sup> The high levels of corruption and income deriving from capital applications and others abroad, will certainly be the most important sources of finance of consumption and savings of this class of citizen.

It was not possible to obtain precise information of this nature for other African countries. However, with regard to the data in the above table it is possible to state that many African countries suffer from the same income distribution problems as those in Angola.

In general terms, the previously cited situations should not differ very much from the Angolan case, at least with respect to the analysis of income distribution<sup>15</sup>. Mozambique, Tanzania and Burundi are the sub-Saharan countries where the rich are poorest and the poor are richest, for the whole of the sample in the table<sup>16</sup>. Burundi, the Ivory Coast and Ghana are the countries with the most equitable income distributions while Swaziland and South Africa are those where the division of income is the most unequal. Here the rich are richest and the poor are poorest. Lesotho, the Central African Republic and Guinea-Bissau are the only countries in the sample where the poorest 10% do not even receive 1% of national income<sup>17</sup>.

Assuming a scenario of sustained national income growth at an annual rate of 7.2%, with a corresponding annual GDP growth rate of approximately 10% (around 15% for the non-mineral economy), and with a demographic variation of 3%, it would take Angola approximately 25 years to reduce the incidence of poverty from its current 62.2% to around 28% (assuming a poverty/income elasticity of 0.7)<sup>18</sup>.

#### 1.4. Mitigation of regional differences in the context of the SADC

The clearly dominant country of the SADC is South Africa, whose annual creation of wealth represents

<sup>15</sup> Probably more aggravated by the consequences of a military conflict for more than a quarter of the post-independence era. The estimates that are available in this connection are somewhat contradictory. For example, the report on human development in Angola of the UNDP (1998) shows a Gini index with a value of 0.55, which is not a proper indicator of a very unequal distribution of income. However, other approximations indicated a distribution in which for every \$100 of the poorest 10%, the richest 10% can earn \$4000.

<sup>16</sup> The source consulted only supplies data for 26 sub-Saharan countries.

<sup>17</sup> For the countries making up the African Economic Indicators, only Niger and Sierra Leone reflect a similar situation.

<sup>18</sup> This reduction – according to the calculations – also depends, to a great extent, on the modification of the model of access to oil income currently in force. The formation of a national middle-class, albeit in a restricted social group, almost exclusively with easy access to oil income, is worthy of discussion. A middle-class formed in this way is not normally entrepreneurial, because it does not have to be, as the formation of wealth is guaranteed and access to all types of consumer goods - basic and ostentatious - is assured. It faces no challenges. A process of this type necessarily marginalises the most capable and competent. The most entrepreneurial.

on average more than three-quarters of the total for the region. It must be a singular case in the world for a country to hold a similar preponderance and dominance in a region, not only by dint of its population, but also – and principally -- by its economic structure and by its productive and technological capacity to create economic activity and increase income. The current regional imbalance in the capacity to create wealth in favour of a single country, causes one to fear that, in a context of free trade and regional economic integration, a significant polarisation of economic activity and income will occur, almost entirely in South Africa's favour. On the other hand, from the standpoint of benefiting from certain internal competitive advantages, the predominance of one country could bring about - within the framework of coordinated national strategies to reduce regional imbalances - the appearance of a high degree of

- Between the lowest average income and the SADC regional mean, there was an approximately ten-fold difference (10.2 times, or appx. 921.8%), while between the latter and the highest income country, the difference was nearly six-fold (around 482%);
- Per capita GDP even among those countries closest to the top, still differed from the highest-income country (Seychelles) by 84% (Mauritius), 101.9% (Botswana) and 106.3% (South Africa).

In terms of dynamics of growth between 1990 and 1999<sup>19</sup>, the emphasis is on Botswana (4.5%), Mozambique (5.5%), Lesotho (4.5%) and Mauritius (5.2%), with average rates of change during the decade considerably above the regional average and that of many other countries. This applies in particular to the island nation of Mauritius, which

INDICATORS	GDP prices in 1995 (millions of US\$)			REGIONAL STRUCTURE OF THE GDP		
COUNTRIES	1994	1996	1999	1994	1996	1999
Angola	4703	5706	6422	2.462433	2.768425	2.942335
Botswana	4662	5239	5893	2.440965	2.541847	2.699966
D.R. of the Congo	6294	6281	6589	3.29546	3.047402	3.018849
Lesotho	892	1026	1079	0.46704	0.497792	0.49436
Malawi	1224	1533	1688	0.640871	0.743778	0.773382
Mauritius	3785	4199	4838	1.981779	2.037262	2.216602
Mozambique	2294	2562	3417	1.20111	1.243026	1.56555
Namibia	3109	3293	3568	1.627834	1.597691	1.634733
Seychelles	511	532	574	0.267553	0.258115	0.262987
S. Africa	146547	157386	164369	76.7302	76.3602	75.30812
Swaziland	1234	1317	1421	0.646107	0.638979	0.651052
Tanzania	5074	5494	6197	2.656684	2.665567	2.839248
Zambia	3559	3699	3841	1.863448	1.794673	1.759812
Zimbabwe	7102	7843	8366	3.718519	3.80525	3.833008
SADC	190990	206110	218262	100	100	100
AFRICA	477884	519380	568198	39.96577	39.68385	38.41302

Sources: African Development Indicators, 2001; World Development Report, 2000

concentration of productive specialisations, thus harming the capacity of internal resistance to external competition.

With regard to mean per capita GDP, the SADC regional average was USD 1,124 in 1999, (i.e., around 66% more than the average for the African continent as a whole). However, the differences between the different countries were stark:

- The lowest per capita GNI (\$110 for the Democratic Congo) was more than fifty-nine times lower than the highest (\$6,540 for the Seychelles) – a difference of 5,845.5%;

increased domestic product at an average annual rate of 5.2%. Mauritius has a relatively diversified internal structure of production - albeit one based on tourism, sugar cane, textiles and clothing - and is the second strongest economy in the region, after South Africa. If the period under analysis were restricted to the years 1994-1999, Angola (with an average annual growth of 6.4%), Botswana (4.8%) and Malawi (6.6%) also present noteworthy rates of variation in the annual average of the domestic product, although for the first this relates only to the growth of the petroleum-extraction industry (with

<sup>19</sup> During this time period the average rate of growth of the Angolan GDP was -0.2%, clearly out of sync when compared with the other countries.

declining production in agriculture, energy/water and trade, and stagnation in manufacturing and non-oil industrial sectors). For the second country, it relates only to the weighting of extraction of diamonds and for the third to the predominance of agriculture. These are, in fact, economic and productive structures that are internally very unbalanced, dependent on a single field of activity, and whose capacity to meet the challenges of a liberalisation of trade is very restricted at the present time.

With respect to the stability of the economies of the SADC, the differences are, similarly, enormous when Angola is compared with the more dynamic regional productive structures, as shown in the above table.

It was also noted that:

- (a) Angola does not reflect any periods considered as either stable (extremely high rates of inflation), or strong (negative economic growth). Depreciation in the exchange-rate was not taken advantage of to promote exports, due to the dominance of oil and minerals extraction in the export sector, and the fact that these products tend to be exported according to the logic of cartels rather than of open competition;
- (b) Mauritius and the Seychelles are the most well-balanced countries in the region, with stable economies, low inflation, healthy competitive environments and robust growth;
- (c) South Africa and Namibia also have well-structured and stable economies, though they have performed less well overall than those of the two previously mentioned countries.

From the standpoint of domestic markets, as typified by rates of capital formation, the best equipped countries are the Seychelles, Mauritius, Botswana, South Africa, Namibia and Swaziland, with rates exceeding the average values in the region. As for Angola, the challenges it faces are immense. Even assuming sustained GDP growth of 6.4%<sup>20</sup> and a zero growth rate for the other SADC member countries:

- 23 years to achieve the average per capita income for the region;

- 51 years to be on a par with the Seychelles;
- 40 years to be on equal terms with South Africa.

INDICATORS	Growth rate GDP90-99	Consumer price index (CPI) 90-99	Spread 90-99	Fiscal deficit
<b>COUNTRIES</b>				
Angola	-0.2	631.5	3.77	-24.3
Botswana	4.5	11	1.08	3.9
D.R. of the Congo	-4.6	900	55.21	-10
Lesotho	4.5	11	1.05	-3.6
Malawi	3.6	30.6	1.19	-13.3
Mauritius	5.2	7	1.05	-3.8
Mozambique	5.5	35.8	1.14	-13.9
Namibia	3.6	10.2	1.06	-4.6
Seychelles	3.3	1.1	1.09	-12.8
S. Africa	1.6	10	1.05	-5.5
Swaziland	3.1	9.9	1.1	-2.5
Tanzania	2.9	24.5	1.21	-2.2
Zambia	0.2	70.6	1.55	-10.8
Zimbabwe	2.9	26.4	1.21	-8.3
<b>SADC</b>	2.578571	127.1143	5.197143	-7.97857
<b>AFRICA</b>	2.4	10.6	..	-5.1

i.e., it will be generations before Angola manages to occupy a leading position in the economic context of the southern region of the African continent.

It is clear that the Democratic Republic of Congo, Mozambique, Lesotho, Malawi, Tanzania and Zambia are in an equally unfavourable position.

As long-run economic growth cannot stop, Angola will have to implement overall growth strategies that favour the sectors and strata with the most internal added value, such as petroleum (refined petroleum products, by-products and chemicals), timber (compounds, plywood, chipboard panels, papermaking pulp), cotton (textiles and cloths), hydroelectric power and products with a high energy content (cement, aluminium, iron and steel). The waiver periods which Angola manages to negotiate for adhering to the protocols of regional trade liberalisation will have to be taken advantage of in order to introduce deep structural reforms in the existing sectors, so as to encourage a dynamic of growth much greater than that which has been recorded in the past, compatible with its natural potential and capable of catapulting the country into stages of development closer to those of its community partners. Following the consolidation of peace, the realisation of basic investments, the promotion of national reconciliation and the successful integration of the domestic economy, it is perfectly reasonable to anticipate average growth

<sup>20</sup> The average recorded between 1994 and 1999.

rates of the domestic product on the order of 12.5% per annum over a 10-year period. Under this scenario the gross domestic product could be increase by a factor of 3.25 in absolute value and per capita GDP by 2.38 (almost US\$ 810).

## 2. Factors influencing the development of the national economy

COUNTRIES	GDP pc
Angola	270
Botswana	3240
D.R. of the Congo	110
Lesotho	550
Malawi	180
Mauritius	3550
Mozambique	220
Namibia	1890
Seychelles	6540
S. Africa	3170
Swaziland	1360
Tanzania	260
Zambia	330
Zimbabwe	530
SADC	1124

### 2.1. The international context

The world economy in 2002 was characterised by a marked softening which translated into a general rate of growth of the GDP of between 2.8% and

US economy, interrupting a golden period of growth throughout the 1990s<sup>21</sup>.

The Japanese economy did not manage, during the course of the year, to reverse the deflationary trend begun more than five years ago, and which has penalised not only its exports but also imports of raw materials from the emerging and developing economies.

For Germany, 2002 was a year of weak economic growth amounting to no more than 0.2% -- among the worst in 15 years. This was aggravated by an increase in the rate of unemployment,<sup>22</sup> from 7.8% in 2001 to 8.2% in 2002, one of the highest in the Euro Zone.

For the Euro Zone estimates of economic behaviour in 2002 are identical to those detected for the other large economies: macroeconomic fundamentals have not recovered. According to the OECD, the differences in growth rates between North America, Japan and Continental Europe are becoming even more accentuated.

As a consequence of the softening of the North American economy, and also due to the financial scandals involving internationally renowned companies, the behaviour of the world's most important stock exchange (i.e., the NYSE) was considerably affected, with indices performing well below expectations. One of the corollaries of this

### ESTIMATES OF THE DEVELOPMENT OF THE WORLD ECONOMY IN 2002

COUNTRIES/AREAS	European Commission	International Monetary Fund	OECD	Consensus Forecasts
World Economy	n.d	2.8	n.d	1.7
USA	2.4	2.4	2.4	2.6
Japan	0.3	0.3	0.3	-0.6
Euro Zone	0.9	0.8	0.9	0.9
United Kingdom	1.8	1.6	1.8	1.6
Germany	0.2	0.2	0.2	0.5
Portugal	0.5	0.5	0.5	0.6

Source: World Economic Outlook, IMF, April 2003; Eurostat; Economic Perspectives of the OECD

3.0%. Retrenchment in the economies driving world economic growth, namely the USA, Japan and Germany, contributed to this situation.

The symptoms of softening of growth have been noticeable since the end of 2001, due in particular to the negative impacts of the events of September 11 in the USA and the subsequent downturn of the

<sup>21</sup> Due to the weighting of the North American economy on the world economy - around one quarter of international trade and one in every three dollars of wealth in circulation throughout the world (more specifically 31.2% of the world GDP) - the growth of practically all countries depends on the force and dynamics of their productive structure and on the predominant factors of positive variations in the American GDP.

<sup>22</sup> As is known, the labour market supports private consumption and whenever the rate of unemployment is aggravated (or declines) that component of aggregate demand of the economy reacts in accordance with the growth in GDP.

situation was the fall in the value of the dollar, which towards the end of 2002 was practically on a par

China, India and South Korea were the countries which experienced the highest rates of growth in the

### GDP GROWTH RATES OF THE EMERGING ECONOMIES

COUNTRIES/YEARS	2000	2001	2002
China	8.0	7.3	8.0
India	5.4	4.2	4.9
Korean Republic	9.3	3.0	6.3
Argentina	-0.8	-4.4	-11.0
Brazil	4.4	1.4	1.5
Mexico	6.6	-0.3	0.9
Egypt	5.4	3.5	2.0
South Africa	3.4	2.8	3.0

**SOURCE:** Outlook, IMF, April 2003

with the euro<sup>23</sup>.

The following table shows some values relating to world economic behaviour and the behaviour of the main economic powers.

In some countries it appears that the economic softening was accompanied by a reduction in the rate of inflation, although in other developed economies inflationary trends were noted. These were apparently due to the economic downturn and the high deficits.

world in 2002, maintaining a strongly positive trend since the year 2000. Of the three largest Latin American economies, only Brazil did not fall into recession between 2000 and 2002, although in the latter year the respective GDP barely reached 1.5%.

As for emerging economies in Africa, Egypt and South Africa both experienced modest GDP growth in 2002.

### INFLATION RATES IN 2002

COUNTRIES/REGIONS	European Commission	IMF	OECD	Consensus Forecasts
Global Economy	n.d	1.2	n.d	1.4
United States	1.6	1.6	1.6	1.6
Japan	0.3	0.3	0.3	-1.2
Euro Zone	2.1	2.3	2.4	2.2
United Kingdom	1.3	2.2	2.2	2.2
Germany	1.3	1.3	2.1	1.3
Portugal	3.7	3.7	3.7	3.5
Spain	3.6	3.6	3.6	2.7
Low Countries (BeNeLux)	3.9	3.9	3.9	3.5

On the world level, prices remained fairly stable, with no variation in the consumer price index (CPI) exceeding 1.4% according to even the most pessimistic estimates.

In the Euro Zone there was some rise in inflation, mainly in Spain, Portugal and the Netherlands.

The behaviour the emerging economies was varied, due not just to what took place within the developed economies, but also between them.

In view of the close economic ties between Argentina and Brazil, in the context of MERCOSUL, the very considerable crisis in Argentina had obvious effects on the Brazilian economy. However, Brazil fared far better than its neighbor, thanks to its defence of the real, diversification of exports and preservation of structural competitiveness.

With regard to industrial production - a relevant indicator for the analysis of the process of economic growth - the emerging economies reflected different behaviours, expressed in the following figures (homologous variation between 2001 and 2002):

Clearly worthy of special mention is the Chinese industrial economy, while the dynamic industries of

<sup>23</sup> The average quotation in relation to the first half of 2003 saw the euro up by around 15% in relation to the North American currency, and this certainly does not augur well for the conditions of the reestablishment of economic growth in the Euro Zone, since exports have been major factors in its economic growth. It will therefore lose the competitiveness which characterised it in the past.



**Average annual short-term interest rates  
Emerging economies**

China	n.d
India	5.72
Korean Republic	4.94
Argentina	19.00
Brazil	17.90
Mexico	7.33
Egypt	6.69
South Africa	13.55

Egypt and South Africa are equally noteworthy<sup>24</sup>. On a more negative note, it is worth mentioning the relative stagnation of industrial production recorded in Brazil and the clear industrial recession of

worsened between 2001 and 2002, from a rate of 5.7% to 10.0%.

The average annual short-term interest rates in the emerging economies reflect figures that were clearly higher than those on a world scale. In Europe and in the USA, interest rates for short-term operations did not exceed 3-4%, while in the emerging economies the rate was around 6.5%.

Another important indicator is the behaviour of exchange rates - measured between each of the national currencies and the US dollar - the values of which were as follows:

**ANNUAL RATES OF INFLATION IN THE EMERGING ECONOMIES**

COUNTRIES/YEARS	2000	2001	2002
China	0,4	0,7	-0,3
India	4,0	3,8	4,5
Korean Republic	2,3	4,1	2,8
Argentina	-0,9	-1,1	25,9
Brazil	7,0	6,8	8,4
Mexico	9,5	6,4	5,0
Egypt	2,8	2,4	2,5
South Africa	5,4	5,7	10,0

SOURCE: Outlook, IMF, April 2003

Argentina in 2002.

With regard to inflation, the world's emerging

- It is appropriate to emphasise the exchange stability recorded between

**BALANCE OF CURRENT TRANSACTIONS AS A PERCENTAGE OF GDP IN THE EMERGING ECONOMIES**

COUNTRIES/YEARS	2000	2001	2002
China	1.9	1.5	1.9
India	-0.9	n.d	0.9
Korean Republic	2.7	2.0	1.3
Argentina	3.1	-1.7	8.3
Brazil	4.7	-4.6	-1.7
Mexico	-3.1	-2.9	-2.2
Egypt	-1.2	n.d	n.d
South Africa	-0.4	-0.1	0.1

SOURCE : Outlook, IMF, April 2003

economies varied greatly. China enjoyed perfect price stability between 2000 and 2002, while in Argentina prices experienced somewhat erratic behaviour, from deflation in 2000 and 2001 to worrying inflation in 2002. In South Africa inflation

2001 and 2002 in China, India and Egypt;

- The revaluation of the currency of the Korean Republic between 2001 and 2002, undoubtedly due to the macroeconomic policies of convergence and the high levels of economic growth;
- The devaluation of the national currencies in Argentina, Brazil, Mexico

<sup>24</sup> In this case of concern to Angola, whose industrial economy suffered a profound process of technological erosion, under-utilisation of the factors of production, an accentuated loss of its relative position in the national economic structure, a decline in its internal and external competitiveness, the corrosion of the professional skills of its workers and businessmen, and an irreversible de-capitalisation in the absence of specific and adequate measures. South Africa is one of the partners of Angola in the SADC - the strongest among the 14 members of the future, common market of Southern Africa - and if the national industrial economy continues to record successive delays in the implementation of a strategy clearly breaking away from that of the

past, the country will end up being merely a market of disposal of South African products, cheaper and of better quality

and South Africa in percentages varying between 41.6% in Brazil,

INDUSTRIAL PRODUCTION PERCENT CHANGE BETWEEN 2001 AND 2002	
China	13.8
India	5.7
Korean Republic	8.5
Argentina	-4.5
Brazil	0.9
Mexico	0.7
Egypt	7.8
South Africa	8.2

260% in Argentina and 8.74% in South Africa.

Finally, it is worth referring to the behaviour of current accounts in these economies. Some key

imports<sup>25</sup> by Angola are, for the most part, from this economic area, imported inflation could to some extent, have fuelled domestic inflationary expectations;

- Japan experienced continued contraction of its GDP, as well as price deflation;
- South Africa in both 2001 and 2002 showed excellent industrial development dynamics, the highest among sub-Saharan African countries.

Thus, it can be said that certain emerging markets have already established the basic conditions for sustained economic growth and foreign investment, having managed to guarantee price and exchange stability and a good macroeconomic climate<sup>26</sup> generally.

AVERAGE NATIONAL/US\$ CURRENCY EXCHANGE RATES		
COUNTRIES/YEARS	2000	2001
China	8.28	8,28
India	48.00	48,30
Korean Republic	1294.00	1227,00
Argentina	1.00	3,60
Brazil	2.74	3,88
Mexico	9.22	10,01
Egypt	4.26	4,63
South Africa	9.38	10,20

Source: Outlook. IMF. September 2002

indicators are shown in the following table:

In conclusion:

- The world economic environment in 2002 was characterised by a relative stagnation in the growth of GDP in the most advanced and industrialised economies, and by a continued increase in the GNPs of the emerging economies. However, Angolan oil exports did not record any shocks due to the fact that the American economy and certain economies in the Euro Zone experienced reductions in their economic growth rates;
- During the course of 2002 certain European economies experienced inflationary trends due to budget deficits higher than those established in the Stability and Growth Agreement of the Euro Zone; considering that

## 2.2. The national context

The national context in 2002 was indelibly marked by the end of the military conflict and the pursuit of a lasting process of pacification and national reconciliation. The importance of this event not only relates to the political domain and the clear reinforcement of the image of Angola abroad - due to the fact that the solution to the war was eminently internal - but also to other facets of society, the most relevant for present purposes being those of an economic nature. The end of the war has made it possible to take a longer-term view, to define individual, collective, entrepreneurial and

<sup>25</sup> Between January and September 2002, Angolan imports from Portugal amounted to approximately 394.6 million euros (approximately 422 million US dollars), which represented an increase of 47.8 million euros in relation to the same period in 2001, and an increase of 43 millions in relation to the cumulative amount to August.

<sup>26</sup> The area represented by the emerging economies - designation of the Bretton Woods institutions - is that which should be disputed, in the first place, by the Angolan economy.

institutional strategies, and to look resolutely to the future.

The war left the country seriously bereft of economic infrastructures<sup>27</sup>, social facilities, qualified human resources, rural population, the satisfaction of basic needs, etc. International support will have an important role to play in complementing the efforts of the Government. Furthermore, the President of the Republic, in his end-of-year message directed towards the accredited diplomatic corps in Angola, renewed his request for the continuation of humanitarian assistance by the international community, also giving thanks for the important contribution made towards resolving the country's politico-military conflict. He also mentioned that the country is relying on international co-operation for its economic and social development and that it will give priority to co-operation with countries contributing specifically towards the national reconstruction of Angola.

An equally relevant development that occurred in 2002 was the appointment of the Prime Minister and the consequent governmental reorganization. The purpose of this institutional adjustment is to reinforce macroeconomic policy, political cohesion and the dynamism of the government structure. The President of the Republic exhorted the new Government to observe more rigorously the performance of its constitutional duty and to avoid unrealistic promises and false expectations.

These are certainly new factors for the Angolan economy. With regard to agricultural recovery, there may be no immediate impacts - its magnitude and pace depend on other factors such as the return of internally displaced people to the countryside, mine clearance, the resolution of land problems, and the guaranteed provision of agricultural inputs, etc. For the industrial sector, however, the impact of the factors cited in the preceding paragraph will be significant.

The opportunity for renewed productive activity amid conditions of peace may open the door to increased industrial activity, particularly considering

the significant cost reductions that are likely to result from the increased circulation of factors of production throughout the country, as well as the possibility of normalisation of water and electricity supplies. Businessmen are also anticipating the approval of the private investment law and the creation of a consistent series of incentives for industrial activity, thus contributing towards the strong restructuring of the nation's entrepreneurial fabric, its technological base, and competitive environment. These actions have extraordinary scope in the context of the signing of the free trade protocol of the SADC and the formation, up to 2008, of a free trade area among the 14 countries of Southern Africa. Businessmen have confidence in the process of modernisation of the Customs Ministry and the new method for the issue of pre-shipment certificates. They hope that these measures will resolve the very slow process for the clearance of goods and that the creation of a new warehouse for raw materials will contribute towards shortening the import period.

However, structural blockages to the normal and competitive functioning of national industry persist, so that by the end of 2002 utilized productive capacity remained at a rather low level<sup>28</sup> nationally and the contribution of Gross Industrial Value Added to the overall GDP remained tiny (approximately 4.3%, valued in current kwanzas).

Intense activity was recorded in the commercial sector in 2002, with the licensing of 14,432 new commercial and services establishments under the authority of the New Policy, Strategy and Commercial Legislation, which entered into force on 3 June 2002.

Unemployment continued to cast a negative shadow over the economic and social situation of the country in 2002. The creation of new jobs did not manage to compensate for the arrival of new assets to the labour market, despite the support of several major job creation initiatives including the Self-Employment Development Programme (which created around 20,000 new jobs), the micro-credit activities of Banco Sol (assisting around 1,400 persons in a total of 667 groups), and the New Horizon Programme (which supported the development of 55 new companies in Huambo, Bié and Kwanza Sul) -

<sup>27</sup> Around 80% of the total asphalted roads network of the country are in a poor state of conservation. Its rehabilitation is one of the essential factors for strengthening the gains of peace, by means of the growing and sustained circulation of resources and factors of production. The question of financing the heavy investments that are necessary for its rehabilitation cannot present a problem, and solutions must be found within the ambit of the new partnerships for the construction and exploration of physical infrastructures, the concessionary assistance of the international financial institutions (the World Bank, the European Union and the African Development Bank) as well as joint projects within the scope of the SADC.

<sup>28</sup> The Associação Agro-Pecuária, Comercial e Industrial do Lubango (AAPCIL) [Agriculture/Livestock, Commercial and Industrial Association of Lubango] considers the situation of industry in the province of Huila to be extremely dismal, as it functioned below 10% of installed capacity, being conditioned by the limitations of operating capacity and by competition from imported products.

Of equal relevance in the national context was the start of technical work in the preparation of the Long-Term Strategy - 2025 and the Medium-term Development Plan 2005-2009, which will incentivise the sustained economic development of the country.

### 3. Monetary and foreign exchange sector

#### 3.1. Introduction

A package of economic liberalisation measures was approved in May 1999, as part of the Government's pursuit of its main economic objective: reversing the negative trend in key macroeconomic indicators, in particular the rate of inflation. The following are noteworthy in relation to monetary and exchange-rate policy:

- I). The liberalisation of exchange rates and interest rates;
- II). The institution of primary monetary and exchange markets, the creation of Central Bank Bonds (CBB) as indirect instruments for controlling liquidity;
- III). Monetary reform embodied by the introduction of the new monetary unit, the Kwanza, with a cut of six zeros in relation to the previous currency, the Readjusted kwanza.

Additionally, as part of the monetary and exchange reform platform, deposits in foreign currency in the banking system for residents and non-residents are now permitted; restrictions on imports of personal resources (including deposits and savings in foreign currencies) have been lifted; and banks are now permitted to issue loans to exporters in foreign currency for up to 50% of the bank's savings portfolio denominated in the respective currency.

From 2000 to 2002, the monetary and exchange policy defined in the "Economic and Social Programmes of the Government" had as its premise "staff-Monitored Programs"<sup>29</sup>, and as its critical objective, micro-economic stability by means of an active and restricted monetary policy, based on the development and improvement of the indirect instruments for the control of liquidity.

However, the monetary and currency exchange markets have seen little evolution since their creation: (I) the expansion and development of the secondary monetary market did not take place, (II) the interest rates of the CBB which assumed a signal role in the market, became negative in real terms (fundamentally in 2002); (III) the active and passive interest rates of the banks did not reflect the true price of money, (III) depreciation of the kwanza remained high and (IV) there was an acceleration of dollarisation in the economy, particularly in the financial system, both at the level of deposits and loans, as well as with transactions between residents.

The objective of macroeconomic stability was not achieved; however, a certain amount of progress was made with the deceleration of inflation, the depreciation of the national currency and the reduction of the "Spread" between the reference and the informal rates, achieved at the expense of high financial costs (with the remuneration of the CBBs) and a loss of foreign reserves for the Central Bank.

The causes of these unsatisfactory results are the excesses of permanent liquidity in the economy, as a result of excessive budgetary allocations; the subjugation of monetary policy to budgeting policy and the lack of independence of the Central Bank; the inadequacy of the mechanisms and strategies for the combination of monetary and budgeting action; as well as institutional constraints in carrying out fundamental structural reforms.

#### 3.2. Monetary policy

Monetary policy as a facet of economic policy formed a part of, and was defined in, the Economic and Social Programmes introduced by the Government during the period 2000 to 2002, the outstanding fundamental objective being macroeconomic stability through price stability, by means of actively exercising restrictive monetary and fiscal policies. At the monetary policy level, decelerating inflation and the depreciation of national currency were identified as critical objectives, as was the refinement of indirect instruments for controlling liquidity.

As a result of these guidelines the Monetary Authority attempted to carry out a restrictive and active monetary policy. Designed to control liquidity in the economy, the goal of this policy is the control of monetary reserves. It seeks to accomplish this goal through monitoring of the monetary programme in order to determine the necessary

<sup>29</sup>The Government signed with the IMF, a memorandum of economic and financial policies, which constituted the Economic Programme of the Government for April to December 2000, monitored by the Technicians of the IMF, and which was subsequently extended for the period January to June 2001.

levels of liquidity, and guarantee its consistency with the defined macroeconomic targets.

To achieve its monetary objectives, the Central Bank's key policy instruments include interventions in the foreign exchange market such as sterilisation of liquidity through the sale of foreign exchange by the Central Bank, supplemented by Open Market operations such as the negotiation of Central Bank Bonds - CBBs.

Other indirect instruments used by the monetary authority for controlling liquidity, were: (i) Obligatory Reserves,<sup>30</sup> fixed at 30% for order deposits in national currency and 5% for order deposits in foreign currency<sup>31</sup>; (ii) the re-discounting rate<sup>32</sup> fixed at 150% per annum (iii) the Limit of Extension of Domestic Liquid Assets of the banking system<sup>33</sup> which in July 2000 substituted the quantitative limits of credit imposed upon the loan institutions.

An evaluation of the behaviour of monetary aggregates and, consequently, the levels of inflation and exchange depreciation recorded in the economy, as well as of the erosion of liquid international reserves of the Central Bank, reveals that monetary policy within the last three years, rather than being restrictive, was expansionist. It was inefficient in achieving its proposed objectives, notwithstanding the acknowledged deceleration of inflation and the depreciation of national currency, as well as the relative convergence between the official and informal foreign-exchange rates of the markets, the latter having reduced arbitrage gains between the two markets.

Among the chief reasons for this weak monetary situation is the lack of independence of the Central Bank and the resulting subordination of monetary policy to the requirements of fiscal implementation. This leads the Central Bank to engage in compulsive monetary financing of the fiscal and quasi-fiscal deficit. It also contributes to a lack of coordination between the implementation of budgetary and monetary policies, as seen in the uncoordinated and inefficient interactions between the BNA and the Ministry of Finance (MINFIN) that were reflected in the loss of certain exchange authority functions by the BNA.

<sup>30</sup> BNA Directive, No 7/200 of 22 August 2000.

<sup>31</sup> Following the introduction of the CBBs [Central Bank Bonds], the free deposits of the financial institutions in the BNA [National Bank of Angola] in national currency ceased to be remunerated, the remuneration passing to the collection of deposits in foreign currency, shared with the BNA.

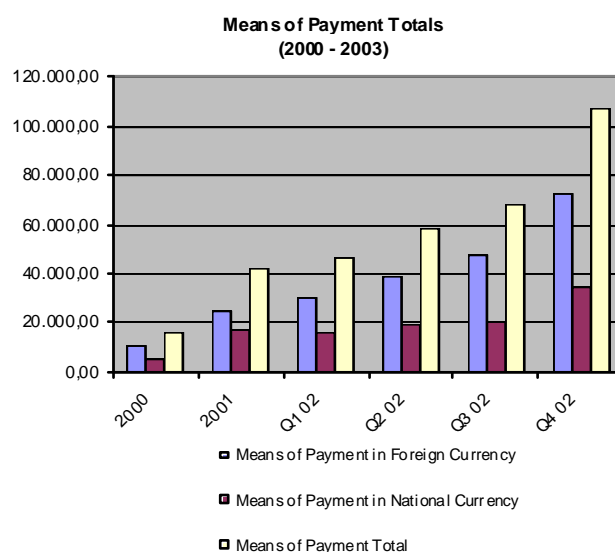
<sup>32</sup> Notice No 5/2000 of 2 August 2000.

<sup>33</sup> BNA Directive No 6/2000 of 21 July 2000

On the other hand, the lack of persistence in applying adopted policies, and the absence of incentives in the productive sector of the economy, represented limited factors on improving monetary policy.

### 3.3. Monetary aggregates

Monetary aggregates experienced reduced expansion between 2000 and 2002, which would appear to explain the deceleration of inflation and the depreciation of the exchange rate during the period.

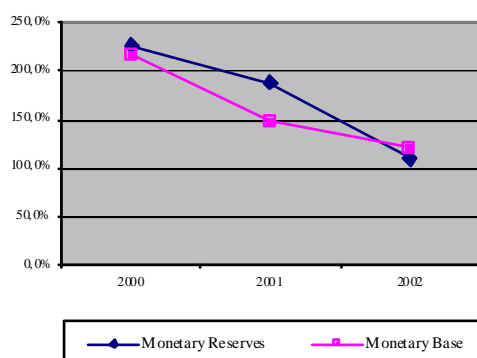


From a nominal expansion of 216.4% in 2000, the increase in the monetary base decelerated to 148.4% in 2001 and to 120.7% in 2002.

For its part, the monetary reserve experienced, in the same period, more accentuated nominal growth in 2000 and 2001, of 226.1% and 187.5%, respectively, as a consequence of the expansion of both the monetary base and of the issue of CBBs - Central Bank Bonds - by the BNA. On the other hand, in 2002 the nominal growth of the monetary reserve of 109.3% was lower than that of the monetary base, due to the reduction in the quantity of CBBs issued during the last quarter, which in turn was a consequence of the need for the BNA to contain expenditures.

In real terms, both the monetary base and reserves experienced decreases in 2000 of 14.1% and 11.5%, respectively, due to the high rate of inflation during that year, accentuated increases in 2001 of around 15% and 33%; and moderate real increases in 2002 of approximately 7.4% and 1.8%, respectively. The growth in the means of payment

**Annual Change in Monetary Base and Monetary Reserves**



(M3) during the period under analysis also reflected a decreasing trend, i.e., M3 expanded in nominal terms by approximately 303.7% in 2000, 162.7% in 2001 and 158.7% in 2002. In real terms, the growth in the means of payment was accentuated in view of a deceleration of inflation, growth having been 4.6% in 2000, 21.54% in 2001 and 25.8% in 2002.

The accentuated nominal growth of the means of payment in 2000 was associated with a strong expansion of its components in foreign currency<sup>34</sup> of 307.3%, compared with 296.6% in national currency<sup>35</sup>, as a result of authorisation to open accounts in foreign currency for exchange residents and non-residents, causing part of the savings in foreign currency concentrated in the banks, to be dispersed into the economy. In 2001 the nominal growth of the components in national currency of 226.3% was higher than that of the components in foreign currency (132.1%) due to a strong nominal expansion of deposits in national currency of 1802.3%<sup>36</sup>, due to the increased expectations of stabilisation. In 2002, there was increased growth in the means of payment in foreign currency relative to the component in national currency, i.e., 192.5% as compared with 105.1%.

In the last three years there was a rise in financial intermediation, with an increase in the monetary multiplier from 2.5% in 2000 to 2.8% in 2002, notwithstanding an increase in the share of national savings held in dollars. That is to say, deposits in foreign currency increased from 81% of total

deposits in 2000, to 85% in 2002. After removing the effect of exchange depreciation, deposits in foreign currency in the banks expanded by around 34.9% in 2000, 22.2% in 2001 and 59.3% in 2002.

Other monetary indicators, the behaviour of which is explained by inflationary pressures, include sharp increases of publicly held notes and coins, -- 346.1% in 2000, 176.7% in 2001 and 154.1% in 2002 -- and a preference for liquidity, which increased from 18.7% in 2000, to 19.7% in 2001, remaining at around 19.4% in 2002.

<sup>34</sup> It included demand and term deposits, as well as other obligations in foreign currency.

<sup>35</sup> This includes the notes and coins in the possession of the public, demand and term deposits in national currency, and other financial instruments (CBBs).

<sup>36</sup> The increase in the remuneration of savings by the banks and expectations of a better control of inflation, explain this increase, notwithstanding that it was accentuated by a very low base.

## MONETARY AGGREGATES

	(In millions of Kz)							
	Dec-99	Dec-00	Dec-01	Mar-02	Jun-02	Sept-02	Dec-02	Annual variation
Means of Payment M3	3.923.471	5.840.414	1.613.234	6.662.535	8.199.866	8.560.47	107.632,6	
<i>Variation</i>		303.7%	162.7%	12.1%	24.7%	17.8%	57.0%	158.7%
Means of Payment M2	3.923.471	5.840.414	1.291.944	6.291.595	7.660.236	7.811.56	106.983,4	
<i>Rate of Variation</i>		303.7%	160.7%	12.1%	24.6%	17.6%	57.8%	159.1%
Money M1	3.052.601	3.308.183	0.119.643	2.194.643	3.504.394	5.821.75	69.440.05	
<i>Variation</i>		336.0%	126.3%	6.9%	19.6%	19.0%	51.5%	130.5%
Notes and coins in the possession of the public	665.43	2.968.63	8.215.30	6.402.20	7.083.96	8.166.18	20.878.51	
<i>Variation</i>		346.1%	176.7%	-22.1%	10.6%	15.3%	155.7%	154.1%
Notes and coins in circulation	3.456.64	9.715.57	8.005.25	8.722.12	9.667.81	23.497.17		141.9%
-Cash at commercial banks	-488.02	-1.500.27	-1.603.06	-1.638.16	-1.501.64	-2.618.67		74.5%
Demand deposits - NC	537.56	2.130.33	7.383.46	7.952.31	8.466.53	10.343.61	11.123.94	
<i>Variation</i>		296.3%	246.6%	7.7%	6.5%	22.2%	7.5%	50.7%
Demand deposits - FC	1.849.61	8.209.22	14.520.88	17.840.14	22.953.90	27.311.96	37.437.60	
<i>Variation</i>		343.8%	76.9%	22.9%	28.7%	19.0%	37.1%	157.8%
Quasi-money	870.87	2.532.23	11.172.31	14.096.95	19.155.84	21.989.81	37.543.38	
<i>Variation</i>		190.8%	341.2%	26.2%	35.9%	14.8%	70.7%	236.0%
Term deposits - NC	94.13	45.38	863.25	1.666.50	2.912.11	1.363.27	1.899.97	
<i>Variation</i>		-51.8%	1802.3%	93.0%	74.7%	-53.2%	39.4%	120.1%
Other Obligations - FC	101.34	1.179.78	2.987.28	3.210.67	3.951.41	5.102.89	7.059.48	136.3%
Term deposits - FC	675.40	1.307.07	7.321.78	9.219.78	12.292.31	15.523.65	28.133.92	284.2%
<i>Variation (Term deposits + other obl.)</i>		220.2%	314.5%	20.6%	30.7%	27.0%	70.6%	241.4%
Other Financial Instruments	0.00	0.00	321.29	370.94	539.63	748.91	649.23	102.1%
<i>Variation</i>				15.5%	45.5%	38.8%	-13.3%	102.1%
Monetary Reserve	1976.56	6446.43	18531.11	20050.74	19518.04	22326.37	38789.44	
<i>Variation</i>		226.1%	187.5%	8.2%	-2.7%	14.4%	73.7%	109.3%
Monetary base	1948.03	6163.15	15309.02	14705.48	15072.25	16544.81	33789.44	
<i>Variation</i>		216.4%	148.4%	-3.9%	2.5%	9.8%	104.2%	120.7%
% Notes and coins in circulation	38.0%	53.6%	52.4%	39.9%	44.7%	43.3%	60.6%	8.1%
% deposits in banks NC	30.0%	12.8%	24.7%	27.2%	24.9%	22.3%	19.9%	-4.7%
% deposits in banks FC	30.5%	12.8%	5.5%	6.2%	7.6%	8.5%	5.5%	0.0%
% CBBs	0.4%	2.9%	17.8%	26.2%	22.0%	25.2%	13.6%	-4.2%
Monetary multiplier (M3/Monetary Reserve)	2.0	2.5	2.2	2.3	3.0	3.1	2.8	
Preference for liquidity (Notes and coins in possession of the public/M3)	17.0%	18.7%	19.7%	13.7%	12.2%	11.9%	19.4%	

The above analysis would tend to indicate positive results in the control of liquidity in the first quarter, accomplished by controlling the operating target (monetary reserve), through Central Bank interventions in the exchange and monetary markets. Monetary reserves contracted in the 2nd quarter (-2,7) having experienced moderate growth (20.5%) up to the 3rd quarter. However, in the last quarter, there was total monetary relaxation as a result of strong financing of the Treasury by the BNA, allowing the monetary base and means of payment to expand by around 73.7% and 57%, respectively. Publicly held notes and coins increased by 155.7%, increasing the preference rate for liquidity from 11.9% in September to 19.4% in December. These results explain the acceleration

of inflation and exchange depreciation at the end of 2002.

