



THE WORLD BANK  
ANGOLA

Assessing the Impacts of Phasing Out Utility  
Price Subsidies

Inception Report

By

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March 2005

## Acknowledgments

This inception report has been drafted by Emilson Silva, Associate Professor at Tulane University and consultant to the World Bank for this task. The consultations described in the main text took place during the period of February 14 to February 25, 2005 in Luanda. Camilla Rossaak, Social Scientist at the World Bank, was an integral member of the team. Her inputs during consultations, comments on the issues to be discussed, suggestions for changes in the approach adopted during the interviews, help with setting up appointments and overall contributions to the making of the questionnaire to be adopted in gathering household data were and have been extremely valuable.

The financial support provided by the British Embassy in Luanda to this task is gratefully acknowledged. The wisdom and experience of Mr. John Thompson, British Ambassador in Luanda, have been very useful in refining the scope and the orientation of the work. Many thanks go also to all governmental officials who warmly welcomed the team in their offices and eagerly discussed with them the relevant issues. Many of these individuals also provided the team with key data sets, which will later be extremely important in the development of the economic analysis. The team kindly acknowledges the support from the Ministry of Finance through Vice-Minister Eduardo Severim de Morais, Manoel Neto da Costa, Director of Studies and International Relations, and Francisca Fortes, Director of Prices and Competition. The civil society organizations, donors and professors who made themselves available during the consultations offered very important pieces of information.

This work would not have been possible without the cooperation and assistance of many experts and staff at both World Bank headquarters in Washington and the local office in Luanda. A great number of people at the headquarters helped the team in the conceptualization of the study and on the drafting of the questionnaire. The group of dedicated staff who helped in the early stages of this work includes Masami Kojima, Stefano Paternostro, Sarah Keener, and Louise Fox. As for the local World Bank team, Mr. Laurence Clark, Mr. Olivier Lambert, Ms. Domingas Pegado, Ms. Carla Balça and Mr. Lima da Silva, the team would like to say “muito obrigado por tudo”.

Finally, the team would like to thank Francisco Carneiro, Senior Country Economist for Angola, for his support at all stages of this work, since its inception in Washington, DC. It has been a real pleasure to conduct this work under his supervision.

## I. Background

In a policy program scheduled to be completed by October 2005, the Government of Angola (GoA) has been gradually eliminating fuel price subsidies. When this program is complete, subsidies of public utilities (water and electricity) are supposed to be similarly phased out. By eliminating all subsidies, the GoA's fiscal position is expected to improve, since net revenues should increase – according to the Ministry of Finance, the GoA subsidy liability in 2004 amounted to US\$ 1 billion – and an agreement with the IMF should be facilitated. However, the increases in fuel and utility prices may lead to greater adversity for the vulnerable and poor. The adverse effects may be felt through a higher cost for the basic basket of goods and services or through increased hardship in having access to the various items of such basket.

In the context of the Bank's Country Economic Memorandum and of the negotiations of a Staff Monitored Program between the Government and the IMF, with financial support from the British Embassy in Luanda, the Bank is commissioning an impact analysis of the Government's policy aimed at eliminating utility price subsidies. The main goal of the study is to estimate and evaluate the likely effects associated with the removal of such price subsidies on the distribution of household welfare in Luanda (both urban and rural), government accounts<sup>1</sup> and inflation in Angola. The study will also capture the linkages [market (supply and demand sides), institutional and political (stakeholders)] that may exist between fuel and utility pricing, given the broader objective of examining removal of all price subsidies. Overall, the analysis will foster policy debate and feed relevant (quantitative and qualitative) information back into policy choices.

This report highlights the issues raised in stakeholder consultations undertaken in Luanda during a two-week period ranging from February 14 to February 25, 2005. The group of stakeholders consulted consisted of governmental officials, civil society organizations, donors, researchers and economics professors. The meetings produced a gamma of inputs, data and suggestions for reshaping the scope of the study. For a better understanding of the changes promoted as a result of the consultations, the original scope of the analysis is presented next in what follows. The main issues raised during the stakeholder consultations are provided in section III. In section IV, the scope of the study is revised according to the inputs obtained during consultations. Section V discusses the methodology to be adopted, and section VI displays the timeline for the remainder of the project.

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<sup>1</sup> In this instance, the study will complement earlier analysis carried out jointly by staffs of the World Bank and the IMF, see IMF (2003), Fiscal Subsidies in Angola, in Angola: Selected Issues and Statistical Appendix, 2003 Article IV Consultation Report, Washington, DC.

