September 1, 2005

Angola
Diagnostic Trade Integration Study
Concept Paper

Introduction

Any analysis of the future for international trade in Angola is inevitably very much influenced by two important facts: First, Angola is a major oil producer and these exports will inevitably dominate not only export performance but the performance and stability of the whole economy and second, it has only recently emerged from a decades-long civil war which resulted in massive dislocation, death and destruction. Oil-induced macroeconomic distortions are perhaps the single most important factor conditioning the performance of non-oil exports which, though relatively unimportant in terms of percentage of value of trade, are extremely important in terms of their contribution to the incomes of the poor majority of Angolans.

A reactivation of non-oil exports coupled with efficient replacement of imports by domestic production is the only feasible way to ensure that growth over the short to medium term is shared by the bottom half of the income distribution. This diversification should occur primarily in the agricultural and light manufacturing sectors which were once a mainstay of the Angolan economy and which still retain the potential to replace imports in a cost effective manner. The challenge to policy makers is to implement a set of interventions that can rehabilitate the physical and institutional infrastructure needed to achieve these goals.

On the import side of Angola's trade the country has long shown a propensity to buy virtually all necessities from abroad even in cases where the country has a potential comparative advantage in production itself. This is a direct result of the decades-long civil conflict which virtually destroyed both Angola's infrastructure and its manufacturing capital base. Ending only recently in 2002 the aftermath of this conflict still has a powerful effect on trade patterns both within the country and across its borders. As with the export side, oil-induced macroeconomic distortions will continue to play an important role in conditioning incentives to import and to invest in import replacing activities.

Accordingly, the primary goal of the Diagnostic Trade Integration Study (DTIS) study is to provide a plan for the reactivation of Angola's productive sectors, both in agriculture and manufacturing, that is capable of replacing the current near-total reliance on imports and to provide for the eventual restoration of export capacity in the medium to long term. Doing this will involve not only investment and rehabilitation of infrastructure destroyed in the war, but also important policy reforms and initiatives aimed not only at providing the institutional underpinnings of a market economy, but also at mitigating the adverse economic consequences of large flows of oil and diamond revenue and the effects these have on non-mineral exports.

In particular, the DTIS will:

- Evaluate the historical performance of the Angolan economy with respect to trade, highlighting not only recent performance, but also the extent to which selected sectors important in the past may have the potential to be rehabilitated.

- Review the policy environment directly affecting trade including the tariff structure, non-tariff measures, export incentives, customs administration, and trade facilitation. Identify the weaknesses and suggest measures to improve the policy environment.

- Analyze the extent to which oil induced macroeconomic distortions may impede the rehabilitation of productive sectors and retard the extent to which Angola substitutes domestic production for imports over the short run and the extent to which it is able to export non-mineral goods in the medium to long run

- Review the extent to which infrastructure rehabilitation and rebuilding, and improvement in business environment will be needed to reactivate investment and production in trade-related sectors.

- Review important sectors in a more in-depth manner, highlighting potentials and needs.

- Review Angola's involvement in regional and international trade agreements, and identify ways to more effectively use this involvement to increase trade-related growth

- Identify institutional constraints to trade, both in terms of institutional linkages and authorities, and in terms of the capacity of existing entities to effectively formulate and implement trade policy.

- Highlight the links between growth in trade related sectors and poverty alleviation.

- Provide an action matrix to summarize the main policy recommendations and identify trade-related technical assistance needs. The action matrix will provide the basis for effectively coordinating financial assistance from the donor community for technical assistance projects.

II. Trade Performance

Angola's exports account for 72 percent of its GDP, and are heavily dependent on oil and diamonds. In recent years, these two products have amounted to an average of about 93 and 6 percent of total merchandize exports, respectively (Table 1). Items such as stones, sand, fish, etc make up the remaining one percent. With limited refining capacity, almost all exported oil is crude oil[1].

[1] Oil is exported largely under long-term contracts with particular countries. This is usually done with oil-backed loans which commit oil production to the repayment of the loans.

Angola imports almost everything, including products that the country has a comparative advantage in producing. Merchandise imports being about 30 percent of GDP, trade account generates a large surplus averaging 40 percent of GDP (Table 1). This is offset by payments for services related to investment in the oil sector and interest charges on large short-term external debt. The current account generates a deficit or surplus depending on the price of oil.

Table 1: Trends in Merchandise Trade

	1995	1996	1997	1998	1999	2000	2001	2002	2003
					US $ (000)				
Total Exports	3753	4993	4768	3825	4829	7927	6881	8030	9486
Total Imports	1734	1930	2316	2047	2055	2023	3238	2886	4161
Trade Balance	2019	3063	2452	1778	2774	5904	3643	5144	5325
					Percent of GDP				
Total Exports	74.5	66.3	62.1	59.3	79.3	89.5	72.6	71.4	71.9
Total Imports	34.4	25.6	30.2	31.8	33.7	22.8	34.2	25.7	31.5
Trade Balance	40.1	40.7	31.9	27.5	45.6	66.7	38.4	45.7	40.4
					Composition of Exports (percent)				
Crude Oil	90.4	91.1	89.2	85.9	85.1	88.9	88.9	90.5	94.0
Refined Oil	3.1	2.2	1.5	2.0	1.9	2.1	1.7	1.7	1.9
Diamonds	4.4	5.1	6.9	9.2	11.5	7.7	8.2	6.3	3.2
Others	2.1	1.6	2.4	2.9	1.5	1.3	1.2	1.5	0.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: IMF Direction of Trade, Comtrade

Almost half of Angola's exports are shipped to the US and a quarter to China (all crude oil). The EU accounts for about 20 percent of total merchandize exports (Table 2). With regard to the sources of imports, the EU has the largest share at about 50 percent (Table 3), followed by South Africa (13 percent) and the USA (10 percent).

Exports of both oil and diamonds are projected to increase substantially in the coming years. Such increase may not be translated into overall growth and poverty reduction unless the export revenue is used more productively and the policy environment is improved significantly to assist the economy to diversify.