### 3.4. The monetary process

Monetary assets expanded considerably in the last three years, which explains the behaviour of the liabilities (M3), referred to above.

The position of net international reserves (NIR) reflected, during the period under analysis, the degree of dependency of external assets on the behaviour of international crude markets. NIR increased from US\$ 408.14 millions at the end of 1999 to US\$ 1,039 millions in 2000, decreased to US\$ 530.84 millions in 2001 and to US\$ 323.69

millions in 2002. In other words, they increased by approximately US\$ 630.9 millions in 2000. This was largely due to the introduction of oil sector bonuses<sup>37</sup> and the increased world price of crude oil.

#### MONETARY SITUATION

	(In millions of Kz)							
	Dec-99	Dec-00	Dec-01	Mar-02	Jun-02	Sept-02	Dec-02	Annual Variation
<b>Net External Assets</b>	<b>5.767.13</b>	<b>30.516.28</b>	47.767.82	59.302.84	75.052.51	91.570.40	93.278.60	95.27%
In millions of US\$	1.033.55	1.814.52	1.495.11	1.599.87	1.724.60	1.849.57	1.589.89	6.34%
<b>Net International Reserves</b>	<b>2.277.40</b>	<b>17.473.91</b>	16.960.01	24.458.91	30.832.81	38.018.74	18.990.01	11.97%
<b>In millions of US\$</b>	<b>408.14</b>	<b>1.039.01</b>	<b>530.84</b>	<b>659.85</b>	<b>708.50</b>	<b>767.92</b>	<b>323.69</b>	
<b>Variation (in US\$)</b>		<b>630.87</b>	<b>-508.17</b>	<b>129.01</b>	<b>48.65</b>	<b>59.42</b>	<b>-444.22</b>	<b>-207.15</b>
Net external assets of the banks	3.093.04	13.941.07	32.312.46	36.792.32	46.505.05	56.149.85	77.606.08	63.95
<b>In millions of US\$</b>	<b>555.28</b>	<b>828.95</b>	<b>1.011.37</b>	<b>992.58</b>	<b>1.068.62</b>	<b>1.134.14</b>	<b>1.322.84</b>	
<b>Variation (in US\$)</b>		<b>273.66</b>	<b>182.42</b>	<b>-18.79</b>	<b>76.04</b>	<b>65.51</b>	<b>188.70</b>	<b>311.47</b>
<b>Net internal assets</b>	<b>-1.843.66</b>	<b>-14.675.87</b>	-6.154.58	-12.640.31	-16.852.65	-23.009.93	14.354.07	-333.23%
Net internal credit	1.239.73	-13.525.73	-1.379.95	-4.343.03	-5.205.45	-8.559.90	26.737.62	-2037.58%
Credit to the General Government	704.31	-15.714.66	-9.452.68	-15.123.09	-19.719.90	-28.174.52	2.005.85	-121.22%
Credit to the central government (net)	703.89	-15.724.68	-9.475.75	-15.196.00	-19.722.78	-28.196.29	2.002.19	-121.13%
Credit to the economy	535.42	2.188.93	8.072.74	10.780.05	14.514.45	19.614.61	24.731.77	206.36%
<b>In millions of US\$</b>	<b>95.95</b>	<b>130.16</b>	<b>252.67</b>	<b>290.80</b>	<b>333.51</b>	<b>396.17</b>	<b>421.54</b>	
Other Assets and Liabilities	-3.083.40	-1.150.14	-4.774.64	-8.297.28	-11.647.20	-14.450.03	-12.383.55	159.36%
<b>Means of Payment M3</b>	<b>3.923.47</b>	<b>15.840.41</b>	<b>41.613.23</b>	<b>46.662.53</b>	<b>58.199.86</b>	<b>68.560.47</b>	<b>107.632.66</b>	<b>158.65%</b>
Means of Payment M2	3.923.46	15.840.41	41.291.94	46.291.59	57.660.23	67.811.56	106.983.43	159.09%
Money M1	3.052.60	13.308.18	30.119.64	32.194.64	38.504.39	45.821.75	69.440.05	130.55%
Quasi-money	870.87	2.532.23	11.172.31	14.096.95	19.155.84	21.989.81	37.543.38	236.04%
Other Financial Instruments	0.00	0.00	321.29	370.94	539.63	748.91	649.23	102.07%

<sup>38</sup> NIRs fell by approximately US\$ 508.2 millions in 2001 as a consequence of the dip in the world price of crude<sup>39</sup> and intensified interventions by the NBA in the exchange market, with a view to preserving the value of national currency and containing the effect of a transfer of depreciation on prices.

In 2002, notwithstanding a relative increase in the price of crude oil on the international market<sup>40</sup>, the loss of US\$ 207.15 millions of the NIRs occurred mainly in the last quarter (US\$ 444.2 millions). This was due not only to increases in the interventions of the BNA in the exchange market (in order to soak up excess liquidity deriving from strong fiscal execution), but also to the temporary advancement

by the BNA of external finance to the Treasury, as mentioned above.

In terms of covering imports, the respective coefficient of cover of the NIRs fell from 4.7 months

of imports in 2000, to 2.8 months in 2001, a decline in this indicator in 2002 being forecast<sup>41</sup> in view of a reduction of the NIRs.

On the other hand, the banks of the system accumulated funds abroad, their net external assets having increased by around US\$ 273.6 millions in 2000, US\$ 182.42 millions in 2001 and US\$ 311.47 millions in 2002, i.e., there was a clear transfer of exchange currencies from the Central Bank to the banks by means of interventions of the BNA in the Primary Exchange Market, instead of a full transfer of resources to the economy. This is contrary to regulations relating to the limits of the exchange position with which the banks must conform, they being required to sell to the BNA all surplus funds that are not transferred into the economy within established time limits.

In relation to net domestic assets, the surplus position in 2000 and 2001 of Net Credit to the General Government (CLGG) should be

<sup>37</sup> Receipts relating to the granting of petroleum exploration rights.

<sup>38</sup> Average gross price of exports of Angolan crude oil (US\$/per barrel) in 2000, US\$ 27.4.

<sup>39</sup> Average gross export price of Angolan crude oil (US\$/per barrel) in 2001, US\$ 22.93.

<sup>40</sup> Average gross price of Angolan crude oil for export (US\$/per barrel) in 2002, US\$ 23.70.

<sup>41</sup> Due to the unavailability of information concerning imports in 2002, it is not possible to calculate this indicator.



emphasised through the financial system, of Kz 15,714.66 millions, with an increase in receipts from petroleum taxes and bonuses from the National Treasury as well as certain improvements in the control and collection of revenues by the State.

The net credit situation of the General Government in relation to the financial system, was reversed at the end of 2002, with a positive balance of Kz 28,174.52 millions in September, the National Treasury having acquired a deficit of Kz 2,005.85 millions during the same period. This situation was due to the fact that the Treasury was forced to seek financing from the BNA at the end of the year, and also to the fact that the BNA provided for certain regularisations of quasi-fiscal operations within the scope of the protocol<sup>42</sup> signed with the MINFIN.

The credit stock of the banking system has been increasing significantly in the last three years. It was

122.51 millions in 2001 and US\$ 168.87 millions in 2002, as a consequence of the removal of credit expansion limits on banks,<sup>43</sup> as well as the set of liberalising measures introduced in May 1999, which raised the concentration of savings in the banks and the granting of loans in foreign currency to exporters. In practice, these measures have been extended by the banks to other customers through the granting of dollar-indexed loans.

From 17% of deposits in 2000, credit increased to 24% of deposits in 2001 and to 29% in 2002, representing approximately 2.4% of GDP in 2000, 4.1% of GDP in 2001 and 5.7% of GDP in 2002. Despite this visible expansion, credit remains at inappropriately low levels for an economy in need of fast-paced growth. Among the factors explaining the slow pace of credit expansion in Angola are the institutional weakness of legal entities responsible

#### TRANSACTIONS OF THE PRIME MONETARY MARKET CBB

(in millions of KZ)					
Period	Issued Value	Nominal Value	Redeemed Value	Sterilisation Charges	Financial Issue Structure
14-days	734.3	634.5	99.8	20.70	37.00%
28-days	956.53	888.1	68.4	48.43	48.20%
63-days	293.6	231.1	62.5	34.70	14.79%
91-days	0.25	0.2	0.1	34.70	0.01%
182-days	0	0.0	0.0	0.05	0.00%
<b>Total 2000</b>	<b>1,984.7</b>	<b>1,753.9</b>	<b>230.8</b>	<b>138.58</b>	<b>100.00%</b>
14-days	20,956.3	20,136.5	819.8	605.10	53.79%
28-days	14,950.6	12,822.7	2,127.9	879.60	38.37%
63-days	2,392.7	2,104.5	288.2	302.90	6.14%
91-days	562.9	581.1	-18.2	91.40	1.44%
182-days	100.0	100.0	0.0	34.60	0.26%
<b>Total 2001</b>	<b>38,962.5</b>	<b>35,744.8</b>	<b>3,217.7</b>	<b>1,308.50</b>	<b>100.00%</b>
14-days	7,789.4	8,709.7	-920.3	154.30	22.21%
28-days	9,246.7	11,059.5	-1,812.8	379.00	26.36%
63-days	11,971.9	10,265.5	1,706.4	1,333.40	34.13%
91-days	3,943.3	2,733.0	1,210.3	617.20	11.24%
182-days	2,124.3	409.9	1,714.4	639.60	6.06%
<b>Total 2002</b>	<b>35,075.6</b>	<b>33,177.6</b>	<b>1,898.0</b>	<b>3,123.5</b>	<b>100.00%</b>

Source: BNA, Statistical Information.

approximately Kz 2,188.9 millions (US\$ 130.16 millions) in 2000, Kz 8,072.7 millions (US\$ 252.67 millions) in 2001 and Kz 24,731.77 millions (US\$ 421.54 millions) in 2002. This mirrors an expansion of credit flows to the economy during the last three years, of around US \$34.2 millions in 2000, US\$

for making credit guarantees, the lack of accountability of certain entities, and the low level of savings generated by the domestic economy.

<sup>42</sup> Protocol on Management of Fiscal and Monetary Policy between the BNA and the MINFIN, of 19 September 2002.

<sup>43</sup> This direct monetary control instrument was abandoned in the ambit of the liberalising package introduced in May 1999, the credit limits to the banks having been substituted by the limit of expansion of the internal assets of the banks, which, although it was not revoked, was, in practice, abandoned since 2001.

On the liabilities side, the means of payment (M3) amounted to Kz 15,840.4 millions in 2000, Kz 41,613.23 millions in 2001 and Kz 107,632.66 millions in 2002, representing nominal growth rates of 303.7%, 162.7% and 158.6%, respectively, and real annual increases of 9.6%, 21.6% and 26.1%, during the same period.

When analyzing the composition of the means of payment, emphasis should be placed on the increase in the percentage of M1 to 16% in 2001, 27% in 2001 and 35% in 2002, to the detriment of the weighting of M1, which is explained by the significant increase in terms of deposits in foreign currency after May 1999. On the other hand, the meager share of the other financial instruments (CBB) in the total means of payment, reflects the lack of interest on the part of the banks to pass the CBBs on to their customers.

### 3.5. The money market

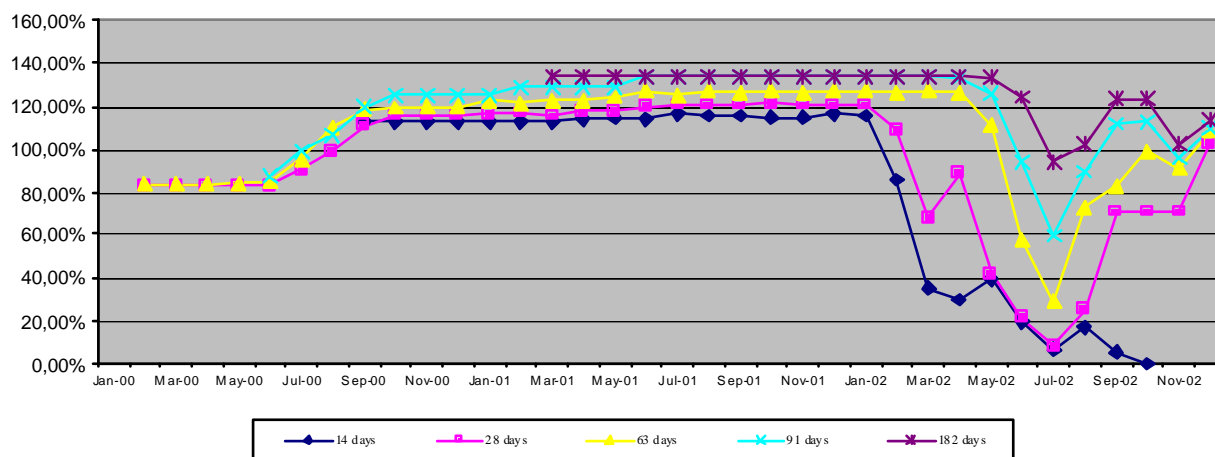
The Primary Money Market Institution and the introduction of Central Bank Bonds (CBBs) in May

extended in 2000 to 14 days.<sup>44</sup> Participation in the primary market was also extended, on a par with the issuing entity and banking institutions, to the National Insurer and Autonomous Funds, their participation having been prohibited in 2002.

Though insufficient, the primary Monetary Market of the CBBs experienced free development over the last three years, causing the CBB transactions, in the form of auctions, to assume the role of a second instrument used by the monetary authority for soaking up liquidity. However, the intensive use of this instrument, in the absence of alternative products such as securities and Treasury Bills, gave rise to considerable efforts on the part of the Monetary Authority with regard to costs and remuneration, at a time when a rigorous cost control policy was in place, constraining the positive remuneration of the CBB in real terms.

During 2000 Kz 1,984.7 millions of CBBs were issued by the BNA in attendance and non-attendance sessions<sup>45</sup> and redeemed Kz 1,753.9 millions, resulting in the contraction of the monetary

Nominal Interest Rates on Central Bank Bonds



1999 represented an important framework for the transfer to indirect instruments in order to control liquidity and increase the dynamism of the financial market. The introduction of "good quality" (i.e., low risk) financial products expressed in national currency, served as an alternative to the purchase of foreign exchange and contributed to the preservation of the value of national currency, thus avoiding excessive procurement by means of foreign exchange and the continuous depreciation of the exchange rate. Initially the BNA issued CBBs of 28, 63, 91 and 182 days, but these were

base of the issuing entity, by around Kz 138.58 millions. In 2001, issues of CBBs in the Money Market by the BNA amounted to Kz 38,962.5 millions, and redemptions to Kz 35,744.8 millions, resulting in a sterilisation of the monetary base of Kz 3,217.7 and total charges of Kz 1,308.5 millions.

In 2002 the BNA restricted the quantities of CBBs available for auction, mainly for the shorter

<sup>44</sup> Notice BNA No 06/00 of 25 August 2000.

<sup>45</sup> Nominal value of CBBs negotiated.

maturities (14<sup>46</sup> and 28 days), obliging banks to apply their surpluses in the national currency in CBBs of longer maturity. Therefore, in 2002 the issues of CBBs were reduced by a nominal total of Kz 35,075.6 millions and consequently the soaking up of the monetary base via CBBs was reduced by Kz 1,898 millions. However, due to the fact that CBBs of longer maturity were negotiated in 2002, the commissions were increased to Kz 3,123.5 millions, instead of being reduced, which was of concern to the BNA.

Due to the instability of the national currency the institutions endeavoured to invest their funds in national currency in more liquid and lower-risk assets, i.e., in CBBs of shorter maturity, from 14 and 28 days in 2000 and 2001. The demand for CBBs of 63, 91 and 182 days increased in 2002, in view of the restrictions in supply imposed by the BNA.

The secondary monetary market did not experience any development between 2000 and 2002, the quantity of securities issued by banks to their customers having been reduced, as the latter preferred to retain gains with application in CBBs and to continue to base their business on exchange operations. On the other hand, the fact that the remuneration of the CBBs was, in several months of 2000 to 2002, negative in real terms, contributed towards the weak development of this market.

Considering that the preservation of the value of national currency and the reduction in the pressure on exchange did not occur; that the money market experienced weak development; and that the issue of the CBBs effectively increased the costs of the BNA at a time of financial fragility of the institution; it can be said that, while the formation of the money market provided an important framework for the development of the financial system and for the issue of indirect instruments for the management of liquidity, the objectives proposed by their creation were not fully achieved.

### 3.5.1. The interest rates of CBBs

The nominal interest rates (annual) of the CBBs, for all maturities, increased between 2000 and 2001. The 112.5% interest rate on 14-day CBBs applying in September 2000 had increased to 115.9% by December 2001, the 82.5% rate on 28-day CBBs applying in February 2000 increased to 120.8% by December 2001, while in the same period the interest rate on 63-day CBBs increased from 83.5%

to 127%. CBBs of 182 days were being negotiated at a rate of 134% in March 2001.

The nominal interest rates on (CBBs) fell significantly in 2002, particularly for certificates with lower maturity (14 and 28 days). This was due, on the one hand, to the reduction in the quantities of CBBs issued by the Central Bank, and on the other hand, to the fact that the Central Bank opted for price auctioning, meaning that the banks determined the price of the CBBs. The rate of remuneration of 14-day CBBs fell from 115.86% per annum in December 2001 to 5.5% per annum in September 2002, while for CBBs of 28 days, the interest rate fell from 120% to 71% per annum, during the same period, increasing to 120.74% per annum in December 2002.

Nominal interest rates for CBBs of 63, 91 and 182 days recorded lower reductions, of 127% per annum, in December 2001. The interest rate for CBBs of 63 days fell to 107.9% per annum in December 2002, while the interest rate for CBBs of 91 days fell from 133.9% per annum in February 2002 to 119.16% per annum in December 2002. For CBBs of 182 days, the rate fell from 134% per annum to 113% per annum during the same period. In real terms<sup>47</sup>, the interest rates on CBBs were negative for most months of 2000 for the various maturities, this situation having reverted in 2001, with an increase in interest rates of CBBs and a deceleration of inflation, leading to a situation where CBBs generated positive real income for the banks.

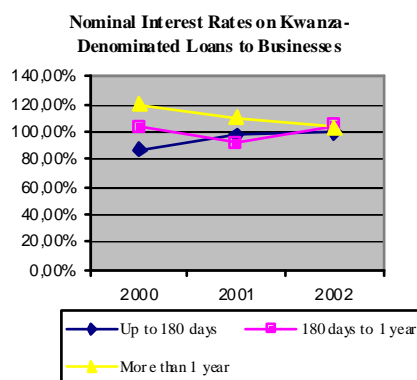
In 2002, the rates of remuneration of CBBs again became negative, in real terms, for the majority of maturities throughout the months of the year, due to a significant fall in nominal interest rates. However, considering the minimum costs of attraction by the banks, the losses in the application of the surpluses of liquidity in CBBs proved to be insignificant for the banks, even in periods when rates of remuneration were less favourable.

### 3.6. The interest rates of the banking system

The nominal interest rates of the banking system were liberalised in May 1999, and since then have been determined by means of free negotiation between the banks and their customers. However, the interest rates applied in the financial system for applications and loans in national currency still failed to serve

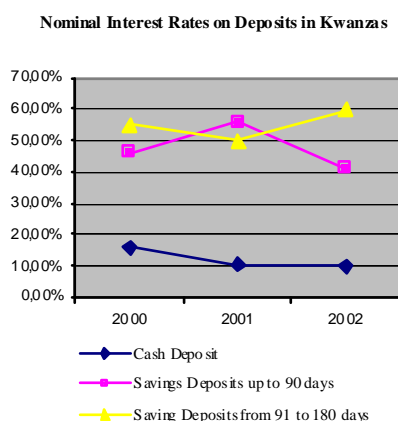
<sup>46</sup> With effect from September 2002 the BNA cancelled the supply of 14-day and 28-day CBBs, and in December re-established the issue of the 28-day CBB.

<sup>47</sup> Monthly adjusted nominal interest rates, deflated for monthly inflation.



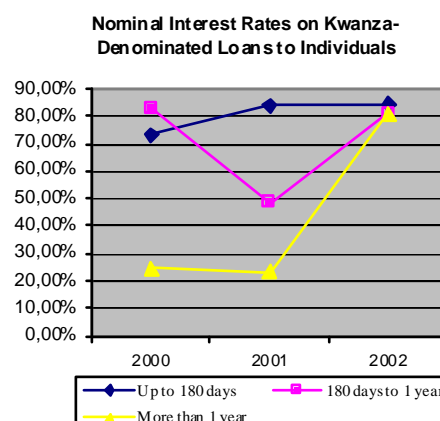
as reliable money market indicators since, having remained negative in real terms (due to high inflation), the common practice of seeking refuge in applications and credit in foreign currency was justified. However, due to a high rate of liquidity in the banking system, the discounting rate of the Central Bank fixed at 150% per annum in August 2000, notwithstanding that it was positive in real terms, ceased to serve as a market indicator, this role having been transferred to the interest rates of CBBs.

Nominal interest rates charged and received in national currency applied by the banking system



fluctuated marginally between 2000 and 2002, mainly experiencing upward movements, and emphasis should be given to the high margin of intermediation of monetary operations carried out by the banks, i.e., the maintenance of a high *spread* between the charged and received rate and the application of higher rates for loans to the business sector, in comparison with those applied to private individuals. In view of the unavailability of detailed information on the sectorisation of credit, we have not carried out an analysis. However, empirical knowledge indicates that the majority of loans to the business sector were connected with commerce

and that individuals accounted for housing and automobiles loans, thus justifying the "spreads" of rates between the two sectors.



The average weighted nominal interest rates of loans up to 180 days in national currency reflected an annual behaviour for the business sector similar to that for the personal sector, i.e., an increasing trend over the last three years. The rates were 99.66% for the business sector and 84.29% for individuals in December 2002.

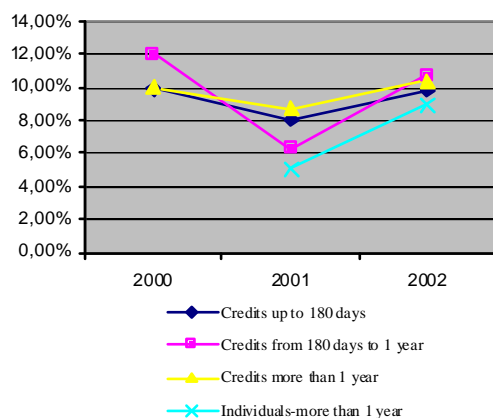
For loans in national currency from 181 days to 1 year, the behaviour of the nominal interest rate was identical for the two sectors, having decreased in 2001 and increased in 2002, being 104.55% and 80.69% for the business and private sectors, respectively, as at December 2002. On the other hand, long-term interest rates (over 1 year) in national currency, reflected opposite movements in the two sectors in 2001, as the interest rate for the business sector was falling between 2000 and 2002, having been recorded as 102.84% in December 2002, and the rate decreased in 2001 for the private sector, and rose again markedly in 2002, when it was 80.99% in December 2002.

The nominal rate of remuneration of demand deposits in national currency for the banks decreased by around 5.79 percentage points between 2000 and 2002, being 10.02% in December 2002.

In regard to nominal remuneration of short-term deposits (up to 90 days) in national currency, after experiencing a marked increase of 10.09 percentage points in 2001, it then decreased again, being 40.96% in December 2002. The interest rate for deposits in national currency of 91 to 180 days, experienced the opposite behaviour, i.e., it decreased in 2001 by 5 percentage points, and then increased to 59.65% in December 2002.

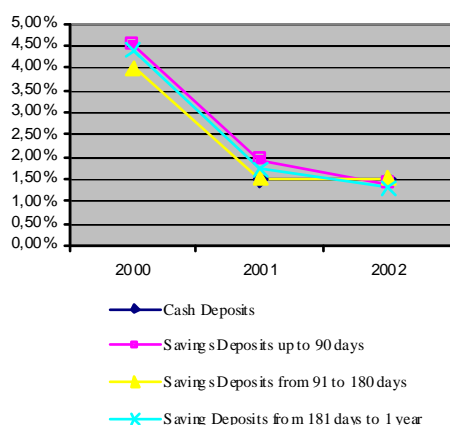
Notwithstanding the marked fluctuations of nominal interest rates for loans and deposits in national currency, both rates remained negative in real terms, for all maturities in the period under analysis, as a result of the unpredictability of persistent inflation as well as expectations that they would soften.

Nominal Interest Rates on Foreign Currency Credits



As a result of this situation, there was increased refuge in foreign currency (the US dollar), and the commercial banks granted loans in foreign currency or indexed to foreign currency (the US dollar) to residents in general, notwithstanding the legislative provision only to grant them to exporters.

Nominal Interest Rates on Foreign Currency Credits



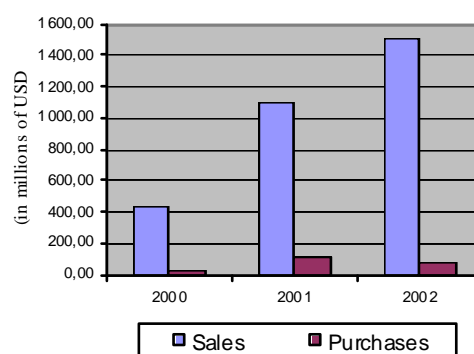
The charged nominal interest rates in foreign currency experienced the same behaviour for all maturities, softening in 2001, and increasing again in 2002 due to the increased demand for this type of loan, thus counteracting the decreasing trend of interest rates on international markets, this factor being equally explained by the underlying risk of the country's situation. On the other hand, passive rates for deposits in foreign currency also experienced a

downward trend recorded in certain international markets. This proved an incentive for capital flight from Angola to more secure markets.

### 3.7. Exchange-rate policy

Exchange policy became the anchor for monetary policy applied by the Central Bank between 2000 and 2002, with preservation of the value of the national currency and convergence between the exchange rates in the formal and informal markets being the fundamental objectives of the policy throughout the three-year period.

Central Bank (BNA) Transactions on the Primary Exchange Market



This objective was pursued, as already mentioned, with intense interventions on the part of the BNA in the Primary Exchange Market, complemented with interventions in the money market, but without achieving exchange stability, and with the consequences and situations already mentioned, such as: (i) the impairment of the level of net international reserves, higher financial costs for the BNA, accumulation of external assets in the commercial banks, due to the fragility of the regulations and fulfilment of the exchange position limits by the banks. On the other hand, certain management mechanisms of the monetary and fiscal policies between the BNA and the MINFIN, turned out to be confused and inadequate, with a loss of exchange authority functions by the BNA, contributing to a deconcentration of the foreign exchange currency of the country.

### 3.8. The foreign-exchange market and exchange rates

With the institution of the Interbank Exchange Market and the liberalisation of the reference exchange rates<sup>48</sup> to May 1999, the banking

<sup>48</sup> The reference exchange rate is published daily by the BNA, calculated as the weighted average of the daily transactions of the commercial banks with their customers, carried out on the previous

institutions authorised to engage in exchange, negotiated among themselves and with the BNA currency exchange according to the auction system initially organised in attendance sessions and subsequently in non-attendance sessions<sup>49</sup>; the exchange rate also became freely determined in the exchange market, by means of free negotiation between the banks and their customers.

However, due to the fact that the Central Bank is the biggest holder of exchange reserves in the country, the transactions in the Exchange Market represented in the main sessions of sale of exchange currency by the BNA and its interventions, intensified in order to respond to the growing demand by the banks due to the constant

that the exchange currencies sold by the BNA were cheaper.

From a total of US\$ 430.7 millions of exchange currency sold in 2000, the BNA increased its sales of exchange currencies to the banks to US\$ 1,106.3 millions in 2001 and to US\$ 1,511.2 millions in 2002.

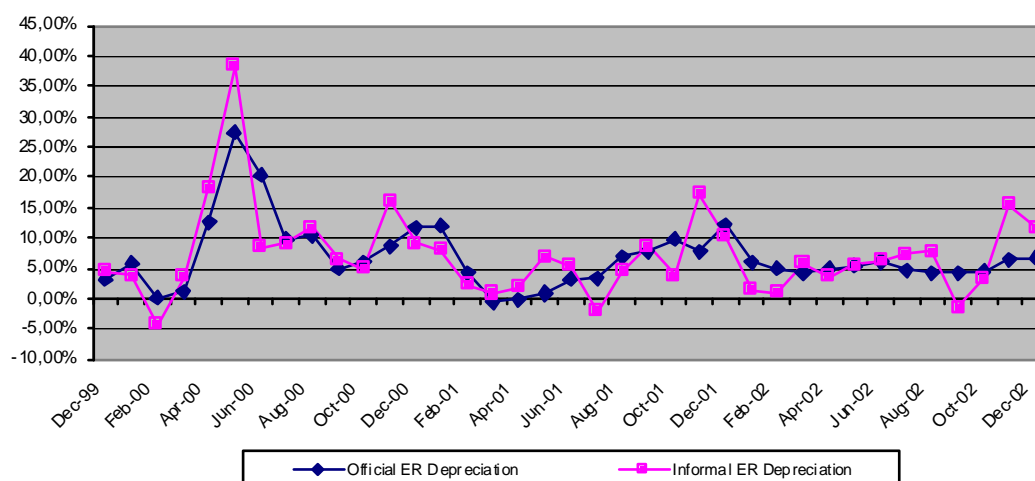
Purchases of exchange by the Central Bank from the banks during the same period were insignificant in relation to the volume of sales, namely US\$ 22.4 millions in 2000, US\$ 109.2 [millions] in 2001, and US\$ 71.4 millions in 2002.

Notwithstanding these interventions, the exchange rate continued to depreciate substantially, though at a decelerating pace, in the two markets between

NET TRANSACTIONS <sup>50</sup> IN THE PRIMARY EXCHANGE MARKET AND VARIATION OF THE EXCHANGE RATE					
Years	Net Transactions in the Primary Exchange Market (In millions of US\$)	Nominal Variation of Exchange Rate		Real Variation of Exchange Rate	
		reference	unofficial	reference	unofficial
2000	408.3	201.9%	214.6%	-18.7%	-12.6%
2001	997.1	90.0%	90.0%	-9.9%	-9.6%
2002	1,439.8	83.6%	90.5%	-7.4%	-8.2%

(variation: depreciation (+), appreciation (-))

Monthly Exchange Rate Depreciation (Dec. 1999 to Dec. 2002)



abundance of liquidity resulting from fiscal executions. On the other hand, the banks preferred to purchase from the BNA instead of utilising the Interbank market, which is permitted, due to the fact

2000 and 2002. The reference rate depreciated by approximately 201.9% in 2000, 90% in 2001 and 83.6% in 2002, as compared with annual depreciations in the unofficial exchange rate of 214.6%, 90% and 90.5% in 2000, 2001 and 2002, respectively. The average monthly depreciation of the reference exchange rate also decelerated, i.e., it was 9.9% in 2000, 5.6% in 2001 and 5.2% in 2002, while in the unofficial market it was 10.5% in 2000, 5.6% in 2001 and 5.8% in 2002.

day. This serves as an accounting indicator in the economy and as a rate for the opening of the auctions between the BNA and the banks.

<sup>49</sup> In 2001.

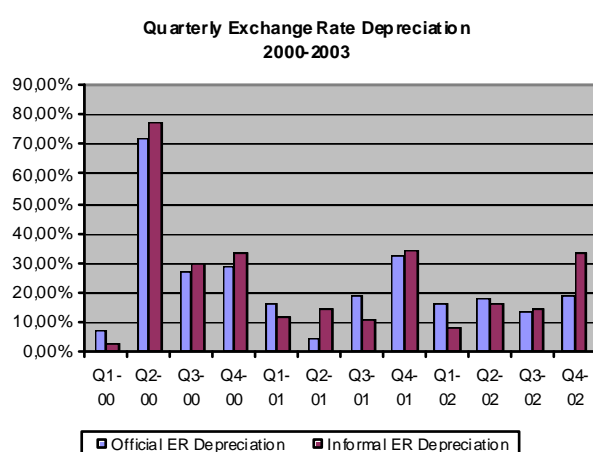
<sup>50</sup> Sales of exchange currency by the BNA less purchasing of exchange currency by the BNA from the banks.

The deceleration of exchange rate depreciation in the last two years was due to the intensification of interventions by the BNA in the money and primary exchange markets, leading to a situation where, from May 2001, the exchange rate became, in reality, a "dirty float" instead of freely fluctuating, which led, with the exception of the last two months of the year, to greater stability of exchange rate depreciation in the two markets from that date.

However, after decades of a system of fixed exchange rates and strong exchange restrictions, it is natural that depreciation should continue to be persistent until reaching a point of equilibrium. This situation and that of the increase in prices, will have a tendency to soften in the medium and long-term, with the development of the real sector.

Quarterly analysis of exchange depreciation in the two markets allows one to observe the exception of the second quarter of 2000, a seasonal effect of intensification of the depreciation of the value of national currency in the fourth quarter of the years under analysis, which is associated with the strong monetary expansions that frequently occur at the end of the year, as a result of the fiscal executions during this period.

The differential between the rates in the two exchange markets was 9.5% at the end of 2000 and 2001. In 2002 there was a convergence between the exchange rates of the official and unofficial markets during the majority of the months of the year, with the exception of the months of January, June, August, November and December.



Accordingly, after 7 months with a differential of approximately 1%, this increased to 13.64% in December 2002, reflecting the lack of monetary control which occurred at the end of the year.

In real terms an appreciation of the exchange rate, measured by the variation of the RERI<sup>51</sup>, could be seen in the two markets between 2000 and 2002, i.e., the variation in prices was higher than the variation in the exchange rate, which signifies a loss of purchasing power of the national currency in relation to imported goods. This also reflects the suppression of exchange currency in the economy higher than its absorptive capacity and GDP growth. The increase in exchange in the economy was due to the increased availability of funds as a consequence of the increase in the price of crude oil on the international market and the introduction of the oil bonuses.

This situation normally occurs in oil-exporting countries at times of increased prices; however, the structure of public expenses requires adjustment in order to reduce the current expenditure and increase investment expenditure so that the additional receipts guarantee the expansion of the true, non-oil economy and the increase of long-term disposable national output, so as to attenuate the short-term effect of the reduction of purchasing power arising from the appreciation of the real exchange rate.

### 3.9. The financial system

The level of development of a country's financial system is reflective of its level of economic development. From the standpoint of domestic intervention, once the functions of monetisation, intermediation, banking development and financing of productive activities are applied, a country's relationship with the rest of the world depends on the degree of openness of the economy. Therefore, the macroeconomic instability which has been experienced by Angola, is conditional upon the development and modernisation of the Angolan financial system. Furthermore, the climate of insecurity that reigned throughout the country affected the entry of foreign capital banks and the geographical expansion of the banking system. The latter remains concentrated in the coastal area, which offered better security, better socio-economic and political development and a higher concentration of the population.

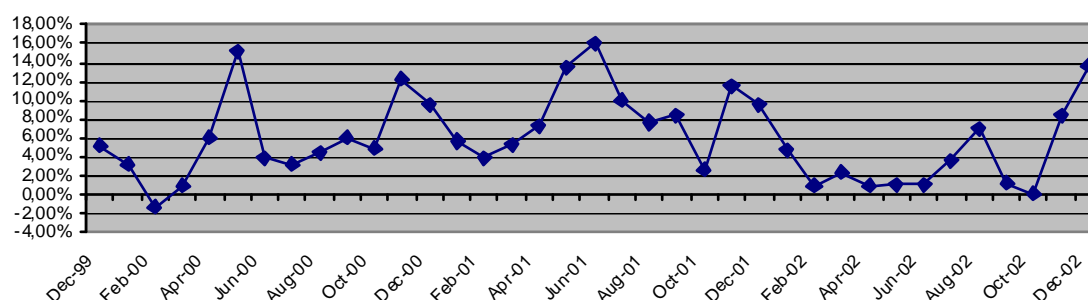
During the last three years, the financial system, mainly the banking network, expanded and was the object of development, both at the level of new operators and in terms of the quality and modernisation of the services provided. Another important factor was the increase in financial intermediation in the economy, not only due to the



entry of new operators, but fundamentally due to the opening up which took place in May 1999, when

payment terminals, called the *Multicaixa* network;

Differential Between Official and Informal Exchange Markets (Dec. 1999 to Dec. 2002)



deposits in foreign currency into the banking system for exchange residents and non-residents, were allowed, restrictions on imports with their own resources (deposits and savings in foreign currency) were lifted, and the granting of loans in foreign currency by banks to exporters was permitted.

Among the developments that took place in the financial system between 2000 and 2002, emphasis should be placed on the following:

- The transformation of two of the three branches of foreign banks into banks under Angolan law, namely the Banco Totta de Angola (BTA) and the Banco de Fomento de Angola (BFA);
- The licensing of two new private capital banks: the Banco Sol (BSOL) which introduced the micro-loan as a new financial product, and the Banco Espírito Santo Angola (BESA) which opened a markets room, with innovative services;
- The institution in 2001 of the *Sistema de Pagamentos de Angola* (SPA) [Payments System of Angola];
- The creation in 2002 of infrastructures with a view to the modernisation of the SPA, namely the creation of an interbank services body owned by the Banks (EMIS), responsible for processing domestic electronic financial transactions between the banking institutions;
- The installation by the banking institutions of a set of automatic tills and automatic

- An improvement in the exchange of information between the Central Bank and the banks, with the implementation of an electronic communications network, using Protocol-X25 ;
- An improvement in the on-line link systems between the headquarter of the banks and their branches.

The Angolan financial system currently consists of:

- The Central Bank, to which there are entrusted the functions of issuer, monetary and exchange authority, state banker, exclusive manager of the exchange reserves, supervisor of the financial system and the system of payments;
- Nine banks having universal characteristics, two with public capital and seven with private capital, specialising in the area of micro-finance and another in the area of investments;
- An Economic and Social Development Fund, to support private productive initiative in areas defined by the government as priority areas;
- Three pensions funds and
- Two insurance companies.

There also exist in Angola, representative offices of Equator Bank, City Bank and Banque Paribas and the first branch of a national bank abroad has been opened (in Portugal) by the BAI, which is the Angolan bank with the largest number of participations in banks abroad.

<sup>51</sup> Real Exchange Rate Index, measured by nominal depreciation, deflated by internal and external inflation (USA).



Competition between the banks has increased in recent years, with the opening of new institutions, the share of market quota being determined by competitive capacity and by the number and geographical location of the branches that are opened, while in terms of the shareholding structure the sharing of competition is virtually equal. At the deposits level, a relative advantage can now be discerned for banks holding foreign capital, the position of leadership being equally challenged by the public banks, which concentrate the deposits of the State and Central Government Organisations.<sup>52</sup>

Notwithstanding the entry of new operators into the financial system, and the developments of recent years, there can be seen as weaknesses in the existing structure, the lack of specialised financial institutions and differentiated financial services, in addition to the lack of a capitals market. The services of the current banking intermediation rely fundamentally on exchange operations, translated into the purchase and sale of exchange currency for the importing of goods and services and reserve value, these operations having contributed 69% of the total receipts of the banks in 2000 and 53% in 2001. Financial intermediation strictly speaking, occupied only 20% of the total results of the banking system in 2000 and 35% in 2001.

In its role as supervisor, the Central Bank obliges the banks to meet three requirements in terms of Adequacy of capital: i) minimum capital, ii) the adequacy of equity in relation to assets risks, iii) the limits of indebtedness, in addition to other prudent rules in accordance with the 25 principles of BASILEIA.

## 4. Budgeting execution

### 4.1. Introduction

Fiscal policy in Angola represents the main instrument for macroeconomic management and is the main vehicle for economic development. The relatively underdeveloped nature of the financial system substantially reduces the efficiency of monetary policy, causing fiscal positioning to be the determining key to the macroeconomics stage. The enclave nature of the dominant sector of oil production ensures that the biggest slice of national wealth passes through the coffers of the State, making budgeting the principal source of resources for the domestic economy, both for the public sector and for the private sector.

On examining the fiscal developments throughout the period 1996-2002, we can analyse the trend of fiscal balance (the usual measure of fiscal policy) as well as the structure of income and expenditure. During the discussion, two factors are omnipresent: the intensity of the war campaign and developments in the petroleum market. The first factor has a tendency to affect both the level and distribution of expenditure, while the extreme dependency of receipts deriving from petroleum exposes both the level of fiscal receipts and the global fiscal result to a considerable risk (based on the price of oil). This is particularly true due to the absence of a political framework safeguarding the economy against variations in the price of oil. On the expenditure side, we will analyse the level of the structure of expenditure, particularly allocations to the social sectors, using comparisons with other countries, internationally agreed targets and sectorial strategies in order to evaluate the current policy.

Taking into account the recent administrative changes in the area of decentralisation, we will also discuss the role of the provinces in the provision of public services. In principle, the acknowledgement of the need for improvements in terms of both the quality and efficiency of public services may be consistent with the decentralisation of government functions. Assuming the existence of the political will to proceed with this option, we put forward an initial set of recommendations in the area of inter-governmental fiscal relations.