## II. Original Scope

The original scope of the study, which the team responsible for the impact analysis (Emilson Silva and Camilla Rossaak) explained to stakeholders in the beginning of the consultation period, was as follows. The analysis would consider the social and economic impacts of phasing out price subsidies for fuels and utilities. The study would investigate both macro and micro economic aspects of the problem at hand. The macroeconomic components of the study would include the possible impacts on governmental finances and inflation. The microeconomic impacts would be assessed by gathering information from households in what respects their demands for fuels and utility services (electricity and water). This would be done through a household survey, which would be conducted throughout the country, encompassing urban and rural areas. The original idea was to concentrate our efforts in understanding the impacts associated with the phasing out of fuel price subsidies, since the government had already started a program of eliminating such subsidies. We would also try to understand the issues pertaining to pricing of and access to utilities, but this investigation would not be the primary source of motivation for the study. There was also the intention of putting more emphasis on the social problems surrounding pricing of and access to energy sources rather than to water sources.

In some consultations we also mentioned that the study would consider different scenarios concerning the speed of price adjustment and the trade off between rules and discretion. As for the speed of adjustment, the goal was to evaluate whether the adjustment should be made once and for all or gradually. As for the trade off between rules and discretion, the study would consider the pros and cons of establishing trigger rules of adjustment (e.g., tying within a narrow band domestic fuel prices to international prices) and contrast them with the current state of affairs where government authorities are given full discretion over price adjustments. The analysis in either case would fully account for political considerations, including suggestions for palliative measures that should be adopted in order to mitigate some of the negative effects associated with increases in fuel prices.

In broad terms, the study would be structured to address the following main questions:

- I. What are the problems associated with subsidies? Who benefits from them?
- II. What are the likely impacts of eliminating/reducing subsidies on households and on the (macro) economy? Who are the likely winners and losers?
- III. How to design a program to compensate the poorest among the losers and also to moderate resistance?

In order to address the questions above, it was deemed necessary to focus on the following issues:

1. **Incidence of subsidies:** What is the incidence of subsidies by income groups and per person in Angola? What are the characteristics (income and socioeconomic) of the various segments of the population affected by subsidies? How much do

Angolans pay for fuel and utility services in comparison to other countries in Africa and other parts of the world?

2. **Access to fuels:** Which energy sources do urban and rural households typically use for heating, lighting and cooking? How accessible are the fuels for the urban and rural poor? How substitutable are the fuels for the different types of consumers?
3. **Size and consequences of price adjustments:** By how much should prices be raised, and what are the timing issues involved (short and long term)? What are the estimated effects of rising fuel prices on food prices? Which segments of the population will be directly (indirectly through rising transportation and input costs) affected by rising fuel prices? Which segments of the population, if any, will not be affected at all by rising fuel and utility prices?
4. **Secondary effects:** Are there secondary markets (resale) for fuels and water in urban and rural areas? If so, how do they operate and what is the price premium charged? Are the officially set prices the effective prices charged for fuels? How does the distribution mechanism work? Are there unofficial intermediaries?
5. **Operational efficiency:** How does Sonangol operate as a distributor? What are Sonangol's operation costs? How can the pricing mechanism be more transparent? How can sector efficiency be enhanced, either through pricing or other mechanisms? How can political influence be minimized in price setting? How can consumers benefit from sector efficiency enhancement?
6. **Use of fiscal savings:** How much will the GoA save with the elimination of the subsidies? Are the savings obtained sufficiently large to compensate the poorer households and improve social protection? Should the GoA improve or augment existing social programs with the savings? How to phase fiscal savings relative to spending?
7. **Monitoring and evaluation:** Which monitoring and evaluation systems do exist and/or should be put in place to assess both the impacts of (i) the actual subsidy removal on households and on the economy; and (ii) the spending programs put in place to compensate the losers?

### III. Fruits from Stakeholder Consultations

Starting on February 14 and running until February 25, 2005, the World Bank team in charge of the subsidy study conducted consultations with several governmental officials, civil society groups, donors and economics professors. The team met with the following governmental officials:

- Mr. António da G. Lopes Teixeira, General Associate Director, Angola's Roads Institute (Instituto de Estradas de Angola (INEA)).