Table 2: Destination of Exports (percent)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Economic Union	21.6	19.3	14.3	17.0	17.0	17.7	26.3	26.4	13.4
France	2.4	2.9	3.8	2.9	2.0	4.7	9.7	7.9	7.3
North America	64.0	59.9	62.2	64.4	53.2	46.0	48.1	40.8	47.5
USA	63.7	57.2	62.2	64.1	53.2	45.6	47.6	40.8	47.5
Latin America	3.0	5.3	3.8	2.3	1.5	2.4	3.6	1.4	2.4
Brazil	1.1	3.1	0.8	0.6	0.6	0.4	2.8	0.2	0.1
Asia	10.8	12.9	18.6	15.9	27.3	33.3	21.3	30.5	36.0
China	3.6	4.9	12.7	4.0	7.4	20.8	10.5	13.5	23.3
Sub-Saharan Africa	0.5	1.4	1.3	0.3	0.9	0.6	0.8	0.9	0.7
South Africa	0.0	1.1	0.9	0.1	0.7	0.5	0.6	0.5	0.6
Others	0.0	1.1	0.9	0.1	0.7	0.5	0.6	0.5	0.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: IMF Direction of Trade

III. Trade Policy

Angola has a relatively open trade regime with a rating of 3 on the IMF's trade restrictiveness scale ranging from zero to 10, 10 being the most restrictive. The simple average of applied most favored nation (MFN) tariff is 17 percent[2]. The ad valorem tariff comprises 6 bands: 2, 5, 15, 20, 25, and 35 percent. Tariff rates for agricultural and food products are 5 percent or less providing inadequate protection for these products. An additional fee of 2 percent is charged for all imports to cover clearing costs, raising the average MFN rate to 19 percent. A consumption tax that varies from 2 to 30 percent is also levied on both imported and domestically produced goods. Export products are charged a tariff that averages at 4 percent.

[2] A new tariff regime was introduced in March 2005. The details of this regime were not available to us at the time of writing. Some of the expected changes are as follows: reduction of the maximum rate from 35 to 30 percent; increase in tariff rate for products that Angola has comparative advantage; reduction of tariff rates for raw materials, and intermediate and capital goods; and, elimination of tariff on exports.

Table 3: Sources of Imports (percent)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Economic Union	60.4	50.0	29.1	31.8	44.9	46.2	37.9	45.8	51.6
Portugal	19.8	20.6	19.9	20.0	14.3	16.8	13.8	18.7	17.7
North America	15.2	14.1	12.4	17.6	12.7	11.6	8.6	13.1	12.2
USA	15.0	13.9	12.1	17.3	12.3	10.8	8.5	12.9	11.8
Latin America	2.3	3.9	3.7	6.7	3.5	5.9	5.0	8.2	7.4
Brazil	1.2	1.8	3.5	5.9	3.1	5.2	4.4	6.9	5.6
Asia	9.4	9.0	19.9	9.2	19.5	9.5	28.0	8.7	11.1
China	1.2	1.5	1.3	1.8	0.8	1.7	1.4	2.1	3.5
Sub-Saharan Africa	10.7	21.6	6.1	7.8	12.3	20.8	16.2	18.7	14.9
South Africa	8.6	19.7	4.7	6.1	10.3	16.8	12.9	15.7	13.2
Others	2.0	1.5	28.8	26.9	7.2	6.0	4.2	5.4	2.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: IMF Direction of Trade

All quantitative restrictions have been eliminated. Licensing is required for all trade activities but they are granted almost automatically. However, bureaucratic delays and corruption can be an issue and have been known to cause significant delays in some instances. Importation of certain products (transmitters, receivers, explosives, plants, fruits, seeds, drugs, etc) require ministerial permit. In 2001, the Government introduced a Customs Expansion and Modernization Project to improve customs administration. The Project has been implemented in collaboration with the Crown Agent, a consulting company. Most products require pre-shipment inspection that is provided by BIVAC Standards. There is no export incentives system in place (duty drawback, bonded warehousing, export processing zones, etc.) but investment goods in the oil and mining sectors are exempted from import duties.

Angola participates in a number of trade agreements. It is a member of regional trade agreements including the Southern African Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMESA), but it does not participate in SADC's Trade Protocol and COMESA's free trade area (FTA). It also benefits from non-reciprocal preferential treatment from many industrialized countries under the Generalized System of Preferences (GSP) including the EU's Everything But Arms (EBA) Initiative and the US's Africa Growth and Opportunity Act (AGOA). Angola is a signatory to the Cotonou Agreement and, together with some SADC members, negotiating a reciprocal Economic Partnership Agreement (EPA) with the EU which will replace the Cotonou agreement. Angola has not been able to take advantage of any of these preferential arrangements because of its lack of capacity to produce and its lack of competitiveness. It is essential therefore to remove the supply-side constraints to be able to fully benefit from these preferential arrangements.

IV. Macroeconomic Conditions and the Exchange Rate

As can be seen in Table 4 Angolan GDP growth is closely linked to growth in the oil sector. This situation was in fact almost inevitable over the many years of conflict, when production in rural areas was virtually impossible and cities were cut off from both sources of supply and potential markets for manufactures. Now that hostilities have ended, growth in non-oil sectors has slowly started to rebound but oil remains dominant. Recent price increases to more than $60 per barrel will provide additional growth if they are sustained.[3]

Oil has accounted for at least half of GDP in recent years and this percentage will climb steeply as new production comes on line and if world prices remain at higher levels than in the past. Looking at non-mineral sectors, services are quite important, while agriculture and manufacturing accounting for a relatively small share. These sectors have nevertheless shown a high growth rate in recent years as economic reactivation has proceeded from the extremely low level of activity of the immediate post-conflict period.

GDP per capita is relatively high at approximately $970 in 2003, but its distribution across the population is extremely skewed, leaving many in conditions of extreme poverty. According to the government, well over two thirds of the population subsist on less than $2/day, a fact mirrored in the sectoral distribution of both GDP and labor, where less than 10% of value added (in agriculture) is produced by more than two thirds of the work force.