The next section will discuss the fiscal policy exercised during the years 1996 to 2002. The third section analyses the level and structure of budget expenditure in the social sectors. The fourth section discusses the role which the provinces currently play, as well as the role that they could play, in the provision of public services. The final section concludes with a general discussion on the necessary requirements to improve the role of fiscal policy, as well as a summary of the recommendations set out in this chapter.

### 4.2. Fiscal policy: 1996-2002

Economic policy in Angola can perhaps best be described as a series of announced reforms, typically followed by abrupt reversals.<sup>53</sup> In line with this posture, fiscal policy has been marked by an irregular implementation of programmed measures

<sup>52</sup> In 2001 the institution of a Banking Operator of the Treasury Cashier Service was introduced (executed by the BPC) which increased the volume of Government deposits in the banks.

<sup>53</sup> Hodges (2001), Rocha (2000) and Roque (1997) discuss budgeting details per budget since the first initiative of economic reforms in 1987. Hodges (2001) also details the excessive number of changes of those responsible for economic affairs.

in conjunction with considerable changes in direction. First, the significant variations in the fiscal deficit, together with excessive levels of expenditure, have had a tendency to exclude the private sector and to reduce economic growth, as well as increasing inflationary pressures. Second, budgeting execution has varied considerably in the approved programmes, not only with respect to the total expenditure and the fiscal balance, but also in relation to budget allocations. These persistent discrepancies between programming and implementation have created a lack of credibility which is likely to complicate the task of convincing

## A. Receipts and the fiscal balance

The inconsistency between fiscal programming and budgetary execution is evident in the considerable variations in the fiscal balance between 1996 and 2002. The fiscal balance ended up being lower than the programmed target by 7% of GDP. In addition, the following graphic indicates that the average fiscal balance of -12 per cent of GDP commences with a positive balance in 1996 (2% of GDP), includes an enormous deficit in 1999 (36% of GDP), a stable improvement in 2000 and 2001, and finally a return to relatively large deficits in 2002 (8.5% of

### Box 1. Non-Renewable Resources: The Response of the Economic Policy

Extreme dependency on a non-renewable resource, as in the case of Angola, is common to oil producers throughout the developing world. Economic theory suggests that the response in terms of economic policy should take into account the non-intentional consequences on the competitiveness of the non-oil sector (an effect that is known as “the Dutch disease”), vulnerability as a result of adverse movements in the price of oil, and the non-renewable nature of the asset.

Empirical evidence suggests that a high dependency on oil receipts constrains the development of the non-oil sector, and increases the pro-cyclical nature of fiscal policy (with a tendency to induce excessive levels of consumption followed by unsustainable increases in the level of public debt when the price of petroleum or production levels fall). In addition, the combination of significant financial flows and weak institutions gives rise to high levels of corruption in the majority of the countries that are highly dependent on non-renewable natural resources.<sup>54</sup>

In Angola, where the petroleum sector constitutes an enclave of intensive capital, with very few links with the rest of the economy, these considerations are all the more pertinent. In this case, while the majority of the population suffer the non-intentional consequences of a super dependency on oil production, the benefits generated by the oil sector flow almost entirely through the accounts of the Ministry of Finance, in the form of fiscal receipts. Therefore, the extent to which the country benefits from the existence of the oil sector is determined exclusively by the degree of rationality with which these receipts are generated.

Operationally, the policymakers must therefore fight to improve the efficiency of public expenditure, including by means of the reallocation of resources to the social sectors; increasing the prospects for the non-oil economy, by means of the generation of economies in the public sector that are sufficiently substantial to ensure macroeconomic stability; structural measures that lower the transaction costs and release resources for investment in the private sector. In order to complement these efforts, the savings or stabilisation funds could contribute towards protecting budgeting policy both in relation to changes in oil receipts and political pressures.<sup>55</sup>

the economic agents that the next programme of reforms has a higher likelihood of being implemented successfully. At the same time, the distortions introduced in the price signals have had a tendency to reduce the efficiency of the allocation of economic resources.

GDP).

In a significant way, these changes in the fiscal results, as with trends in the general policies, reflect developments in the petroleum market. In fact, the graphic set out below confirms that variations both in the share of income from oil, and in the global fiscal balance, have a tendency to reflect movements in the world price of oil – compatible with the fact that the share in income from oil in the receipts of the government typically exceed 80%. Significantly, this level of dependency is almost unique throughout the world: receipts from oil as a percentage of government income are in the lower band of the 80s for Nigeria, in the mid-70s both for Saudi Arabia and Venezuela, and lower than 25%

<sup>54</sup> Leite and Weidmann (1999) investigate the link between dependency on natural resources, the level of corruption and the effects on the economic growth rate.

<sup>55</sup> In the context of high dependency of receipts from renewable sources, Alier and Kaufman (1999) argue for persistent positive fiscal balances, and Fasano (2000) analyses the experience of stabilisation and savings funds.

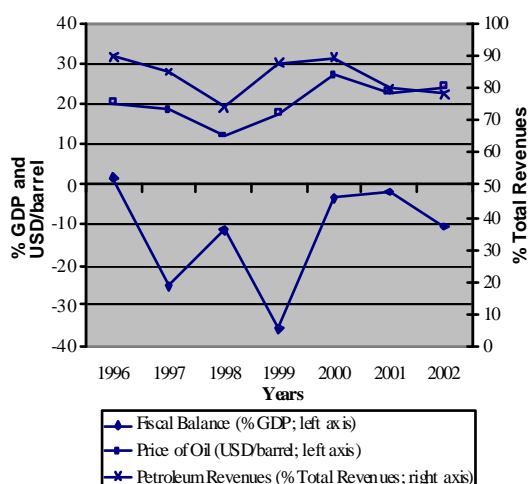
for Norway. Consequently, the absence of a framework of policies with a view to the attenuation of the adverse impacts of variability in the price of oil, exposes the Angolan economy to substantial uncertainties in terms of budget receipts – see box 1 for a brief orientation concerning policies.

The impact of other factors can also be conjectured on the basis of this graphic. In particular, the depression in the fiscal balance of 1999 (unexpected due to the progression of oil prices) is explainable by the resumption of the war at the end of 1998. Equally, the unexpected fall in 2002 could perhaps be explained by the higher expenditure with the process of peace – a conclusion which still depends on the production of a complete set of data on fiscal execution for 2002.

The relatively accentuated fall in the share of receipts from oil which commenced in 2000/2001 is partially explained by an increase in non-oil receipts following fiscal reform measures introduced in 1999 and 2000. These measures – which include (i) customs reforms, consisting in the reorganisation of import duty (reducing the maximum rate of 110% to 35% and a reduction in the number of tariff restrictions from 43 to 8) as well as modernisation of customs management (led by the Crown Agents), (ii) the broadening of income and sales tax, (iii) the reduction in the rate of industrial income tax from 50% to 30%, and (iv) the strengthening of the efforts to recover taxes, including by means of the establishment of the Large Taxpayers Unit – increased the rate of taxation in the non-oil sector from around 10% in 1996 to an estimated 17% in 2002.

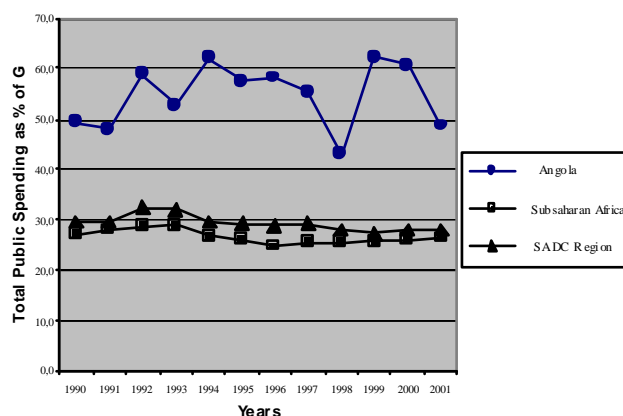
## B. Public expenditure

**Petroleum Sector and Fiscal Balance, 1996-2002**



Although economic theory does not identify an optimum level of government expenditure, comparisons between countries can identify useful parameters for decision making. The following graphic indicates that the level of public expenditure in Angola (as a percentage of GDP) has been close to double the average level for the countries of the SADC and of sub-Saharan Africa. Unless the

**Total Public Spending - Angola and Sub-Saharan Africa**



quality of services supplied is comparatively higher than in neighbouring countries, this level of expenditure necessarily places the economy under a considerable amount of pressure.

As has been widely discussed, the prolonged war served to limit the options available to policymakers. In terms of public expenditure, the following graphic indicates that the conflict absorbed a significant amount of resources – in 2001, 46% of the executed budget was allocated for military purposes, as compared with 12% for the countries of the SADC. However, with a durable peace in prospect, it should now be possible for the Angolan economy to benefit from the dividends of peace so long awaited. By way of a rapid evaluation of the potential increase in well-being based on such a dividend, it is considered that the reduction in the level of expenditure on defence in Angola in 2001 to a level comparable with neighbouring countries, would make available US\$ 1 billion for additional investments in the social sector. By comparison, the total cost of the full implementation of the peace agreements of 1995, known as the Lusaka Protocol, was budgeted at US\$ 1,250 millions.<sup>56</sup> According

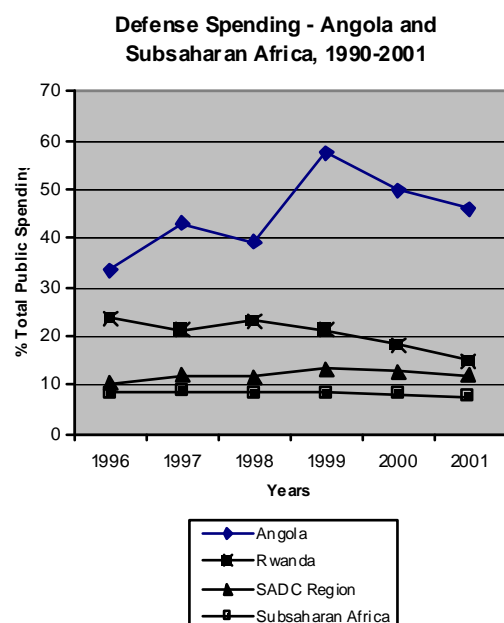
<sup>56</sup> For details, see IMF (1995, p. 40). Implementation of the Lusaka Protocol included costs of approximately US\$ 500 millions for the billeting, de-demobilisation and reintegration of ex-military personnel; and approximately US\$ 400 millions for the infrastructure projects. The first set of expenditure would take place over a period of 2 to 3 years while the second set of expenditure would take place over a longer period.

to reports, the government is considering an application for a similar amount at a conference of potential donors, for the purpose of mobilising funds for national reconstruction. Clearly, a more rational use of internal resources would represent a good step in satisfying the urgent requirements of national reconstruction.

With the mobilisation for war constituting a clear priority, in terms of the budgeting allocations, allocations to other sectors, mainly to health and education, in regard to the fiscal balance, tended to undergo pressure. In order to evaluate the economic impact of the resulting expenditure patterns, we will analyse in the next section the allocations made to the social sectors. Globally, the high levels of public expenditure and the resulting fiscal deficits were financed by a combination of credit from the BNA, foreign loans guaranteed with deliveries of oil, and the accumulation of overdue payments, both internal and external – with significant macroeconomic impact. Immediately below we analyse the structure of expenses by economic classification, and we briefly review some of the areas of important macroeconomic impact due to the high levels of public expenditure.

### C. Expenses by economic classification

The impact of the war effort is again clear from the



economic classification of public expenditure. Between 1997 and 2000, the average allocations for goods and services leapt from approximately 18% to 27% of GDP and allocations for transfers leapt from 3% to 7% of GDP – with a significant part

of these purchases probably ending up as war materiel – the allocations to personnel fell from 10% to 6% of GDP. With the number of civil service employees effectively on the increase throughout the period, this is clear evidence of the widely discussed reduction in the true value of salaries of the public function, probably one of the factors that also contributed to the prevalence of low morale and the widespread practice of parallel payment of public services.

Overall, the softening of the intensity of the war in 2001 and its conclusion in 2002, made it possible for global fiscal expenditure to be reduced by 50%, with a more rational allocation of the total package. In 2002, the percentage of GDP spent on salaries reverted to the 10% recorded in 1997 (a significant improvement on the 5% recorded in 1999), and expenditure on goods and services was lower than in 1997. However, the transfers (mainly subsidies for refined petroleum products and assistance to public enterprises) remained inflexibly above their 1997 levels and essential capital expenditure was stagnated.

In order to evaluate the rationality of allocation of budget expenditure, we refer, once again, to comparisons between countries. Available data suggest that in Angola the tranche of expenditure on personnel expenses is very much below the level of neighbouring countries. Between 1998 and 2001, the countries of the SADC allocated approximately 36% of public expenditure under the heading of salaries, as compared with 12% in Angola. The implication does not reside in the fact that the level of salaries in Angola should be increased unilaterally, but that within a reasonable package of public expenditure the improvement in the level of services of the government will probably require higher salaries, in addition to investments in the areas of training and management.

### D. Impact on macroeconomic variables

The high share of government consumption in the GDP has a tendency to constrain the actions of the private sector, not only reducing the flow of resources to the private sector<sup>57</sup>, but also making the private sector highly dependent on the operations of the government. With the public sector accumulating internal delays, at an average of 6.5% of GDP per annum, the financial health of the private sector becomes weaker. In addition, the

<sup>57</sup> Including by the extensive practice of direct importation, it significantly reduces the operations of the private sector.

simultaneous proliferation of exemptions (including customs duty) and the special provisions for government purchases (as well as their non-intentional extension to privileged individuals) increases even further the level of uncertainty confronting businesses in the private sector. Under these circumstances, the business fabric in Angola remains fragile and this fragility contributes considerably to the softening of growth in the non-oil sector.

In Angola, as in any other country, high levels of public expenditure tend to be associated with high levels of inflation. In particular, as analysed in the chapter on inflation, and as shown in the following graphic, the severe limitations to non-inflationary monetary finance strengthens the link between increases in the money supply and high public expenditure with high inflation. In Angola the resulting rate of inflation is almost entirely a tax supported by those groups that are unable to participate in the dollarised economy and to avoid transactions in Kwanzas, typically those in the lower income bands – making the credit of the BNA a highly regressive form of financing the budget expansions.

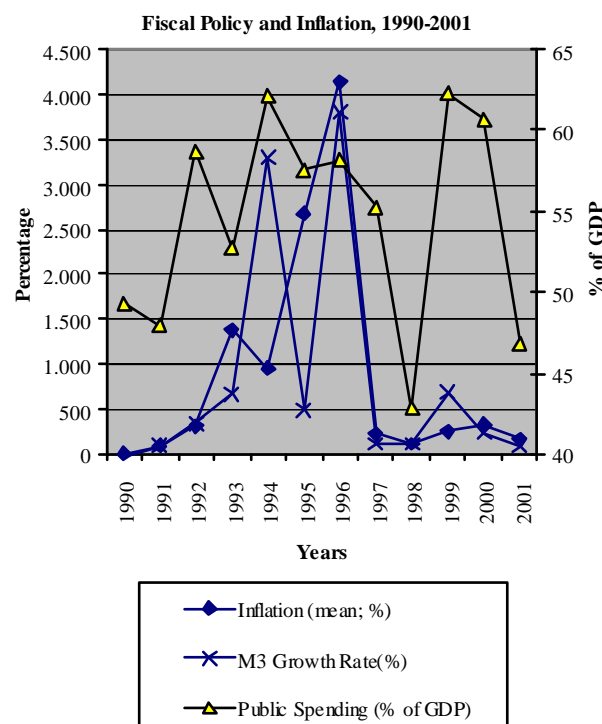
Finally, the same graphic also shows the obvious impact of increased access to foreign finance. The receipt, in 1999 and 2000, of significant bonus payments due to the signing of oil contracts, made fiscal expansion possible, without an increase in the money supply (or in inflation) – albeit it was necessary to sell large quantities of exchange currency, which resulted in the drastic reduction of exchange reserves up until 2002, as observed previously.

#### 4.3. Social sectors

The high rate of political instability during the last three decades was accompanied by relatively meagre budget allocations<sup>58</sup> to the social sectors, despite the fact of (and possibly also contributing towards) high rates of poverty<sup>59</sup>. The consequence has been a lack of progress in terms of social development, with Angola currently occupying a position close to the bottom of the scale for most social indicators, such as the UNO human

<sup>58</sup> In practice, fiscal expenditure had a tendency to be lower than budget allocations.

<sup>59</sup> The last and most encompassing study to date, indicates that more than 60% of Angolans live below the poverty line. For reference purposes, see: INE (2001), *Caracterização da Pobreza em Angola (Perfil da Pobreza)* [Characterisation of Poverty in Angola (Profile of Poverty)], a lecture presented at the Seminar on Social Policies (Luanda, July 2001).



development indicator, infant mortality rates, access to drinking water, and rates of education<sup>60</sup>. The following analysis takes into account both the level and the intra-sectorial distribution of expenses in the social sector, and uses comparisons with other countries, international standards and sectorial strategies as patterns to evaluate the adequacy of fiscal policy in this area.

The link between higher allocations to education and health, and improvements in the social results, is seen not only from the empirical evidence relating to the primacy of human capital in the economic growth process, but also considering the high level of poverty prevalent in Angola. Growth accounting exercises typically attribute 30-40% of growth in aggregate production to the growth of human capital per se<sup>61</sup> and an additional 30-40% to productivity improvements. The accumulation of human capital arises, primarily, by means of investment in education and health, while improvement in the level of productivity primarily implies the incorporation of more efficient methods of production and workers who are better trained. In other words, increased expenditure on education and health has a significant direct and indirect impact on the level of income. In the context of relatively extensive poverty, such as in Angola,

<sup>60</sup> See, for example, Hodges (2001), p. 60-1

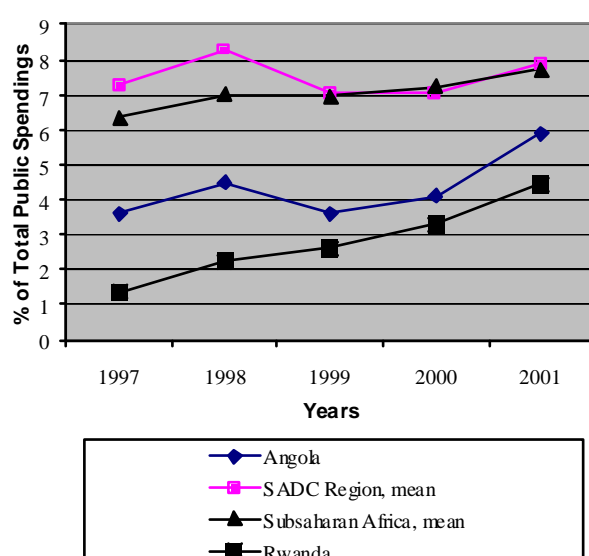
<sup>61</sup> Technically, this is the contribution of improvements in the workforce "qualitatively adjusted" to "production" of national income. The qualitative adjustment reflects increases in average years of education and better health.

public expenditure on education and health is necessary in order to ensure that the accumulation of human capital, the most valuable resource of the poor, becomes as generalised as possible.

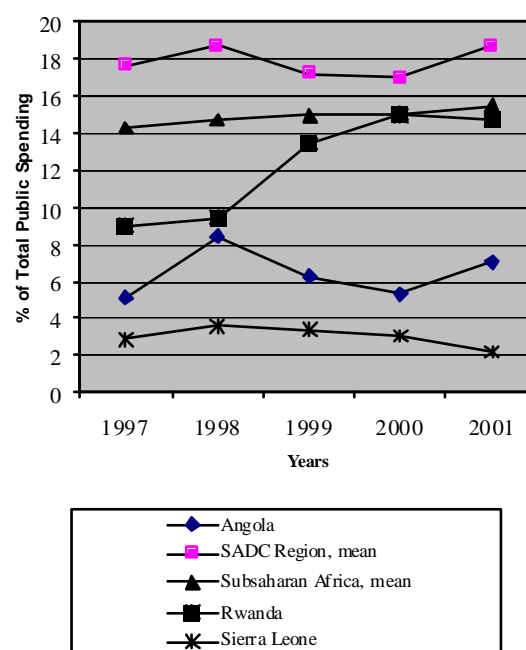
For Angola, a useful pattern for public expenditure in the social sectors is supplied by a comparison with other members of the SADC – against which Angolan human capital must be capable of competing. The following two graphics indicate that in the gap between the average level of public expenditure allocated to the social sectors in the countries of the SADC and in Angola the education sector is particularly noteworthy – around 15% of fiscal expenditure in the case of education, as compared with 2% in the case of health.

In this context, Angola has been consistently under investing in the social sectors. This result of the policy is even more accentuated, given that Angola, in the context of the sub-region, is currently at a disadvantage in terms of the level of human capital. Among the 14 members of the SADC, Angola is classified in 12th place in the Human Development Index, compiled by the UNO and in last place in the Human Poverty Index, also compiled by the UNO. Consequently, in order to become more competitive, Angola requires investments, principally in the areas of education and health, higher than those allocated by other countries in the region.

#### Public Spending on Health



#### Public Spending on Education



teaching is important, and (ii) investments in schools at the primary and secondary levels are particularly productive and favour the poor. Equally, the poor tend to have less access to health care and to have worse health conditions<sup>62</sup>. For these groups, the crucial aspect is access to primary health care which must, in the main, be supplied by the public sector. The statistics relating to social development for Angola (in particular, the extraordinarily high rates of infant mortality) reinforce even further the need for substantial improvements in primary health care. In other words, when increasing the budget allocations to the social sectors, it is equally important to fix a target for additional expenditure (for reasons relating both to the promotion of growth and to the reduction of poverty).

In this sense, a useful barometer for the evaluation of fiscal policy is the 20/20 initiative, a joint undertaking of the governments of the developing and developed countries for an average of 20% of expenditure of the government to be allocated to basic social services<sup>63</sup>. When defining the latter to

<sup>62</sup> World Bank (2000; p. 61 and pp. 65-6).

<sup>63</sup> The engagement includes the allocation of 20% of foreign development assistance to the basic social services. For details see UNDP et al (1998).



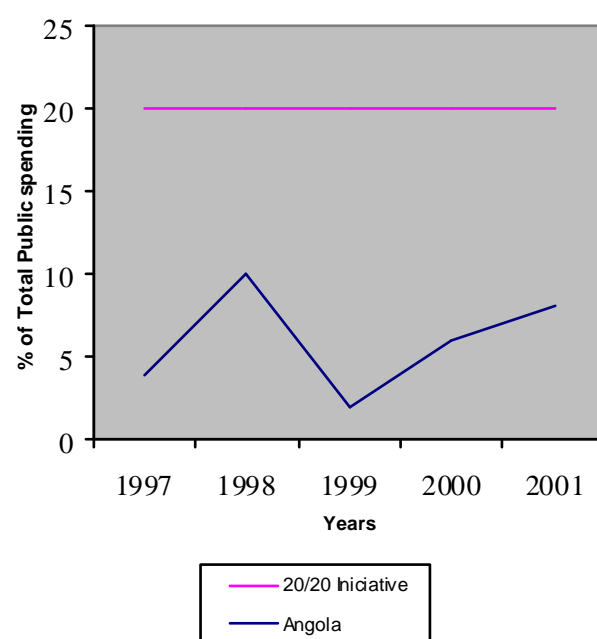
include primary health care, hospitals and municipal maternity wards, as well as basic education and water and drainage. Vinyals (2002) supplies estimates of expenditure on basic social services<sup>64</sup>. As shown in the next paragraph, the increase in the weighting of basic social services, which has been evident since 1999, still leaves allocations considerably short of the target of 20%.

In the circumstances, Vinyals (2002, pp. 69-71) notes that for education and health the intra-sectorial priorities revealed by the fiscal expenditure are not consistent with the objects established by the Millennium Development Targets (MDTs) and, perhaps more aggravating, with the objectives set out in the pertinent sectorial strategies. With basic education accounting for only 39% of expenditures on education, during the period 1997-2001, it is difficult to be confident with respect to the possibility of meeting the Millennium Development Target of achieving primary education for everyone by 2015, particularly with the current recorded rates of around 50%. With primary health care receiving only 17% of expenditure on health during the period 1997-2001, it is equally difficult to be confident that with respect to the probability of achieving the Millennium Development Targets of reducing infant mortality by two thirds and the maternal mortality rate by three quarters, by 2015.

The inconsistency between fiscal expenditure and the intra-sectorial priorities indicates a high degree of disarticulation between policy declarations and implementation – instead of a drainage of resources to the military. The National Action Plan on Education for Everyone 2000-2015, approved by the Council of Ministers in August 2001, includes the MDT objective of achieving primary education for everyone by 2015. The Basic Law on the System of National Health and the draft Health Development Plan, both advocate the expansion of the network of primary health care and the focusing of attention on efforts to combat the great endemic diseases. A more consistent intra-sectorial distribution of resources could start with a substantial reduction in allocations for: (i) scholarships abroad (which amount to around half of the allocations for basic education and exceed the projected amounts required for higher education

in the country) and (ii) medical evacuations abroad

**Public Spending on Primary Social Services**



(which are almost equal to the resources allocated to the entire network of primary health)<sup>65</sup>.

## CONCLUSIONS

The most important barrier to the efficiency of fiscal policy in Angola has clearly been the predominance of political considerations and the resurgence of a significant credibility gap. Since the days of the economy under the command and control of the First Republic (particularly in the context of the civil war), until the attempts to introduce reforms in the 1990s, public policy in Angola has been consistently held hostage to political objectives, frequently with the justification that the State itself was under siege. Throughout the 1990s, the combination of:

- pretentious declarations of intent followed by abrupt reversals, and
- a permanent and accentuated decline in the living standards of Angolans (notwithstanding

<sup>64</sup> As observed in Vinyals (2002), the current system of budgeting classification does not directly generate data in a form that is appropriate for an analysis of expenditure, per level of service (primary, secondary, tertiary level, etc). Vinyals (2002) first used information concerning the entity managing the pertinent budgeting funds ("the managers"), in addition to additional classifiers of the programme and activity, in order to determine the intra-sectorial distribution of the social expenditure.

<sup>65</sup> In the circumstances, and despite the nominally low salary levels, the bulk of expenditure on basic education and healthcare is used for permanent staff, leaving both the level of sectorial investment and the supply of materials woefully inadequate for managing the expansion of capacity and improving the supply of services. In the wider context of the political economy, it is perhaps of more concern to note that defence expenses of a higher level than normal would not normally have an impact on intra-sectorial distribution of social expenditure, though this cannot be affirmed with certainty in relation to the overall participation of social expenses.

the continuous increase in the levels of petroleum production),

served to create a substantial credibility gap with regard to government efforts concerning policy.

While political errors must be corrected and misalignments of incentives adjusted, credible protagonism and the stability of economic policy are often as important as the specifics of the policies themselves<sup>66</sup>. Throughout the brief history of Angola, the generalised nature of intervention by the government in the economy stifled the possibility of effective development of the private sector. In addition, the political instability generated by the prolonged civil conflict, together with the credibility gap with regard to policies, in turn created a situation where the economic agents are (relatively) unreceptive to attempts to create a new set of rules. It is now essential that Angola establish a credible framework of economic incentives to provide guidance in the adoption of policies relative to the public sector, as well as to assist with decision-making for the private sector. In the medium term, such an approach will ensure that economic stability will be added to the country's newfound political stability.

The second barrier to the efficiency of fiscal policy in Angola has been the lack of an institutional balancing mechanism to ensure a reasonable level of efficiency in terms of public expenditure, including:

The non-availability of basic socio-economic data (or, in the best of the hypotheses, a long wait until they became available). The resulting lack of political analysis barely allows sufficient information for the policymakers, and produces an even greater effect of softening with respect to the quality and consistency of the available data;

Lack of a set of guidelines to isolate fiscal policy from the risks typically associated with extreme dependency on the petroleum sector;

Lack of application of the existing budget-control procedures – for example, the execution of a considerable part of the fiscal expenditure outside the budget system, the generalised nature of (unaudited) treasury operations, conducted through Sonangol, and the continuous accumulation of internal and external defaults; and

Lack of fulfilment of the existing requirements in the preparation of financial reports, by the economically significant sector of public bodies and other budgeting units.

The resulting lack of compliance with policy declarations (for example the announcement by the Ministry of Finance of reductions in expenditure are often counteracted by expenditure units that have access to the use of financing by Sonangol) and the lack of institutional continuity (for example, frequent ministerial changes at the level of the Ministry of Finance) have increased the frequency of changes in the policy rules which, as mentioned above, increases the level of uncertainty for the policy makers and finally has an adverse effect on economic performance.

With regard to poverty reduction, a clear engagement in order to achieve the objectives defined by the national strategies for the social sectors will be essential in order to overcome the current constraints in terms of capacity and to develop a general accumulation of human capital. In this connection, a significant increase of participation in the public expenditure allocated to the social sectors, in particular primary education and primary health care, should be one of the priorities of fiscal policy during the short term.

The adoption of processes that promote inter-sectorial co-operation through the institutions, as well as a medium-term expenditure framework and a strategy of reduction of poverty, supply useful mechanisms for the preparation of rational fiscal policies in the medium-term. In operational terms, these processes require a high degree of consistency, both horizontal and vertical, in the economic plans. Horizontally, it is necessary:

To coordinate the actions of a certain number of agents, including central and provincial bodies, donors, NGOs and autonomous funds;

To ensure that the investment plans are consistent with recurring levels of expenditure; and

To ensure adequate intra-sectorial distribution of the resources.

Vertically, it is necessary:

To ensure consistency between the macro objectives and the sectorial requirements; and

<sup>66</sup> Without a doubt, international evidence suggests that most economies appear to be resistant and capable of acting relatively



To ensure an adequate implementation of the broad objectives of the policies.

With regard to decentralisation, the foregoing analysis supplied a certain number of recommendations resulting from the literature, both theoretical and empirical, including the suggestion that allocations for basic education and healthcare at lower levels of government should be matched by a determination of national standards and the supply of financial transfers directed on behalf of the central government.

## 5. Expenditure components

The breakdown of aggregate demand of the economy is a line of analysis of the factors which at any given time determine the essential processes of economic growth of countries<sup>67</sup>.

The dynamics of growth of the national economy have concentrated, for a long time and due to the war situation since independence in 1975, on

Angolan model of economic growth is clear, and is equally noteworthy if investment is the reference variable.

According to the available data, the gross formation of capital - including variation of stocks - is weighted by foreign direct investment in primary activities of extraction of petroleum and diamonds. The internal component of gross investment (Angolan companies and State) has been presented not only sparsely in the general computation, but is undulating in terms of its evolution dynamic.

The above table contains certain information that allows an appreciation of the way in which these final demand variables have behaved throughout the reference period (values in millions of current US dollars).

The rate of expansion of oil exports reflected an average annual growth rate of 15.4% between 1997 and 2000 and of 4.6% between 1997 and 2002. This deceleration was due to the effect of the price

FINAL DEMAND VARIABLES (In millions of current US dollars)					
YEARS	GDP	Public investment	Foreign private investment	National private investment	Exports of goods and services
1997	7486.3	359.7	1050.3		5297.4
1998	6387.4	381.0	1491.7		4028.2
1999	5989.7	277.1	3124.8		5335.8
2000	9040.3	299.0	1807.1		8222.7
2001	8911.4	317.8	3072.6	128.5	6759.5
2002	10406.9	279.5	3444.7	265.1	5959.2

**SOURCES:** INE (National Accounts), department of studies and statistics (DEE) of the BNA (Balance of Payments) and studies and statistics office of the Ministry of Petroleum

exports and foreign direct investment.

Exports are dominated by primary products which are extraordinarily volatile in terms of price and are strongly dependent on the strategies of the multinationals in terms of elasticity of supply. Prior to 1995, petroleum accounted for more than 95% of export receipts. Only after that time did diamonds begin to occupy a position of some importance in the context of external economic relations (for further details see the chapter referring to the analysis on the Balance of Payments). Meanwhile, the outward-looking and enclave nature of the

of oil on international markets, translated into price devaluations of 16.4% in 2001 and 11.9% in 2002. Moreover, it was precisely this fall in world oil prices that explains the reduction in the value of exports, 17.8% in 2001 and 11.8% in 2002<sup>68</sup>.

With regard to investment, there were different types of behaviour:

- Foreign direct investment increased between 1997 and 2002 at an average annual rate of 26.8%, corroborating the international statistical information that Angola is one of the countries that attracted the most foreign direct investment in

well, under an ample series of "policy rules".

<sup>67</sup> The alignment of the Angolan National Accounts takes place exclusively on the side of aggregate supply, although information is now available in relation to the components of national expenditure between 1985 and 1990 in a publication entitled "Contas Nacionais de Angola" [National Accounts of Angola], a publication of the Instituto Nacional de Estatística [National Institute of Statistics] of November 1993.

<sup>68</sup> It should be pointed out that petroleum extraction between 2001 and 2002 increased from 735,420 barrels per day to 903,113 barrels per day, a percentage of 22.8% absorbed by the cumulative effects since 2000 of the fall in oil prices.

recent years. However, the investment, which flows in and out with the same degree of rapidity, without creating roots - on average expatriated profits and dividends amount to around 950 million dollars per annum - does not form a part of the non-mineral economy;

- Public investment tended to decrease during the period between 1997 and 2002, the numeric expression having been -4.9% per annum. The war situation certainly limited the entrepreneurial capacity of the State, which was accompanied to a certain extent by the random behaviour of the price of oil on the international market, the reductions of which -- in certain significant years such as 1998 -- involved the introduction of readjustments to the public investments budget. What is clear is the incompatibility between the creation of a competitive infrastructure facilitating corporate productivity gains and the low levels of public investment, the undertaking capacity of which should be substantially reinforced, in line with the national capacity of absorption;
- Private national investment was not expressed: 1.4% of representation in aggregate demand in 2001 and 2.5% in 2002. In order for economic development within the country to be more sustainable and endogenous, private national investment must assume leadership in the processes of reconstruction, reconversion and modernisation of the economic structure.

Another aspect to be highlighted is concerned with the strict correlation between the evolution of Gross Domestic Product and total exports, where oil predominated, as can be appreciated from the following table which represents the average rates of growth of the two macro-economic variables:

It is also appropriate to point out that from 1998/1999 non-oil exports - of which diamonds predominated - showed a strong variation dynamic expressed as an average annual rate of variation of 14.2%.

**EVOLUTION OF THE GDP %**

YEAR S	GDP	Exp. goods/serv.
1998	-14.7	-24.0
1999	-6.2	32.5
2000	50.9	54.1
2001	-1.4	-17.8
2002	16.8	-11.8
<b>Average rate annual</b>	<b>6.8</b>	<b>2.4</b>

This being the case, there were no structural changes in the Angolan economy, so that external demand continued to clearly represent the main contribution towards the formation of the Gross Domestic Product. In fact, between 1997 and 2001 total Angolan exports represented, on average, more than 78% of GDP, which leads one to conclude that national economic activity depends, to a risky extent, on the evolution of world demand for basic non-processed products, in particular oil and diamonds.<sup>69</sup>

<sup>69</sup> The expansion or contraction of domestic economic activity therefore ends up depending heavily on the growth or contraction of external demand, while the processes of adjustment of domestic expenditure have only marginal effects on the formation of the domestic product. It is clear from this that for the next economic cycle of the country, emphasis should be placed on the implementation of a New Policy of Use of Non-renewable Resources in two specific areas: The application of financial resources deriving from exports of basic products and fiscal receipts in activities structuring a New Internal Economic Order and an increase in the internal value added from activities geared to exports. It is by these means that the strategic nature of petroleum and diamonds exploration should be affirmed in the future and not only as a spearhead and enclave economy.

In consonance with this positioning of the exports of non-processed basic products, there is the

1997 and 2002, and was constructed on the basis of information gathered from different sources.

#### AGGREGATE NATIONAL EXPENDITURE (millions of current US\$)

YEARS	GDP	Public. Consu.	Priv. Cons.	Total invest.	Exp. Goods/Serv.	Imp. Goods/Serv.
1997	7486.3	2144.9	4614.4	1410	5297.4	5980.4
1998	6387.4	1732.2	3565.1	1872.7	4028.2	4810.8
1999	5989.7	1879.1	2472.9	3401.9	5335.8	7100.0
2000	9040.3	3157.8	3030.5	2106.1	8222.7	7476.8
2001	8911.4	2922.0	3992.2	3518.9	6759.5	8281.2
2002	10406.9	3527.7	4438.5	3989.3	5959.2	7507.8

SOURCES : BNA/DEE, Ministry of Planning - MINPLAN (Execution of Public Investments Programme), Fiscal Balance of the Ministry of Finance

behaviour of gross direct foreign investment. Corresponding with the intensification of petroleum research and exploration in deep and ultra-deep

Private consumption was obtained on the basis of difference, and is therefore a residual variable, reflecting the greater or lesser consistency of the

#### STRUCTURE OF AGGREGATE EXPENDITURE (%)

YEARS	GDP	Publ. Cons.	Priv. Cons.	Public Inv.	For. Priv. Inv.	Nat. Priv. Inv.	Exp. Goods/Serv.	Imp. Goods/Serv.
1997	100.0	28.7	61.6	4.8	14.0	0.0	70.8	79.9
1998	100.0	27.1	55.8	6.0	23.4	0.0	63.1	75.3
1999	100.0	31.4	41.3	4.6	52.2	0.0	89.1	118.5
2000	100.0	34.9	33.5	3.3	20.0	0.0	91.0	82.7
2001	100.0	32.8	44.8	3.6	34.5	1.4	75.9	92.9
2002	100.0	33.9	42.6	2.7	33.1	2.5	57.3	72.1
Average	100.0	31.9	45.9	4.0	29.0	0.8	73.8	85.3

waters, direct foreign investment amounted to 1,050.3 million US dollars in 1997, 1,807.1 million dollars in 2000 and 3,444.7 million dollars in 2002. Furthermore, exports of basic products and direct foreign investment in the key sectors of the national

statistical information relating to the other components of aggregate demand.

#### AVERAGE GROWTH RATES

YEARS	GDP	Public Cons.	Private Cons.	Public Invest.	For. Priv. Inv.	Nat. Priv. Inv.	Exp. goods/serv.	Imp. goods/serv.
1998	-14.7	-19.2	-22.7	5.9	42.0		-24.0	-19.6
1999	-6.2	8.5	-30.6	-27.3	109.5		32.5	47.6
2000	50.9	68.0	22.5	7.9	-42.2		54.1	5.3
2001	-1.4	-7.5	31.7	6.3	70.0		-17.8	10.8
2002	16.8	20.7	11.2	-12.1	12.1	106.3	-11.8	-9.3
Average rate								
annual	6.8	10.5	-0.8	-4.9	26.8		2.4	4.7

economy were the most relevant factors in the growth of the Gross Domestic Product.

In effect, both public and private non-mineral investment, in particular Angolan, reflected very modest relative weighting in the gross formation of domestic fixed capital.

The "Structure of Aggregate Expenditure" table attempts to provide an approximation of the aggregate values of national expenditure between

It can thus be seen that:

- Public investment had an average participation between 1997 and 2002 of only 4% of GNP, and was clearly not a factor in the growth of the national economy;
- Angolan private investment was insignificant in the process of economic growth, with an average

participation not exceeding 0.8% of GDP<sup>70</sup>;

- Direct foreign investment, representing, on average, almost 30% of GDP, was the principal factor in the growth of GDP, with the following consequences:
  - The process of Angolan economic growth depends on the decisions and strategies of the multinationals that exploit basic Angolan products;
  - The annual economic results have been the subject of enormous amounts transferred abroad as profits and dividends, and it is therefore obvious that the GNP is, on average, 40% lower than GDP;
- Exports of goods and services accounted for approximately 74% of gross domestic product, which makes them the principal engine of economic growth, with the known consequences arising from the high volatility of the international price of a barrel of oil;
- Finally, the high dependence on imports - on average more than 85% of GDP - the clear result of the de-structuring of the non-mineral economy, the weakness in the domestic economic fabric incapable of competing with products from abroad, the rentist nature of the mineral economy, the heavy weighting of services, freight, etc

The average rates of growth recorded in the period under analysis provide a better idea of the true factors of economic growth in Angola:

The behaviour of public consumption - for personnel engaged in Public Functions and operating expenses - was very sinuous throughout the period, which can be justified for two reasons:

<sup>70</sup> Although the estimates with respect to its values appear to be somewhat reserved, one gains the impression, from parallel or complementary indicators, that the participation of Angolan capital in economic growth has been absolutely marginal.

- In the first place, due to the dependence for public receipts on petroleum tax receipts, subject to fluctuations in international oil prices;

In the second place, due to the insufficiency of a structured budgeting policy based on internal objectives of macroeconomic stabilisation and economic growth.

## 6. General level of activity

Notwithstanding an internal context considerably different from that which conditioned economic activity in Angola during the 27 post-Independence years, the year under consideration did not reflect any evident structural modifications. There are insufficient signs of optimism on the part of businessmen with respect to the possibilities of relaunching private activities, and intentions voiced by the economic policy decision makers are clearly inadequate. The process of economic and institutional reforms should be accelerated and in certain aspects reviewed in order to adjust it to the new post- conflict conditions. The administrative culture of facilitation and corruption should be substituted by a pro-development attitude<sup>71</sup> and the size of the State in the economy must be forcibly reduced in order to improve its functions of allocation of public assets, as the protector of macroeconomic stability, the promoter of development and the guarantor of a better distribution of the national income. These functions must be exercised by means of adequate public policies generating the maximum national consensus and also by means of implementing public investment projects with an external positive outcome.