- Mr. Rui Augusto Tito, Vice Minister, Ministry of Energy and Water Affairs.
- Mr. Paulo Matos, Director, Ministry of Energy and Water Affairs.
- Mr. Bonifácio Manuel, Director, Ministry of Agriculture and Rural Development.
- Ms. Luzia B. da Costa, Head, Department of Planning and Statistics, Ministry of Petroleum.
- Mr. Mavinga B. David, Head, Department of Investments and Projects, Ministry of Petroleum.
- Mr. Manuel da Costa, Director, Office of Studies and International Economic Relations, Ministry of Finance.
- Ms. Francisca Fortes, Director, Office of Prices and Competition, Ministry of Finance.
- Ms. Efigénia da Purificação S. S. Martins, Head, Department of Public Enterprises, Ministry of Finance.
- Ms. Joana Cordeiro dos Santos, National Director of Accounting, Ministry of Finance.
- Mr. Simão Neto, Director, Office of Informatics, Ministry of Finance.
- Mr. Joaquim Flávio de Sousa Couto, General Director, National Statistics Institute (Instituto Nacional de Estatística (INE)).
- Mr. Domingos Bernardo, Technical Associate, Office of the President of the Administration Council, Water Public Enterprise (Empresa Pública de Águas (EPAL)).
- Mr. José Ambriz, Administrator, Office of the President of the Administration Council, Water Public Enterprise (Empresa Pública de Águas (EPAL)).

Non-governmental and civil society organizations consulted included FAS, FMEA, CARE – Angola, YME, CEEA, DW, SAL, ADRA, COIEPA, FONGA, MEDAIR, AIA, Angola 2000. The donors consulted included British Embassy, UNDP, US Embassy, South African Embassy, WHO, Swedish Embassy, German Embassy, Norwegian Embassy, Italian Embassy, Spanish Embassy, UNFPA, European Commission, UN Human Rights. The team also met with Professors Laurinda Hoygaard, University Agostinho Neto, and Justino Pinto de Andrade and Manuel Alves da Rocha, Catholic University of Angola.

The main issues raised during consultations with governmental officials are summarized below. The list is organized according to the chronology of the consultations.

### 1. INEA

- Intercity roads are in very poor condition; around 90% of them are damaged. Access to some places inland is only possible via air (airplane or helicopter).
- Transportation cost is very high.
- Food is much more expensive in the countryside than in coastal areas because of transportation costs.

- Roads along the coast were de-mined; there is a “safe” perimeter ranging from 8 to 12 meters along these roads.
- Massive investment is necessary in order to improve the country’s road system.

## 2. Ministry of Petroleum

- The refinery in Luanda produces 50% of the fuels utilized in the country.
- Fuels produced in the refinery are sold to Sonangol Distribuidora, which is in charge of distributing the products to gas stations and other resale outlets.
- Most gas stations belong to Sonangol. There are a few small private gas stations distributed across the country, mainly in urban areas.
- The Ministry of Petroleum is currently working on implementing a law designed to increase competition in distribution and resale of fuels.
- A large fraction of gasoline consumption is for generation of electricity (private generators).
- Unavailability of gas stations in the countryside generates the conditions for the emergence of secondary markets. Hence, a policy that aims to increase the number of operating gas stations in remote areas in the provinces is of paramount importance.
- The country is a net importer of gasoline. Its single refinery’s productive capacity cannot match the market demand.
- Fuels are not smuggled out of the country. (There appears to be no restriction in reselling the product abroad.)
- The main reason for keeping low fuel prices is to compensate the population for low salaries.

## 3. Ministry of Finance

- Due to the current transition period, the issue of eliminating fuel subsidies is very delicate. The practice of controlling prices has been inherited from the previous communist system, characterized by a command-and-control economy.
- Civil service salaries are low. Nobody knows for sure the distribution of salaries in the private sector. In any case, increases in fuel prices generate

pressure to increase salaries in public and private sectors alike. One must then account for the inflationary impacts associated with such measures.

- Last year, the government spent around US\$ 1 billion in subsidies. There is no doubt that governmental finances would improve if subsidies were eliminated.
- As for water and electricity, rises in prices would not solve the problems. The public companies are poorly administered; workers have low skills and are known to shirk their working duties. The services provided by these companies are of poor quality. Any attempt in increasing prices would then encounter public resistance. The public is willing to pay higher prices for these services only if their quality levels improve.
- One common problem generated by a rise in fuel price is the subsequent increase in urban transportation fares, as the rise in operating cost is shifted in its entirety to consumers by van operators. Increases in transportation fares have in some occasions led to social unrest, protests and discontentment amongst the urban population that relies on this mode of transport.
- The majority of Luanda's urban population lives in the periphery. It is mostly affected by the impacts of the rising fuel prices on transportation and secondary markets.
- The government should not subsidize fuel prices, since such subsidies are regressive, benefiting the rich and not the poor. The government should instead subsidize industry and agriculture, the productive sectors.
- One of the critical problems faced by the population which resides in the countryside is the fact that Sonangol has not systematically distributed fuels to the provinces. Due to high transportation costs, fuel prices are sometimes twice as large in the provinces as in Luanda (official prices). Sonangol often hires private transportation companies to distribute fuels in the provinces.
- The electricity companies determine electricity charges. One must also account for cross subsidization, since electricity companies use subsidized fuels to generate electricity.
- Public servants at public enterprises earn higher salaries than officials in other public sector areas. The wage bill in the public sector as a whole last year amounted to US\$ 2 billion, which represented 10% of GDP.
- Between February and May, 2005, adjustments in the prices of fuels will occur on a biweekly basis.