GDP growth in 2003 was 3.4%, largely due to the performance of the oil sector, though non-oil sectors also grew in the first full year of peace. This growth rate has been estimated to have increased to more than 11% in 2004 year and to go even higher in 2005. These projections rely on oil production estimates and as such are contingent upon the state of the world oil market. While physical production estimates can be made with some level of confidence, world oil prices are of course dependent upon a host of factors well beyond the control of Angola. Outside of oil, it is also reasonable to expect higher growth rates in agriculture and elsewhere as the process of rehabilitation and reactivation continues.

---

[3] Data collection systems are extremely deficient, particularly outside of Luanda, making reported figures difficult to rely on. The government's statistical network is largely non-existent outside of major cities, with even the size of the population a subject of some debate. Oil production estimates are better known, though the disposition of oil receipts has been a major bone of contention between the government and international lending institutions. Allegations of huge diversions have been made but verification of these claims has been difficult. Recent moves toward more transparency are very welcome, but do little to improve historical information.

Table 4: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004
GDP growth (%)	6.8	3.2	3.0	3.1	14.4	3.4	11.1
Composition of GDP (%)							
Agriculture	13.0	6.3	5.7	8.2	8.1	8.2	9.1
Mining	43.1	66.4	66.5	57.4	58.0	52.9	49.8
of which oil	37.8	58.1	60.1	51.2	53.2	48.3	46.7
Manufacturing	6.3	3.2	2.9	3.9	3.7	3.8	4.2
Construction	6.2	3.1	2.7	3.6	3.5	3.6	4.0
Electricity, gas and water	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Services	31.3	21.0	22.2	27.0	26.7	31.5	32.8
Inflation (%)	107.4	248.2	325.0	152.6	108.9	98.3	44.4
Real exchange rate*	--	98	89	80	76	67	51
Gross investment/GDP (%)	35.5	27.1	12.7	13.4	13.3	12.8	12.0
Composition of investment (%)							
Public	16.6	47.0	48.3	47.4	53.8	59.9	64.2
Private	83.4	53.0	51.7	52.6	46.2	40.1	35.8
Domestic savings/GDP	19.3	20.7	39.5	15.0	26.7	19.4	27.5
Fiscal balance/GDP (%)	-11.3	-35.4	-8.4	-3.6	-9.4	-7.1	-0.2
Current account balance/GDP (%)	-32.5	-27.8	8.7	-14.9	-1.4	-5.2	4.4
External debt/GDP (%)	167.3	167.4	103.0	104.0	85.7	70.1	53.3

* Real exchange rate index measured at end June in each year: January 2001=100

Source: LDB, World Bank.

From independence in 1975 until the past few years Angola went through a series of hyperinflationary episodes followed by stabilization/control policy packages and then renewed inflation. The root cause of these cycles was monetization of fiscal deficits. Spending fueled by oil receipts would be unsustainable after a period of growth, with declining oil receipts from either production declines or adverse price movements often triggering the need to print money, or to borrow against future oil receipts.

This cycle of hyperinflation followed by renewed control was broken in the middle of 2003 by the implementation of the “hard Kwanza” policy by the government. In essence, this policy used foreign exchange revenues from oil exports and oil-backed borrowing to purchase excess Kwanzas and remove them from circulation. These excess Kwanzas were a result of the continuing fiscal deficits of the government. The stated goal of this policy was to bring inflation down to acceptable levels while restoring confidence in the national currency. This has been largely achieved as of the writing of this paper, with monthly inflation now in the low single digits.

One of the results of large amounts of oil backed borrowing together with a legacy of large external debts from the past three decades is the relatively high level of indebtedness at the present time. Angola currently has an external debt of about $8 billion, of which about $1 billion is short term. Nevertheless, the high levels of exports make Angola relatively secure in its ability to service debt, with a current debt service ratio of about 20 and a ratio of debt to GDP of around 50. However, it is also true that high levels of pre-commitment of oil revenue to debt service reduce the extent to which Angola can actually benefit from future increases in production.

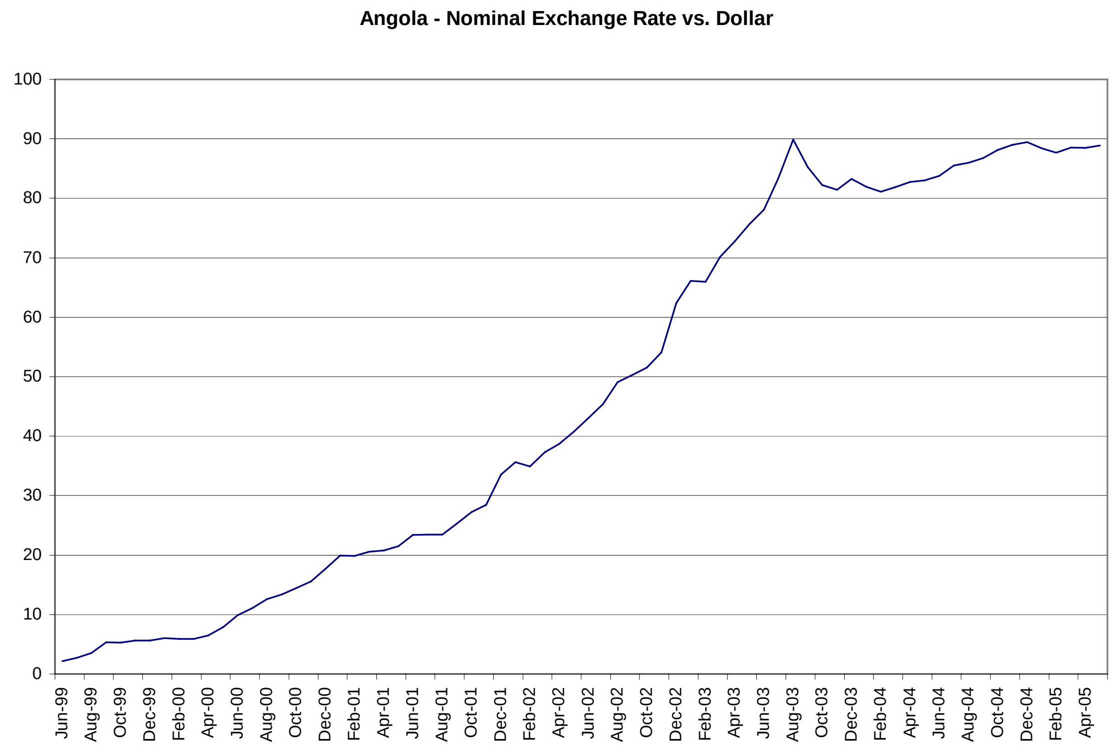
Table 4 shows the overall fiscal balance as a percent of GDP, where it can be seen that the overall deficit in the fiscal accounts of the government reached very high levels until the recent surge in oil production. The government has been reluctant to engage in a strong fiscal adjustment given the need for expenditures on rehabilitation and rebuilding of infrastructure in the aftermath of the long conflict. However, the very high level of government spending (40% of GDP in 2004) indicates that such increases can likely only be consistent with continued macro stability if cuts are made in other areas of the budget. The Government has been progressing on the implementation of a new monitoring system for fiscal expenditures and have accepted the validity of the recommendations contained in the World Bank's recently completed review of Public Expenditure Management.