For these reasons during 2002 the features of the basic structures of the national economy remained unchanged, with a weighting clearly biased towards the mineral economy, with the emphasis on petroleum.

<sup>71</sup> This is clearly not going to be easy, when low-intensity corruption predominates, and State services normally only assist citizens in exchange for exorbitant payments. Then there is the "old" question of the salaries of the Public Services, insufficient to motivate the officials to dedicate themselves with more effort and skill to their normal functions, but clearly disproportionate when compared with the administrative productivity and financial capacity of the General State Budget. The solution cannot be based merely on the licensing of certain civil servants of the State, but should, on the contrary, be based on a set of substantial modifications: Reduction in the value of servicing the external debt by means of re-scaling and renegotiation, a reduction in the weighting of operating expenses in order to eliminate wastage and certain expenses of debatable social utility, as well as increased efficiency in tax collection (reduction of its financial cost, measures against tax evasion and fraud, etc.).

The relevant aspects to be emphasised are:

- An apparent reducing trend in the relative weighting of the oil economy, which, however, may not be consolidated in the scheduled petroleum extraction investments, which could be in the order of 4 to 5 billions

- The maintenance of the process of de-industrialisation translated into a decreasing weighting of the industrial Gross Value Added (GVA) in total GDP which in 2002 reached a figure of 4.3% (the average participation during the period under analysis was 4.1%, with a peak of 6.3% in 1998, the year in which, coincidentally, a significant

#### SECTORIAL STRUCTURE

	1998	1999	2000	2001	2002
<b>Agriculture, forestry, fisheries</b>	13.01	6.36	5.74	8.57	9.18
<b>Crude Oil and Gas</b>	37.84	58.75	60.84	51.84	49.48
<b>Diamonds and others</b>	5.35	8.35	6.49	6.24	6.26
<b>Manufacturing industry</b>	6.31	3.26	2.93	4.07	4.28
<b>Energy and water</b>	0.07	0.04	0.03	0.04	0.04
<b>Construction</b>	6.15	3.12	2.76	3.80	3.99
<b>Commercial services</b>	19.32	15.04	14.46	15.95	16.13
<b>Non-commercial services</b>	10.55	4.87	6.71	9.44	10.57
<b>GDP market prices</b>	98.61	99.78	99.96	99.94	99.94

Source: Ministry of Planning, INE, National Accounts

NOTE: the column total does not amount to 100% because import duty is not included in the calculation of the structure of the national economy.

per annum in coming years, (more precisely, 5,984.8 million dollars in 2003, 3,927.7 million dollars in 2004 and 4,513.4 million dollars in 2005)<sup>72</sup>;

- In percentage terms, the participation of the petroleum sector in the structure of the GDP increased from 37.8% in 1998, to 58.7% in 1999, i.e. it recorded a percentage increase of around 20 points in only one year, and in that year the Extractive Industries contributed 66.7% to the total GDP, which translated into a reduction of 50% in the participation of the other productive sectors (Agriculture, Manufacturing Industry, Construction and Non-Commercial Services), as compared with the previous year. In the following year the increasing trend of the contribution of the petroleum sector continued and the result was identical in terms of a reduction in the participation of the other sectors. In 2001 and 2002 the trend changed, though none of the other sectors, with the exception of non-commercial services, achieved the percentages of participation in the GDP of 1998;

increase was recorded in credit to the economy and various programmes of relaunching of the productive activity were implemented, consisting of an increase in bread production and the development of agricultural production and rural commerce)<sup>73</sup>;

- A clearly marginal relative weighting of energy and water, a sector of extraordinary importance for the recovery and development of the country;
- A relatively stable weighting of commercial services, which included commerce and related activities, insurance, banking, transport, telecommunications, etc;
- A modest participation also in the construction sector, undoubtedly one of the pillars that will support the process of economic growth of Angola.

However, it is apparently more correct to analyse these structures by reducing the respective values to 1992 constant prices in order to have a better

<sup>72</sup> In the context of a necessary policy of sectorial economic integration, Chevron-Texaco announced to advance a project called "Angola Partnership Initiative", with a budget of 50 million US dollars, intended, among other things, for the promotion and development of small companies in other fields of activity.

<sup>73</sup> Notwithstanding a new climate that was more propitious to the business and industrial initiative, the fact is that during the course of 2002 there was a considerable number of stoppages in factories in various provinces, particularly noteworthy cases being África Têxtil and Companhia de Celulose e Papel de Angola in Benguela, Corassol and Toflex in Viana, Peskwanza in Kwanza Sul, Mabor and Siderurgia in Luanda, with the fear that Metalúrgica de Viana, due to difficulties in the flow of the respective products, would close its industrial activity.

understanding of the structural changes that were taking place (if indeed they did take place).

The contrast with the figures in the above table is clear, and it can be concluded that there was a clear stagnation in the process of economic structural changes up until 2002.<sup>74</sup>:

- The structural sectors of an endogenous development configuring internal economic integration

dependency and which contribute to a reduction of national income (as opposed to GDP),, was improved, albeit slightly: 49.1% in 1998 and 50.3% in 2002<sup>76</sup>.

The analysis of the dynamics of growth to some extent corroborated the above affirmations, particularly in regard to diamond exploration.

#### STRUCTURE OF PRODUCTIO IN 1992 PRICES

	1998	1999	2000	2001	2002
<b>Agriculture, forestry, fisheries</b>	12.45	12.28	12.96	14.53	14.10
<b>Crude oil and natural gas</b>	44.48	43.75	42.39	39.85	43.14
<b>Diamonds and other minerals</b>	4.62	6.28	6.86	7.79	7.19
<b>Manufacturing</b>	3.98	4.15	4.36	4.55	4.33
<b>Energy and water</b>	0.07	0.07	0.07	0.07	0.07
<b>Construction</b>	4.91	5.02	5.20	5.36	5.11
<b>Commercial services</b>	16.70	16.97	16.93	17.05	16.47
<b>Non-commercial services</b>	11.48	10.34	10.13	9.72	8.62
<b>Import duties</b>	1.30	1.14	1.10	1.07	0.98
<b>GDP market prices</b>	100.00	100.00	100.00	100.00	100.00

(sectorial and regional) retained an inertia preventing an improvement in their relative participation in the national economic fabric: Agriculture, manufacturing industry, construction and energy and water.<sup>75</sup>;

The relationship between the economic growth of the country and the dynamics of evolution of the mineral economy is strong, which is equivalent to considering that the degree of dependence of the internal economic activity on the behaviour of international markets for crude oil and diamonds - world price and demand - is very high.

#### ANNUAL AVERAGE GROWTH RATES IN 1992 PRICES

	1997	1998	1999	2000	2001	2002
<b>Agriculture, forestry, fisheries</b>	10.2	5.2	1.3	9.3	18	12.1
<b>Crude oil and natural gas</b>	4.7	3.5	1	0.4	-1	25
<b>Diamonds and other minerals</b>	53.4	90.2	39.5	13.3	19.5	6.6
<b>Manufacturing</b>	9.3	4.9	7.1	8.9	9.8	10.1
<b>Energy and water</b>	9.4	14.5	1.3	0.8	10	10
<b>Construction</b>	13	10	5	7.5	8.5	10
<b>Commercial services</b>	9.4	5	4.4	3.4	6	11.6
<b>Non-commercial services</b>	5.5	0	-7.5	1.5	1	2.5
<b>GDP market prices</b>	7.7	5.5	2.7	3.6	5.2	15.5

Source: Ministry of Planning. INE. National Accounts

- the overall position of the enclave sectors, which have a strong external

One can therefore observe - authenticating a widely known reality - that the mineral economy represents the biggest contribution to Angola's economic growth. The driving sectors of a more endogenous growth - agriculture, manufacturing industry,

<sup>74</sup> Not even the fact and continuation of war could fully justify in particular the already mentioned process of de-industrialisation which occurred soon after independence in 1975. Examples where the war was used as a factor to reinforce internal economic activities and the creation of an internal institutional market of medium size are well known.

<sup>75</sup> Attention should be drawn to the virtual non-existing representation of this sector of activity: its relative contribution is irrelevant - 0.07% during the period under analysis - and it remained static between 1998 and 2002.

<sup>76</sup> The anticipated investments between 2003 and 2005 in the petroleum extraction sector will increase production to 942,000 barrels per day in 2003, 1,097,000 in 2004 and 12,230,000 in 2005, which, "*ceteris paribus*" in the remaining sectors of activity,

construction and energy and water - contributed, overall, with percentages which in some years are very much below that of the enclave economy.

It is also clear that the essential economic growth dynamic of the country is indexed to oil exports - as emphasised in the analysis of the components of

constant 1992 values; the results are shown in the tables on the following page.

The following should be emphasised:

- The meagre domestic market of manufactured goods, the average size of which, during the

#### GDP GROWTH BY SECTOR IN PERCENTAGE TERMS

	1997	1998	1999	2000	2001	2002
<b>Agriculture, forestry, fisheries</b>	1.27	0.65	0.16	0.53	1.54	1.11
<b>Crude Petroleum and Gas</b>	2.13	1.56	0.44	0.24	-0.52	12.37
<b>Diamonds and others</b>	1.37	4.17	2.48	0.86	1.22	0.41
<b>Manufacturing industry</b>	0.37	0.19	0.29	0.26	0.40	0.43
<b>Energy and water</b>	0.01	0.01	0.00	0.00	0.00	0.00
<b>Construction</b>	0.61	0.49	0.25	0.21	0.32	0.40
<b>Commercial services</b>	1.58	0.84	0.75	0.49	0.96	1.87
<b>Non-commercial services</b>	0.67	0.00	-0.78	0.10	0.09	0.26
<b>Import duty</b>	0.10	-0.39	-0.11	0.00	0.00	0.01

aggregate demand - which presented the following behaviour (in quantities):

Accordingly:

- The average price of a barrel of oil remained practically stable during the period under consideration, at around 19 US dollars per barrel, despite intermediate oscillations in opposite directions;

period under analysis, did not exceed 330 million US dollars;

- The significant increase in the extraction of diamonds, today the third biggest activity of the country (the added value of agriculture has a strong component of internal consumption);
- Commerce and the remaining mercantile services accounted for a sizeable slice of the domestic economic activity.

#### EXPORTS AND DOMESTIC CONSUMPTION OF OIL

	1997	1998	1999	2000	2001	2002
Average price of oil	18.5	12.1	17.4	27.1	22.7	20.0
Barrels of oil per annum (thousands)	260256	269588	272378	273183	270309	329641
Barrels of oil per day (thousands)	713	739	746	748	741	927
Oil exports (thousands of barrels)	242474	250830	253600	256100	255200	275232
Internal consumption of oil (% production)	6.8	6.95	6.89	6.25	5.59	18.64
Rate of growth in oil exports		3.45	1.10	0.99	-0.35	7.85

- With the exception of 2001, exports of crude oil constantly increased, with a maximum of 7.9% in 2002;
- Internal consumption of crude oil was stationary, at around 6% throughout the period under consideration (the 2002 value should be perfectly atypical, and as such is inexplicable).

The same dynamic can be viewed through the valuation in US dollars of domestic economic activity. This has been done in current values and

The evolution of GDP in constant 1992 dollars is illustrated by the figures set out in the following table.

One of the most relevant observations relates to the implicit devaluation of the US dollar between 1997 and 2002, with two maxima in 1998 and 1999.

The average rate of growth of economic activity, in constant dollars - 1992, was 6.4%, with a peak in 2001 of 5.2%.

will aggravate even further the internal disarticulations and external dependency.

The slowest recovery was in the agriculture and construction sectors; following a fall of virtually 50% in 1993, only in 2000 did the respective activity

be useful; the respective information is set out in the following tables.

Petroleum production, in terms of physical

#### NATIONAL ACCOUNTS (THOUSANDS OF CURRENT US\$)

	1997	1998	1999	2000	2001	2002
<b>Agriculture, forestry, fisheries</b>	673914.5	831194	380853.3	519205.2	754104.44	932580.17
<b>Crude Oil and Gas</b>	3585765	2417194	3519020	5505579	4562393.2	5025127.8
<b>Diamonds and others</b>	326559.8	341836.3	499856.5	587200.4	549019.67	635635.12
<b>Manufacturing industry</b>	327777.8	402964.7	195143.2	264905.2	358092.09	434966.61
<b>Energy and water</b>	3534.188	4743.073	2172.779	2731.927	3699.9412	4489.5823
<b>Construction</b>	304888.9	393050.4	186616.7	250156.8	334173.83	405483.58
<b>Commercial services</b>	1207338	1233962	901036.3	1308328	1403672.5	1638315.3
<b>Non-commercial services</b>	879508.5	673634.8	291990.5	607264.4	831198.52	1073353.6
<b>GDP market prices</b>	7486308	6387370	5989740	9040257	8911403.5	10156214

SOURCE: Ministry of Planning. INE. National Accounts

exceeded, by 4 percentage points, the level of 1992.

The extractive industry was, without doubt, the industry which recovered the most rapidly, having in 2000 exceeded the 1992 level by 7.5 percentage points. The petroleum sector contributed significantly, reaching the 1992 level by 1994, subsequently recording an average annual growth rate (at constant 1992 prices) of 5.4%. The other extractive industries, however, particularly the diamonds sector, only regained 1992 levels in 1997; it had nonetheless more than doubled extraction by 1999 and extraction almost

quantities, recorded, throughout the period, an increasing trend, with the sole exception of 2001, when production compared with the previous year decreased by 2,874 thousand barrels.

Production increased more significantly in 1998 (9,332 million barrels) and in 2002 (67,978 million barrels); however, the drastic reduction in the price per barrel of oil, which was US\$ 12.1 in 1998, did not allow this increase to be reflected in the percentage structure of the GDP, as occurred in 1999 with the increase to US\$ 17.4 per barrel of oil. In 2002 production reached 338,287 thousand

#### NATIONAL ACCOUNTS IN CONSTANT DOLLARS - 1992 (thousands of US\$)

	1997	1998	1999	2000	2001	2002
<b>Agriculture, forestry, fisheries</b>	996.1	1048.3	1062.3	1161.4	1370.1	1536.0
<b>Crude Oil and Gas</b>	3619.5	3745.0	3783.7	3798.2	3758.4	4699.0
<b>Diamonds and others</b>	204.6	389.1	542.7	614.7	734.6	783.0
<b>Manufacturing industry</b>	319.3	335.0	358.7	390.5	428.8	472.1
<b>Energy and water</b>	5.2	6.0	6.1	6.1	6.7	7.4
<b>Construction</b>	375.6	413.1	433.8	466.3	505.9	556.5
<b>Commercial services</b>	1339.8	1406.3	1467.7	1517.2	1608.2	1793.9
<b>Non-commercial services</b>	966.4	966.4	893.9	907.4	916.4	939.3
<b>Import duty</b>	156.9	109.8	98.8	98.8	101.3	106.4
<b>GDP market prices</b>	7983.4	8419.0	8647.7	8960.6	9430.4	10893.7
<b>Implicit devaluation of the dollar</b>	-6.2	-24.1	-30.7	1.0	-6.7	-6.8

SOURCE: Ministry of Planning. INE. National Accounts

quadrupled by 2002. This situation may be due, on the one hand, to large national and foreign investments in this sector, but also to certain measures of security and restructuring that were implemented for the sector, even during the armed conflict.

In view of the size and characteristics of the enclave sectors, a closer analysis with respect to their behaviour during the period under analysis would

barrels of oil, the increase in production amounting to 25.1% in relation to the previous year.

The average price of a barrel of oil during the period under consideration, remained practically stabilised at approximately 19 US dollars per barrel.

Another sector whose available information allows certain comments in relative terms, is the diamonds sector.



Diamond production which, up until 1996 had not recovered to the production levels of 1992 (1,254 thousand carats), recorded during the period (1997-2002) a permanently increasing trend, despite the fact that a reverse trend was recorded for prices.

The average rate of growth for the period amounted to 37.1% and its participation in the GDP varied

undoubtedly give rise to an increase in production (it should be noted that production of crude oil increased in 2002 in relation to the previous year, in terms of physical quantities, by 67,978 thousand barrels).

In this connection, although it is certain that the receipts provided by the extraction sector are crucial to the financing of the economy, emphasis

#### ENCLAVE SECTORS

Crude Oil	1997	1998	1999	2000	2001	2002
Total Production (Thousands of Barrels)	260256	269588	272378	273183	270309	329641
Index of previous year=100	104.7	103.6	101.0	100.3	98.9	125.1
Price per Barrel (in US\$)	18.5	12.1	17.4	27.1	22.7	20.0
Total Exports (Thousands of Barrels)	242474.8	250830	253600	256100	255200	275232
Index of previous year=100	106.3	103.4	101.1	101	99.6	107.8
Participation of petroleum sector in the GDP						
at current prices	47.9	37.5	58.1	60.1	51.2	48.3
at prices of the previous year	56.2	46.4	36.7	56.7	57.6	54.7
at constant prices - 1992	45.3	44.5	43.8	42.4	39.9	43.1

SOURCE: NATIONAL INSTITUTE OF STATISTICS (INE)/MINISTRY OF PLANNING (MINPLAN)

between 4.4 in 1997, and 8.3% in 1999, at current prices, and 4.7 and 9.1% in 1997 and 2000, at prices of the previous year, respectively.

Diamond production recorded an increase of 4,083 (thousand carats) corresponding to the difference in the quantities produced in 1997 (1,417 thousand carats) and (5,500 thousand carats), in 2002. In 1992, diamond production had reached the figure of

should nonetheless be given to the fundamental requirement for the other sectors to gain more weight relative not only to the positive effects of this structural adjustment with a view to the creation of more jobs, but also in relation to the increase and the diversification of domestic supply and exports.

Meanwhile, the end of the armed conflict will itself certainly contribute to the increase in agricultural

#### ENCLAVE SECTORS

Diamonds	1997	1998	1999	2000	2001	2002
Production (in thousands of carats)	1417	2716	3806	4313	5159	5500
Index of previous year=100	153.4	190.2	139.5	113.3	119.5	106.6
Price per carat (in US\$)	287.0	156.2	165.3	171.2	133.5	145.0
Participation of the diamonds sector in the GDP						
at current prices	4.4	5.3	8.3	6.4	6.2	6.1
at prices of the previous year	4.7	7.8	7.2	9.1	7.4	5.6

SOURCE: NATIONAL INSTITUTE OF STATISTICS (INE)/MINISTRY OF PLANNING (MINPLAN)

1,405 (thousand carats), having been subsequently between 194 and 339 thousand carats (during the period 93/95).

However, as can be observed from table 5, the price of diamonds, inversely, experienced a decreasing trend.

Accordingly, it is noted that the national economy continues to be increasingly dependent on petroleum, with the aggravating factor that this sector provides the least national salaried employment (around 1%). The recent discovery of new wells (in 2003) and the Middle East crisis, will

activities and commercial services, as well as encouraging internal investment and attracting foreign capital, which will undoubtedly have positive results in terms of the growth of the economy and the diversification and increase in domestic supply.

## 7. Balance of payments

### 7.1. Introduction

The balance of payments reflects the set of economic and financial transactions carried out by a country with the rest of the world, i.e., the economic and financial relations during any given period,

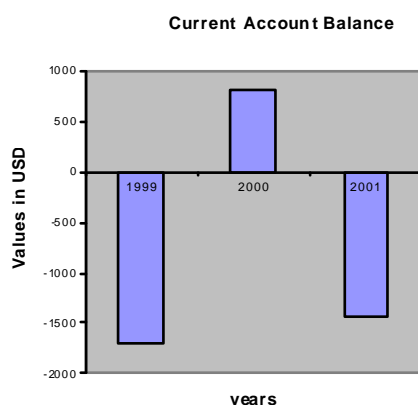
normally one year, between the residents of an economy and the residents of other economies.

The balance of payments of Angola during the last three years clearly reflected the enormous vulnerability of economies dependent on an export product to external shocks.

As is well known, around 90% of the total exports of Angola are accounted for by crude oil, the prices of which are defined on the international market and are characterised by considerable volatility.

We will therefore examine, in this chapter, the behaviour of the balance of payments in the three-year period 1999-2001, given that the balancing of the external accounts is also a factor of stabilisation and economic growth.

## 7.2. Balance of current transactions



During the said three-year period, the Current Account closed the 1999 fiscal year with a deficit of US\$ 1,702 millions, which represented approximately 28.4% of Gross Domestic Product, followed by a surplus of US\$ 813.7 millions in 2000, which represented 9.0% of Gross Domestic Product, and a further deficit in 2001, representing 14.4% of Gross Domestic Product, nonetheless an improvement in relation to 1999.

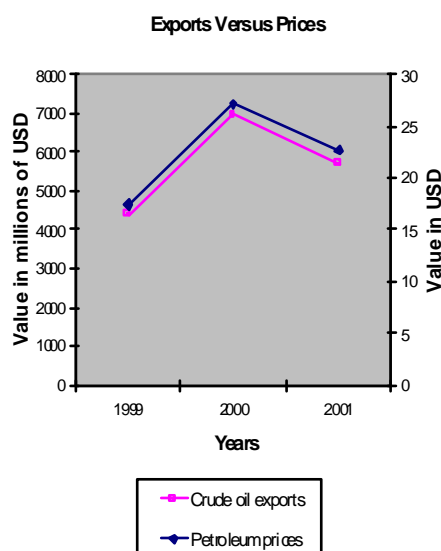
The above graphic shows the balance of the account during the three-year period under analysis, as well as the oscillations experienced during said period.

### 7.2.1. Trade balance

The behaviour of major components of the current account contributed towards these oscillations during the three-year period under review, namely a permanent surplus in the trade balance, of 39.9% in 1999, 138.4% [in 2000] and 31.3%, in 2001.

A relevant factor for these surpluses is the price of crude oil on the international market, which varied between US\$ 17.4 in 1999, US\$ 27.1 in 2000 and US\$ 22.7 in 2001.

Since 1998 – the year in which prices of crude oil reached their lowest levels of the 1990s – the price of oil has followed an upward trend, as shown by the foregoing values.



The price per barrel of oil on the international market affects the main indicators of the external equilibrium of the Republic of Angola, due to the dependence of its economy on receipts from exports in the petroleum sector.

As can be seen in the above graphic, there is a direct correlation between the increase in prices of crude oil on the international market and the increase in receipts from oil exports.

The surplus of the trade balance represented, during the three-year period under analysis, 34.2%, 54% and 37.6% of gross domestic product in 1999, 2000 and 2001, respectively.

#### 7.2.1.1. Exports

Total exports during the three-year period under analysis maintained an almost constant trend, the emphasis being on exports of crude oil and diamonds, the behaviour of which was as follows:

In the general computation of exports, crude oil continues to hold first place, participating with an average percentage of approximately 87%, followed by diamonds, with an average of 12%; it is therefore

concluded that a change in the prices of these products will inevitably have an impact on the balance of current transactions.

During the period under analysis, current consumer goods continued to have considerable weighting in the overall volume of imports, representing 66.8%,

#### TOTAL EXPORTS (millions of US dollars)

Category Heading	1999	2000	2001
Total exports	5,157	7,921	6,534
Crude Oil	4,406	6,951	5,690
Diamonds	629	739	689
Others <sup>77</sup>	122	231	155

Source: BNA-DEE/BP

#### 7.2.1.2. Imports

Imports, for their part, reflected a slight decrease in 2000 in relation to the previous year, falling from US\$ 3,109 millions in 1999 to US\$ 3,039 millions in

64.2% and 68.4%, respectively, in 1999, 2000 and 2001, indicating a continued strong dependency by Angola on food from abroad. It also demonstrates the clear constriction of national production and limitations on the free movement of individuals and goods due to the armed conflict.

#### ECONOMIC CLASSIFICATION OF IMPORTS US\$ - Millions

Years	1999	2000	2001
Current Consumer Goods	2,076.6	1,950.1	2,173.5
Intermediate Consumer Goods	182.3	245.4	303.9
Capital Goods	850.1	843.9	701.7

Source: BNA-DEE/BP

2000. This decrease of 2.2 % was a consequence of the policy of exchange convergence resulting from the liberalisation measures introduced by the *Banco Nacional de Angola* - BNA [National Bank of Angola]. In 2001 imports of goods increased to US\$ 3,179.1 millions, corresponding to a percentage variation of 4.6%. This negative behaviour was

#### 7.2.2. Balance of services and income

Notwithstanding improvements in the Trade Balance during the three-year period under review, the deficit in the Balance of Services and Income, characteristic of a developing country, continued to be chronic. Deficits of this account in relation to the Gross Domestic Product were 63.9% in 1999,

#### BALANCE OF SERVICES AND INCOME US\$ - millions

Heading	1999	2000	2001
Balance of Services and Income	-3,812.0	-4,113.1	-4,876.6
Credit of Services	178.8	301.7	225.5
Debit of Services	3,990.7	4,414.8	5,102.1
Interest	568.9	596.7	539.0
Profits and Dividends	653.4	928.6	927.1
Transport and Travel	510.9	440.0	454.7

Source: BNA-DEE/BP

apparently due to the chronic insufficiency of domestic supply and the fact that the exchange liberalisation measures were insufficient to provide incentives for the national production of goods.

45.5% in 2000 and 54.7% in 2001. As can be seen, this account continued in deficit throughout the period, despite a slight improvement in 2000.

The following contributed significantly to the deficit

- ♦ The payment of profits and dividends to direct investors, particularly in the petroleum sector.

- ♦ The payment of interest and late payment interest on external debt.
- ♦ Excessive expenditures on transport services and travel
- ♦ A significant surplus in the balance of this account continues to result from charges for technical assistance, in particular charges for research and the drilling of oil wells, charges relating to the rehabilitation of administrative infrastructures and maintenance of diplomatic missions outside Angola.

The credits of the services and income account do not compensate the effects of the volume of debits, since, as a developing country we continue to be a strong importer of services. We feel that considerable potential remains unexplored, and that a stronger policy in certain sectors, such as in sea

### 7.3.1. Medium and long-term capital

The years 1999 and 2000 were characterised by excellent external economic and financial conditions, combined with structural changes in the Angolan economy. In effect, it provided continuity for a period of global recovery of the world economy, particularly the Asian economies, which presented an increasing recovery phase, as well as considerable dynamism in the US economy.

These factors had a positive effect on the amount of direct investment in Angola, and consequently on the improvement of the balance of this account in the years under analysis, having shown the following behaviour during the three-year period:

a) In 1999, the medium- and long-term capital account presented a positive balance of US\$ 2,181 millions, as compared with US\$ 139.9 millions in

#### CAPITAL ACCOUNT US\$ - millions

Heading	1999	2000	2001
Capital account - medium and long-term	2,180.7	112.3	1,527.1
Direct foreign investment (net)	2,471.4	878.5	2145.5
Other capital operations (net)	-290.7	-766.2	-618.4
Disbursements	1,500.5	1,609.5	1,618.9
Amortisations	1,791.1	2,375.7	2,237.3

Source: WWW.Ebonet.netbna

transport, civil construction and insurance, could improve the balance of this account.

### 7.2.3. Balance of unilateral transfers

This account fundamentally reflects the credit of donations received and the debit of remittances of foreign workers. This account presented positive balances throughout the three-year period, having gone from US\$ 62.5 millions in 1999 to US\$ 45.6 millions in 2000 and to US\$ 94.4 millions in 2001, with a percentage variation of -27% and 7%, respectively.

It is noted that the balance of this account is still influenced by a strong dependency on expatriate labour, particularly in the petroleum sector.

### 7.3. Capital account

1998. This positive balance resulted from an inflow of capital amounting to US\$ 4,605 millions, US\$ 2,538 millions more than in 1998 and an outflow of capital amounting to US\$ 2,425 millions, US\$ 497.1 millions more than in the previous year.

b) In 1999 there was a significant inflow of medium- and long-term capital, due to the significant inflow of bonuses originating from the concessions of petroleum exploration areas and the continuous programmes of research and development of new areas of petroleum production.

Meanwhile, on the one hand, inflows in the petroleum sector resulting from the signing of new contracts, in addition to research and production, amounted to US\$ 3,103.4 millions in 1999, (1998 - US\$ 1,449 millions), and on the other hand, outflows amounted to US\$ 633 millions in amortisations of finance (1998 - US\$ 360.5 millions) made by the parent company, amounting

to a total net direct investment in this sector of US\$ 2,471.5 millions, reflecting an increase of 121.8% in comparison with the previous year.

Amortisations of other medium and long-term capital amounted, in the year under analysis, to US\$ 1,791 millions. Of this amount, US\$ 428 millions relate to the amortisation of the external debt of the petroleum sector.

c) In 2000, the medium and long-term capital account presented a positive balance of US\$ 112.3 millions.

This year, direct net foreign investment fell significantly compared with 1999.

During the year under review there was a decrease in gross direct investment of approximately 30% compared with the previous year.

However, due to a more rapid recovery in direct investment in the petroleum sector, caused by the increase in the price of a barrel of crude oil on the international market, in the year 2000 capital outflows amounted to US\$ 1,295.9 millions, US\$ 662.3 millions more than in the previous year.

In relation to the balances of other medium- and long-term capital operations, there was a difference of approximately 163.6% compared with the previous year. This difference was due to the fact

amortisations reflected a greater increase, on the order of US\$ 584.6 millions or 32.6%.

It is also noteworthy that disbursements include the rescheduling of future debt in the amount of US\$ 48.4 millions.

d) - In 2001 the world economy experienced a recession influenced by the contraction of economic activity in the developed countries, especially the USA, Japan and the countries of the Euro Zone.

Despite these factors, the balance of the medium- and long-term capital account showed a surplus of US\$ 1,527 millions, compared with US\$ 112 millions in 2000.

During this year, net foreign direct investment increased significantly compared with the year 2000, having increased from US\$ 879 millions to US\$ 2,146 millions in 2001, an increase in percentage terms of 144.1%, due to the investment costs in research and prospection, particularly in the new blocks of deep waters, and the inclusion of the bonuses of this sector in the investment.

In relation to the balance of the other medium- and long-term capital operations, a slight improvement was noted in comparison with the previous year.

During the year under analysis there was a slight increase in disbursements, which recorded an overall increase of US\$ 9.4 millions.

#### BALANCE OF UNILATERAL TRANSFERS US\$ - millions

Category Heading	1999	2000	2001
Balance of Unilateral Transfers	62.5	45.6	94.4
Forgiveness of future debt	6.8	18.2	3.9
Workers' remittances	-82.6	-71.4	-73.3

Source: BNA-DEE/BP

that the amortisations of the capital of the external debt during the year were substantially higher than in 1999.

Accordingly, in the year 2000 the disbursements were US\$ 1,609.5 millions, of which US\$ 421.3 millions related to the petroleum sector, while amortisations amounted to US\$ 2,375.7 millions with an emphasis on US\$ 383.5 millions in this sector.

However, compared to the year ended, disbursements presented an increase of US\$ 109.00 millions representing 7.3%, while

For amortisations there was a reduction in their volume, from US\$ 2,376 to US\$ 2,237 millions, representing a fall in the order of US\$ 141 millions.

In regard to the amortisation of medium- and long-term external debt during the year 2001, it should be pointed out that the net accumulation of arrears amounted to US\$ 171 millions, as compared with US\$ 116 millions in 2000.

The weak level of amortisations noted during the period, reflects Angola's difficulties in honouring its external commitments.

The increase in foreign direct investment during the period under analysis results from a growing interest on the part of petroleum companies in the Angolan petroleum sector, especially considering the potential of the country's Maritime Coast and the fact that petroleum will continue, for some time, to be an important source of energy, despite the volatility of the prices of this product on the international market.

However, the stabilisation of the economy and the consequent growth of a macroeconomic environment suitable for foreign investment in other areas is associated with the establishment of clear and transparent legislation, respect for private property and the introduction of incentives of a microeconomic nature, which will allow the development of the enormous natural resources of the country, thus contributing to reductions in poverty and unemployment.

### 7.3.2. Short-term capital

The high extent of short-term indebtedness is the consequence of the increasing difficulty of Angola to obtain medium- and long-term concessional loans, due to the increase in its external debt arrears, as a result of non-fulfilment of obligations to its external partners as well as an increase in the country's risk ranking.

This situation makes finance onerous and the terms relatively short. It involves higher interest rates, an increase in agency commissions and in the margins of risk, which consequently makes the import of goods more expensive due to the supplementary financial charges.

In the period under analysis, the balance of the short-term capital account showed an almost stable behaviour: US\$ - 524 millions in 1999, US\$ - 580.4 millions in 2000 and US\$ - 577.2 millions [in 2001].

Although the balance of the medium- and long-term capital account was positive, it was insufficient to cover the deficit in the Balance of Payments Current Account, resulting in a strong concentration of servicing of the external debt and a reduction in the capacity to obtain new loans without real guarantees.

It can therefore be concluded that Angola will continue to finance the deficit of the Balance of Payments Current Account, particularly with the net accumulation of arrears, causing the country to have little credibility in the eyes of the international

community, and thus making it difficult to obtain loans of a concessional nature.

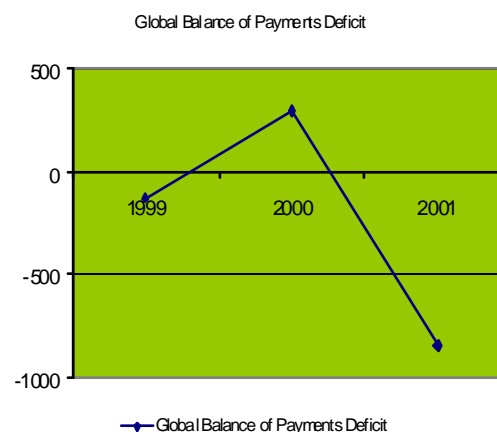
### 7.4. Errors and omissions

Errors and omissions still reflect certain insufficiencies and difficulties in covering all the transactions for the purpose of recording and compiling the statistics of the balance of payments.

Accordingly, the errors and omissions amounted to US\$ - 81 millions in 1999, US\$ - 50 millions in 2000 and US\$ - 365.1 millions in 2001.

### 7.5. Global balance of payments

As can be seen in the graphic, the global balance of payments experienced very different cyclical variations during the last three years, namely the



deficits in 1999 and 2001 and a surplus in 2000, albeit unsustainable in the long term. The behaviour of this balance sheet clearly reflects the lack of adjustments of the external sector of the Angolan economy, and its vulnerability in relation to external impacts, in particular its dependency on exports of its principal products (petroleum and diamonds).

On the other hand, it also demonstrates the difficulties which the country has in financing its current account with concessional loans or public development assistance through international agencies.

The overall balance of payments was financed during the last three years, as follows:

The financing of the balance of payments during the three-year period under review took place, as can be seen in the above table, by means of an increase in net international reserves in the years 1999 and 2000, and an increase in arrears in 1999 and 2001. On the other hand, 2001 was characterised by a significant loss of net international reserves of the Central Bank

As the table shows, in 1999 and 2000 there was a significant increase in the Net International Reserves of the National Bank of Angola, in the amount of US\$ 530 millions and US\$ 630.9 millions, respectively, as a consequence of the liberalisation measures of the monetary and exchange policy adopted by the National Bank of Angola, the reforms approved by the Government, and a new stance on the part of the Central Bank, with a view to improving the internal and external credibility of the institution.

Despite an improvement in international net

behaviour can be observed in the graphic set out below.

Unlike the previous year, in 2001 the reduction of stock was mainly associated with a more accentuated verified reduction in medium- and long-term debt, mainly outstanding capital and late-payment interest.

The outstanding capital decreased from US\$ 7,341.6 millions, in 2000, to US\$ 6,926.8 millions, in 2001, with a verified decrease of US\$ 414.8 millions, while outstanding interest decreased from

**GLOBAL BALANCE SHEET US\$ – millions**

Years	1999	2000	2001
Global Balance Sheet	-126.2	295.2	-842.2
Financing	126.2	-295.2	- 842.2
1- Variation in Reserves (-increase)	-530.3	-630.9	508.2
2- Net Accumulation of Arrears	656.1	133.7	294.4
Medium and Long Term	581.6	115.8	171.2
Current	626.7	416.2	316.6
Arrears	- 45.1	-300.3	-145.4
Short Term	-39.2	-138.3	-36.2
Late Payment Interest	113.7	156.2	159.4
3 - Rescheduling	0.3	202.0	39.7

Source: BNA-DEE/BP

reserves of the Central Bank in the years 1999 and 2000, gross international reserves barely covered 1 and 2.5 months of imports of non-factorial goods and services, respectively.

In 2001 there was a significant fall in Angola's net international reserves, in the amount of US\$ 508.2 millions, with gross international reserves at the end of 2001 barely covering 1.3 months of imports of factorial goods and services, signifying a decrease compared with the previous year, the cover of which was 2.5 months.

This loss of reserves was chiefly due to the defence of the exchange rate, and the influence of the world economic recession in 2001.

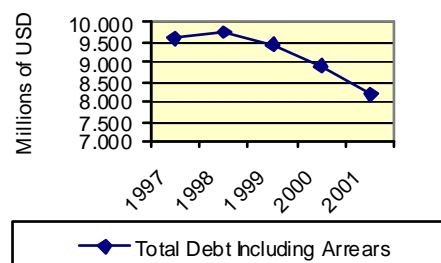
## 7.6. External debt

The stock of the external debt, including late payment interest, stood at US\$ 8,172.7 millions, at the end of 2001, which was US\$ 743.7 millions less than the position in the previous year. However, excluding late payment interest, the stock was US\$ 7,261.3 millions, which represented a decrease of 6.8%, compared with the previous year. This

US\$ 1,102.3 [millions] in 2000, to US\$ 893.2 millions in 2001, a reduction of US\$ 239.1 millions.

The high amount of outstanding debt and the impossibility of honouring the debt at the due time, leaves the country with few alternatives, so that it

External Debt Stock



continues to have recourse to penalising and onerous short-term financial loans, with real guarantees.

During the year under analysis, a decrease in the ratio of debt stock over GDP was noted, which fell from 100.6% in 2000, to 82.7% in 2001.

Unlike the previous year, the ratio of debt service to exports of non-factorial goods and services suffered a slight increase, having gone from 39.2% in 2000, to 43.0% in 2001, due chiefly to the decrease in exports of goods and services.

In 2001 a slight improvement was noted in the ratio of medium- and long-term debt as a percentage of exports of non-factorial goods and services, which stood at 116.1%, as compared to 103.1% in the previous year.

#### **Medium-, long- and short-term external debt (stock)**

The absence of an external short-, medium- and long-term debt strategy and a coherent programme of negotiation and rescheduling of the external debt, resulted in an external debt policy that was not consonant with the level of economic growth of the gross domestic product, and consequently with the level of financial resources, which could become unsustainable for the economy in general, and in particular for the long-term balance of payments.

### **8. Employment**

#### **8.1. The employment market**

##### **8.1.1. Employment supply and demand**

One of the most important factors of the increase in the supply of employment is of a demographic nature. It is considered that the population of Angola is approximately 13 million inhabitants, the natural growth rate being 2.9% per annum. This

represents a structural factor of Angolan society: A young and progressively urbanised expanding population. Having regard to the current trends, though the figures are estimated, Angola has a working-age population on the order of 47.5%<sup>78</sup> of the total population.

On the other hand there are demographic pressures, current unemployment, and additional job losses and underemployment associated with the liberalisation of the economic system and the immediate post-war situation, characterized by hundreds of thousands of internally displaced peoples, refugees and de-mobilised citizens.

Consequently, based on their volume and characteristics, we can identify several population groups whose purpose is to procure remunerated work, the following being worthy of mention:

- a) Emerging workforce, seeking a first job, calculated on the basis of the age-band of 15 years of age, exceeding 300,000 jobs per annum;
- b) Numerous underemployed workers, particularly in public services and paralysed companies, which have practically ceased to exist for different reasons;
- c) Demobilised soldiers, internally displaced peoples, and refugees;
- d) Young persons without family support, whose exact numbers are unknown;
- e) Widowers and, especially, widows who are heads of large families;
- f) Disabled persons.



The employment market recorded strong pressure, with the indicators showing a relatively low degree

workforce finding itself at a disadvantage due to the lack of opportunities offered by the market.

**MEDIUM-, LONG- AND SHORT-TERM EXTERNAL DEBT - US\$ millions  
(STOCK)**

DESCRIPTION	1999	2000	2001
<b>Debt of m/l term excluding interest in arrears</b>	<b>7,915</b>	<b>7,342</b>	<b>6,927</b>
Western Creditors	5,130		6,168
Eastern Creditors	2,424		369
Multilateral Institutions	318		273
Other creditors	44		117
<b>Short-term debt excluding interest in arrears</b>	<b>640</b>	<b>449</b>	<b>334</b>
Western Creditors	571		313
Eastern Creditors	48		11
Other creditors	21		11
<b>Total debt excluding interest in arrears</b>	<b>8,555</b>	<b>7,791</b>	<b>7,261</b>
<b>Interest in arrears of m/l term</b>	<b>874</b>	<b>1,102</b>	<b>893</b>
Western Creditors	723		794
Eastern Creditors	119		99
Multilateral Institutions	28		0
Other creditors	4		0
<b>Short-term interest in arrears</b>	<b>15</b>	<b>23</b>	<b>18</b>
Western Creditors	13		5
Eastern Creditors	1		12
Other creditors	1		0
<b>Total interest in arrears</b>	<b>889</b>	<b>1,126</b>	<b>911</b>
 <b>Debt of m/l term including interest in arrears</b>	 <b>8,789</b>	 <b>8,444</b>	 <b>7,820</b>
Western Creditors	5,853		6,962
Eastern Creditors	2,542		468
Multilateral Institutions	346		273
Other creditors	48		117
<b>Short-term debt including interest in arrears</b>	<b>655</b>	<b>473</b>	<b>353</b>
Western Creditors	584		318
Eastern Creditors	49		23
Other creditors	22		11
<b>Total debt including interest in arrears</b>	<b>9,444</b>	<b>8,916</b>	<b>8,173</b>

Source: DTC/DEE-BP

of satisfaction in job procurement, resulting above all from the low or virtually non-existent qualifications of the job candidates, and the paralisation or virtual inoperation of the business sector.

The correlation between supply and demand relating to the majority of the country's provinces demonstrates that employment opportunities in the official sector are restricted, the non-qualified

It can therefore be observed that, on average, the supply of labour is approximately three times that of demand. In turn, placements represent on average only 72.2 % of job offers. Consequently, it can be seen that job offers are not being satisfied, despite the volume of the labour supply. This situation is due chiefly to the profile of the candidates and the lack of creation of new jobs (see following table).

On the other hand, there is an absence of integration in the professional training system and the failure rate in classical education. The structure of employment is such that young people who do not receive complete formal education find it

In turn, according to a survey carried out by the *Observatório de Emprego e Formação Profissional* [Employment and Professional Training Observatory], in three provinces, it was observed

EVOLUTION OF THE OFFICIAL EMPLOYMENT MARKET \*

Years	Demand for Employment	Supply of Employment	Placements	Placements /Supply	Demand /Supply	Placements /Demand	Working Population
1998	111 123 143	9748	8053	82.61	237.41	34.80	572 160
1999	153 15	6847	6611	96.55	223.67	43.17	5899.20
2000	17989	4661	4464	95.77	385.95	24.82	6083.20
2001	16728	4630	4561	98.51	361.30	27.27	6260.40
2002	25606	7748	5978	77.16	330.49	23.35	7293.60
AVERAGES	19756.20	6726.80	4857.40	72.21	29.37	24.58	

\* Information recorded at job centres

impossible to obtain regular jobs and must become established as self-employed persons or seek jobs in the unofficial market sector.

However, no reliable data are available with respect to the rate of unemployment. Mr. Adauta affirms that the gross rate of unemployment in the unofficial economy in Luanda was estimated as being 32.3% in 1995 and in the official sector, 28.6%.<sup>79</sup>

However, Alves da Rocha<sup>80</sup> indicates urban unemployment as being 35%, and the INE [National Institute of Statistics] in its publication "PERFIL DA POBREZA" [PROFILE OF POVERTY] covering the provinces of Cabinda, Luanda, Benguela, Moxico and Huila, mentions a rate of 45%. The indicators shown in the above table reflect the unemployment situation in the country.

With regard to underemployment, one can only gain an impression by means of the productivity and duration of work; in an urban and semi-urban environment it is very high; in a rural environment, agriculture, which represents 73% of the working population (10% in industry and 17% in services), barely contributed 10% of the gross domestic product.

### 8.1.2. Professional training

The survey (IDR), carried out by the INE [National Institute of Statistics] in 2000/2001, reveals that around 73% of those questioned did not have any profession or trade and among those having a trade or occupation, 35.7% exercise the activity of kiosk seller, seller of miscellaneous items, ambulant sellers and those selling from home, with only 1.6% stating that they are mechanics, 2.1% farmers and 2.2% manual workers.

that<sup>81</sup>:

#### In the official sector

- More than half of the workers (55%) were educated to sixth grade, approximately 12% have no school education at all, and an even smaller percentage (5.5%) of the workers have received advanced education.
- The demand for the training of workers occupying executive posts reached a maximum percentage of 76% in Cabinda and a minimum percentage of 60% in Luanda. This demand was observed, chiefly, in the fields of company management and administration, accounts, civil construction, economics and computing.

#### In the unofficial sector

- The majority of the workers (approximately 65%) in this sector had a relatively low level of education, i.e., between 4th and 6th grade.
- 14.3% did not have any formal education.

The survey of work apprenticeships, reveals that the provinces of Benguela and Cabinda have full rates of absorption of apprentices, while Luanda has 39%, and Huila was seen to have the lowest true rate of absorption of apprentices:

**Luanda** has the most apprentices in automobile workshops;

**Benguela** covers agricultural products;

In **Huila** the situation is reflected in the field of clothing manufacture and repair of shoes and clothes;

In **Cabinda** carpentry/cabinet-making predominate. The above data confirm that professional training requirements are immeasurable. In effect, on a par with education, the lack and/or poor quality of professional training, understood as being "the set of activities with a view to the acquisition of

the considerable challenges the country faces in this area, namely:

- a. The weak level of training and the considerable shortage of qualified workers at all levels and in all sectors,
- b. Young people leaving the formal education system annually with or without compulsory education,

EMPLOYED POPULATION (2002)

PROVINCE	POPULATION	POP. EMPLOYED IN PUBLIC OFFICE	POP. EMPLOYED IN BUSINESS SECTOR	EAP*
CABINDA	245,000	9,076	8,004	133,687
ZAIRE	323,000	3,848	1,512	175,460
UIGE	1,213,000	10,343	1,059	601,027
LUANDA	2,490,000	57,601	62,252	1,299,454
NORTH K.	542,000	5,091	11,345	270,750
SOUTH K.	874,000	9,715	4,019	431,485
MALANGE	1,256,000	5,786		698,076
NORTH L.	394,000	4,075	6,845	199,354
BENGUELA	884,000	24,140	68,754	500,050
MOXICO	443,000	6,511		201,607
K, KUANGO	171,000	4,179	4,748	80,758
HUAMBO	2,131,000	14,173	4,259	1,061,059
BIÉ	1,576,000	10,109	12,196	679,247
NAMIBE	190,000	5,942	22,760	88,047
HUILA	1,175,000	18,905	32,646	502,368
KUNENE	314,000	3,999	2,273	149,195
SOUTH LUANDA	203,000	3,633	2,304	98,900
BENGO	234,000	3,495	5,660	123,089
<b>TOTAL</b>	<b>14,658,000</b>	<b>200,621</b>	<b>250,636</b>	<b>7,293,613</b>

\*14 to 60 years of age

knowledge, practical ability, attitudes and forms of behaviour for the exercise of a profession" can be considered a limiting factor for the improvement of the country's standards.

At the present time the country has 216 professional training centres, of which 46 are sponsored by public bodies and 27 belong to the National Institute of Employment and Professional Training. The remaining centres belong to the private sector, though it is chiefly in the centres sponsored by the professional training body where courses in the arts and professions are conducted.

The total installed capacity of the centres is 15,502 training positions, of which 11,728 were fully taken up during the year under consideration.

The Basic Law on the National System of Professional Training emphasises two key points:

First - The strategic importance that should be assumed by professional training in Angola, given

- c. The lack of adjustment between technical instruction and training
- d. The dispersion of the network of institutions through different sponsorships, leading to an enormous waste of resources.

Second - The Introduction of a National System of Employment and Professional Training, articulating with the policies and major programmes up until 2005.

- The intent of this part of the law is to form an Employment and Professional Training System that is capable of ensuring essential correspondence between employment and training

### 8.1.3. Employment in the business sector

As can be seen from the table on the previous page, for a modern workforce on the order of

451,257 permanent workers, 44.4% are engaged in Public Administration.

With regard to the creation of jobs, the situation continues to be critical due, essentially, to the virtual non-operation of the sectors generating economic growth.

The reduction in the volume of employment in all sectors of the national economy is clear<sup>82</sup>. Notwithstanding the advances recorded in recent years, there is a persistent virtual paralysis of the important sectors of manufacturing industry, which in 1974, consisted of 3,846 companies employing an average of 52 workers each, occupying a total of 200,250 workers.

It is particularly in the small- and medium-sized companies that the majority of the labour force in the employment market can be employed to best advantage.

A further survey<sup>83</sup> carried out within the scope of the project of development and training of national labour, reveals that:

- The predominance of SMEs (companies with up to 99 workers) is common knowledge, the majority (48.5%) employing between 11 and 49 workers.
- Manufacturing industry is the sector of predominant activity, followed by the food industry and civil construction and public works. These three sectors together represent approximately 75% of companies. It is also in manufacturing industry that the greatest extent of durability of the business fabric can be noted, with a significant number of companies having been in operation for more than 10 years, many of which were paralysed or semi-paralysed as a result of the economic situation experienced by the country.
- The informal economy absorbs a significant number of companies which, despite the difficulties experienced by their owners in exercising their activities, assume a very important role in the absorption of labour.
- Contrary to popular belief, the survey reveals that the unofficial economy consists in the main of workers employed by someone else. In effect, 78.5% are

remunerated personnel, followed by apprentices (15.3%) and in last place non-remunerated relatives (6.2%). The sectors of activity of industry, services and commerce represent 75% of the total of the companies.

With the consolidation of peace, the prospect for the creation of remunerated activities can be considered to be real and even promising.

The reconstruction of the productive and social infrastructures makes it possible to plan the creation on a large scale of new jobs and new remunerated activities.

In the modern structured sector, including the petroleum sector, it will not be possible to anticipate the creation of large numbers of jobs. Some sectors are more promising than others but, in general, growth will be achieved rather from increased productivity than from an increase in the volume of jobs; it is therefore appropriate to consider a general improvement in qualifications and professional competence.

The unofficial economy (both urban and rural) will undoubtedly continue to play a role in absorbing surplus labour and it will undoubtedly exceed the already high levels which it occupies in the employment structure. It already represents the survival of a good number of families in the urban territories and main cities. There is therefore tremendous scope for the promotion of micro-enterprises and self-employed work.

In regard to the rural sector, there is great potential at the level of agricultural and non-agricultural activities (upstream and downstream production). Labour will be needed mainly for creating the conditions for the settlement of a good portion of the communities of refugees and dislocated persons. According to all the evidence, activities in this sector will mainly assume a self-employed nature, combining production and handicrafts, requiring basic simple and limited training with a certain technological content.

#### 8.1.4. Employment in the public administration sector

The rules and principles relating to employment in Public Administration are established in decree No 25/91, of 29 June. In effect, this decree provides that the legal relationship of employment in public administration is created on the basis of an

administrative act (appointment) or contract, the former being reserved for career functions while the contract generally applies to the lower categories of administrative careers. This does not ensure professional development in Public Administration, in that the contract is of a specific nature.

The Public Administration in Angola, in 2002, employed 200,621 staff and agents, both full-time and temporary. The territorial distribution of the administration is strongly asymmetrical: 62% of the jobs are concentrated in five provinces: Luanda (with 57,601 employees, or 28.7% of the total), Benguela [sic], Huíla (18,905), Huambo (14,173) and Cabinda (9,076)<sup>84</sup>. Based on the 1997 statistics, which should not have varied significantly, it is estimated that 41.6% of employees have less than nine years' service and that 6.8% have more than twenty-five years' service. The overwhelming majority of the administration (80.5%) has received secondary education or less, with 16.6% of employees (32,444) having received less than four years schooling<sup>85</sup>.

The Administration grew considerably during the first fifteen years of independence, having reached 131,178 employees in 1990. This rapid growth occurred for two essential reasons: (a) to carry out the duties of a collectivist State, occupying almost all economic activity (commerce, industry, agriculture and services), but also having a developed sense of social responsibility, which involved the strong growth of the departments providing direct goods and services in the areas of education, health, social support, justice, security, public utility infrastructures and general administration; and (b) to provide employment to a population of young adults leaving the education system and with no alternatives of professional occupation.

## 8.2. Wages

### 8.2.1. Minimum national wage

The fixing of the minimum wage(s), although an element of the income policy, was based on the need to protect workers with fewer qualifications and to foster a demonstration effect on the remaining wages.

In effect, the minimum wage policy was applied with the widest possible scope, i.e. the income policy, so as to ensure an equitable redistribution of income in the fight against poverty.

Labour legislation (articles 168 to 171 of the General Labour Law), establishes specifically that the minimum wage is fixed periodically, following consultation with representatives of the most representative organisations of employers and workers, and that the fixing of the minimum wage should consider:

- a) The evolution and trend of the National Consumer Prices Index, the general level of wages and of social security benefits, and the relative living standards of other social groups.
- b) The conditioning economic factors, including the requirements for economic development, productivity levels and the need to achieve and maintain a high level of employment.

In accordance with convention No 131 and recommendation No 135 of the ILO, adopted in 1970, aimed in particular at developing countries, "The elements to be taken into consideration in determining the level of minimum wages shall, so far as possible and appropriate in relation to national practice and conditions, include:

- a) the needs of workers and their families, taking into account the general level of wages in the country, the cost of living, social security benefits, and the relative living standards of other social groups;
- b) economic factors, including the requirements of economic development, levels of productivity and the desirability of attaining and maintaining a high level of employment".

Consequently, these factors, backed by national legislation, seek to harmonise the interests of the workers and the employers, as well as the concerns of the Government, in relation to macroeconomic policy.

Like other developing countries, in Angola the necessary income to cover the requirements of the workers and their families proves to be too high, being impracticable in the short term, under pain of giving rise to undesirable effects on the economy, namely the level of employment.

In fact, a multidisciplinary team, formed within the scope of the National Council for Social Dialogue, indicates a minimum wage of kz 3,500.00, i.e. an amount equivalent to 50 US dollars.

For the fixing of this value the capacity on the part of companies to pay was paramount, together with factors conditioning economic development.

Another way of considering capacity to pay is to calculate the productivity of the work of the economy as a whole. According to the estimates for 2001, GDP, at current prices, should amount to 208,920 million kwanzas. Accepting that the total number of persons employed during that year was 4.4 million persons (identical to the year 2000), one obtains a value of 47,481.82 kwanzas for the GDP/Employment ratio, which in monthly terms corresponds to 3,956.81 and 3,391.55 kwanzas, according as to whether one uses 12 or 14 months for the purpose of the measurement.<sup>86</sup>

The legislation also defines the modalities of the minimum national wage. In effect, the minimum wage can assume the following modalities:

- a) Guaranteed national standard minimum wage.
- b) National minimum wage by large economic groups (industry, commerce, transport, agriculture and services).
- c) National minimum wage by geographical areas.

Modalities b) and c), can be combined with modality a), and modality c) can be combined with modality b). In turn, as the workers covered by modality b), are covered by collective labour agreements, the fixing of the minimum wage ceases to adopt modality c).

### 8.2.2. Remuneration system of the civil service

The remuneration system of the Civil Service is combined with the general remuneration system or with salary tables, where gradually increasing salary levels correspond to degrees of responsibility, complexity of functions and gradually increasing experience.

This is the challenge which it was sought to achieve in 1991, with the definition of the general principles of structuring of Civil Service careers,<sup>87</sup> and subsequently, in 1995, with the establishment of administrative careers and the salary index structure<sup>88</sup>.

In effect, these two measures introduced, in the organisation of the public services, modern

management instruments, which allowed the creation and consolidation of management construction concepts, namely the career system and the employment system, both for general careers and for special system careers, principles of organisation and structuring of personnel plans, horizontal and vertical inter-communicability and, subsequently, the index structure of the salary table.

Furthermore, the careers structure was combined with the salary table in such a way that it was agreed that this is the "set of careers, categories and indices or pecuniary values that integrate a given salary structure"<sup>89</sup>. This means that all elements comprising the careers structure should be reflected in the salary table. Accordingly, the concept of "index" became the key reference element for determining the basic remuneration of public officials and administrative agents<sup>90</sup>, the index corresponding to the minimum salary being 100 and the index corresponding to the maximum salary being 900.

This reform allowed the restructuring, not only of the careers in the general system, but also those of the special system, thus responding to the specificity of functions of determined sectorial professional groups.

However, the dynamic created by the new legal framework and the pressure exercised by certain professional groups in the restructuring of careers according to the special system, and in the negotiation of salaries led to certain disfunctionalities in the organisation of salary tables, translating into a multiplicity of salary levels with extremely fine salary ranges, which did not stimulate promotion by merit.

The proliferation of salary tables had the immediate effect of creating fine divisions or salary variations between categories of the same career, on the order of 46kz to 360kz, a factor which, in itself, does not provide promotion incentive.

Furthermore, from the standpoint of rational management the structuring of careers at differentiated salary levels should correspond with categories having a differentiated functional content. However, this did not occur. Frequently, the wage levels did not reflect the nature, complexity and responsibility of the duties inherent in the respective categories, translated into specific functional content, but rather were very much determined by the relevant department, so that:

- a) As a rule, career officials in the general system integrated in public services, with special system careers, received a higher base salary than the officials of the same careers in departments where no special system careers existed.
- b) Categories which, by their nature, are general system careers and which were included in special system careers, sometimes earned a lower base salary than those in the categories of the general system, as reflected in the following table.
- c) Wage inequality was also reflected among categories with the same designation and functional content of special system careers.
- d) Subsidies were frequently used, not as a form of remuneration for the special circumstances in which the work was provided, but rather as a mere form of obtaining wage increases, with situations where the same official received, on a permanent basis, subsidies which substantially exceeded the basic remuneration.
- b. Attracting and permanently employing qualified and competent personnel.
- c. Increasing the amplitudes or differences between levels and positions of remuneration.
- d. Structuring the salary indices on the basis of levels of ability, professional qualifications, and the complexity and nature of the duties.
- e. Simplifying the administrative and financial management of human resources, by means of a substantial reduction the salary levels and positions.
- f. Appropriate empowerment of the different levels of the Civil Service.

These disfunctionalities in the structuring of the posts and careers in the Civil Service partially contributed to a lack of motivation and reduced professional competitiveness, at the level of public services, in addition to disrespecting the principles and criteria of the organisation and functioning of the public administration.

Therefore, with a view to correcting the above-mentioned disfunctionalities and applying the principles of internal equity underlying the specific legislation, in accordance with the provisions of article 6 of Decree No 24/91, of 29 June, whereby the functional categories of the special system careers should, as a rule, have specific designations, in October of the year under examination a plan of restructuring of the index tables of the remuneration system was implemented with a view to:

- a. Providing to the staff and administrative agents greater opportunities for professional development.

### 8.3. Policies

#### 8.3.1. Employment and professional training

As a result of historic vicissitudes, structural distortions and temporary imperatives which the Angolan society and economy have experienced, it will undoubtedly be within the capacity of the State apparatus to reverse the current macroeconomic situation and implement efficient medium and long-term public policies that value employability and increase the number of qualified workers positions, in order to overcome the current employment situation.

By focusing on people as the fundamental way of improving current living standards, and action aimed at the progress of the country, in recent years measures were adopted with a view to empowering national labour, namely:

##### a) In the institutional sphere

**a.1)** The transformation of the INAFOP (National Institute of Professional Training) to the INEFOP (National Institute of Employment and Professional Training), under the responsibility of the Ministry in charge of labour administration.

**a.2)** The extinguishment of the INARP (National Institute of Professional Rehabilitation) and integration of the respective functions in the INEFOP.

**a.3)** The recent creation of the employment and professional training observatory, a service which, based on the use of daily "auscultation" methods will measure the signals emitted by the labour market.

**a.4)** The creation of the integrated employment and professional training centres, where the balance between supply and demand can be realised in the same location and, in so far as possible, solutions can be found to adjust for the negative balance.

**a.5)** The reactivation and expansion of the network of public and private professional training centres in the main localities of the country and their creation where training facilities are lacking and where they can do the most good, also with recourse to itinerant professional training.

**a.6)** The creation of a tripartite commission for employment and professional training, a consultative organisation the purpose of which is the establishment of platforms (alliances) with social partners

##### b) In the domain of legislative measures, it is appropriate to emphasise

**b.1)** The approval of Law 18-B/92 of 24 July, on Employment.

**b.2)** The approval of Law No 21-A/92 of 28 August on the National System of Professional Training.

**b.3)** The approval of Law No 2/00 – General Labour Law .

**b.4)** Decree No 27/91 of 5 July, concerning the temporary system of protection from unemployment, with a view to assisting the involuntary unemployment situation resulting from the application of measures of re-dimensioning and/or organisation of the business sector, paying unemployment subsidies, the inefficiency of which led to the respective revocations and, consequently, to the introduction of legislation on Support for Local Employment Initiatives (ILE'S) and the Support for the Creation of Small Family Businesses (ACPEF), whose adaptation to the existing situation led to the implementation of the programme of development of self-employment.

**b.5)** Approval of Decree No 51/01, of 17 August, which created the inter-ministerial commission for the qualification of human resources for the economy.

##### c) In the economic sphere

It is common knowledge that only the coordination of policies of stabilisation of the macro-economies favouring the growth of the economy can lead to the generation of new jobs of a quantity and quality sufficient to meet the existing levels of unemployment and underemployment.

Consequently, the adoption of active policies promoting and providing incentives for productive and remunerated employment, apart from incentives from certain institutions (Economic and Social Development Fund - ESDF, Institute for the Promotion of Small and Medium Enterprises -



INAPEM, etc.), is still dependent on the removal of constraints, namely of a macro-economic and institutional nature: reduction of inflation, fiscal and credit measures to stimulate production by sectors and geographical areas, an improvement in the functioning of the financial, banking and judicial systems, and an improved relationship between the public administration and the economic agents.

However, it is important to emphasise:

- The adoption of measures adapted to situations, in order to attenuate the growth of the rate of unemployment (support for local employment initiatives and the creation of small family concerns) implemented through the local administrations and associations, and which resulted in the creation of 17,869 jobs, corresponding to 4,284 micro companies, of which 989 were in Luanda, 450 in Benguela, 438 in K. South and the remainder in other provinces of the country. In Luanda, it is estimated that approximately 45% are still in operation.
- Formulation of the de-bureaucratisation programme of administrative acts and procedures, in relation to the public administration, the economic agents and the citizens.
- Implementation of the national minimum wage for which provision is made in the legislation, following consultation with the social partners.
- Improvement in experience of self-employment, with the involvement of specialised credit institutions, based on the implementation of the incentives programme for small economic activities.
- Activities relating to micro credit.

#### **d) The programme initiated by the Government for the empowerment of national labour**

It is clear that the best antidote against unemployment is the promotion and empowerment of human resources.

Consequently, in assuming the challenges of stability and reconstruction of the national economy, the preparation and qualification of national labour

by means of specific policies, strategies and programmes favouring the reconstruction and economic stability of the country, is essential. This will be achieved by means of the competitiveness of the different sectors and at the level of each company, with the assurance that every citizen, throughout his life, may apply his potential with equality.

Accordingly, the indicative programme initiated by the Government for the valorisation of national labour was approved, the coordination of which is in the charge of an inter-ministerial commission for the qualification of human resources for the economy. The programme, which is already under way, has six major components, namely:

Component A - Urgent Sub-Programme, the objectives of which are:

- To provide professional training courses for employment and self-employment to young people, giving priority to demobilised persons who are unemployed and training them to participate in improving the socio-economic conditions of the community;
- The development of training action for selected companies in priority fields, with a view to national reconstruction;
- Training the technicians of the INEFOP and Professional Technical Instruction technicians, to develop this programme based on the launch of specific employment, training and technical/professional instruction programmes;
- Training courses, recycling, further training for trained young people seeking their first job, in order to facilitate their acceptance by employers and their inclusion in the labour force;
- Support for population settlement, by means of appropriate training courses, to improve the living standards of the communities.

Component B - Sub-Programme of Support for the Professional Training Area, the principal objectives of which are:

- To support the institutional reorganisation and reorientation of Professional Training and to develop its efficiency;

- To improve the quality of Training of Trainers at the Professional Training and Employment Centres;
- To develop labour skills in the various key sectors of the economy, by means of implementing continuous training programmes;
- To provide to young candidates seeking their first job, and to disabled persons, the necessary occupational professional training to enable them to become integrated in the employment and/or self-employment market and to facilitate the acceptance of those who have already received training.

Component C - Sub-Programme of Support for the Employment Area, which has two objectives:

- Reinforcement of the link between Employment and Professional Training by means of the provision of up-to-date information on the behaviour of the job market, by the Employment and Professional Training Observatory;
- Support for the development of planning and monitoring capacity in the area of employment, of INEFOP, and its partners at all levels throughout the country;
- Providing incentives for the mobility of the job market and the creation of jobs based on the reformulated law;
- Creating a nucleus of trainers of trainers of information and professional guidance for the Professional Training and Employment Centres.

Component D - Sub-Programme of Support for Professional Technical Training / Ministry of Education

Technical/Professional Training is one of the subsystems of the Ministry of Education, the purpose of which is initial, medium or long-term technical training, including academic apprenticeships, which enable the trainee to pursue his studies in other sub-systems of the same Ministry.

This subsystem consists of Secondary Institutes and Professional Colleges, many of which are annexed to the Institutes of the professions pursued.

Considering that it is one of the tasks of the Ministry of Education and Culture (MEC) to develop long-term professional training, this necessitates the creation of mechanisms to link professional training and employment, as they are pursuing the same objective: the training of the national workforce.

Component E – Sub-Programme of Support for the Unofficial Sector and Community Development has the following objectives:

- The creation of institutional backing for the provision of support in Professional Training within the unofficial economy.
- The creation of mechanisms for the study of the resurgence of professions on the point of extinction, and to place them at the disposal of the trainees;
- To support the rural and sub-urban communities by means of basic qualifications, improvement or reconversion, with a view to contributing towards the identification of their problems and alleviating poverty;
- To encourage participation by women by means of training action relating to planning, execution and management of small activities generating income.

Component F – Sub-Programme of Institutionalisation of Advanced Technical Training (non-university), the objectives of which are:

To ensure high levels of qualification and certified technical specialisation of national labour.

#### 8.4. Public administration

In general, it is considered that the Public Administration has a vast normative expanse, namely in the areas of human resources (public tenders for acceptance and access, personnel plan, performance evaluation, remuneration system, etc); structuring of services, standards for administrative activity and procedure, etc., whose efficacy requires the application of management instruments and an increase in the quality and productivity of public servants in relation to services provided to the users, i.e., the citizen, who is considered to be the nuclear element of actuation in the public administration, whether in his quality as client/external user or as official of that same Administration.

Consequently, with respect to the Public Administration, the following relevant measures have been implemented, some of which are in progress at the present time:

#### a) In the Area of Human Resources

**a.1)** The start of the creation of the information system in relation to human resources management, a function which should be organised in the form of a system, as provided in articles 4 and 6 of Decree Law No 13/94, of 1 July, concerning the organic structure of the public services;

**a.2)** Implementation of the General Plan of Civil Servants;

**a.3)** Project of Creation of the National School of Administration;

**a.4)** Incentives for motivation and retention of qualified professionals, mainly by means of a gradual process of improvement in internal equity and the competitiveness of salaries;

**a.5)** Transfer and secondment of personnel suitable for performing technical and management and supervision duties to the level of the local administration of the State;

**a.6)** Definition of rules and procedures for the preparation of personnel plans.

#### b) Within the scope of the Structuring of Administrative Public Services

**b.1)** Implementation of the recommendations of the Study on the Macrostructure of the Angolan Public Administration in regard to the organic structure of the central public services and the sponsored autonomous organisations;

**b.2)** The Study of the Macrostructure of the Public Administration by means of identifying the essential and non-essential activities that the Public Administration must perform, the functions to be privatised or subcontracted, and areas of partnership with the private sector;

**b.3)** Institutional Diagnosis of Local Administration, in order to plan the future of local powers in Angola and the way in which relations between the different levels of Administration at the local level should be developed.

#### d) Within the scope of the relationship between the Public Administration, the citizens and the economic agents

**d.1** - Approval of the rules of procedure and the administrative activity.

**d.2** - Project of national programme of de-bureaucratisation.

#### 9. INFLATION, LIVING STANDARDS AND PURCHASING POWER

##### 9.1. Civil service salaries and purchasing power

The assessment of the behaviour of a variable such as wages - important as one of the macro-prices of

Civil Service Salaries						
MONTHS	average salary	salary index	purchasing power of kwanza	purchasing power of salary	monthly purchasing power	cumulative Consumer Price Index
January	3212.34	1	0.929109	0.929109	0.929109	1.0763
February	3212.34	1	0.874785	0.874785	0.941531	1.143138
March	3212.34	1	0.828238	0.828238	0.94679	1.207383
April	4103.2	1.277324	0.795312	1.015871	1.226545	1.257368
May	4103.2	1.277324	0.743421	0.94959	0.934754	1.345133
June	4103.2	1.277324	0.707751	0.904027	0.952018	1.412927
July	4103.2	1.277324	0.6596	0.842523	0.931966	1.516071
August	4103.2	1.277324	0.61421	0.784545	0.931185	1.628109
September	4103.2	1.277324	0.583849	0.745765	0.95057	1.71277
October	23500	7.315539	0.560854	4.102953	5.501669	1.782994
November	23500	7.315539	0.528311	3.864877	0.941974	1.892826
December	23500	7.315539	0.485937	3.55489	0.919794	2.057881
Cumulative		0			3.55489	

Source: Ministry of Public Administration, Employment and Social Security

the economy, determining the conditions of operation of the labour market and the processes of adjustment and macroeconomic stabilisation - must take place with considerable methodological rigour. The conclusions drawn from its analysis are important for defining the policies of income and prices, so any inaccuracy or erratic assessment could have serious consequences on the desired results.<sup>91</sup>

The information set out in the following table allows a concrete analysis to be made with respect to the behaviour of salaries of Civil Servants between January and December of the year under consideration.

It can therefore be seen that:

- Between January and December 2002, the

purchasing power of the average salary, of 22.65%, which was sufficient for the average salary to indicate a cumulative gain between January and April, of 1.575%;

- Although between April and October there were no further modifications in the average nominal salary, there were losses in monthly purchasing power: 6.5% in May, 4.798% in June, 6.8% in July, 6.88% in August and 4.943% in September; the variations noted were entirely explained by the different monthly values in the rate of inflation;
- With the substantial salary increase introduced in October – 472.72% as already referred to - the loss in purchasing power recorded between April and September - and which could be calculated as 26.588% in cumulative values - was totally reversed;

#### MONTHLY EVOLUTION OF PURCHASING POWER OF AVERAGE SALARIES OF CIVIL SERVANTS IN 2001

	Average salary (kz)	Increases (%)	Cumulative inflation (%)	Purchasing power Cumulative
December 2000	445.00	-	268.35	-
March	1177.92	164.70	19.22	2.220
September	1796.33	52.5	73.0	2.333
November	3212.33	78.83	87.62	3.847
December	3212.33	-	116.07	3.341
Cumulative	-	621.87	116.07	3.341

Source: Ministry of Public Administration, Labour and Social Matters

average salary of a Civil Servant increased by 631.55% (which corresponds to a cumulative index of 7.315539, according to the third column of the table), with partial indices of 27.7% between January and March and of 472.72% (index of 5.727) between September and December;

- The monthly purchasing power of the average salary of a Civil Servant is reflected in the values of the sixth column in the table: a loss of 7.1% in January – i.e., considering that the average nominal salary of January 2002 was the same as December 2001, the average salary in January represented 92.9% of the value of December 2001 - another loss of 5.8% in February 2002 as compared to the value in January 2002<sup>92</sup> - and another of 5.3% in March; as a result of a combination of the increase in the average salary in April, of 27.7% (third column in the table) and a fall in the monthly inflation rate for the same month, there was a gain in the

in effect, in October gains in the purchasing power of the average salary of a Civil Servant amounted to a round figure of 450% (index 5.50, column 6), which allowed the cumulative gains since January to be positioned at 310.295% (index 4.102953, column 5);

- In conclusion: between January and December 2002 the average purchasing power of a Civil Servant improved by 259.5234% (index 3.595234, columns 5 and 6).

Another angle of analysis that can be obtained by means of the values in column four of the above table, relates to the loss in the value of the national currency: between January and December the internal purchasing power of the kwanza decreased by 50.85%. The different population incomes which could not be indexed to inflation - such as the members of the population living in poverty (62.8%

of households) - suffered a reduction amounting to more than 50% in 2002, further worsening the already very asymptotic distribution of income.

Taking into account the information from the Ministry of Public Administration, Employment and Social Security, the salary increases which took place in 2001 made it possible to transfer from an average monthly salary of kz 445.00 in December 2000, to an average monthly salary of kz 3212.33 in December 2001, as set out in the following table:

## 9.2. The behaviour of inflation from various viewpoints

As is well known, the chronological analysis of

### (a) Average annual rates

The following table shows the behaviour of inflation since 1991:

It can be seen that there is a sustained trend of reduction in inflation:

- average monthly inflation rates have been gradually diminishing, particularly since 1999, with the structural market reforms introduced in the monetary policy and exchange system<sup>93</sup>;
- Average annual inflation - unlike inflation measured during the last month of each year

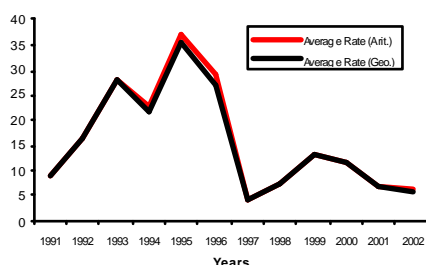
**INFLATION SINCE 1991**

YEARS	Arithmetic mean	Geometric mean	Average inflation (arith.)	Average inflation (geog.)	Cumulative inflation
1991	9.195	8.819215	183.5984	180.0912	175.72
1992	16.55667	16.03571	275.7449	252.9149	495.8
1993	28.23583	28.01887	1169.63	1060.334	1837.7
1994	22.48583	21.85554	1155.726	1104.762	971.87
1995	37.04083	35.65624	2067.582	1916.993	3783.98
1996	29.34083	26.94439	5867.907	5026.988	1651.31
1997	4.289167	4.206147	343.3238	143.7719	63.95
1998	7.534167	7.371189	103.9831	98.77034	134.78
1999	13.05333	12.90251	231.4826	223.0195	328.99
2000	11.63417	11.4778	344.4482	339.7344	268.35
2001	6.703333	6.630764	169.2928	162.4812	116.07
2002	6.199167	6.189987	109.3221	108.9565	105.59

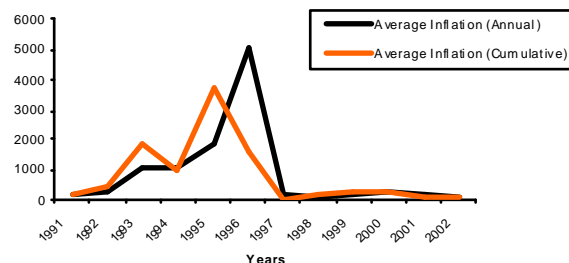
inflation - "time series" analysis - allows one to emphasise various components, such as the long-term trend, seasonal influences, cyclical disturbances and irregular elements.

- also records a positive marked decreasing trend. The oscillations recorded up until 1999 were replaced by a clear trend of reducing inflation; the fall which took place

**Inflation since 1991**



**Inflation since 1991**



### 9.2.1. The trend component

One is not attempting to carry out a true "time-series" analysis; certain synthetic measurements of descriptive statistics were taken to evaluate the inflation behaviour trends in Angola.

between 2000 and 2001, of around 51% should be emphasised;

- The cumulative end-of-year inflation rate also shows a decreasing trend. It is appropriate to emphasise the falls that took place in the rate of increase in prices

between 1999 and 2000 (18.43%) and between 2000 and 2001 (56.75%).

(b) Homologous variations and average inflation during the last three months

### 9.2.2. The seasonal component

Seasonal inflation displayed a marked reversal, in the direction of sustained reduction.

#### HOMOLOGOUS INFLATION BETWEEN 1996 AND 2002

years	1996	1997	1998	1999	2000	2001	2002
<b>months</b>							
January	3711.123	1289.455	60.15452	146.2917	340.3148	241.119	121.2692
February	3425.62	1059.657	61.48601	167.8891	332.9324	234.6524	117.2799
March	3590.263	729.1978	72.14797	177.3441	356.3111	212.7359	118.813
April	4699.618	462.9547	75.33713	184.6864	360.3327	228.18	99.6949
May	7639	208.6174	84.45842	195.707	436.7209	179.8897	94.81452
June	10648.91	91.77729	90.23707	217.1793	414.9587	173.4117	96.29082
July	12037.56	40.74314	107.5433	224.9244	389.7268	163.8428	102.6167
August	9174.691	36.84861	145.7693	201.0087	395.3452	131.1026	110.2726
September	6279.501	38.12538	141.898	271.6815	305.0028	126.8468	113.9123
October	4894.609	45.32251	135.7954	326.8073	269.939	115.1771	113.5427
November	2662.678	53.23318	138.1944	335.2853	263.4441	108.4879	117.7685
December	1651.306	63.95325	134.7757	328.9859	268.3501	116.0679	105.5904

Viewing the trend from these two standpoints, the conclusion is that of a sustained reduction in the rate of inflation.

For example, in January homologous inflation reduced from 340.31% in 2000 to 121.3% in 2002, a reduction of practically 75%. The cuts that took

An explicit indication of improvement can be seen in the seasonal indices, in the sense of a reduction in the influence of the intra-annual variations, which could be an indication of a stabilising trend in the markets. For example:

- The month of December - traditionally the month that is most disposed to a perverse

#### AVERAGE INFLATION DURING THE LAST THREE MONTHS

years	1997	1998	1999	2000	2001	2002
<b>months</b>						
January	4.643182	8.088555	9.669167	10.8141	7.85832	8.866746
February	5.184366	7.039784	11.31484	11.1139	8.098718	9.597371
March	2.100184	3.773664	9.700614	11.98204	6.036168	6.483333
April	0.563165	3.645511	8.773419	10.39743	8.983568	5.319725
May	0.128505	4.667598	8.171892	16.20476	9.485064	5.573627
June	1.517129	4.955148	9.757041	14.27104	9.265403	5.380024
July	0.939471	6.775749	11.58638	13.91263	5.92121	6.435297
August	2.756908	13.07174	13.74349	10.74217	3.89285	6.571094
September	4.587457	13.3075	19.45767	10.26625	3.613056	6.625178
October	6.635072	11.26936	21.85932	10.98156	3.689418	5.520694
November	6.528133	5.422256	19.21493	7.524436	3.896091	5.116283
December	8.774699	7.696477	12.96888	9.452681	7.690877	6.275844

place in the months of May and June 2000 to 2002 were also significant.

Specifically with effect from 1999, the behaviour of average inflation during the last three months reflected a sustained decreasing trend.

influence of the seasonal variations - recorded a clear improvement in the respective seasonal index: 1.545 in 1999, 1.486 in 2000 and 1.358 in 2002 (with an increase in December 2001, which makes the reduction that took place in the year under examination even more impressive);

## SEASONAL COEFFICIENTS

Years Months	1996	1997	1998	1999	2000	2001	2002
January	1.226959	1.84185	0.716735	0.809755	1.159516	0.760816	1.230811
February	0.766849	0.522246	0.410132	0.929265	0.881026	1.217305	1.001748
March	1.190491	-0.82067	0.378277	0.496425	1.051214	0.727996	0.906573
April	1.767503	0.722751	0.664971	0.596782	0.751236	2.104923	0.667832
May	2.865972	0.214494	0.818936	0.787538	2.456558	1.441074	1.125958
June	2.10662	0.12823	0.491096	0.860317	0.577609	0.634013	0.813013
July	1.298532	0.314746	1.402942	1.016599	0.663563	0.589259	1.177578
August	0.323781	1.508452	3.461564	1.287028	1.559201	0.519145	1.192096
September	0.171774	1.403536	0.57737	2.210163	0.459852	0.508702	0.838822
October	0.071573	1.72994	0.625152	1.550562	0.844925	0.62357	0.645248
November	0.022835	1.433845	0.959628	0.717058	0.639496	0.611636	0.993682
December	0.187111	3.000583	1.493198	0.738509	0.955805	2.261561	1.406641

- The months of influence most benefiting from seasonal variations - February, March, June and July<sup>94</sup> - maintain, during the period under analysis, their characteristic as dampers of inflation<sup>95</sup>;
- January remains as a critical month, with a
- A rapid increase in the monetary base as a percentage of GDP (the so-called "seigniorage" of the Central Bank);
- The high speed of circulation of the currency (the rate of circulation of the currency or the number of times which

## SEASONAL INDEXES 1999-2002

Years >>> Months	AVER AGE 2001	AVER AGE 2000	AVER AGE 1999	AVER AGE 2002
January	1.361529	1.421601	1.450721	1.350636
February	0.761238	0.715632	0.697254	0.72065
March	0.52336	0.502896	0.441972	0.521762
April	0.983871	0.871766	0.885159	0.860106
May	1.097151	1.062758	0.907892	1.055866
June	0.654882	0.656968	0.665786	0.643952
July	0.657482	0.664305	0.664387	0.729281
August	1.235287	1.306901	1.278867	1.163987
September	0.951123	0.995366	1.054867	0.891736
October	1.020799	1.060522	1.084478	0.942286
November	1.196786	1.255301	1.323723	1.075093
December	1.556492	1.485985	1.544893	1.357943

seasonal index of 1.35 in 2002, possibly due to the influence of inflation by inertia from the months of November and December.

the currency changes hands within a given period of time);

### 9.3. The causes of inflation in Angola

There would appear to be no clear consensus around either what causes inflation in Angola, or what can best be done to combat it.