The current account has swung into surplus as oil prices and production have surged, and this is expected to remain the case as long as the oil market remains strong. However, Angola's extreme dependence on oil makes it very vulnerable to downward fluctuations, supporting the government's use of conservative estimates of oil prices in its planning exercises.

Relations with international organizations were uneven through the various episodes of inflation and stabilization, as the government proved unable to adhere to the terms required by the IMF for approval. However, over the past year the government has shown a renewed determination to achieve stability and to do whatever is necessary to normalize relations with the IMF, the World Bank, and other donors. Recent announcements regarding oil-related receipts are a break with the past and could, if continued and extended sector-wide, provide the basis for a sustained move to a more transparent mode of operation.

Figure 1 shows the evolution of the exchange rate over the past five years. Of particular interest is the clear change in the trend as of August 2003 where the effects of government activity in the foreign exchange market can be seen in the stabilization of the nominal exchange rate from the last five months of 2003 through the present at a level between 80 and 90 to the US Dollar.

Figure 1



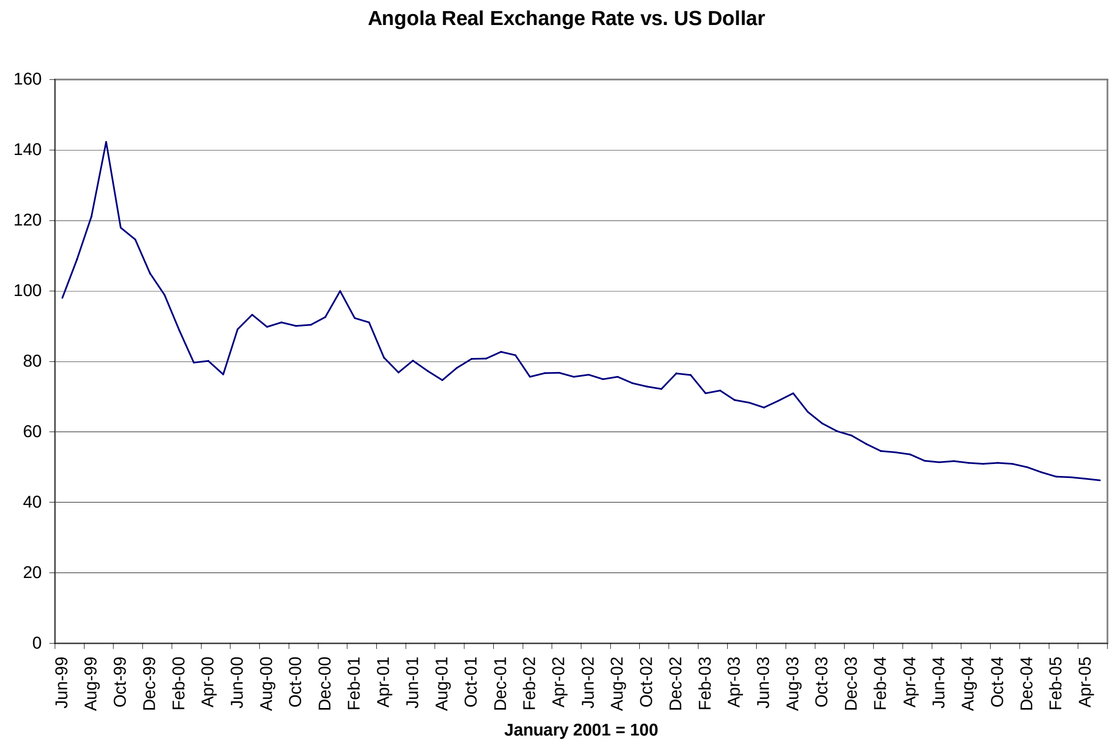
The government has maintained this exchange rate through a policy of using foreign exchange to purchase excess Kwanzas emitted to finance persistent fiscal deficits. This policy has reduced inflation to acceptable levels, with inflation in 2004 at about 35-40%, or about half of the 2003 figure of 75%. Inflation in 2005 has remained at single digit levels so far.

Though the Kwanza has been stabilized the continued inflation (though at a reduced level) has unambiguous implications for the real exchange rate. With the nominal rate stable or appreciating over the past year, and with inflation recorded at 76% in 2003 and 31% in 2004, there has been a huge real appreciation. This has not been a conscious policy objective of the government. Rather, it is a result of the combination of policies in which the policy target is the rate of inflation, and the tool used to get there in the face of large fiscal deficits is the use of large quantities of foreign exchange for financing as discussed above.