The IMF<sup>96</sup>, as always, places the whole emphasis on the monetary components, suggesting that the persistence of inflation in Angola is due to:

- The rapid growth in the speed of circulation of the currency.

The study "O Sistema e a Política de Preços em Angola" [The System and Policy of Prices in Angola]<sup>97</sup> identified as the principal causes:

- The formation of oligopolistic structures in the principal commercial circuits;

- The structure and nature of the system of subsidies;
- Macroeconomic policies, in particular fiscal, monetary and prices;
- Factors associated with the "chain" of imports<sup>98</sup>;
- Factors concerned with domestic supply, from infrastructures (particularly energy and water), to state bureaucracy and the obtaining of credit;
- Factors associated with the organisation of the markets of distribution.

More recently, another work entitled "Estudo sobre a Política de Rendimentos e Preços" [Study on the Policy of Income and Prices]<sup>99</sup> indicated as causes of inflation in the country:

- The method of conversion of oil tax receipts;
- The deregulation of import prices;
- Receipts from "seigniorage";
- Deregulation of monetary aggregates;
- Budget deficits and the decontrol of public expenditure;
- The functioning of the markets.

José Cerqueira<sup>100</sup> identifies four distinct sources of inflation:

- Fiscal inflation, corresponding to the relative measure of the fiscal deficit expressed as a fraction of the

simultaneous flow of national production;

- Capitalist inflation, measured by changes in the stock of credit occurring during a given period of production;
- Imported inflation corresponding to the relative measure of exports and expressed as a fraction of the flow of production;
- labour inflation, measured by the rate of increase in the volume of wages occurring above productivity gains.

Alves da Rocha<sup>101</sup> emphasises: "the administrative economic system and the incorrect economic policy (particularly exchange policy) of the past, led the national productive sector, especially manufacturing industry, through false situations of full employment, to drastically reduce the operating capacity of production, consequently increasing the gap between installed capacity and true use of capacity. This reduction in used capacity, changed from temporary to true and effective, due to technological obsolescence, lack of maintenance of the installations and equipment, spoiled equipment due to lack of use, and the decapitalisation of the knowledge and experience of the workers, etc. The non-oil productive system was thus gradually forced into false full employment, and an open and declared inflation was only avoided because the temporary decompressions through imports and the broadening of an unofficial sector of social solidarity and economic reproduction prevented or deferred it. The systematic resorting to imports was counterbalanced by a structural imbalance of the external accounts and the expansion of the external debt of the country."



## RESULTS OF PARAMETERISATION OF THE CAUSES OF INFLATION IN ANGOLA

VARIABLES	PARAMETERS REGRESSION	STANDARD ERROR	STATISTICS T-STUDENT	COEFFICIENT F OF SNEDECOR	COEFFICIENT DETERMINATION
Intercept	1.828	1.764	1.037		
Official Rate of Exchange (tco)	0.0166	0.0169	0.987		
Parallel Exchange Rate (tcp)	0.333	0.0429	7.759		
Currency (m)	0.186	0.0434	4.292	74.502	81.569%
Previous rate of inflation (pt-1)	0.429	0.0573	7.477		
Variation in Economic activity	-0.277	0.0641	-4.317		
Dummy	-1.236	1.726	-0.716		

In effect, we have here a domestic economic structure with a very weak capacity to withstand shocks: any increase in public expenses in goods and services or in salaries of public officials is immediately absorbed by prices. The immunological system of the domestic economy does not reflect the capacity to resist given internal and external shocks, which means that before reinforcing it with supply policies, the shocks will have to be controlled. That is to say: is it worth granting tax and financial incentives to production if inflation caused by the shocks of excessive and unbudgeted public expenditure (and therefore not controllable by fiscal policy), cancel out their true and effective expression?

Carl Seidtmann<sup>102</sup> contends, in summarised form, that inflation is more than a monetary phenomenon, it is also an institutional phenomenon: "the increased involvement of the State in the economy, the strengthening of customs barriers, a hostile environment for investment, few technological changes and a highly regulated labour market, contribute towards a rising trend in inflation."

Notwithstanding all these contributions, it is a fact that the phenomenon of inflation continues to represent a serious dysfunction of the national economic system and that even though the long-term trend indicates a general reduction in prices<sup>103</sup>, its current level is already very high, resulting in the phenomena of the flight of national currency and the dollarisation of the economy.

The Ministry of Planning has been systematically studying the phenomenon of inflation in the country<sup>104</sup>. In the study which led to the establishment of a small model of interpretation of

inflation, a multiple linear regression was analysed between the monthly rates of inflation and a diverse set of variables potentially explaining the behaviour of prices: some of a monetary nature (such as M1 and M2, the reference and parallel market exchange rates), others within the scope of the true economy and a variable "dummy" translating modifications in economic policy (more disposed towards the market or administrative). The results are as follows, based on the function,

**Pt = Pt(tco, tcp, m, pt-1, y) (108 observations).**

The signs of the parameters of regression are correct and in general the significance tests are acceptable, so that one can conclude:

- That inertial inflation offers the greatest explanatory value;
- That the variations in the parallel market exchange rate correspond to a reasonable explanation, given that a devaluation of 1% could lead to an increase in the consumer prices index of more than 0.33%;
- That any positive unit percentage variation in the domestic supply of goods and services could contribute to a reduction in inflation of approximately 0.28%.

The following graphics allow one to see the correlations found.

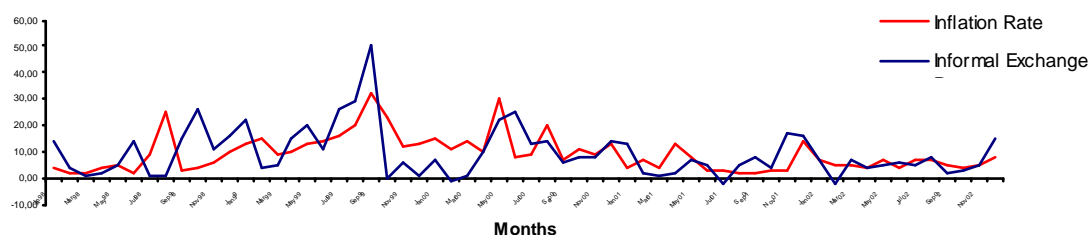
### 9.3.1. Conclusions

However, despite the fact that a strong reducing trend in prices and increased control of inflation has been noted:

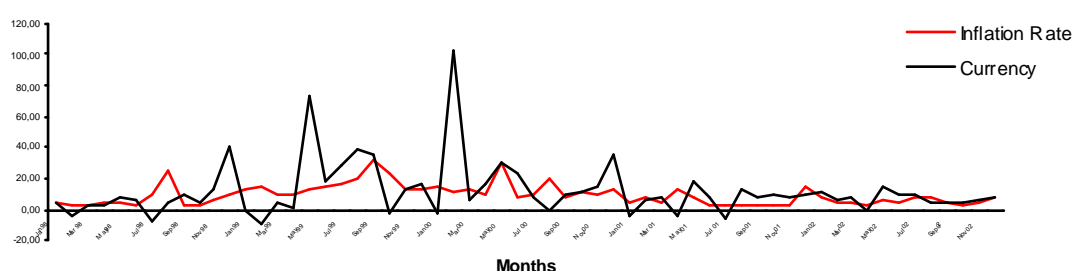
- Inflation is still very high: average monthly (annual or quarterly) rates above 1% do not reflect the projected scenarios of market stability and the competitiveness of the

The increased circulation of persons and goods facilitated by the peace either did not occur to the extent and intensity hoped for, or was not translated visibly into a reduction in the rate of inflation between 2001 and 2002.

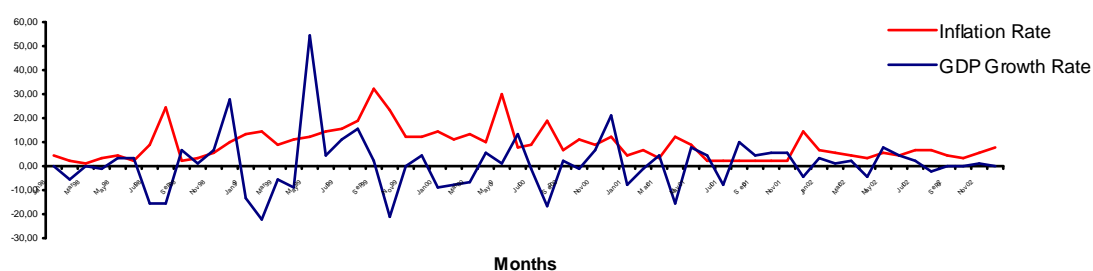
Rates of Inflation and the Informal Exchange Rate (1998-2002)



Rates of Inflation and Currency (1998-2002)



Rates of Inflation and GDP Growth Rate (1998-2002)



economy;

- The monetary and exchange reforms, despite being correct and in a positive direction, have still not led to the anticipated results, which leads one to presume that other factors exist that are preventing a swifter reduction of inflation in the short-term<sup>105</sup>;

### 10. Perspectives of evolution of the Angolan economy for 2003

The General State Budget, reviewed and recently approved by the National Assembly is the most

- Social expenditure could, for the first time, amount to a relatively important percentage, it being estimated that education, health and social security and assistance, housing and community services and culture will together

GENERAL STATE BUDGET	(% of GDP)		
	2002	YEAR 2003	
		Initial	Review
<b>Receipts</b>	<b>44.5</b>	<b>39.7</b>	<b>36.3</b>
<i>Tax receipts</i>	44.1	38.8	35.8
<i>Petroleum tax receipts</i>	<b>34.6</b>	31.8	29.7
<i>Non-petroleum tax receipts</i>	9.5	7	6.1
Income tax	2.6	1.9	1.5
<b>Current expenditure</b>	<b>45.7</b>	<b>27.4</b>	<b>33.7</b>
<i>Personnel expenditure</i>	10.3	10.8	14.7
<i>Goods and services</i>	25.9	13.3	12.7
<i>External interest in arrears</i>	4.6	1.3	2.2
<i>Subsidies</i>		1.1	1.1
<b>Capital expenditure</b>	<b>4.2</b>	<b>7.8</b>	<b>8.8</b>
<b>Total expenditure</b>	<b>49.9</b>	<b>35.2</b>	<b>42.5</b>
<b>Commitment deficit</b>	<b>-5.4</b>	<b>4.5</b>	<b>-6.2</b>
<b>Social expenditure</b> (Education, health, social security and assistance, housing and community services, culture and sport)			<b>11.2</b>
<b>National defence and security</b>			<b>7.4</b>

important economic forecasting document for the current year. The following table establishes a comparison between the main budget items for the years 2002 and 2003:

It can be seen that:

- Provision is made for a worsening of the fiscal deficit for 2003 of around 15%, compared with the value recorded in 2002;
- Capital expenditure - which includes public investment expenditure - reflects an estimated increase of 109.5% between 2002 and 2003;
- There is a reduction in petroleum receipts of around 5 percentage points, due mainly to the planned reduction in petroleum production: The respective quantities will be reduced by around 1%;
- Non-petroleum fiscal receipts also reflect a reduction in 2003, from 9.5% of GDP to 6.1%;

amount for more than 11% of GDP.

The average growth rates forecast for 2003 are:

- For global GDP 3.6%;
- For petroleum GDP -0.5%;
- For the GDP of the rest of the economy, approximately 7.6%.

The rate of inflation established as a target for 2003 is 65%.

## PART II

### MODELS AND STRATEGIES OF DEVELOPMENT

#### POINTS OF VIEW AND EXPERIENCES

##### 1. Introduction

For many years, academic economists have considered that they did not have the instruments to stimulate economic growth in a sustained manner. In reality, the sole source of growth, with permanent effect, was technical progress, as the traditional productive factors (labour and capital) were subject to decreasing marginal returns, leading to cycles of limited growth over time and the breakdown of the model of growth of a given country.

In relation to underdeveloped countries (or regions, for that matter) the main problem was the relative scarcity of capital and, therefore, "receipts" meant the transfer of financial resources to those countries or regions. The blockage due to the decreasing marginal return was superseded by the fact that the leading countries or regions, from the technological standpoint, proceeded to spread their innovations over time, until fully achieving the "catching-up" process, the exhaustion of the development model. The international economic organisations known collectively as the Bretton Woods Institutions (World Bank, IMF, etc.) used and still use this methodology, imposing conditions on developing countries as a counterpart to finance -- the so-called "conditionality". From a conceptual standpoint, this posture was based on institutional assumptions that evolved over time:

- Hollis Chenery, Chief-Economist of the World Bank during the 1950s, defended an interventionist posture on the part of the State, based on centralised planning and coordination of public policy;
- In the 1970s, Anne Krueger defended a situation where, in addition to market deficiencies, there were also deficiencies on the part of the State, which it was necessary to minimise. With a view to overcoming the frailties of the public agencies, namely in the underdeveloped countries, "new" concepts of economic development emerged, based on premises that continued to remain on the agenda,

such as liberalisation, deregulation and privatisation.

The failure of the political models and strategies of economic and social development favoured by the countries of Central and Eastern Europe and the lack of success of the excessively interventionist options assumed by different countries around the globe, led to the reinforcement of this liberalising approach and to economic practice basically characterised by a clear assumption of a less interventionist and a more regulatory State, concerned with overcoming market failures in order to guarantee an efficient functioning of the economy.

Curiously, until the mid-1980s, despite the generalised options on the part of different countries in respect of developmental policies and for the protection of the industrialising national industries, the dominant economic thinking, very much influenced by the most influential academics on a global scale, did not have theoretical instruments that made it possible to understand and act on the processes of economic growth. In fact, for many years there was consensus among economists on the explanations for economic growth proposed within the ambit of the so-called neoclassical theory, whose precursor, Robert Solow, proposed the basic ideas of this school of thought during the 1950s.

As Paul Krugman explains to us in the first chapter of his book *"Geography and Trade"*, the main limitation to this theoretical approach is the fact of not attaching sufficient weight to the temporal and territorial dimensions of economic phenomena and assuming, albeit implicitly, that economic activity arose from an abstract universe, devoid of any historic or geographical positioning, and where certain socio-political institutions, of considerable relevance to the behaviour of the economic agents, are not explicitly taken into consideration.

The new economic approaches, whether one attempts to understand and explain the behaviour and the problems, or considering the definition of control strategies, always take into account, in addition to the agreement of new dominant lines of theoretical development that **time** (history and prospective), **space** (geography and the territories) and **institutions** are three essential vectors to understanding or acting upon such complex realities as development, competitiveness, innovation, knowledge, minimising of regional imbalances and social cohesion. In short: the foundation of a sustainable development strategy. These

assumptions not only influence the analysis of the behaviour and performance of the economic agents and the very understanding of the processes of economic growth, but do in fact condition the principles and the philosophy underlying the public policy and the role which the State can play in the design of the economic development strategies of a country.

Based on this intellectual and conceptual patrimony, we can proceed with a stylised analysis (structured on the basis of the so-called "growth accounting") of the experiences of growth in the developed countries, as a point of departure for reflection on the new development policies.

## 2. Determining factors of economic growth in the developed countries

Table 1 establishes an "account of growth"<sup>106</sup> which allows one to identify the main factors explaining the different rates of growth between 1970 and 2000 within the scope of a representative subset of the countries of the OECD. The second column of the table establishes the growth differential between each country and the average growth of the OECD; the columns positioned to the right, explain the breakdown of the growth differential by the contribution of the different factors affecting economic growth, including a specific residual of each country that summarises the systemic degree of efficiency and which is normally designated by the term "total factor productivity." These results suggest the following conclusions:

- The systemic effects arising from the functioning model of the markets, the institutions of civil society and the State (specific residue of each country) do in fact have a significant influence on the economic performance of the different countries. In some cases, such as Portugal and Greece, this factor, in itself, would have contributed towards the economy of those countries diverging, by an average of 1.5% relative to the average performance of the OECD countries; conversely, the USA is seen to have a "comparative advantage" in systemic competitiveness, with such a weighting that if all the other factors were neutral, total factor productivity would suffice to ensure that the average growth rate of the USA amounted to 1.89% above the countries of the OECD as a whole.
- The less developed countries, such as Portugal, Greece and Ireland, benefited from this fact in their journey towards convergence. The interpretation that the neoclassical theory of growth offers with regard to this result is as follows: the existence of a technological gap between countries with different levels of development, allows the diffusion of technologies and cumulative knowledge from the more developed countries to the less developed countries, making it possible to overcome the so-called law of diminishing returns and facilitating, in an initial stage, convergence<sup>107</sup>. This result is presented in the column relating to initial conditions.
- The investment deficit in human capital decisively affected the process of growth of countries such as Portugal, Spain and, albeit on a smaller scale, Greece and Italy. On the other hand, it was a decisive "weapon" in the thrust towards growth in the USA, Australia, Canada and Switzerland.
- Although Portugal, and to a lesser extent, Denmark, leveraged their growth on the basis of investment, in the English-speaking countries, a low level of saving/investment constituted one of the weaknesses of their process of growth.
- The rapid population growth in countries such as Australia, Canada, Ireland and New Zealand, affected the growth rate, at least initially.
- Curiously, macroeconomic instability (measured by the standard deviation of inflation) does not appear to have had negative effects in terms of economic growth. It should be pointed out that this result could be due, in particular, to the fact that, in general, the countries of the OECD reflected situations of high macroeconomic stability and, therefore, this factor is relatively neutral<sup>108</sup>.
- It is also somewhat unexpected that the "State dimension" (measured by public consumption) did not present an obstacle to growth. In certain countries, such as the USA, Portugal, Greece, Switzerland and New Zealand, the State ended up by itself constituting one of the engines of growth.
- Small countries, such as Belgium, Holland, Ireland and Portugal, benefited from opening up to international trade. In the case of

Table 1 - Explainers of the Difference Rates of Economic Growth Among OECD Countries

	Average Annual Growth Rate	Growth Differential	Initial Conditions of GDP per capita	Rate of Investment	Human Capital	Population Growth	Variability in Inflation	Public Consumption	Exports	Residual
Ireland	3,02	1,47	1,54	-0,18	-0,32	-0,18	0,01	0,09	0,17	0,34
Portugal	2,15	0,6	2,56	0,58	-1,2	0,07	-0,1	0,1	0,11	-1,52
United States	1,93	0,38	-1,62	-0,34	0,63	-0,09	0,07	0,09	-0,25	1,89
Finland	1,82	0,27	0,51	0,05	0,02	0,15	0	-0,06	-0,26	-0,14
Italy	1,73	0,18	0,22	-0,13	-0,69	0,13	0,02	0,01	0,14	0,48
Norway	1,72	0,17	-0,12	-0,05	0,35	0,07	0,03	-0,06	-0,04	-0,01
Denmark	1,69	0,14	-0,57	0,28	0,21	0,12	0,02	-0,14	-0,05	0,27
Australia	1,68	0,13	-0,37	0,2	0,52	-0,25	0,03	0,01	-0,41	0,4
Belgium	1,66	0,11	-0,53	0,02	-0,15	0,2	0,03	-0,05	0,53	0,06
United Kingdom	1,63	0,08	0,05	-0,21	0,17	0,15	-0,03	-0,02	0,31	-0,34
Austria	1,57	0,02	-0,41	0,07	0,26	0,01	0,05	0	0,03	0,01
France	1,35	-0,2	-0,59	-0,09	-0,1	0,07	0,07	-0,08	0,05	0,48
Canada	1,32	-0,23	-0,9	-0,21	0,62	-0,18	0,04	-0,07	0,14	0,32
Spain	1,28	-0,27	0,73	0,04	-1,12	0	0,03	0,07	-0,14	0,11
Holland	1,26	-0,29	-0,47	-0,03	0,25	0,01	0,06	-0,13	0,52	-0,05
Sweden	1,2	-0,35	-0,6	-0,1	0,21	0,11	-0,1	-0,17	0,01	0,3
Greece	1,15	-0,4	2	0,19	-0,56	-0,07	-0,16	0,17	-0,51	-1,48
Switzerland	0,81	-0,74	-1,75	0,08	0,59	-0,04	0	0,15	0,02	0,21
New Zealand	0,53	-1,02	0,34	-0,17	0,31	-0,29	-0,07	0,1	-0,36	-0,87

countries with geographical discontinuities, as in the case of Greece (in relation to the European Union), Australia and New Zealand, this factor seems to be one of the blockages to their process of growth.

The reflection concerning "growth accounting" suggests to us what we had anticipated: there are no unquestionable "recipes" for growth, no "perfect" experiences or success stories. But for this very reason the experience of the countries leading the consolidation of economic development can be instructive, especially if we resist the tendency to draw mechanical conclusions from them.. In addition, the analysis of these results gave rise to certain reflections which we present in the following points.

### 3. The State and the organisation of the business system

#### i) The life cycle of companies and the functioning of the markets

Companies must be created easily, operate in a healthy environment and bow out peacefully when the time comes. The most efficient management of the life cycle of companies does not always align with political priorities. The existence of barriers to entry preventing access to markets by the most innovative and efficient companies, the prevalence

of distortions in relation to competition, penalising the performance of the most dynamic companies, and the existence of taboos and a not very efficient bankruptcy legislation tend to prevent the demise of companies which, in another context, could be substituted by new, more efficient, incoming companies. For this reason, it appears to us that an essential vector would be the creation of conditions that make possible the redeployment of resources among more efficient companies and those exhibiting the most promising performance. We are considering initiatives which minimise entry barriers, which make the competition policy more operative, and which facilitate exit from the market (bankruptcy legislation).

**It would appear to be indisputable that any neo-liberal economist would agree with this minimalist version of the State. It is necessary to be more daring and to delve more deeply into the action of the State in the structuring of economies!**

#### ii) The correction of market deficiencies

The great majority of politicians, leaders of opinion and economists tend to consider the State and the market as being two complementary institutional frameworks! There is broad consensus today that private economic agents, the public sector, and civil society, all play essential roles in the process of economic development. It is acknowledged that

markets have functional imperfections, requiring, on the part of the governments, the adoption of modifications of an institutional or regulatory nature, or the use of economic policy instruments that make it possible to correct market weaknesses.

There appears to be consensus that there should be a transfer from the conception of an interventionist State to a regulating State which carries out the economic functions that are normally attributed in dominant economic thinking: efficiency (regulation and minimising of market deficiencies), equity (promotion of a fairer and more balanced distribution of income), stability and development.

For many years economists have held the view that although the State could develop public policies making it possible to control medium-term cyclical fluctuations, such actions were not permanently effective in the long-term, it being explicitly admitted that there were no instruments that made it possible to influence the processes of economic growth. In effect, for many years the theories on economic growth presumed that the dynamic of economies was determined by the expansion of productive factors, in a context in which it was admitted that technical progress was exogenous. Paul Romer was the precursor, since 1986, of a different methodological approach, developing models that made it possible to endogenise technical progress and knowledge.<sup>109</sup> Heuristically and perhaps simplifying the complexity of the models developed by this brilliant economist, the essential question of this "new" approach is the fact that it is acknowledged that ideas are not necessarily a scarce resource (i.e., fortunately, as happens with other productive factors, a fixed quota of ideas does not exist). Ideas, therefore, escape the law of diminishing returns, thus allowing processes of sustained and controllable growth by means of the promotion of suitable public policies that stimulate and create the prerequisites for the "production of ideas". We are naturally speaking of the promotion of education and training policies that provide incentives for the preparation of citizens for change, public investments in the reinforcement and consolidation of the technological and training infrastructures, and a very clear commitment to reinforcing the training centres.

Considerable empirical evidence has been produced that enables one to conclude that the supply of public assets that stimulate the diffusion of innovations and the exploration of "virtuous circles" resulting from the synergies existing between intangible investment and productive investment,

have a positive influence either on the productivity of labour or on the global productivity of the factors. In fact, both in the report on the "Competitiveness of European Industry" (European Commission, 1999, pp. 55-66), and in a work produced by the OECD the scope of which is the member countries (Elmeskov and Scarpetta, 2000) it was concluded that public assets and intangible investments (in particular, the new information technologies) will contribute very significantly towards increasing the productivity of industry.

Without questioning this approach in principle, we must endeavour to resist a redeeming image on the part of the State which is often seen as a benevolent dictator which, equipped with complete and perfect information on the functioning of the economy, acts in a way that optimises social well-being. In reality, there is a growing number of authors who focus their attention on the failures of the State which, along this line of approach, is seen as being a complex and heterogeneous collective entity in which differentiated, and sometimes contradictory, interests and objectives coexist, equipped with deficient information on the functioning of the markets and the behaviour of the agents and which, for all these reasons, is strongly conditioned, and even ruled, by market dynamics.

### iii) The coordinating State

Notwithstanding that it continues to be defended by certain leaders of opinion, it does not appear to us to be a realistic option, particularly in the case of the new emerging economies, to have a neo-liberal State which, in addition to the normal functions of sovereignty and provision of public assets, merely sees to creating the conditions for a favourable environment for business activity and, at most, assumes minimalist regulation of economic activity.

To govern signifies, increasingly, to generate expectations, to motivate the stakeholders and to build consensus or, basically, to exercise coordinating action, particularly in projects of a structuring nature. The regulating and coordinating State exercises a leadership function in creating consensus based on a strategic vision shared with civil society and the business sector. If we view microeconomic policies as voluntarist mechanisms of coordination between knowledge, technology and activities, the ex-ante coordination of the State can strengthen positive externalities, above all in economies that are at a stage of true convergence and in a process of accelerated<sup>110</sup> industrial<sup>111</sup> restructuring. In sectors where strong economies of

scale exist and the investments are irrecoverable ("sunk costs"), the coordination of the investments by the State could avoid under-investment (with no satisfaction of potential demand) or over-investment (avoiding the wastage of resources in a situation of scarcity of resources).

The emergence of new activities in developing economies gives rise to levels of uncertainty which are unlikely to be assumed exclusively by the private sector. What role can be played by instruments such as risk capital, "golden-shares", Public-Private Partnerships? It is accepted that, in the initial stage of launching of emerging industries, the State can become the reference shareholder, contributing in this way to sharing the inherent risk arising from the uncertainty of certain businesses. Risk capital could be the appropriate instrument for such situations.

I would like to raise another point concerning State action: There is virtual consensus that sectorial policies involve greater risks, given that the governments have revealed great difficulties in identifying the "winning horse". It also appears to me somewhat ingenuous to claim that it is possible to achieve "take-off" for development by altering the packaging and hoping, passively, that the invisible hand will function.

#### 4. State, reforms and growth

The weighting of the State in the different economies expanded throughout the 20th century. If we take as a reference a sample consisting of 17 of the most industrialised countries, we can see that the weighting of public expenditure was only 8.3% in 1870, transferring successively to 15.4% in 1920, 28.5% in 1960 and, finally, to 47.1% in 1996 (see table 2).<sup>112</sup> On the other hand, according to the data

Even in countries that adopted a clear stance opposing an increase in public expenditure, the results of these policies were not visible. If we take, for example, the United Kingdom, we can see that in 1980 at the start of the Thatcher era, public expenditure represented 43% of GDP and twenty years later, following the violent struggle which the Conservative Government exercised against State expenditure and all the initiatives taken against the *welfare state*, the weighting of the State decreased ... to 42%!<sup>113</sup>

An initial explanation for increased public expenditure has to do with the fact that the rate of growth of productivity of public services is very much lower than that which takes place, for example, in industry. In addition to traditional inefficiency resulting from the lack of a proper incentives scheme within the ambit of the public sector, another factor of weighting is the low rate of growth of productivity that has in general existed for services (the so-called law of Baumol) and which, by the nature of the activities carried out, also affects the functioning of the Public Administration. However, perhaps a more relevant explanation is that increased public expenditure is related to the growth of subsidies to companies and transfers for individuals (subsidised unemployment, pensions, etc.).

The fact that Public Expenditure has reached, for half of the OECD countries, a value close to 50%, corresponds with the perception that the State continues to be an excessive weighting in economic activity, and there is also empirical evidence that civil society benefits if decisions relating to the allocation of a part of those resources are the responsibility of the private sector. For that very reason, there is considerable discussion today, in contradistinction to the so-called market

Table 2 - WEIGHT OF PUBLIC EXPENSES IN THE GDP IN THE INDUSTRIALISED COUNTRIES

1870	1920	1960	1980	1990	1996
8.3%	15.4%	27.9%	42.6%	44.8%	45.9%

Source: IMF, cited by Crook (1997, p. 11)

presented by Kudrle (2000, p. 200), calculated on the basis of the primary values published by the OECD, although in the period between 1965 and 1994 the increase in taxation was not very significant in the USA, where taxes as a percentage of GDP increased from 24.3% to 27.6%, in the European Union this same percentage, during an identical period, increased from 28.3% to 42.5%.

deficiencies, concerning State deficiencies.<sup>114</sup> There are many studies that allow one to affirm that the Reform of the State can have enormous repercussions on economic growth:

- Scully (1988) shows that countries in which the institutions function correctly, are, on average, twice as efficient, and grow three times more rapidly;



- In 2002, the Bank of Portugal held a Conference which dedicated its attention to this subject<sup>115</sup>. The following are cited purely by way of example:

- The duration of legal proceedings in Portugal is around double that observed in the European Union or in the new Asiatic countries (Tavares, 2002);
- There is an estimated inefficiency in the health sector, also in Portugal, of 9.1%. If the use of expenditure were efficient, even retaining the same level of expenditure, life expectancy could increase by 3.2 years, from 69.3 to 72.5 years (St. Aubyn, 2002);
- The estimated inefficiency in education is around 13.5 % (St. Aubyn, 2002).

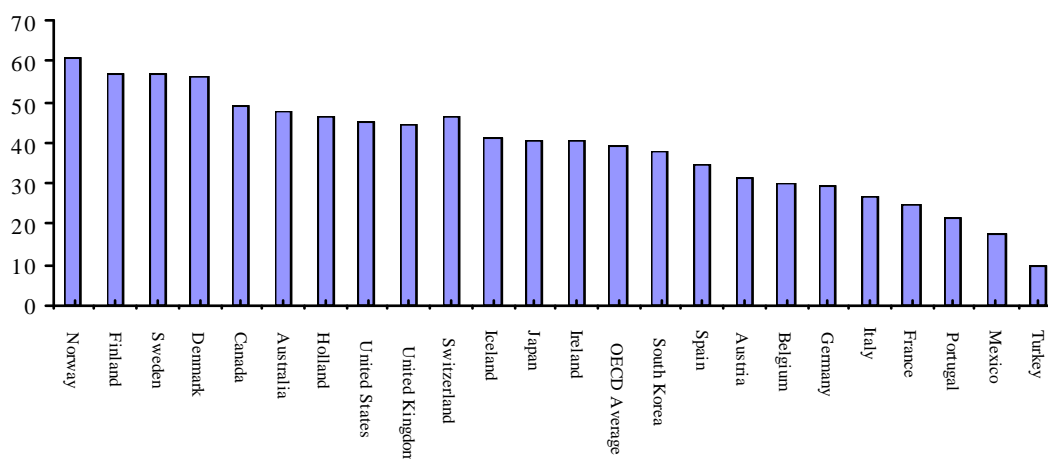
These results give rise to questions that are increasingly unavoidable and are a strong motivation for the pressing need for action:

- How is it possible to evolve towards new management models which, for example, reward merit, or bring about a rethinking of

models that make possible systemic public action of a more transversal nature?

- Furthermore, in relation to the State, certain authors discuss the notion of establishing new models of governance that promote decentralisation, transparency of processes and mechanisms of efficient scrutiny facilitating access to information and stimulating the participation of the citizenry, due to the innovative effects that they can introduce into the decision-making process and for the positive effects that they could have on efficiency and on the efficacy of public decisions.
- The formulation of a medium- or long-term strategy requires conciliation and concretisation of the preferences and desires of current generations without compromising the future of generations to come. It is well known by everyone that the pendular dimension of electoral cycles leads to political decision-makers taking a

Figure 1 - Confidence Index



Source: World Values Study, Knack, S. and Keefer, P. (1997), "Does social capital have an economic payoff? A cross-country investigation", *Quarterly Journal of Economics*, vol. 112 (4), pp. 1251-88.

This index was developed on the basis of the respondents' answers to the following question: "Generally speaking, would you say that you have confidence in most of the people you deal with?".

the public administration structure in order to facilitate changes in the existing organisational systems - characterised by the choice of management models based on excessive specialisation and sectorial isolation of policies - towards matrix

shortsighted view in their options and, therefore, they value short-term repercussions of their political decisions and discount, or even ignore, the implications of their choices for the quality of life of future generations. How can the democratic political systems be reformed

so as to provide incentives to public decision makers to attribute greater importance to the long term?

## 5. Social capital and development

Certain authors defend the idea that the strategy of economic development of each country naturally depends on tangible factors such as the investment effort, the qualification of human resources and the availability of natural resources, but it is also often decisively influenced by factors of a cultural and social nature, such as moral ties of confidence, a predisposition towards cooperation and the dominant principles and ethical values of each society. In slight opposition to the economic view of things, this set of "intangible assets" is designated "social capital" and takes the form of a set of conventions and social practices that are implicit in everyday life and have a decisive influence on transactions, creativity and individual performance, justifying the greater or lesser degree of success of collective action.<sup>16</sup> At a time when the philosophy of regulation makes the intervention of civil society increasingly responsible, investment in "social capital" is an essential condition for the initiatives developed by civil society to have a dynamic and sufficient critical mass and to be able, in this way, to provide an alternative to the State, with the advantage of being more efficacious and more efficient.

Confidence, sociability and the capacity to benefit from synergies arising from cooperation vary considerably from one society to another, it being possible to distinguish extreme situations, such as, Japan and Germany, which exhibit a high degree of sociability, and other countries, such as, in the opinion of Fukuyama, in the Latin/Catholic societies such as France or Italy, where voluntary associativism has much less expression. From this perspective, societies having a high degree of sociability will be more likely to create economic organisations that are simultaneously more flexible and have a minimum critical dimension that will allow them to be successful within the context of an increasingly globalised economy.

Notwithstanding wide debate in respect of the content and interpretation of the different indicators of "social capital", many empirical studies have sought to establish the way in which the level of confidence affects economic performance. As always happens in economics, empirical studies never lead to consensual results, although it can definitely be said that the majority of applications

indicate a positive correlation between economic growth and social capital (see figure 1). For example, Knack and Keefer (1997) reach the conclusion that an increase of 10 points on the confidence index leads to an average annual increase of 0.8% in GDP. These data suggest that public policies must take a proactive stance with a view to promoting "investment in social capital". Naturally, it is not an easy matter, given that there exists a certain sociological determinism associated with the evolution of "social capital" which is very much influenced by factors as diverse as, for example, family structure, cultural values and the history of each society.

However, empirical evidence and good sense suggest that the Government can play a crucial role in promoting "investment in social capital". Access to education and the quality of the learning system, as well as policies that stimulate social inclusion, are two clear examples of actions that reinforce "social capital". A Public Administration and a Political System which give priority to the promotion of the public interest, decentralisation, transparency in the processes and efficient mechanisms of scrutiny, as essential principles, are also essential for the preservation of a good level of confidence. The reinforcement of a legal and institutional framework that stimulates the emergence of civil society is also, naturally, a factor that induces the involvement of the citizens and consolidates the level of confidence. However, certain authors have a tendency to make a very clear distinction between the initiatives of citizens who wish to defend collective interests shared by society and the so-called pressure groups which seek to defend specific interests that benefit particular segments of the economy or of society. Mancur Olson dedicates his attention to this matter in his well-known work "The Rise and Fall of Nations" and concludes, without questioning the legitimacy of the groups of interests in modern democracies, that the absence of regulation and the weakness of governments faced with the excessive corporatisation of contemporary capitalist societies could lead to their downfall.

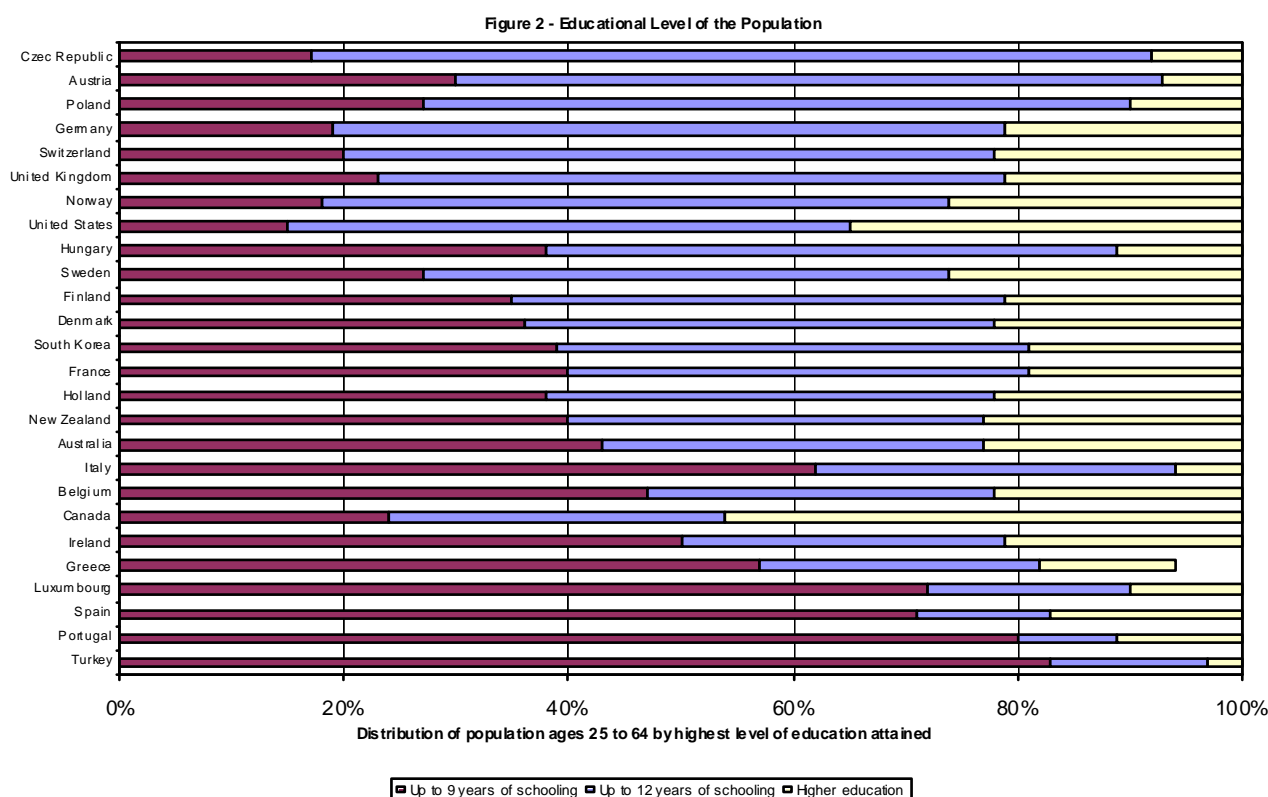
It is also accepted that policies of innovation and competitiveness flourish and benefit from socio-economic environments marked by a high degree of sociability whilst simultaneously allowing the reinforcement and consolidation of "social capital". Existing studies show, moreover, that invention, adoption and diffusion of new technologies are not isolated acts but, quite the contrary, constitute very complex processes, conditioned by market

deficiencies and for that very reason they require an appropriate institutional design in order that the processes of innovation, and the consequent effects of diffusion, are reflected in terms of economic growth. This is the increasingly consensual positioning among the theorists of innovation who consider that the creation and diffusion of innovations result from interdependence between different actors and institutions that interact throughout the cycle of innovation and whose financing and coordination cannot be assured by the Market alone, so that there is a place for the State to take appropriate action in this connection. It is also necessary not to overlook the fact that the increasing globalisation of economic activities and the emergence of new information and communication technologies are contributing to challenging organisational models based on excessive centralisation and on hierarchical relations, leading us to adopt a new approach that values organisational flexibility, decentralisation and co-operation. For all the reasons given above, it would appear to be unquestionable that public policy in regard to innovation must be increasingly considered within the framework of the so-called national innovation systems that constitute the institutional framework essential to promote technological advancement, stimulate the transfer of technology and provide for the diffusion of innovations.