This is perhaps the biggest obstacle to the reactivation of trade exposed sectors in Angola. Every farmer wishing to produce maize for the coastal urban market has been effectively taxed over the past year by the real appreciation. To date, farmers in the interior have been protected by virtue of their very isolation, but this will change as transport infrastructure improves and markets are connected. Manufacturing in coastal cities is already in a precarious situation given the lack of transportation barriers for import competition together with the still poor state of utilities and other services necessary for production.

The extent of the appreciation of the real exchange rate can be seen in Figure 2**.** This index is calculated on the basis of the Banco Nacional de Angola's reported informal market exchange rate against the US Dollar. The respective CPI's for each country are used to generate the real exchange rate. It should be noted that the choice of a base year (in this case January of 2001) is inevitably arbitrary. This is particularly so in Angola, where there is no point in the recent past which can be regarded as "normal" or "stable".

Figure 2



It is clear from the chart that there has been a steady appreciation of the real exchange rate over the 1999-2003 period. Since January of 2001 the appreciation has amounted to more than 50%, a very substantial change. As noted above, if the appreciation continues domestic producers will eventually be priced out of the market in coastal demand centers. The case of Nigeria is instructive with respect to this point: real exchange rate appreciation of the Nigerian naira was so extreme that domestic producers were in danger of being priced out of the domestic market altogether and not simply in coastal cities. The same could conceivably occur in Angola if appreciation continues unchecked.

V. Sectoral Considerations and Analytical Needs

Clearly, Angola's exports will be dominated by oil and oil products (and diamonds to a lesser extent) over the next decade. However, current reserves and production trends indicate that there will be a peak in production at some point in the decade between 2010 and 2020. (See Draft 2005 CEM for Angola and supporting analytical work for details). This indicates that the most immediate task is the definition of an optimal policy for extraction of mineral wealth and for the disposition of the revenue generated from them.

Several recent examples of petroleum revenue funds designed to optimize the intertemporal profile of revenue generation and expenditure exist in the literature and have been discussed at some length in the forthcoming Angola CEM as well as in various other publications such as various studies published under IMF auspices. (See for example, Menachem Katz, Ulrich Bartsch, Harinder Malothra and Milan Cuc "Lifting the Oil Curse – Improving Petroleum Revenue Management in Sub Saharan Africa, IMF 2004)

Standard macroeconomic analyses of the resource curse indicate that there is a strong incentive for countries to use oil proceeds to invest in their economies in such a way that the eventual downward trend of mineral receipts can be offset by increasing production from other sectors. This means investing in sectors in which Angola has a potential or actual comparative advantage and which could become leading export sectors in the absence of mineral income.

In the Angolan case there are several areas where there is potential for investment in efficient import substituting domestic production, given the virtual total collapse of many parts of the domestic economy during the recurrent periods of conflict after independence. Replacement of destroyed or degraded infrastructure is obviously high on the list, and is in fact already underway in many parts of the country.

In sectoral terms it is apparent that Angola can produce far more of its food and fiber needs than was possible during the war years. Similarly, restoration of peace and basic infrastructure and utilities will enable the rehabilitation of light manufacturing in many areas where imports are currently dominant.

The overvaluation of the Kwanza discussed above will complicate the process of re-establishing such import-competing activities, and is a prime reason for the emphasis on good exchange rate management as a prerequisite for Angola to turn its current trade deficit into a more nearly balanced account. Continuing overvaluation will likely result in pressure to provide tariff protection to agriculture and other trade exposed sectors; indeed this has already occurred in the most recent adjustment of import duties.

In the long run Angola's potential comparative advantage in producing surplus food for export, particularly maize, makes the potential for regional trade integration of real value. The SADC region contains several chronic food deficit countries, all of which prefer maize as a staple source of calories. Angola could be the residual supplier of needed imports as well as being an exporter of various other food and fiber products.

Analytical Sources and Needs

The considerations above imply that the DTIS study will require a solid analytical foundation not only in the policy framework of Angola and its still-evolving institutional structure, but also in the cost advantages of different sectors and the effects that investments in infrastructure will have on these measures. Much foundation work has already been done by various government ministries and international donors.

Chief among these, and guiding the overall thrust of Angolan policy, is the government's poverty reduction strategy, the Estrategia de Combate a Pobreza. This document provides a clear statement of the government's goals in terms of poverty alleviation and the importance of various productive and service sectors in achieving these aims. Each Ministry provided detailed plans for its future operations and investments in support of the formulation of the Estrategia. Of particular importance for the DTIS are current plans and status reports for the Ministry of Commerce and of Customs since these are directly related to international trade issues.

In terms of macroeconomic policy analysis significant work has already been done both by the IMF country team and also by the World Bank in the course of the recent Article IV consultations and in preparation for the writing of the Country Economic Memorandum which will be available in draft form within the next two months. All of this work analyzed in detail the role of oil revenue in conditioning macroeconomic incentives and also provides detailed studies of the need for rehabilitation of infrastructure, particularly roads and bridges. Indeed, this last topic was the subject of project appraisal efforts by the World Bank in preparation for loans in these areas.

Some donors are already involved in trade related assistance. The EU provides support for EPA negotiations. The WTO is in the process of finalizing a Trade Policy Review. In agriculture the FAO completed in December 2004 a sector wide study of current status and needs for investment. Given the relatively recent (2002) end to the civil war and the subsequent reopening of rural areas and resettlement of displaced populations this study is particularly important in providing detailed studies of the prospects for different subsectors and regions within agriculture. The World Bank also completed a rural development strategy in early 2005 which will provide additional material upon which the DTIS can draw.

The DTIS will use all these studies and focus on particular areas where more information and analysis is required. In particular, it will review Angola's trade policies and performance in more detail, identify the main constraints to replacing imports and increasing exports, and develop an action matrix which summarizes the policy reforms and technical assistance needed to remove these constraints. It will support the Government of Angola to (a) build national consensus around the reforms, (b) mainstream trade priorities into its development and poverty reduction strategies, and (c) enhance trade capacity in and outside government to formulate and implement trade policies, to negotiate trade agreements, and to tackle supply-side challenges in responding to new market access opportunities. It will provide the basis for effectively coordinating donor support and mobilizing additional resources for trade related technical assistance.