## 6. Qualifications

The analysis we carried out for the purpose of the

**countries with the highest levels of education are, simultaneously, the countries that invest more in continuous training (figure 3).**



“accounting of growth” allowed us to consider that the quantity and quality of education and training of individuals is one of the most important determining factors in increasing the rate of growth of productivity. In fact, the OECD estimates that an increase by one year in the average education of a country could contribute towards an increase of between 4% and 7% in the domestic product per person of working age. Although in Turkey or in Portugal less than 20% of the population has higher secondary education or advanced education, in the context of the OECD countries, around 60% of the population is in this category (figure 2). This difference therefore measures the immense gap that exists, even between countries that have already penetrated beyond the industrialisation barrier. Although it is true that the “upgrading” and renewal of the stock of human capital involves the compulsory involvement in formal education of the youngest children, it is also necessary to take into consideration that this is a slow process, the acceleration of which inevitably translates into continuous training. However, **there are also reasons for fearing that this could widen the gap between the industrialised countries: the**

## 7. Territory and competitiveness

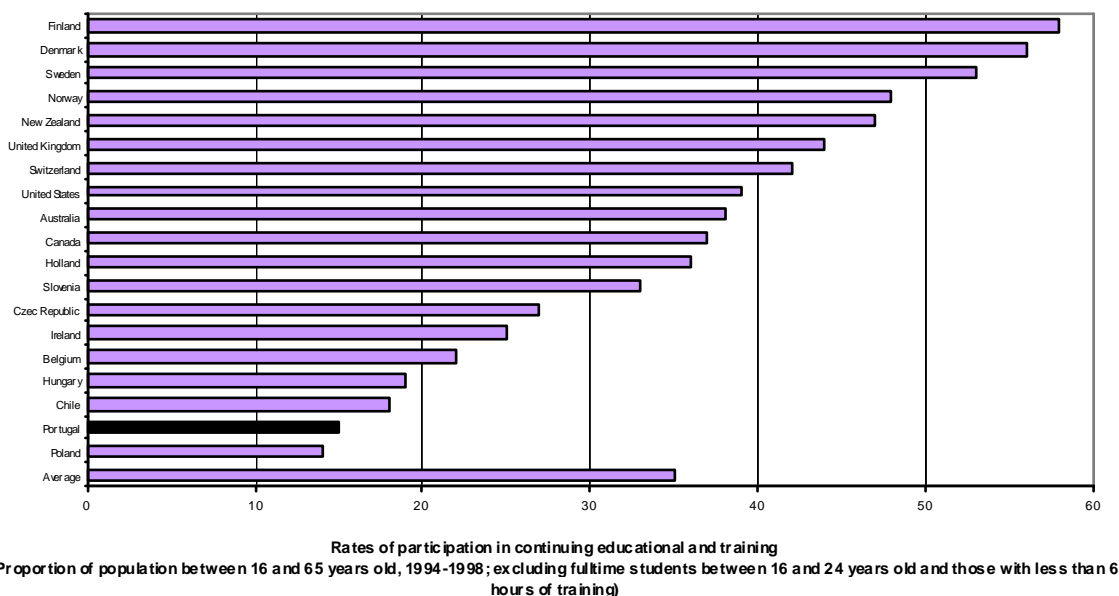
In connection with the new approaches concerning economic geography<sup>117</sup>, the challenge facing the political decision-makers was that of being capable of defining policies establishing a definite commitment between, on the one hand, the need to create catalyst centres of a business and regional dimension, that allow a competitive national economic base to be retained and, on the other, to create the conditions that guarantee that the inter-regional asymmetries which may result from this do not jeopardise social cohesion and, therefore, the process of economic development *per se*.

Traditionally, a dichotomy was established between, on the one hand, the horizontal policies of national scope that rewarded efficiency and, on the other, the policies of local or regional scope, albeit with differentiated statements and terminologies (the creation of employment, local development, social cohesion, etc.) seeking fairness.

It appears to us to be increasingly clear that the territory should not continue, as hitherto, to be the privileged environment for the application of

- Governments displayed a certain lack of legislative realism which led to the mechanical transposition to the internal law of international

Figura 3 - Participation in Adult Educational and Training



Source: Conceição, Pedro (2002), "Notes on Productivity in Portugal," In Victor Santos (ed.), *Globalization, Public Policies, and Competitiveness*. CELTA, Lisbon.

redistributive strategies; on the contrary, it should increasingly be viewed as being the natural dimension for the concretisation of efficient strategies.

## 8. Environment and competitiveness

Environmental quality cannot continue to be viewed as a cost to be met by the productive system but rather as a dynamic factor of competitiveness and, from this standpoint, it is a prerequisite for economic development. Reverting to Schumacher, we also ask ourselves whether economists and managers will continue to be excessively concerned about studying the ideal distribution of deckchairs on the Titanic instead of investing in an evaluation of the general seaworthiness of the ship.

Although it is acknowledged that very significant improvements were recorded in relation to environmental matters in the last 20 years, it is also true that more rapid advances could have been made if certain barriers had not existed between the business system and the public agencies. On the question of the environment, the last two decades were closely marked by the different behaviour of the two principal protagonists:

legislation which is not, in general, conveniently adapted to the specific characteristics of local economies and societies.

- Some businesses continue to see environmental protection as an additional cost or an objective that conflicts with the development of the company and not as a management instrument generating higher profitability.

We consider that this situation will change progressively because the reputation of companies and the political credibility of governments is, today, strongly marked by their approach to environmental matters<sup>118</sup>. In the first place, the public image of the company as a potential disrespector of the environment could adversely affect sales and give rise to the erosion of the goodwill of the company. In the second place, the preferences expressed by consumers in the markets have changed in the industrialised countries: environmental amenities are a superior asset and, consequently, consumers are increasingly opting for purchases of company products and practices that they consider to be more compatible with the environment. In the third place, technological development, the diffusion of information and the transfer from defensive and

curative strategies of end-of-the-line type, to proactive strategies of a more preventive nature, demonstrate that valuing environmental quality can be an eco-efficient management strategy. Finally, the “invention” of the concept of sustainable development, which seeks a compromise between competitiveness, environmental quality and social cohesion, led to the option of proactive or innovative strategies that had a tendency to view the environment not as a liability or an objective conflicting with the development of the company, but, on the contrary, as a means of winning markets and gaining profits. And, contrary to what some people think, it is not a question of a zero sum game where one wins and the vast majority loses. No! It is in fact a positive sum game in which all the players can win and benefit from more efficient economies, a more egalitarian society and a more healthy environment.

### 9. Final considerations: The newly emerging economies and “recipes” for development

Until quite recently the emerging economies of Asia represented paradigmatic examples of excellent performance in the prosecution of economic development strategies. The recipe for success appeared to have, as conditioning principles, a prevalence for a mitigated democracy in which an authoritarian, voluntarist State was the protagonist, with a superior capacity to exercise functions of coordination of economic activity and to stimulate co-operation between the different economic agents.

The efficacy and efficiency of the public agencies of these countries represent favourite contra-examples in response to those who invoke the inevitability of the failure of state interventionism. For that very reason everyone is attempting to pursue these success stories closely, and there are even attempts to adapt these strategies to an endless number of countries which in some cases are not very proficient. Due to its size and dramatic result, the Indian experience, excellently portrayed in the *Economist*, represents another more visible side of the same coin!<sup>119</sup>

More recently, the rates of growth of the Asian tigers, in particular the second generation, began to decelerate and the different indicators of competitiveness and economic health began to assume an evolution very close to average.

Various reasons have been put forward for the decline of the so-called Asian tigers, but in our opinion, one of the more convincing arguments was suggested by *Paul Krugman* in his delightful essay *The Myth of Asia's Miracle*.<sup>120</sup> The high rates of growth observed in the Asian countries are due essentially to the concomitant expansion of the productive factors and not precisely to the increase in the overall efficiency of the system; i.e., together with a predisposition to sacrifice current consumption for the benefit of future production, these countries revealed an extraordinary capacity to mobilise growing resources (human, technological and capital resources) without, however, being capable of reflecting this dynamic in the evolution of productivity. As is well known, when the processes of growth are only based on an increase in *inputs* and do not reflect the greater efficiency of the economic system, diminishing returns inevitably exist and, consequently, the process of growth is unsustainable.

Comparing the evolution of the emerging economies of Asia such as Japan or China, Krugman concludes that for various reasons these economies will have a lower probability of entering, in the short term, into a process of decline: while the Japanese economy managed to sustain its process of growth by increasing the productive factors and efficiency, China is a vast territory, so vast and unexplored, that the public and private decision makers are faced with an extremely dilated horizon in order to take advantage of the considerable potential of productive factors affecting production before they enter into a phase of diminishing returns. The perversities of the Japanese political system, the promiscuities existing between financial capital and industrial capital and deflation already appear to have challenged the prospective analysis of Krugman in regard to Japan!

The arguments put forward by Krugman to explain the not very brilliant evolution of the productivity of the Asian countries, should be seen in relation to the likewise not very encouraging evolution of productivity in the more advanced countries, during the course of the last two decades. In fact, the mass adoption of new information technologies that has occurred in recent years, has not had a comparable impact on productivity. This phenomenon, usually called the *paradox of productivity*, is due to the fact that technological changes require a period of relatively slow internalisation until they have been fully potentialised and endogenised by their users.<sup>121</sup> In fact, we all have the intuition that it is not sufficient merely to purchase computers, but

also to know how to use them efficiently; or as Pam Woodall, the economics editor of *The Economist* states, we have to understand that computers not only enable us to do the same things in a different way, but that, above all, they make it possible for us to do completely different things (Woodall, 1996, page 15).

This learning process is not instantaneous, it takes time!

We will now discuss other tigers (Chile, Ireland, Pakistan, among others), not necessarily Asiatic and which have little in common from the standpoint of the institutional framework or the conception of State that characterise them.

Up until now it has been accepted, almost axiomatically, that the neo-liberal approaches defended by international economic organisations, such as the World Bank and the IMF, and the prevalence of fully democratic systems, do not adjust to the dominant “environment” in the less developed countries. Ireland demonstrates, as we “suspected”, that the existence of a complete democratic system does not constitute an obstacle to development and Chile suggests to us that a mitigated liberalism can successfully guarantee the true convergence of the less developed economies.

The most recent experience suggests that there are no miraculous recipes for development! This fact at least has the advantage of stimulating the governments of countries that are taking steps with a view to guaranteeing true convergence not to mechanically imitate the strategies developed by others, but to creatively pursue their own path, without ignoring earlier experience but above all paying attention to their own specificities.

#### INDUSTRIAL POLICY AND COMPETITIVENESS IN BRAZIL

In barely more than forty years, Brazil has constructed a broad and diversified industry, increasing participation in the secondary sector of GDP - Gross Domestic Product - and introducing industrialised goods into the export flow, some with a high value added and technological content, such as medium-sized jet aircraft. In four decades, with differentiated nuances and emphases, Brazil utilised the same industrial policy to promote rapid industrialisation, notwithstanding governments with very different political orientations and ideologies (from the populism of Getúlio Vargas to the modernising military dictatorship of the 1970s). This policy combined **the substitution of imports**

based on external protectionism – exchange and customs – with strong **State investment**. In the dominant pattern of competitiveness during this period of world economic history, this appears to have been a unique alternative to break the vicious cycle of external dependency and the international division of labour. The State substituted for the businessman, who had limited capacity and little interest in investing in sectors with a low and slow return on capital; and the external barriers made the domestic market captive, making investments of lower profitability and productivity viable, in addition to attracting external capital interested in national domestic demand. Starting with President Getúlio Vargas, this political orientation intensified during the military era, with the creation of major public investment and financing funds, some of which were applied in the construction of a broad energy network and modern communication and telephone systems.

#### 1. Protected and State industrialisation

The policy of substitution of imports and State investment undoubtedly generated very positive results, forming an industrial structure based on the coexistence of strong state enterprises - concentrating on basic products (iron and steel, petroleum, etc), energy and telecommunications – powerful multinationals - acting in sectors of greatest technological density, such as the automobile industry, chemicals and petrochemicals – and an incipient entrepreneur of national capital. It would have been difficult for Brazil to have become industrialised if it had awaited the “invisible hand of the world market” and had not implemented this industrial policy, continuously over a long period of time.

However, it seems appropriate also to consider that the success of the policy arose from its consistency with the historic conditions of world and national capitalism, and it is worth mentioning the patterns of competitiveness of the initial post-war decades. What was predominant during that stage for the attraction of investments, apart from the size of the market offered by Brazil, was the abundance of natural resources, the lower cost of labour (albeit not very qualified) and few environmental requirements, so as not to increase the business costs of production; during the decade of the 1970s, when the central countries had already started to implement rigorous mechanisms of environmental control, the Brazilian government welcomed chimneys that polluted the air and the rivers in the industrial cities of Brazil.

The policy of substitution of imports and statism constituted in fact, a shortcut to compensate for the low degree of competitiveness of the economy and the limited accumulation of national capital, taking advantage of the considerable potential of the domestic market. The State became a national entrepreneur and the customs barriers made imports prohibitive, which meant that domestic production of goods and services demanded by the economy and by society was viable. To some extent there was the expectation that this compensatory process could, in the long-term, generate new conditions of accumulation and competitiveness, guaranteeing sustainability in the Brazilian industrialisation process.

The positive development of the policy, however, had a high cost for the national economy and was based on an industrial structure with weaknesses due to reduced competition, always depending on persistent protection and incentives by the State, in addition to the presence of the State in segments of low profitability. In effect, the political orientation had a tendency to preserve the lack of competition and to inhibit innovative capacity on the part of the business community, thus favouring the formation of a conservative culture in the social segment that should have been introducing innovations and technological changes. Although they contributed towards the creation of an important technological base in Brazil, together with certain sectorial research centres, the state agencies, are, in general, instruments of economic policy without concern for profitability and productive efficiency. Even when operating in potentially profitable sectors, such as iron and steel and telecommunications, the large state enterprises remained, until the 1990s, low profitability enterprises requiring budget resources to make new investments viable.

From this standpoint, the industrial policy as with any other policy of substitution of imports, was most effective, but it also had limitations that led to weakness, even in the Fordist paradigm which predominated until almost the end of the last century. But it has proven to be completely obsolete and inadequate in the new information and knowledge economy and society occupying the world economic system since the 1990s. As stated by Marcos Cavalcanti, the "competitiveness of Brazilian companies was always based on comparative advantages deriving from the classical factors of production – land, capital and labour. In the new economy these advantages ceased to be

relevant faced with the new factor of production: information knowledge" (Cavalcanti, 2001, page 245). In effect, the process of globalisation, associated with considerable technological and institutional changes, redefined the possibilities of development of each country and its capacity to engage in competition. These changes in the pattern of competitiveness, coincide with the perception that the advantages of an economy in terms of competition are not precise or definitive, and neither do they depend on traditional comparative advantages based on the availability of natural resources.

## 2. Productive restructuring and integration in the globalised world

At different rates and speeds, the so-called "new paradigm of development" is bringing about a radical change in the conditions of competitiveness of nations and of the various economic spaces. From the advantages arising due to the abundance of natural resources, low salaries and reduced environmental requirements - which characterised the expansive post-war cycle - there has been an increasing move towards the advantages of knowledge and information with increased emphasis on the importance of the intangible factors of production, such as technology, information, organisation and co-operation. As these aspects are dynamic and are not dependent on the special gifts of nature, they can be constructed and improved upon; unlike the static comparative advantages, the position of each economy can be modified, constructed or worsened by the different initiatives taken in each territory.

In addition to the changes in international conditions, the weakening of the policy of substitution of imports was accelerated in Brazil due to the public finances crisis, from the 1980s, stifling its investment capacity and exposing the deficiencies of the entrepreneur State. Notwithstanding the said contribution towards technological development, the State entities as a rule were not very efficient or profitable and were generally heavily in debt. After almost a decade of absence of industrial policy (during the 1980s), due to the partial bankruptcy of the State, during the 1990s there was a radical upset in the orientation of Brazilian policy, based on two pillars opposed to the substitution of imports: **the external opening up of the economy**, with a marked reduction in customs barriers, and **privatisation** of the industrial base dominated by the public sector.



In less than ten years, Brazil broadly exposed the economy to outside competition, with a reduction in the mechanisms of customs protection, for which most of the sectors were ill prepared; in some of these sectors and productive fields, such as footwear and textiles/clothing, the impact was dramatic, though they have managed to recover somewhat in recent years. At the same time, it promoted an ambitious and rapid programme of withdrawal of State involvement from the energy, telecommunications and iron and steel sectors. This new orientation was more consistent with the conditions of emerging competition, which required continuous innovations and coincided with a lack of capacity on the part of the State to allocate resources to investments in the fundamental segments of the new economy, principally the system of innovation. After several years of fiscal crisis, the logistical conditions and economic externalities of Brazil, particularly in relation to transport, telecommunications and energy, had deteriorated and become stifled, compromising the capacity for investment and competitiveness. The Brazilian State could no longer be the huge investor of the past, both in the infrastructures creating positive externalities and in the productive undertakings in which it was engaged.

The results of privatisation were very unequal in sectorial terms; but in general, privatisation and external opening up to abroad gave rise to the modernisation of the industrial base and to a significant expansion in private investment; in telecommunications especially, there was a considerable change in the Brazilian economy, with increased supply and access by society to services as well as an improvement in the quality of products. In order to have some idea of the situation, at the beginning of the 1990s (before privatisation) Brazil had around 8 telephones per 100 inhabitants and it cost US\$ 5,000 to get a telephone line installed in some large Brazilian capitals; today, there are approximately 39 million land lines and 38 million mobile lines (amounting to a total of around 50 lines per 100 inhabitants), and there is an oversupply of lines at a cost of less than US\$ 15 for the installation of a line, though the cost of calls has increased substantially. For iron and steel, privatisation of the state interests was also a success, especially the Companhia Vale do Rio Doce, a large iron and steel mining conglomerate of international scale. The performance of private initiative in the public services with oligopolistic characteristics, depends on the existence of competent institutional systems for regulating the market, both to avoid a monopoly and to stimulate

competition, as well as ensuring universal access by the population. The difficulties presented by the privatisation of the energy sector arose from the limitations and imprecise nature of the regulatory framework and the regulating agency, defining the rules for investment, sale and tariffs, as this is a very complex segment that retained a State presence for part of the generation/ transmission/ distribution cycle.

The biggest problems with the 1990s policy of openness and privatisation were due to the fact that it coincided with the policy of macroeconomic stabilisation, centred on the exchange anchor to end the culture of price indexing. This led to an artificially broad external opening up due to the over-valuation of the Brazilian currency (the *Real*), with a view to creating downward price pressure by means of very cheap imports. On the other hand, privatisations mixed the objective of increasing efficiency and investment in strategic sectors of the Brazilian economy and industry, with the immediate interest of providing resources for public finances. In any event, after ten years of the "shock of capitalism" (an expression of ex-governor Mário Covas, a reduction of the inefficiency of protectionism), Brazilian industry today has increased productivity and quality of products, modernisation and specialisation, with better conditions for competing in the globalised system. Clearly this transition had a social cost and it gave rise to a restructuring of the industrial base, with the emergence and strengthening of new sectors, but also to a crisis and virtual elimination of other activities.

### **3. Systemic competitiveness and new industrial policy**

Industrial policy in the 1990s saw a profound reorientation of the strategy implemented during the four previous decades, the focus being centered on the competitiveness of the economy and of the industrial base, which included involvement in the globalised economy and, therefore, the expansion of business productivity, but mainly increased efficiency in the Brazilian economic system. The new political concepts were based on the principle that an industrial sector cannot be competitive in isolation if the environment in which it operates is unfavourable in terms of the supply of raw materials and factors that are decisive for its efficiency; in addition to the economic and logistical infrastructure, it is also appropriate to emphasise in the new paradigm of development the level of education and qualification of labour, and the

scientific and technological capability of the country or region.

Systemic competitiveness, which was the essence of the policy, places companies in a network of connections that involve the education system, the infrastructure, technology and relations between employees and employers, the public and private institutional apparatus and the financial system (CEPAL, 1990). Understood as the joint capacity of the economic and social system as a whole to occupy spaces and enjoy advantages in market disputes, systemic competitiveness should express the collective efficiency of the economy (or industrial sector).

In addition to the externalities that determine collective efficiency, cooperation between the companies themselves and other economic actors such as commercial and marketing agents, business associations, trade unions, and centres of technological research and design, is of fundamental importance for the creation of an innovative environment suited to industrial development and competitiveness. To a great extent, these factors depend on social, cultural and even institutional conditions that stimulate co-operation and creativity; some can be created by means of public action -- and through the initiative of businessmen themselves -- in the business chain, expanding the educational level and qualifications of the labour stock and the scientific and technological base, and defining a legislation and a system of regulation that stimulates creativity and the search for solutions and alternatives.

As the extent of knowledge and technical/professional qualification (as well as an innovative environment) is distributed unequally within the territory, the process of globalisation has a tendency to reinforce economic concentration, although new possibilities open up for the countries, based on their capacity and their initiatives. All the authors agree that the fundamental parts of the new conditions of competitiveness of industry are local characteristics and that "the local sources of competitiveness are important for the growth of firms and that such sources are linked to the establishment of innovative capacity of a localised nature" (Cassiolato, 2001, page 36). Or, as Michael Porter states, competitive advantage is created and maintained by means of a highly localised process (Porter, 1993), in such a way that global industries spread worldwide, according to the characteristics of each region, benefiting from diversities and particularities in competitive conditions.

These diversities can constitute a factor of local competitiveness to attract investments, which are reproduced and are differentiated in the process of globalisation. Notwithstanding adjustments in trade, globalisation does not lead to a decline of local identities, nor to economic, social, and much less cultural, homogenization. On the contrary, as Albagli reminds us, "each society or social group is capable of preserving and developing its own set of representations, expressing an identity which is at once spatial and community oriented, around the locality" (Albagli, 1998, page 6). To a certain extent (and paradoxically), globalisation would be causing an increase in differentiation and cultural complexity, thus allowing local and national identities to be maintained and even strengthened.<sup>122</sup>

The position of each country in the globalisation process depends on the way in which these characteristics and identities are attuned to the requirements of competitiveness, with considerable emphasis on innovative capacity which has cultural roots though in the final analysis it depends on economic externalities. Therefore, it is insufficient to highlight the identities and potentialities, in general identified as static comparative advantages; one must, on the contrary, concentrate attention on the quality of the economic infrastructure, the level of education, the training of human resources and the local scientific and technological base. In order to expand these conditions, investments are required with no direct financial return, so that the State has a central role to play in constructing the systemic competitiveness of a region. To a certain extent, contrary to what has been published, globalisation and its requirements for competitiveness have a tendency to increase the importance of the public sector in the debate over competitiveness and, therefore, in the development of nations and regions. In this respect, another limitation of the industrial policy implemented during the 1990s is brought to light: given the considerable government budgeting difficulties and restrictive macroeconomic policies facing most developing countries during this period, investments in fundamental externalities for the construction of competitiveness were markedly insufficient to meet the challenges of the time.

Beyond increasing the economic weighting of the State, the new paradigm leads to a change in the form and segments of activation of the State, which ceases to be the great entrepreneur of the poor countries and the protector of national undertakings

with a low degree of competitiveness, and becomes the promoter of an innovative environment that complements national collective efficiency. In effect, the nature of the public institutions and their role in the industrial development process has undergone important changes in recent decades – throughout the world including in Brazil -- in part as a response to the new challenges of globalisation and the need for competitiveness, particularly in relation to the formation of an innovative environment. Far from being the solitary sponsor of industrialisation and development – substituting the businessman and compensating for inefficiency - as happened in the past, the State has become a major partner; it continues to be the most important promoter, by its coverage and by the force of its instruments, but the State cannot respond to contemporary requirements and demands without the co-operation and participation of the social actors, especially the business community, the main innovative force of the economy.

Recent industrial development experience shows the importance of decisions and initiatives negotiated and shared by governments, institutions and social actors, forming multiparty relationships; they lose the traditional hierarchised and centralised management formats, organising horizontal systems of articulation between institutions and actors, without a hierarchy but with leadership and with shared and accepted rules and roles based on confidence and respect, with an agreed distribution of responsibilities<sup>123</sup>. These characteristics appear to have had an important weighting in the development of regions of high collective efficiency, as in the already mentioned model of the Third Italy, with minimum formalism and maximum co-operation and confidence surrounding a collective project (Matos Macedo, 1995). Although continuing to assume a central role in the promotion of development, principally in the creation of competitive advantages and the innovative environment, the State is expanding its function and responsibility as a regulator and encourager of the various organisations and interest groups of regional society, acting as a catalyst and an adhesive force in relation to multiple local initiatives.

In addition to this, it must contribute with the creation of regulation mechanisms to expanding an innovative environment, based on creativity and on the capacity to generate productive alternatives and the diffusion of knowledge in the local economy. These mechanisms must favour and stimulate the capacity of creation and continuous learning on the part of society and the business community,

inventing, testing and adapting alternatives and paths that allow development (Boisier, 1995). Unlike the orientation of the industrial policies of the past, based on protectionism and tax and financial incentives which, acting in the short term and in a situation of scarcity of capital and low competitiveness, ended up by inhibiting the creative and innovative capacity of society. As Cassiolato states, "fiscal wars to attract investments do not attract the type of investments that generate learning and innovation" (Cassiolato, 2001, page 39); furthermore, it functions as a mechanism for accommodating the productive agents. Although it depends on more general conditions, innovation is a direct result of the business approach and its willingness to take risks and to explore new avenues taking advantage of regional and State potentialities.

Understanding the central role of innovation in competitiveness has led countries to engage in the construction of "National Systems of Innovation", with a view to articulating the various stages of the process of innovation focused on industrial priorities. For nations with a limited scientific and technological capacity, such as Brazil, it is of fundamental importance to form learning systems that stimulate diffusion, absorption and, in particular, the adaptation of external technologies, with a view to articulating around the principal productive chains, in a deliberate strategy of promoting improvements in and upgrading technologies (Macedo, 2001).

On the other hand, in the new paradigm of development, increased competitiveness in the poor countries is necessarily accompanied by social changes which lead to better social equality, improvements in living standards, higher levels of education, and better quality labour, thus attracting private investment. Within the new patterns of world economic competition, fairness is also manifested as a fundamental condition for the competitiveness of nations, to the extent that is sustained better by the deliberate introduction of technological innovation (technical progress) and an increase in productivity and not by low salary levels, as in the past (CEPAL, 1990). It will be difficult to form an innovative environment for attracting investments into a country with violence, insecurity, poverty and slums, and with the degradation of the natural and constructed environment, factors which, to a great extent, arise from social inequality and a lack of public services. Competitiveness is therefore only achieved if a sizeable part of the surpluses generated in the country are allocated for

investments in the areas of education and qualification of the workforce – expanding opportunities and contributing to a reduction of inequality and poverty – and for the provision of social services, in particular basic health services. All these social components which impact on competitiveness and the innovative environment require the active presence of the State in mobilising and allocating public resources.

During the recent phase of modernisation and industrial reconstruction of Brazil, there was a worsening of social conditions in the cities and larger towns, especially with respect to urban violence, which must have had a negative impact on competitiveness and innovative capacity to attract productive investments. Although the second half of the 1990s was a more intense period of external investment in Brazil (and not only speculative investments), which resulted in its being the second emerging country for investments (after China), national competitiveness was certainly adversely affected by the social and environmental deterioration of the cities. From this standpoint, the implementation of social policy and investment represented a fundamental contribution towards the industrial development of the country, in some ways more important than the government initiatives in the industrial sector. However, the Social Democrat orientation of the majority party in power notwithstanding, the public finance and macroeconomic policy difficulties of the current Brazilian government, struggling as it is to undertake strong fiscal adjustments based on the target of a primary surplus of 4.25% of GDP, are preventing bold and strong action for social development and the improvement of living conditions in the cities. The effect has been to delay the expansion of Brazil's competitiveness and innovative environment, the bases for an effective and consistent industrial policy.

The technological innovations of the new development paradigm also have an important impact on economies of scale, allowing high profitability in small businesses, to the extent that the economic scale in various productive sectors is reduced. The IT and telecom revolution is allowing an integration of the markets and considerable flexibility in the process of production and distribution, facilitating the viability of small sized companies. However, there is also a tendency to require the organisation of productive chains in flexible productive systems, capable of responding to rapid changes and to the new market profile, as well as demonstrating greater agility in response to

market turbulence. This also appears to have been one of the characteristics of the Italian industrial districts, which, in the formulation of Tironi, "obtained competitive advantages from the fact that they offered a technologically innovative flexible productive structure and a territorial distribution favouring the flourishing of competitive associativism..." (Tironi, 2001, page 326). For several decades Brazil has had a financially strong institution for the promotion of small and micro companies, though the results are modest. In addition to this, the orientation of its projects has not emphasised industry and businesses of high technology and quality, decisive factors for competitiveness.

Concerning contemporary industrial policies, it is appropriate to emphasise that the competitiveness of an economy is manifested in a limited set of productive arrangements effectively presenting conditions that are more suitable and advantageous for production and marketing; to the extent that competitiveness is very selective, it has a tendency to be manifested in territorially defined densities, forming productive clusters with a high degree of synergy and efficiency; the clusters are understood as being agglomerates of related economic activities articulated in a productive value chain, organised in a geographically concentrated system of interconnected companies, thus generating joint efficiency. Considering these characteristics of productive organisation, industrial development strategies must be oriented for the consolidation and expansion of the clusters, that is to say the structuring and development of productive chains (local productive compositions) both to increase systemic efficiency and to provide for value added along their principal links and productive segments. In this way, advances are made in the production of goods and services requiring greater processing and technological content. The performance of each undertaking and each of the productive activities is the result of the set of interactions and exchanges in a systemic relationship linking integrated segments. But it also depends on the collective efficiency of the society and of the national economy, as well as on economic externalities and the innovative environment.

As productive arrangements tend to form cluster economies in given locations (regions), an increase in competitiveness, and the linkage process, generate forward and backward linkages and spillovers to the economy as a whole, promoting local economic dynamism. For this purpose, the investments to create and expand positive

externalities must be articulated around the principal potential productive chains, so as to optimise their results in those segments with the greatest local advantages. The search for consolidation in the productive chains therefore represents the selectivity of the investments, centred on the productive conglomerates of most potential and with effective market possibilities. Therefore, instead of pursuing high rates of economic autonomy, industrial policy should work with a level of specialisation in the chains with most potential, in particular when it has a small-scale domestic market (small countries). Each country should therefore endeavour to obtain niches of competitiveness in accordance with its conditions and potentialities, highlighting those areas that could become more competitive.

#### 4. Challenges of a new industrial policy

Despite the broadness and diversity of its industrial base and technological competence in certain areas, Brazil still faces a difficult future for its competitive involvement in the globalised economy, especially due to the predominance of the low level of education and the deficient living conditions in the principal cities of the Brazilian urban network, including urban violence in the large cities which primarily compromise the innovative environment. These difficulties are accentuated by the lack of a tradition of co-operation and associativism among Brazilian business community, partially caused by the old policy of import substituting industrialization. With an innovative culture, and in the main amenable to novelty and innovation, Brazil formed a dynamic business sector, though it is still limited in terms of the great challenges of competitive involvement in a globalised world. On the other hand, although it has a large domestic market, it still has a relatively low per capita income and, in general, has a concentration of income that depresses domestic demand; even with around 170 million inhabitants, the concentration of income and poverty is depressing the consumer market, from which more than 50 million Brazilians are totally or partially excluded.

The government of President Luís Inácio Lula da Silva still does not have an industrial policy, in part due to internal differences between the representatives of the business community, through the Ministry of Development, and certain leaders of the Workers Party or economists of the old ECLA school (the most representative of which is the current president of the BNDES-*Banco Nacional de Desenvolvimento Económico e Social* [National

Bank of Economic and Social Development] Carlos Lessa)<sup>24</sup>. The former defend a universal policy focused on the search for competitiveness, which, in large measure, represents a continuation of the dominant strategy since the first government of Fernando Henrique Cardoso, in 1995; among the latter, the theory of support and encouragement for development in selected industrial sectors predominates, including components of protectionism and government intervention.

Apart from reflecting an out-of-season ideological debate, the contest is without foundation and creates a false dichotomy. If, based on what has been said and on an interpretation of the conditions of competitiveness of the contemporary world, industrial development does not appear to be sustainable with the old State entrepreneur and the substitution of imports, it is also true that policies should give priority and emphasis to initiatives and instruments for clusters or productive chains of greater potential competitive advantage. In this way, although the industrial strategy should be oriented towards the construction of conditions for the systemic competitiveness of the economy (collective efficiency) and the formation of an innovative environment, it will be necessary to complement this universal and horizontal policy with measures of sectorial development in the various links of the value chains, increasing value added and internal synergy. These measures could contemplate a protection mechanism for newly-formed industries which, however, must be small, transitory and complementary.

But the great contribution of government towards the development of industry and its competitiveness should be the creation of economic and social externalities, promoting the recovery and expansion of the economic infrastructure, but at the same time, investment in the social infrastructure and in urban services in order to improve living conditions and reduce poverty and violence. In this way, it will be improving the living standards of the population, the objective of all social policy, and contributing to an increase in the collective efficiency of Brazil.

## SOME REFLECTIONS ON COMMUNITY DEVELOPMENT

### Introduction

The reflections on community development presented here derive from experience of just over ten years within the scope of the work of the ADRA - *Acção para o Desenvolvimento Rural e Ambiente* [Action for Rural and Environmental Development], an Angolan non-governmental organisation which, since the early 1990s, has contributed, through a closer knowledge of the true situation, to the development of a proposal for sustainable development in Angola, based on the participation of excluded population groups, the transformation of their living conditions, the strengthening of civil society, democratisation, national reconciliation and peace. It is not, therefore, an academic or scientific work. Nor is it even the fruit of a systematisation of experiences, i.e., a reflection on the practice and critical interpretation of those experiences, allowing the production of new knowledge and an improvement in practice. This still has to be done. These reflections were fuelled, above all, by the experiences of the on-the-ground teams of ADRA intervening in communities, and by other reflections, albeit superficial and incomplete, during the training of those teams, which has been done since 2001.

### Brief prior considerations

Before delving into core concepts, it is appropriate to point out that social intervention exists when there is conscious, intentional and structured action on the part of an intervening system, that operates as a resource for responding to the social needs of a client system.<sup>125</sup> This situation of social intervention presupposes an interaction<sup>126</sup> between the two foregoing systems which is translated into the establishment of relations and an exchange of information that can lead to the identification of requirements – for which adequate solutions and resources to be used for implementing such solutions – should be sought. Social intervention also presupposes the existence of a political, economic and socio-cultural environment to configure the interaction, providing favourable or unfavourable conditions for intervention (Camo, 1999: 34-35).

Social intervention takes place when one has a situation that corresponds to one or more social problems, i.e., when one is faced with a situation that affects a significant number of individuals and is considered by them, or by a significant number of other individuals, to be a source of difficulty – and

not a disaster – and, for that very reason, susceptible to improvement and, consequently, being able to give rise to a structured action of change (Camo, 1999:68).

### Evolution of the concept of Community Development

The English designation “community development” was translated into Portuguese as “*desenvolvimento comunitário*” [community development], but some Brazilian authors preferred to use “*desenvolvimento de comunidades*” [development of communities], which causes a certain amount of misunderstanding, the concept being confused with the idea of the “development of communities”, as sometimes happens today, in Angola.

The concept of Community Development arose in parallel with that of development following the Second World War. Its origins were the indirect rule system used by the British Government in its colonies during the first half of the twentieth century, with a view to the formation of local leaders who could ensure the management of the life of the community. The main concern of the British was to promote the living standards of the community population groups with their active participation and, if possible, on their own initiative.

Community Development was affirmed as a method of social intervention after 1945 in an attempt to respond to the social problems presented by the context, not only as a consequence of the world conflict, but also due to the political transformations that had been occurring in the underdeveloped world, particularly in those countries that were advancing towards independence. India was the first country to officially launch a national programme of Community Development in 1952. Both in the case of this country and in the case of others following it, the humanist ideas of Gandhi and his concerns for social education made an important contribution, as did the action of the educating missionaries in some colonised countries, as well as the wave of nationalism in the underdeveloped countries and the social conflicts present in many of those countries, in addition to the Cold War which was beginning to develop.

Community Development was revealing different tendencies and concepts depending on the historic process in which it took place. César Rodrigues, in his book *Análisis conceptual del desarrollo de la*

*comunidad* [Conceptual Analysis of Community Development], cited by Maria Luiza de Sousa (1993:53), noted twenty-five known definitions between 1948 and 1961. The United Nations initially defined Community Development as "a process designed to create conditions of economic and social progress for the whole community with its active participation and the fullest possible reliance upon the community's initiative". The concept was subsequently revised by the UNO itself, then being considered as "the processes by which the efforts of the people themselves are united with those of governmental authorities to improve the economic, social and cultural conditions of the communities, to integrate these communities into the life of the nation, and to enable them to contribute fully to the national progress". (CBCISS, also cited by M. Luiza de Souza, 1999:55). These definitions emphasise the active participation of the population, whenever possible on its own initiative, at all stages of development, including the decision to initiate the process. But special emphasis is given to the importance of co-operation between the population and the public institutions, so that the process is balanced and harmonious. Emphasis is also given to the articulation of communities with global society and the life of the nation, facilitating an active contribution towards the social, economic and cultural progress of the country. Finally, these definitions eliminate the idea that Community Development is reduced to social intervention, due to the value which they allocate to the economic aspect (Nogueira: 10).

More recently, Ezequiel Ander-Egg (1980:69) characterised Community Development as "the social technique for promoting mankind and mobilising human and institutional resources, by means of the active and democratic participation of the population in the study, planning and execution of programmes at the level of the basic communities, for the purpose of improving their living standards". In turn, Maria Luiza de Souza (1993:57) expressed in a clearer way the pedagogical and political components of the concept, considering it to be "the pedagogical process of social organisation of the community population, by means of which the population manages to improve its conditions of individual and collective consumption, as well as exercising control over these conditions, gradually evolving towards participation at broader levels of society and, above all, in relation to the fundamental problems of the popular strata".

Underlying the different definitions of the concept it is possible to identify four dimensions:

- A doctrinal or politico-ideological dimension which involves a specific view of the world, connoting concern for the poor, the excluded and the oppressed;
- A theoretical dimension which is conferred by the sociological and economic analysis underlying it;
- A methodological dimension for the purpose of the conscious, intentional and structured movement which it defends;
- A practical dimension related to its application on the ground and the origin of community action, both by the involvement of communities in their own development process, and by changes in attitudes and professional practices obliging the same (Carmo 1999:78).

Having reached this point, I consider it useful to refer to two concepts that are essential for an understanding of the matter I have been covering: that of *community* as an object of the practice of Community Development and that of *development* based on which the practice should be developed.

### **The concepts of community and development**

The concept of community acquires various meanings depending on the context in which it is applied. Thus, it can be applied to designate small population aggregates (villages), groups of a certain religious affiliation (Christian community), professional or occupational groups (medical community, student community) or even systems of greater complexity (European Community, international community). In all these designations the existence of a given similarity between the elements comprising the system is common, conferring upon it a given identity and, in turn, determining a boundary between the elements belonging to it, and those which are outside it (Carmo, 1999:73). The German sociologist Ferdinand Tönnies was responsible for the oldest theoretical approach to the concept, in opposition to that of society. It is also sometimes said that community is a specific form of expression of society itself and, this being the case, in order to understand it, it is necessary to comprehend global society and the particularities or elements of that

specificity (M. Luiza de Souza, 1993:66-67). The evolution of the concept has confirmed the ambiguity and the polemics surrounding it, due to the problems connected with its very definition, or the method of analysis and the theoretical references. However, its utility must be recognised in operational terms, since expressions such as “community” [noun] and “community” [adjective] continue to form a part of the lexicon of those interacting with populations that present a certain degree of interconnection, social cohesion, solidarity or affectivity in social relations. In terms of Community Development, therefore, the community should be seen as an operating concept in relation to the geographical area as the common area of habitation, coexistence and relationships between persons and groups. However, the substance of the community does not relate to its geographical aspect but to the relationships of powers and counter-powers that are structured as a function of common interests and concerns and therefore, often instead of the geographical area, there is a preference for the use of social space, where people establish relationships with one another. This being the case, it is possible to adapt the definition of Ezequiel Ander-Egg and to consider the community as *the set of groups and subgroups that have a common identity, interests and concerns, and a sense of belonging, within a given geographical area or within a social space in which people interact more intensely than in any other context.*

As in the case of community, it is possible to find an enormous diversity of variations in relation to the concept of development. It nonetheless seems appropriate today to accept the definition of the United Nations Development Programme (UNDP) which considers human development to be “a process of enlarging people's choices”, which includes political freedom, respect for human rights and self-esteem. *“In principle, these choices can be infinite and can evolve with change over time. But at all levels of development, the three essential ones are for people to lead a long and healthy life, to acquire knowledge and to have access to resources needed for a decent standard of living”.* This definition of development, understood as the total social phenomenon, has strong links with freedom, along the line of thought of Julius Nyerere (1973) and, more recently, of Amartya Sen (2003). And also according to this line of thought the Belgian sociologist Guy Bajoit theorised the model of development which he designated as being one of “conflict” or of “social movements”, connoting development and democracy as two faces of the

same coin which inspired the NGOs and the social movements that have been affirmed on a global level.