VI. Areas of Focus

Looking ahead, the overarching objective of economic policy in Angola is to accelerate growth and alleviate poverty by restoring the diversity and dynamism the economy had before independence. This would require a carefully planned and phased trade strategy that aims initially for import-substitution (investment in import-replacing activities) in sectors where Angola has proven comparative advantage and in sectors where Angola used to be a major producer before independence. Food security will be high up on the import-substitution agenda given Angola's status as a low cost food producer capable not only of efficient satisfaction of domestic needs but also as a competitive producer of food for the international market. It must be remembered that Angola's current need to engage in import substitution stems from the entirely non-economic reasons for its loss of domestic production capacity in the first place – the decades long civil war and its attendant destruction.

The trade strategy should also aim at gradually restoring the capacity in non-mineral exports once efficient import-substitution takes hold. The emphasis on eventual export-led growth is essential in Angola because with more than two-thirds of the population living on less than $1.70 a day[4], Angola's domestic market is too small to support the sustained high growth in production and employment necessary to make a marked reduction in poverty. Therefore, export growth and diversification must be the focus for generating growth in Angola in the medium to longer-term.

With its vast natural resources, Angola has substantial potential to implement the proposed phased strategy that initially focuses on import substitution with the intention of eventually moving towards export-led growth within a diversified economy. In particular, opportunities exist in agriculture (maize, coffee, rice, cassava, sorghum/millet, livestock, cotton, potatoes, etc.), fisheries, light manufacturing (agro-processing, wood products, leather products), and services (port services and transit trade, tourism). This strategy would provide the most effective anti-poverty program because all potential import-substitution and export-oriented activities, particularly in the rural areas where about two-thirds of the population live, are labor-intensive activities.

Implementation of this strategy requires significant improvements in trade policy. However, improved trade policy is not enough. A comprehensive reform package is needed which would include eliminating overvaluation of the exchange rate, rehabilitation of infrastructure, further stabilization of the macro economy, the strengthening of sector-specific policies, and improvement in the private sector enabling environment to encourage private investment in import-substitution and export-oriented sectors and a more effective supply-side response to trade policies. A competitive real exchange rate would be the single most important instrument to bring back the diversity of production and exports.

All of the policies with a major impact on trade, both direct and indirect, need to be evaluated in terms of their ability to promote the broad based trade-oriented and private sector-led growth that is needed. This must be weighed against the cost of each.

[4] Estrategia de Combate a Pobreza, page 2. Based on 2001 survey

The DTIS will focus particularly on the following priority areas.

- **Competitive exchange rate.** As noted above, a competitive real exchange rate is critical for promoting both efficient import substitution and production for export. However, exiting from the current policy regime would also entail some costs and would need to be carefully managed. In close collaboration with the IMF, the DTIS will assess options available to the government to improve the competitiveness of the exchange rate.

- **Tariff protection.** Angola has one of the most open trade regimes in Africa. The Government has recently engaged in some modifications of its tariffs on various categories of goods. The reforms involve some increase in tariffs in sectors where Angola has comparative advantage and a decrease in tariffs for capital goods and essential inputs. The DTIS will review these changes and assess whether they provide adequate temporary protection to encourage investment for import replacement, consider what further actions needed for efficient import-substitution and export promotion, and evaluate the costs and benefits of alternative policies to achieve these goals.

- **Export incentive schemes**. For most products, the immediate objective of trade policy will be to promote import-substitution even though it is obvious that if Angola possesses a comparative advantage in the production of a given item it will make sense to export it as well. For some products (coffee, for example) exports can potentially start once the production capacity is rehabilitated because domestic demand is limited. Accordingly, it makes sense to evaluate such sectors ex ante in order to know whether current cost and market structures indicate that a viable and profitable export sector is in fact possible. If so, complementary public good investments can be justified but given the many demands on public resources it is important to be very parsimonious in allocating such resources. Among more general schemes needing evaluation are proposals for a duty drawback system, bonded warehousing, export processing zones and an export credit system, among others. The DTIS will identify the needs and propose measures to improve the export incentive schemes.

- **Trade facilitation.** An efficient transport system, customs administration, and health and safety standards infrastructure are essential to developing a cost-effective trade network. The Government has already initiated steps to reform customs administration. The program should include upgrading equipment and infrastructure, integrating border agencies, reducing border clearance time, and training staff. Angola will also need to develop a standards infrastructure and testing services to be able to export agricultural products. As a country with a lengthy coastal line and a number of neighboring land-locked countries, Angola has the potential to provide port and transit services to its neighbors. To realize this potential, it is necessary to develop a transit strategy and to harmonize customs procedures in collaboration with neighboring countries and SADC and COMESA. The DTIS will assess the needs and propose actions to improve trade facilitation.

- **Sector development strategies.** Trade policies and other complementary reforms improve the national policy environment and indirectly affect all sectors. It is also necessary to identify sector-specific barriers to growth in production and exports and to develop sector development strategies. In Angola, priority sectors for focus in removing such barriers include agriculture and agro-processing, fisheries, livestock, light manufacturing, and tourism. The DTIS will contribute to developing strategies in these sectors.

- **Trade capacity**. The responsibility for formulating and implementing policies that affect trade is shared by a number of ministries and agencies. Each agency deals with a different aspect of trade, and inter-agency coordination is very weak. In addition, all agencies face a serious shortage of technical capacity to develop trade policies and negotiate regional and global trade agreements. It is necessary to strengthen the analytical capacity of all concerned agencies within and outside the government and improve co-ordination among them. The DTIS will assess the existing trade capacity, identify the specific areas where trade capacity requires strengthening, and propose technical assistance projects to improve the situation.

- **Trade agreements**. Angola needs to determine its long-term trade interests and participate actively in regional and global trade negotiations to ensure that its interests are adequately reflected in future outcomes. Regional markets are important for Angola for non-mineral exports. It is advisable that Angola explore the terms upon which it might enter the SADC and COMESA FTAs. Maintaining access to the EU market will also present various opportunities. The DTIS will generate information to develop a national negotiating position to guide the Government in these negotiations.

Clearly, not all of the reforms and initiatives can or should be accomplished in the immediate future. The DTIS will provide an opportunity to analyze and evaluate each of these potential interventions in order to arrive at a concrete set of priorities and phased steps to be recommended to the government. It is particularly important that each be evaluated in terms of its ability to contribute to the Government's stated objectives as embodied in its poverty reduction strategy, the ECP, and other policy documents.

VII. Tentative Outline

Based on the assessment of the key issues outlined above, the proposed outline of the DTIS is shown below:

i. Executive Summary

ii. Matrix of Proposed Actions and Technical Assistance Needs

I. Introduction

A. Rationale for Study
B. Socioeconomic context and recent economic history

II. Trade in Angola and its Relation to Poverty

A. The Pattern of Trade
   - Sectoral Distribution of Exports and Imports
   - Trade Partners and Regional Integration
B. Production and Poverty

III. Oil, Macroeconomic Incentives and Trade

A. Oil Revenue, Macro Stability and the Real Exchange Rate
B. Rehabilitation of Angolan Production of Tradable Goods

IV. Trade Barriers

A. Trade Policy: Tariffs, non-tariff barriers, export incentives, revenues from trade

B. Trade Facilitation: Customs administration, transportation, health and safety standards, export credit.

C. Trade Capacity and Policy Coordination

V. Private Sector Development in Angola

A. The enabling policy environment and the regulatory framework
B. Infrastructure and provision of public services

VI. Potential for Import Substitution and Export Diversification

A. Agriculture
B. Manufacturing and other non-Agricultural sectors
C. Tourism
D. Fisheries

VII. Donor Initiatives

VIII. Summary and Outline of a Trade Strategy

VIII. Staffing

The DTIS is contracted to Nathan Associates (NA). It will be prepared by a NA team led by Dr Steven Kyle of Cornell University with contribution from the World Bank and WTO. The DTIS will be prepared under the overall supervision of Fahrettin Yagci of the World Bank. The peer reviewers are Paul Brenton (PRMTR), Jorge Araujo (FRM), Manuel de la Rocha (AFTP2), and Jon Shields (IMF).

Individual contributions are as follows:

Section	**Contributors**	**Comments/New Sources**
Economic Background	World Bank/Team Leader	CEM and other World Bank studies
Trade Performance	World Bank/Team Leader/Lance Graef	Data work has been completed from a UN data set. Analytical work will be needed to interpret the data.
Trade Issues	World Bank	CEM
Trade Policies	WTO	To be taken from information being gathered for the upcoming WTO Trade Policy Review for Angola
Macroeconomic Conditions	World Bank/Team Leader	CEM
Business Environment	World Bank/Team Leader	CEM
Customs Administration and Transport	TBD Nathan Consultant	Information will need to be collected from secondary sources and through the technical mission
Quality and Safety Standards	TBD Nathan Consultant	Information will need to be collected from secondary sources and through the technical mission
Export Credit	TBD Nathan Consultant	Information will need to be collected from secondary sources and through the technical mission
Potential for Export Diversification		
1. Agriculture	World Bank/Team Leader	CEM
2. Fisheries	TBD Nathan Consultant	Information will need to be collected from secondary sources and through the technical mission
3. Tourism	TBD Nathan Consultant	Information will need to be collected from secondary sources and through the technical mission
4. Other industries/ sectors	TBD Nathan Consultant	Information will need to be collected from secondary sources and through the technical mission
Enhancing Trade Capacity	Lance Graef/Ashok Menon	Technical mission
Other Donor Work	EU	Information will be collected by the EU on the ground in Luanda

IX. Proposed Timeline

Date	Task	Responsibility
August 30	Complete draft of concept paper completed	Nathan/World Bank
September 9	Concept paper review within World Bank.	World Bank, Team Leader
September 19-23	Preliminary Mission to Angola to discuss the concept paper with the Government and other stakeholders, and lay the foundation for the main technical mission.	Nathan Team Leader with World Bank Representatives (possibly also to include Ashok Menon from Nathan/Mozambique)
September 30	Draft inputs received from the World Bank—findings to be incorporated into the DTIS report.	Nathan Team Leader and Nathan Project Coordinator
September 30	Draft Trade Chapter received from WTO and incorporated into the DTIS report	Nathan Team Leader, Nathan Project Coordinator, Ashok Menon/Lance Graef
Mid-October	Technical Mission to Angola, attended by all relevant technical consultants, to conduct research and gather information for the DTIS report.	Nathan Team Leader to lead; Nathan Project Coordinator, Key Technical Consultants, World Bank and other Donor Representatives to attend
November 30	All inputs for the DTIS report submitted to the Team Leader	Key Technical Consultants
December 30	Team Leader provides rough draft of final report to Nathan for editing and review	Nathan Team Leader
January 30	DTIS Report given to World Bank and donors for review	Nathan
February 30	Revisions based on World Bank and donor feedback	Team Leader
March 15	To translator	Nathan
April 15	To GOA and other Angolan stakeholders for review and acceptance/concurrence	World Bank/Nathan to submit
May 15-25	Vetting Mission to Angola	Nathan Team Leader and World Bank representatives
May 30	Revisions to draft DTIS (in English) completed.	Team Leader
June 1 - 15	Nathan editing of English draft	Nathan
June 15-20	Revisions and translation into Portuguese of Final Draft	Nathan
June 25	Submission of Final Draft to the Government	
July and beyond	National Validation Workshop	Nathan Team Leader, Nathan Project Coordinator, Lance Graef and/or Ashok Menon, World Bank representatives

ANNEX

January 2005

INTEGRATED FRAMEWORK
FOR TRADE-RELATED TECHNICAL ASSISTANCE
TO LEAST DEVELOPED COUNTRIES

(The IF)

Objective of and Participation in the IF Program

- Inaugurated in 1997 by six core agencies: IMF, ITC, UNCTAD, UNDP, WTO, and World Bank. A number of multilateral and bilateral donors also participate in the program.