### **The principles and the method of Community Development**

The strategies of Community Development are based on a set of principles, of which the following can be emphasised:

- The needs felt by the population should outweigh the needs considered by the technicians;
- Participation as a condition for populations to take fundamental decisions relating to their own development;
- Respect for the identity and cultural values of each community;
- Sustainability, in order that the processes of change can be balanced, unbroken and continuous over time;
- Universality, embracing the whole population (and not only subgroups of that population) and representing a profound change in the social problems or conditions forming the basis of the situation of underdevelopment.

In this sense, Community Development is related to other educational methods and practices. This is what is happening in Latin America, in particular in Brazil with popular education, which is increasing in size and politico-ideological expression, being understood not as education directed towards the “people”, but the “social people”, which suffer from inequality, injustice, domination, and the “political people”, which become aware of the importance of the struggle against these situations.

Various methodological models of Community Development can also be found in the Brazilian experience, three of which can be emphasised: the basic ecclesiastic communities, which arose from a hermeneutic reading of the Bible by liberation theologians; the institutionalist movement, which was formed on the basic principles of self-government and self-analysis; and the psychosocial, which was based on the participation, organisation and political conscience of the citizen and the fact of confirming that the members of a given community are the main protagonists of their



knowledge, production, vicissitudes and the creation of instruments capable of assisting in the transformation of their reality (Pereira, 2001: 156).

### Community Development in Angola

The year 1961 marked the commencement of the struggle for national liberation and the adoption, by the Portuguese colonial government, of a set of political, economic and social reforms with a view to economic growth, the accelerated transformation of the "traditional" societies and the social promotion of Angolans, within a more general framework of Portugal's interest in maintaining its colonies.

It was in this context that the colonial government began to change its methods of intervention in relation to the rural communities<sup>127</sup> and there arose for the first time the intention of implementing a Community Development service. However, the idea was insufficiently well prepared and was aborted, giving way to another method of intervention which had in the meantime been tested with significant success - Rural Extension. Neither took place in the socialist model framework that applied in the post-independence era.

Only at the beginning of the decade of the 1990s did Community Development emerge as the method of social intervention in Angola, due to the action of certain European and national non-governmental organisations (NGOs) which had recourse to the experience and techniques of Brazil, initially only in rural areas but subsequently on the outskirts of cities. Some time later, the Angolan government decided to adopt the approach to Community Development, albeit in an unexpressed form, when it conceived and prepared, in 1995, with the technical support of the UNDP, the Programme of Community Rehabilitation and National Reconciliation (PRCRN). The civil war and certain other factors did not allow the implementation of the Programme to achieve the planned objectives, but even today such an approach is considered to be correct. More recently, the social support fund (FAS), the government agency charged with implementing the programme for combating poverty, adopted, on the recommendation of the World Bank, its main financier, an identical approach to that of Community Development called Community-Driven Development (CDD). Despite the advances made, the panorama is still poor if we compare the situation of Angola with that of other countries in Africa.

### The experience of ADRA

In a context without relevant references of participative community action or bottom-up development<sup>128</sup>, ADRA decided to construct a method of intervention in the communities based on its own experience on the ground. For this purpose it had the methodological support of the British NGO ACORD, which had become established in Angola at the end of the 1980s, and Brazilian technicians whose experience was based on the ecclesiastic communities and on the psycho-social method. It is appropriate to mention that this was a slow and sinuous process. The objective was to assist the populations in rural communities most affected by the war, to reconstruct their economic and social fabric within a framework of relative autonomy. The type of intervention consisted of an initial stage of direct assistance to countryside families, with a view to assisting them in recovering their production systems and becoming integrated in the market, as well as having access to drinking water and public services such as health and education. For this purpose, the inclusion of elementary organisational forms at the level of the communities to allow the testing of participation and decision-making practices, was of fundamental importance. Initially, ADRA worked in the provinces of Malanje, Huambo and Huíla, subsequently extending its intervention to Benguela, Bengo and Cunene.

The resumption of the civil war made this path difficult and ADRA was obliged to embrace emergency projects for humanitarian assistance. Taking into account its politico-ideological leaning on behalf of the disadvantaged and excluded, and for the purpose of fighting against a dependency culture which was weakening the humanitarian assistance structure, both on the part of the Government and the majority of the NGOs that were participating in Angola, ADRA assumed the organisation of displaced population groups as the fundamental axis of its action. At the same time, during the most intense period of the war following the 1992 elections, ADRA implemented, in partnership with ACORD, a project of Community Development in the municipality of Gambos (Huíla), an area that was not directly affected by the war, which served, to some extent, as a methodological laboratory and came to be considered as the first major reference of Community Development in Angola.

When the politico-military conditions allowed, ADRA, benefiting from those experiences, launched

new projects and actions, for the purpose of assisting in the resettlement of dislocated population groups and return to their areas of origin, with a view to the gradual transfer from direct assistance to families, to the organisational reinforcement of groups and organisations and, in some cases, institutional strengthening, by means of which new NGOs and associations themselves assisted the community population groups in reorganising their economic and social lives.

The actions of training and reflection with respect to practice allowed certain errors and weaknesses to be overcome and provided for a better theoretical preparation. This led to the political expansion of intervention, allowing the teams not to be exclusively concerned with the consequences of the war, violence, poverty, exclusion and social injustice, in order to attack the causes of those situations. It also led to a change of attitude by the expert, with the gradual assumption of the condition of educator. It led to the adoption and adaptation of the approach of the Chilean, José Bengoa to the conditions of Angola, assuming intervention to seek a relative balance between the axes of *modernisation* (the expectation and concerns of all poor people); *identity* (respect and valuing of culture and the affirmation of certain groups, such as women's groups); *participation* (which introduced the dimension of construction of a democratic culture); and *social change* (which allowed the social mobility of persons and groups).

Today ADRA views Community Development as a non-formal educational method, a pedagogical process of interaction between women, men and children living in communities, on the one hand, and the organisational teams on the ground, on the other, with a view to the development of the communities, their autonomy and their "empowerment" as well as the assumption of citizenship by their members. But it also sees it as a set of principles, ideas and convictions that form an ideological option in favour of the poor and excluded elements. It is in this connection that Community Development can facilitate articulation between the communities and broader levels of society and be used as a working method together with the State institutions and other institutions located in the municipalities and communes, thus contributing towards the building of local power. This type of approach is already being used by the Social Support Fund (FAS) and by the Programme of Support for Reconstruction, launched by the Angolan Government and by the European Union. In this way, Community Development can be

understood to be a tool of construction and broadening of citizenship and the ADRA project, as a whole, as a process of education for the citizenry.

The *results* of the intervention of ADRA based on Community Development are clear. To summarise, they are:

- In the domain of material life, as today people have more sustained access to foodstuffs through agricultural production and the sale of surpluses;
- In the social domain, by means of access to health and education services, which are improving in quality due to the constant improvements among teachers;
- In the cultural domain, due to the concern for the regaining of lost assets, the acknowledgement and valuing of organisational forms and traditional institutions, as well as the assumption of a multicultural ethos and the consequences of culture shock between interveners and clients;
- In the civic domain, by the progressive affirmation of the citizenry and of autonomy;
- In the political domain, by the gradual increase in the powers of the various community authorities and their recognition by the governing systems, including municipal and communal administrations, by means of the extension of the said powers to new community actors and by a broader participation of the different groups and individuals in the life of the communities;
- And finally, in the organisational domain, by means of the recovery of the role of certain "traditional" or endogenous organisational forms ("*jangos*", for example) and the introduction of modernising organisation and management structures, such as interest groups for water and sanitation, agricultural production, micro credit, health, the consolidation of parents' associations assisting in the administration of schools and the defence of specific interests of women.

More recently, also as a result of intervention based on Community Development, there has been a plethora of embryonic social movements based on the communities of certain municipalities and communes, the principal objective of which is the establishment of platforms or forums for debate and negotiation between the community groups, associations and organisations, on the one hand, and the respective administrative authorities on the other. This is happening in Catumbela and in Dombe Grande (Benguela), in the Gambos (Huíla) and in Caála (Huambo), albeit at a rudimentary level, but in a much more advanced situation if compared with the impossibility of acknowledgement and dialogue that was the reality a few years ago.

Reflection has made it possible to determine certain weaknesses in the ADRA in terms of intervention, namely:

- The low level of knowledge of the social reality in which the teams are operating;
- The type of basic training which the majority of the technicians have, based on a paternalistic perspective of accelerated modernisation, weak social commitment in favour of the disadvantaged groups, sparse criticism and without the status quo being questioned<sup>129</sup>;
- The deficient grasp of the methodology and the low level of socio-political knowledge on the part of the technicians.

Some of these weaknesses can also be considered to be *obstacles*, to which the following should be added:

- The action of State institutions which, in their relations with the communities, use authoritarian and paternalistic approaches, fostering a lack of responsibility on the part of population groups, keeping them in a situation of dependency and taking away the substance from the work of Community Development;
- The action of national and foreign NGOs and of churches and religious organisations applying philosophies of charitable intervention encouraging a lack of responsibility;

- The absence of successful national models for Community Development and participative development;
- The lack of studies and research in the area of social science to allow upstream and downstream appraisals of the interventions;
- Institutional weakness and the general dysfunctioning of the economy;
- Illiteracy, certain customs and traditions, and the culture of dependency on the Government and other institutions by the population groups.

## Conclusion

The experience of ADRA allows certain lessons to be learned. However, as mentioned previously, a systematic appraisal of this experience is necessary and still remains to be done. For this reason I merely make reference to three questions that require more in-depth consideration and which are therefore presented as questions and not as conclusions. It is well-known that social intervention is always conditional upon the economic, social, political, cultural, ecological and institutional environment. Taken together, or in isolation, these conditions have various degrees of influence on interactive dynamics and the client system. Angola has, for the past 11 years, lived through a particular situation in which these conditioning factors were, in turn, impacted by the civil war which affected everything. Consequently, the population groups adopted very specific behaviours and dynamics when confronted with logic substantially different from their own. To what extent do the responses of the population groups to intervention constitute effective social change, as opposed to mere convenient "adaptation" strategies in order to preserve the socio-cultural and endogenous productive systems? This is the first question that should be posed.

Turning to the second question, I should point out that the interventions are conceived according to criteria of modern rationality and technical / organisational conditions reflecting not only the logic of the intervening system, but also that of the financier. This generally requires rapid responses, which clash with the different paces of change of

the populations. Substantial changes are not possible within two or three years. This being the case, problems of pace are frequently mistaken for resistance on the part of populations or inefficiency of the projects. How does one overcome this without adversely affecting the confidence that must exist between the different actors of Community Development, including the financiers?

A third question is concerned with participation. When an intervention commences, the levels of participation of the populations are, inevitably, not identical to those achieved in subsequent phases. The majority of the projects of ADRA achieve, at the end of five or six years, a level of participation that is close to co-management, according to a graph conceived by Bordenave.<sup>130</sup> This allows for the sharing of fundamental decisions. However, until this level is reached, questions arise which make participative planning and the provision of accounts difficult. What measures should be taken so that the population groups do not feel marginalised in the early stages of the process?

We do not have ready answers to these questions. Many of them are still under consideration. Others will only be answered when social scientists in Angola play an active role in the processes of development under way.

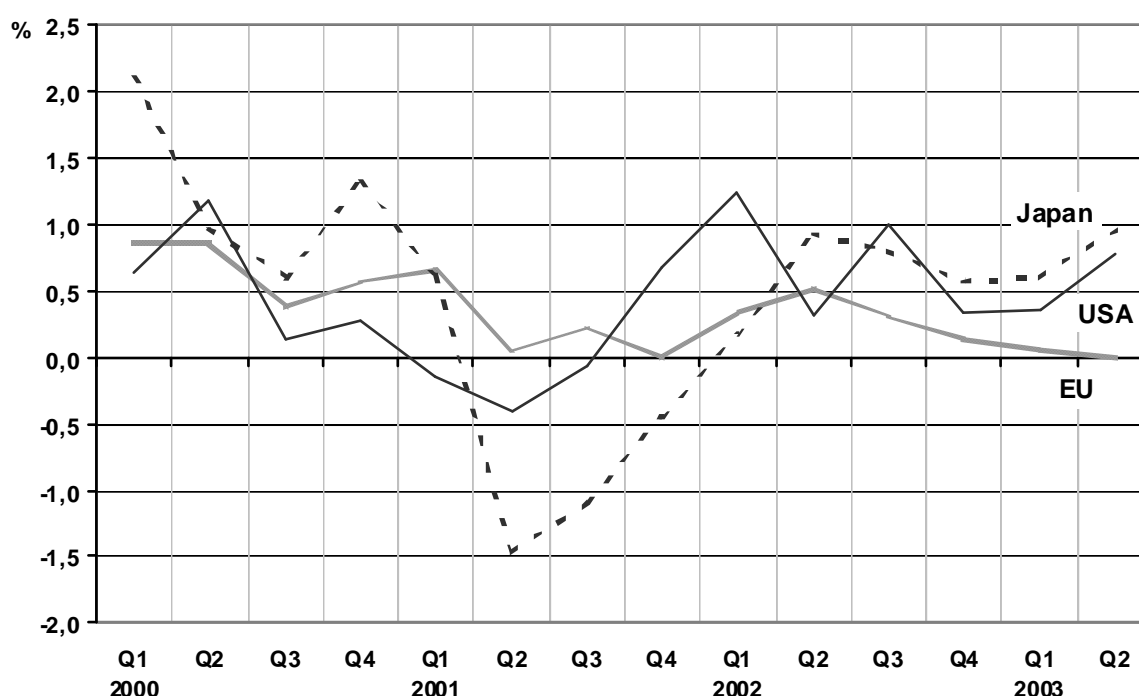
## Prospects of a fragile recovery: Will the global economy support African growth?

Martin Albrecht

During the slowdown in the industrial economies since 2001 GDP growth in Sub-Saharan Africa<sup>131</sup> was well above 3 % and has thus remained relatively robust. For 2003 growth is projected to accelerate slightly, as a moderate recovery of the global economy is expected. How reasonable is the

- With the war in Iraq ending, the **oil price** fell sharply. Since Iraq's contribution to oil production does not seem clear at this point, combined with relatively low oil stocks in OECD countries, the price has, however, increased again. Oil prices are below their pre-war peak, but remain close to 30 US dollar per barrel.
- **Equity markets** recovered markedly although real activity remained subdued, so that this might have been the result of ample liquidity

Figure 1: GDP growth in the United States, Europe and Japan since 2000  
(quarterly percentage change of seasonally adjusted GDP)



assumption of a global recovery, what would be its driving forces, and what are the risks involved?

Some of the brakes on recent economic development have started to vanish:

- Above all, the quick ending of the Iraq war has **reduced geopolitical uncertainties** and allowed economic sentiment to pick up again. An obvious sign of this is that equity prices have risen markedly in the United States, Europe, and Japan.

and a lack of alternative investment opportunities.

- The corporate sector is still working its way through major adjustments after the burst of the equity price bubble in spring 2000. This process of **corporate adjustment** has dampened economic growth markedly, in particular via cutting investment expenditure sharply and reducing employment to eliminate excess capacity and to decrease leverage. It seems that significant progress has been reached, so that there is a gradual diminution

of the after-effects of the bubble. However, restructuring has not been concluded yet.

At the same time **macroeconomic policy**, particularly in the United States and in the United Kingdom, has been set to ease the consequences of the bubble burst. The US economy has, indeed, experienced only a mild recession. Despite their recent increase, long-term interest rates are still on a historically low level. In the United States, in combination with the system of mortgage refinancing, this has fostered private consumption and thus offset the investment slump. At least in 2003 monetary policy should continue to have expansionary effects, considering the typical time lag. Liquidity is ample and is not the limiting factor in the current economic development of industrialised countries. Besides, expansionary effects of the tax reform in the United States will continue for some time to come.

The global recovery will thus be led by the **US economy**. Recent data have shown definite signs of an improvement in the economic situation:

- According to current estimation, **US-GDP** grew by 3.1 % at an annualised rate in the second quarter of 2003, thus clearly outpacing the Euro area economy, though roughly half of this was due to increased credit-financed defence spending. Leading indicators announce even stronger growth in the third quarter.
- **Orders** for machinery and equipment (excluding the military sector) have been pointing upwards recently, hinting at a more buoyant investment activity.
- **Consumer** confidence has been restored after the war in Iraq and remained relatively robust since then. This contributed to still rising retail trade turnover. Part of the rise in consumption, though, was due to very strong automobile sales, which in turn were only achieved by substantial rebates.

- **Industrial** output and capacity utilisation have improved, although the levels are still below their long-term averages.
- As the **consumer price index** has also risen, fear of deflation has been diminished.
- Last but not least, **productivity** grew significantly, continuing the steeper trend of the second half of the nineties and lowering the unit cost of labour. This will raise corporate profitability and may drive up investment.
- At the same time, the substantial rise in productivity points to the draw-back of the current recovery: the disappointing **labour market**. So far, the recovery has been jobless. In fact, growth in GDP was actually accompanied by an increase in the unemployment rate. The higher productivity resulted from both a rise in production and a decrease in the numbers of hours worked. On the other hand, it must be remembered that at the end of the latest boom, unemployment had reached its lowest level for the past forty years, and the rate has not increased to levels seen in previous recessions. The rise in labour productivity does partly result from layoffs, but also from the gradual spread of IT-related productivity gains to other sectors of the economy.

In the **Euro area**, the economic slowdown has been deeper and more persistent than expected. Up to now, signs of a pickup in economic activity are mainly confined to sentiment indicators, whereas solid evidence is still lacking.

- **Consumer confidence** has improved recently, although unemployment remains very high. **Industry sentiment** has also improved in some countries of the Euro Zone, in particular in Germany. However, it has not yet shown any substantial recovery in the Euro Zone as a whole.

- Weak **investment** has been the main drag on economic development, part of it resulting from mounting corporate debt along with extensive merger and acquisition activities during the asset price bubble of the late nineties. Considering both capital and financial investment in nominal terms, business investment in the Euro Zone increased even more than in the United States. As bank loans have been the predominant way of financing investment in Europe, corporate debt rose more, too. Corporate finance in the United States, by contrast, spread the consequences of the bubble burst more widely, including bond and equity markets. Finally, European companies seem to be slower than their US-counterparts in the pace of restructuring their balance sheets.
- The stability and growth pact prevents **fiscal policy** from any remarkable manoeuvres. By comparison with the United States, the overall policy stance is much less expansionary. **Structural reforms** would improve Europe's competitiveness, and they have become more likely at this point. However, their implementation will take some time, and their short-term effects may even be negative on economic activity.

So, current economic development in Europe depends heavily on external demand, while there will be increasingly stabilising effects from the progress in corporate balance sheet adjustments. The low level of interest rates will support this process. On the other hand, the appreciation of the Euro, despite its latest weakening, will hamper an export-led recovery. Consumption may pick up slowly as declining inflation leads to a rise in real incomes. However, consumer confidence is also influenced by employment prospects.

**Japan** experienced its sixth consecutive quarter of rising GDP. In spring, GDP growth increased, after a subdued first quarter, to an annualised rate of 3.9 %. The positive development was, as in

previous quarters, due to both higher net exports and a surge in business investment. Private consumption rose, too, while savings were reduced. However, the Japanese economy still suffers from deflation, the real growth rate therefore being overstated. Actually, there was no nominal growth: comparing the first half of 2003 with the second half of 2002, nominal GDP even shrank by almost 0.1 % – with resulting negative effects on corporate profits. However, in the second quarter of this year, Japan returned to nominal growth after two years of continuous decline. Besides, there has not been enough progress with bank and corporate restructuring yet. Japan's financial system remains fragile. Exports alone, particularly as they partially depend on interventions preventing the yen from appreciating, will not guarantee a sustainable upswing as continuing deflation increases the real burden of debt, and thus the banks' bad loans. A sound recovery requires profound adjustments in the banking system and overcoming deflation. The latter, in turn, depends on a successful elimination of excess capacity. However, the output gap is still considerable, so that it might take some years before deflation comes to an end.

The crucial risk in the current economic development arises from the fact that the expansion in the United States is not supported by a broad-based expansion in other industrial countries. Thus the **recovery is not sufficiently balanced**. Moreover, the current growth of the US economy depends on some factors which will not be long-standing, such as tax cuts and the mortgage refinancing effects on consumption resulting from declining interest rates.

Monetary and fiscal policy in the United States face the serious trade-off between supporting the economy in the short run and minimising the risk of increasing fundamental problems in the long run. The expansionary macro policy brought about growth even after the stock market and investment slump. However, that came at the cost of aggravating imbalances:

- The **government budget** situation deteriorated substantially. According to the Congressional Budget Office, government deficit in relation to nominal GDP will rise from 1.5 % in fiscal year 2002 to 3.7 % in the current fiscal year. Three years ago, the national budget still ran a big surplus. Fiscal consolidation may become inevitable at a time when capacity utilisation is still subdued, and thus hamper economic recovery, not to mention the fact that the monetary and fiscal stimulus which has so far supported demand can hardly be topped. Even worse, the high deficits which have already been reached may now suffice to offset the longer term benefits from tax cuts.
- **Private household debt** increased significantly during the nineties, and debt service has absorbed an increasing share of household income. Mortgage refinancing has not been used to reduce debt, but went straight to increases in consumption expenditure instead.
- Probably the most serious cause for concern, though, is the **current account deficit**, which has reached a record level and will widen further as long as other important industrial economies cannot accelerate growth. This exacerbates the external financial vulnerability of the United States considerably. The current account deficit can only be sustained if the United States continues to attract a large and continuous stream of foreign capital.

It seems reasonable that at some point foreign investors will perceive an increasing risk in investing money in the US economy. Yet risk adjusted return prospects must be maintained to guarantee constant capital inflows to finance the US current account deficit. As a consequence, US asset prices will have to come down, particularly the US dollar. As the Asian countries, notably China and Japan, are still determined to intervene to prevent their currencies appreciating in nominal terms against the US dollar, it will mainly be the Euro that gains in

nominal value. If a **US dollar devaluation** comes rapidly and gains momentum, growth in Europe and Japan will be inhibited. Bond yields will have to be increased as foreign investors will demand a higher risk premium. Some people argue that the US current account deficit is not critical, even if it is still growing, as it represents foreign investors' appreciation of corporate investment opportunities in the US market, and thus the US economy's strength. Recently, however, about half of the US current account deficit was financed by foreign central bank purchases of American securities.

So what will be the **future prospects** against the background of the existing **fundamental imbalances** of the global economy? The first-best scenario would be an adjustment process which is sufficiently balanced with regard to both time and economic regions. For that purpose, US domestic demand growth will have to slow down gradually while, at the same time, domestic demand growth in other countries, notably in Europe and Japan, must accelerate. In the United States, shrinking demand for import and domestic goods would be connected with higher savings in private and public households. The US government may diminish the negative demand effect if it contributes a disproportionate share to the rise in savings, which is necessary to eliminate the economy's imbalance. The development of the US economy will also depend on the extent to which increasing exports can make up for the decrease in domestic demand. The devaluation of the US dollar, which will occur during the adjustment process, will worsen export prospects of the Euro Zone and Japan, and will put pressure on the latter economies to ensure that domestic demand can expand – preferably by structural reforms, if not by expansionary macroeconomic policies. However, it is reasonable to doubt whether Europe or Japan will soon be able to provide extended markets for export goods from the United States.

Another problem may arise if major economies (such as China and Japan) try to prevent currency



appreciation by foreign exchange intervention or by aggressive monetary easing. As a consequence liquidity will increase considerably, and finally both consumer and asset price **inflation** will rise. Real adjustment, though, would be slowed and delayed and make corporate restructuring even more painful. Considering the existing structural rigidities both in Europe and in Japan, and the efforts it already takes to achieve only minimal progress, such a development seems possible, if not likely.

On the other hand, if investors turn away from the US economy so that capital inflow to the United States is interrupted suddenly, there must be a substantial fall in asset prices, and in the value of the US dollar respectively, to maintain financing. That may cause a negative shock to the export-oriented sectors in other economies and, eventually, result in **deflation**, as falling prices and decreasing demand are combined. The world economy would fall into recession. As interest rates are still at a very low level and equity markets have recovered significantly, such a scenario seems to be less likely at this point, although capacity utilisation – especially in the United States – has reached such a low level that firms will have problems raising product prices even after some quarters of GDP growth.

As the moderate growth acceleration in the **Sub-Saharan African economies** is linked to the recovery of the global economy, it is also linked to the fundamental global imbalances discussed above. In particular, the uncertainty about the future US dollar exchange rate will make any short- and mid-term projection of export development extremely difficult.

The future prospects for **Angola** largely depend on the **oil sector**. Angola is Africa's second largest oil exporter. In 2002, oil production increased by 22 % as new oil fields have been developed. This led to GDP growth acceleration from 3.2 % in 2001 to more than 15 % last year. For 2003, both oil production and GDP growth are expected to rise

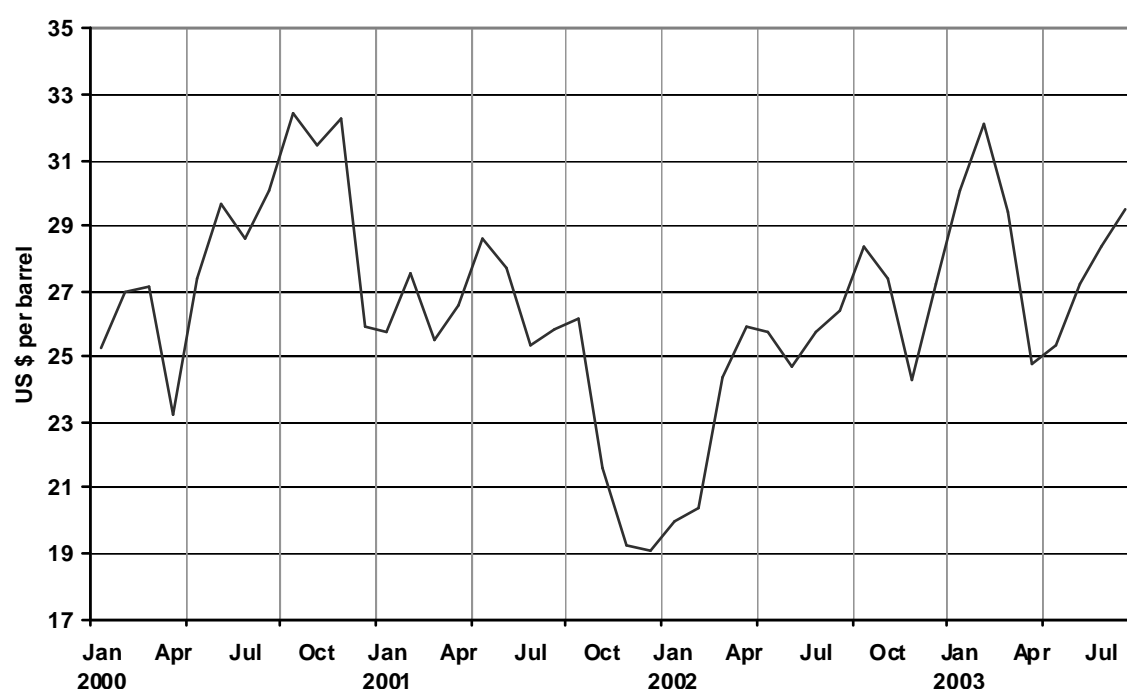
further, though moderately by about 4 % each. For the period 2003 to 2008, the oil sector is expected to grow by an average of 16.5 %.<sup>132</sup> The importance of the oil sector is also reflected in **FDI inflows**. According to the latest World Investment Report, 2002 brought a pronounced decline in FDI inflows for both developed and developing countries, and in particular for Africa (mainly as a result of exceptionally high inflows in 2001). However, FDI in the oil industry remained dominant: Angola together with Algeria, Chad, Nigeria and Tunisia accounted for more than half of the 2002 inflows. According to the IMF report, FDI inflows will only decline slightly until 2005 and still amount to US \$ 1 billion.

The evolution of **oil prices** will play a key role for the Angolan economy. The slump in oil prices in 2001, together with higher service payments to international oil companies, caused a current account deficit of about 15 % of GDP. Although oil prices and oil exports increased significantly in 2002, Angola still ran a current account deficit, amounting to only 5.5 % of GDP, due to a rise in imports and further increasing payments for services. According to the IMF report, the current account deficit will widen in 2003, assuming an average oil price of \$ 24 per barrel. However, up to August this year, the oil price (Brent) has averaged more than \$ 28 per barrel. Prices are below the peak they reached at the start of the invasion of Iraq, but they remain significantly higher than expected. One reason is that Iraqi oil production is still reduced (in June at about 20 % of its pre-war level). Besides, there is a combination of additional factors which keep prices from falling: the stocks of oil in the OECD countries are quite low, OPEC keeps production limited to stabilise prices, and Chinese oil demand has become considerably high. Supposing that Iraq's output will not substantially increase over the next two or three quarters and that OPEC policy is maintained for some time further while global demand starts rising, oil prices will not come down much until spring next year.

Yet mid-term prospects are more favourable for the oil-importing countries. Some of the factors keeping oil prices up are special effects such as Europe's heatwave and Japan's nuclear shutdown, which will not continue. Moreover, Iraq's oil production will move back towards pre-war levels. Finally, the OPEC cartel price and production policies do not prove robust in the competition for market share, as experience shows. The OPEC members know that they would eventually harm themselves if oil price hikes disrupt global economic recovery.<sup>133</sup> On the other hand, the volatility of crude oil prices has

Angola's growth prospects with a negative impact on fiscal sustainability. The most severe macroeconomic problems are the inflation rate and the fiscal deficit. Taking additionally into account the inefficiencies in administration and a lack in market liberalisation, the Angolan economy has not reached potential growth yet.

Figure 2: Oil price (Brent, monthly averages)



increased over the past decade due to the declining trend in commercial inventories.

Angola's currently booming oil sector is confronted with a serious poverty problem which is linked to a declining share of the non-oil sectors in the economy, agriculture in particular (the diamond sector being the only notable exception). Reducing the Angolan economy's extreme **dependence on oil** by pushing forward economic diversification is necessary if poverty is eventually to be reduced. Structural change seems to be even more necessary against the expectation of declining oil prices for the medium term, which would weaken

## ANNEX I

### THE PROBLEM OF DECENTRALISATION IN ANGOLA

#### The Role of the Provinces

The economic transition under way has encouraged certain attempts towards administrative de-concentration and launched an initial debate on the proper role of the lower levels of government. The concomitant effort of extending the formal administration of the State to all areas of the country, makes this a signal opportunity to convey certain lessons from literature with respect to inter-governmental fiscal arrangements, particularly given that experience shows that allocations of expenditure and taxes are more difficult to alter once a more formal administrative system is implemented. After a brief summary of the literature on fiscal decentralisation, the following analysis provides an overall view of the current situation in Angola and advances initial recommendations<sup>134</sup>.

#### A. Review of the Literature

The economic literature on decentralisation emphasises the potential gains in efficiency and well-being based on responsibility for fiscal expenditure. For the proponents of decentralisation, the benefits come from the allocation of this responsibility at the level of government that is in a better position to evaluate the preferences of the beneficiaries. From this standpoint, the selection of services that should be centrally administered is limited to those for which a decision to incur expenditure will have an impact on the population as a whole, including: Defence, justice, external relations and national transport and communications networks. Even services that are considered to be crucial based on their impact (on the nation as a whole) on economic perspectives, such as basic health care and education (which have a decisive influence on the level of human capital), can be managed at a lower level. In these cases, however, the central government must fix national standards for the supply of services, and must also monitor their implementation. In fiscal terms, the central government can retain effective control over the supply of such services or by means of directed fiscal transfers (as occurs, for example, in Canada).

Opposers of decentralisation emphasise the important negative impact on distributional equity and macroeconomic management. In general, the central government is more efficient in ensuring the redistribution of income through greater diversity in the income base (which occurs, partially, as a result of variation in the geographical distribution of natural resources through the regions) and, equally, based on a more limited inter-jurisdictional mobility of the workforce and capital, at the national level<sup>135</sup>. In any event, the central government should ensure minimum standards of public services in order to minimise the negative effects on those regions relatively lacking in resources.

In terms of macroeconomic management, the key objective of the decentralised system remains unchanged: to ensure that the global fiscal imbalances (including all levels of government), do not atrophy the private sector, and do not feed inflation. In a decentralised environment, two situations are of particular concern. First, easier access to independent sources of finance by the lower levels of government could create difficulties for the central government in its efforts to maintain macroeconomic stability. Second, if persistent deficits or surpluses occur at various levels, and the transfer mechanism does not adequately respond with a view to the dislocation of resources, this could lead to serious consequences for economic performance (either by an undesirable reduction in services or by fuelling inflationary pressures).

#### B. Intergovernmental Relations in Angola

The current politico-administrative system in Angola is highly centralised, largely for historic reasons<sup>136</sup>. In structural terms, the public sector consists of: (i) central government; (ii) 18 provincial governments; (iii) 163 municipal authorities; (iv) 532 communes; and (v) public bodies and autonomous institutions that are supervised by the central ministry responsible for their sector of activity. Constitutionally, the divisions of power are incompletely defined and the necessary regulations have not yet been approved.

Fiscally, the relations between the central and lower levels of government are regulated by a General State Budget which, by legal mandate, is comprehensive in terms of its cover.<sup>137</sup> Operationally, the provincial governments constitute some 950 budgeting units, which include the provincial branches of some central ministries, autonomous funds and, at the last reorganisation, even individual schools and hospitals. Financially, the Ministry of Finance deals directly with each of these units, which, in turn, control the flow of funds to dependent entities (located on the lower levels of

(established by means of increasing the number of budgeting units) is related to the facilitation of financial and administrative management, and initial evidence appears to indicate that the flow of funds to the recently created budgeting units has improved considerably (Vinyals, 2002, p. 58).

Meanwhile, up until now the changes have not been perfectly coordinated, and a degree of sectorial disarticulation was added to the ambiguities generated by the continuation of the lack of specific regulation relating to the role and

Public Expenditure, 1997-2001			
	Province	Central	Total
Total Expenditure	11	89	100
Education	53	47	100
Health	44	55	100
Memorandum:			
South Africa 1/	25	75	100
Education	72	28	100
Health	90	10	100
Canada 1/	59	41	100
Education	95	5	100
Health	97	3	100

Source: Calculations of the author; Vinyals (2002) and Ter-Minassian (1997).

the hierarchy).

### Hierarchical Structure

In strategic terms, the recent steps towards administrative de-concentration have had a tendency to reduce the controlling responsibility of the ministries and to decouple the hierarchical financial structure. With the exception of the Ministry of Finance, the Ministry of the Interior and the Ministry of Justice, the provincial branches of the central ministries were transformed into provincial directorates. As a result, some of the functions previously administered by the Ministry of Education and Health – such as primary schools and health centres – currently fall within the remit of the provincial governments.

For its part, the Ministry of Education retains its authority over the universities, but shares authority for secondary schools with the provincial governments.

In financial terms, the Ministry of Finance deals directly both with the universities and with the secondary schools, which are included among the recently created budgeting units.<sup>138</sup> The principal logic for these direct links to the Ministry of Finance

responsibility at the various levels of government. In the context of the existing weaknesses in preparation of the financial reports by the provincial governments and the loss of administrative authority by the responsible ministries, it is now more difficult to design and implement the sectoral strategies effectively and, crucially, to ensure the same standards of delivery of service throughout the nation as a whole. In particular, while provincial governments now have administrative control over health centres and primary schools – key institutions in terms of basic social services – the systems of information and coordination continue to be weak, sectorial policies poorly defined and inspection services rudimentary.

### Financial Relations

Globally, the highly centralised nature of the Angolan system is evident from the geographical distribution of fiscal expenditure. Between 1997 and 2001, the following table shows that only 11 per cent of total expenditure could be directly attributed to specific provincial activities. The other expenditure is either of a general nature (such as the external debt service) or relates to activities exclusively carried out at a central level (such as national defence, the operating costs of central

institutions such as the Presidency, Parliament and the Supreme Court). By contrast, Canada and South Africa, with relatively well-developed federal systems, demonstrate a considerably higher degree of decentralisation.

In addition to this, only a part of the expenditure attributed to the provinces in Angola is in effect administered by provincial governments. As one of the 950 budgeting units, the provincial government is restricted to controlling and executing its own budget, without the possibility of exercising any influence over the budgets of other units of expenditure active within its province. For example, the provincial governments do not control, and for the main part do not interact with, the activities of the branches of the central ministries, national hospitals or autonomous institutions.

As a result, while the following table indicates that 53 per cent of the education budget can be directly attributed to specific provinces, these provincial governments in fact administer only 42 per cent of the education expenditure allocated to their provinces. In the health sector, the provincial governments control only 19 per cent of the health expenditure allocated to their provinces; the balance, although maintained in the specific provinces, is administered by budgeting units (including municipal and provincial hospitals) under the direct control of the Ministry of Finance. By contrast, in both Canada and South Africa, the social sectors reflect a particularly high degree of decentralisation.

Apart from the contributions resulting from the exercise of the annual budget, five provinces producing minerals in Angola receive budgetary revenue, namely:

- Zaire (10% of the petroleum revenue; joint dispatch No 29/96);
- Cabinda (10% of petroleum revenue; joint dispatch No 38/96); and
- Lunda Norte, Lunda Sul and Moxico (10% of revenue from diamonds exploration; joint executive decree No 30/00).

In addition to these politically sensitive allocations, no clearly defined system of inter-governmental transfers exists, and the resources generated at the level of the provinces are limited to fees collected by locally administered public companies. In addition, the roles and functions of the various

levels of government are not very well-defined in the Constitution itself (UNDP, 2002, p. 116). In particular, the constitutional articles that refer specifically to elected "local governments" remain to be implemented.

### C. Recommendations

Although the literature does not furnish a universal range of recommendations, consideration of the general precepts, together with a careful analysis of the special characteristics of each case, could contribute significantly towards the decentralisation effort. Taking into account the need for political will, the analysis set out herein provides for the following set of recommendations.

Efficient local governments require a level of resources compatible with their responsibilities. It is to be hoped that initially, the majority of taxes will be attributed to the centre, as the lower levels of government confront substantial and growing expenditure commitments (resulting, in part, from national policies on the provision of services). It is therefore of crucial importance for the financial structure to be suitable for dealing with the budgeting consequences of the policies of the central government in respect of the lower level governments. In particular, if the budgeted expenditure is not strictly equal to the fiscal commitments, it will be necessary to consider alternative forms of finance, including transfers directed in a way that is clear and transparent.

In view of the variation in the size of the fiscal bases across the regions in Angola (including the tendency for a certain number of regions to maintain a relatively narrow fiscal base during a given period), the reduction in regional imbalances will require that the sharing of receipts take place as a function of the capacity of mobilisation of receipts, irrespective of actual receipts, and irrespective of being linked to the existing gaps between expenditure requirements and actual receipts. In other words, because demand for public services has a tendency to be higher in the richest areas, the allocation of receipts based on actual gaps in expenditure could result in higher transfers (on a per capita basis) to the richest regions, thus exacerbating regional imbalances. In addition, this type of allocation will also have a tendency to reduce the incentive to make more determined efforts in relation to tax collection. The central government must define, and monitor the implementation, of minimum standards for the supply of key public services administered locally,

in particular, access to basic education and health care. In order to make the system compatible with incentives, the central government should also co-finance the cost of those services by means of controlled transfers. As Angola has a highly centralised system, the hypothesis for the central government to lay down minimum standards is of definite significance.

In terms of the definition of specific functions, it is common practice<sup>139</sup> to attribute responsibility for primary and secondary schools to local governments, with the central government retaining responsibility for post-secondary education. In the area of health care, local governments are typically responsible for supplying basic and preventive health care, with the central government retaining responsibility for the prevention of communicable diseases, hospitals and the financing of medical research. The areas of shared responsibility tend to include agriculture, forestry, fisheries and environmental protection.

In terms of receipts, local governments must be responsible for the assets and for taxes on immovable assets, and charges to the users for locally supplied services. On the other hand, the central government should retain customs duty, taxes on income and profits, and, due to their unequal distribution across the regions, taxes on natural resources. However, governments at the sub-national level could be afforded the possibility of collecting surcharges on income and sales tax<sup>140</sup>.

In more general terms, it is important to emphasise that the process of reformulation of inter-governmental relations is very demanding, as regards political negotiations<sup>141</sup>, and that the process of (efficient) implementation is both slow and irregular. The situation in Angola is such that, even with political consensus with respect to the institutional and fiscal structures, the achievement of decentralisation gains would also necessitate the creation of viable local political mechanisms to determine local preferences and to make local governments responsible for their population groups. In addition to this, the fiscal reforms of decentralisation should not detract from the efforts on the part of the central government to ensure and also to improve the fixing of targets and the general efficiency of public expenditure. In Angola, these efforts by the central government represent a prime opportunity for an immediate improvement in living standards and, therefore, changes in the structure of inter-governmental relations should, at least in the short term, be subordinate to the pursuit of these objectives.