- The IF is a multi-agency multi-donor program aimed to coordinate technical assistance to the least developed countries (LDC) to assist them in enhancing their trade opportunities. Its main objective is to assist LDCs to identify the main barriers to expansion of trade and provide trade-related technical assistance in a coordinated way to remove these barriers.

- This will be achieved by assisting LDCs in mainstreaming trade priorities into their national strategies such as Poverty Reduction Strategy Programs (PRSP) and building their capacity to formulate trade policies, to negotiate trade agreements, and to tackle supply-side challenges in responding to new market access opportunities.

- Strong country ownership and commitment, and an effective participatory process, which brings together all stakeholders in the government (Ministries of Trade, Finance, Planning, Agriculture, etc), outside the government (private sector, civil society), and in the donor community, are essential for the success of the IF.

Stages of the IF Process

- Preparation phase. This would include: an official request from the country to participate in the IF process; a technical review of the request prepared by the World Bank and considered by the Integrated Framework Working Group in Geneva (IFWG); and a pre-DTIS mission to the country to lay the groundwork for the IF process, to discuss the scope of the diagnostic study with all stakeholders, and agree on a timetable for processing of the IF.

- Diagnostic phase. A Diagnostic Trade Integration Study (DTIS) prepared by a group of international and local specialists in collaboration with all stakeholders. Normally, the preparation of the DTIS is led by the World Bank. Typically, the DTIS includes a review of country's trade policies and performance, an analysis of selected sectors with export potential, identification of main constraints to expansion of trade, and recommendations for policy reforms to remove these constraints. The DTIS also includes an Action Matrix spelling out the policy recommendations of the DTIS and priority technical assistance needs. The DTIS and the Action Matrix are discussed and validated by all national stakeholders, donors, and IF agencies during a National Workshop and revised in light of these discussions. The final Action Matrix is approved by the Government.

- Implementation phase. After the approval of the Action Matrix, the trade policy priorities are incorporated into the country's PRSP or PRSP progress report. A donor meeting is held to secure financing of the technical assistance needs identified in the Action Matrix and integrate them into donors' assistance programs. Implementation of the IF and interactions with donors is a continuous process. Some of the technical assistance projects can be financed from the Integrated Framework Window II funds (see below).

<u>Funding of the IF Program</u>

- An IF Trust Fund was established in 2001 to finance the IF Program. Contributions have been pledged by both multilateral and bilateral donors towards the fund. The IF Trust Fund is managed by UNDP on behalf of donors.

- The IF Trust Fund has two finance windows operating simultaneously. Window I funds are used to finance the preparation of diagnostic studies, mainstreaming activities in the countries, and the costs of the National Workshop. Window II funds are available to finance concrete, modest, and priority technical assistance projects identified in the DTIS Action Matrix. Window II would provide bridge financing until mobilization of donor funds, and allow prompt funding for follow-up technical assistance projects particularly for trade capacity-building. A maximum amount of $1 million is available for each country under Window II.

- Projects for Window II funding are selected by a Local Project Approval Committee (LPAC) chaired by an appropriate government body. Membership of the LPAC includes as a minimum: The Ministry of Finance or Planning, the Ministry of Trade, UNDP Resident Representative or delegate, the Lead Facilitator, and the World Bank Resident Representative or delegate. During the pre-mission, UNDP organizes a briefing session to inform all parties about project formulation and approval process for Window II projects.

<u>IF Management Structure</u>

- Geneva. The Integrated Framework Steering Committee (IFSC) oversees and governs the IF process. It is a tripartite arrangement with representation from agencies, donors, and LDCs. The day-to-day activities of the IF are managed by the Integrated Framework Working Group (IFWG). The IFWG is chaired by the WTO and consists of representatives of the six core agencies and two representatives each from the least-developed and donor countries. The WTO houses the IF Secretariat which services both the IFSC and IFWG.

- Multilateral donors. The UNDP manages the IF Trust Fund, both Window I and II. The UNDP also manages a fund "Strengthening the National Implementation of the IF

($38,000 for each country)" to support the IF related activities of the Integrated Framework Steering Committee (IFSC) and the Focal Person in the IF country (see below). The lead role in assisting preparation of the DTIS and overseeing implementation of the follow-up activities, with funding provided by the IF Trust Fund, is given to the World Bank.

- Country level. The national management structure includes the following. The Ministry of Trade (MT) is the IF implementing agency. The MT appoints an IF Focal Person (main counterpart of the IF in the government), and sets up an IF National Steering Committee (IFNSC). The IFNSC comprises representatives of the main stakeholders in the government, outside the government and in the donor community, and manages the IF process in the country. The private sector is adequately represented in the IFNSC. In countries where both the IF and JITAP are in place, the government establishes arrangements to ensure synergies including the use of a single national steering committee for both the IF and JITAP, the appointment of the same focal point, and to link the DTIS and JITAP capacity building activities. The MT also identifies a Lead (donor) Facilitator to assist and support the government in managing the IF process. The Lead Facilitator serves as a focal point for interaction between the country and donors at the country level. Early involvement of the donors at the country level is crucial for a successful implementation of the program.

Progress in Implementation of the IF Program

- To date, the number of DTIS reports have been completed and implementation has started for 14 countries. IFWG has approved the IF program for 14 new countries. Preparation of DTIS is at various stages for these new countries. Angola is one of these 14 new IF countries.

- Funds pledged by multilateral and bilateral donors to the IF Trust Fund is presently about $26 million ($15 million for Window I and $11 million for Window II).

Further Information

- www.integratedframework.org