#### 4. INE

- The raining period will last until the end of April. As a result, access to the countryside is extremely difficult prior to the beginning of May. INE's field interviewers typically start their operations after the end of the raining period. In designing our strategy regarding the areas selected for the survey, we must take the restrictions imposed by the weather into account.
- Due to the difficulties in accessing remote areas in the provinces, even during the dry season, nationwide surveys tend to be very costly.
- The last census was carried out in 1970. There are no accurate or official estimates of population size and its regional distribution.
- The Angolan population size is likely to be 12 million, of which 4 million is expected to reside in Luanda.
- Most of the Angolan population is believed to reside in urban areas.
- Luanda is different from other urban centers in many respects; however, the social indicators for Luanda are likely to be representative of the whole country.
- Two household surveys were previously conducted, one in 1997 (4000 respondents) and another in 2001 (6600 respondents). While the first survey covered areas controlled by UNITA, the second did not. Such areas have not been surveyed since 1997.
- A study which focuses on Luanda (urban and rural areas) would be very interesting, since it has not been done before.

#### 5. Sonangol

- Subsidy figures are calculated based on proposed Sonangol delivery prices for fuels in Luanda. Hence, transportation and other logistic costs to deliver products to provinces are typically ignored. This implies that the overall amount of subsidization is higher than the official figure.
- Sonangol subcontracts with private transportation companies to deliver its products in the provinces. Sonangol does not have a sufficiently large number of trucks to supply fuels to all gas stations across the country.
- There are 240 gasoline pumps in the whole country. These do not include pumps serving boats or offshore activities.

- Angola's single refinery was built in 1949. It lacks capacity to meet the market demands for fuels.

## 6. EPAL

- New water treatment systems coexist with old ones in the provision of water. This coexistence negatively affects water quality delivered to the population.
- Electricity and fuels are crucial inputs in the generation of water services. The company is in debt with Sonangol and electricity companies.
- Operating plants provide water of good quality. However, there are problems in the distribution network. The network is old and allows infiltration because of its many holes. Since the sewage network system is located near to the water network and sewage spillovers are common, there is a high degree of contamination. Luanda's sewage system is controlled by the provincial government, which has failed to prevent the system's deterioration.
- The World Bank financed a project called PRP – Programa de Reabilitacao Prioritaria da Rede Esgoto da Cidade de Luanda. The project was not carried out by the local authorities.
- There is a law that enables a private operator to manage water provision and services. However, no firm has yet been granted the right to conduct such operations in the water sector.
- Currently, one third of Luanda's population has water piped to their homes.
- The company does not raise adequate revenues to finance its operating costs. This is due to a number of factors: (i) water charges are low; (ii) many clients fail to systematically pay their bills; (iii) company officials do not exert much effort in measuring clients' water consumption levels; and (iv) there are several clandestine connections to the water system, some of which are facilitated by company officials. The resulting revenue collected enables the company to only pay its wage bill. Other operating costs are typically financed by the central government. However, governmental transfers and subsidies are insufficient and irregular. Money disbursements do not appear to follow any systematic policy.
- There are two types of water trucks responsible for delivering water to the population: (i) those under contract with the company; and (ii) those who are autonomous operators. Since there is no effort made to distinguish them, the water quality provided by autonomous operators is not regulated and cases of corruption are not uncommon, it is likely that the water quality provided in this market is low.

- Water charges were adjusted in May, August and October, 2003. The adjustments, however, were simply to keep up with inflation. Up to now there has been no attempt to increase charges in order to reduce the price subsidy.
- The central government has been investing in expanding capacity. There has been no attempt to substitute old for new plants; hence, System III (new plant) is not a substitute for Systems I and II (older plants). The government is also spending some resources in the improvement of System II.
- System III is not yet producing large social benefits because the distribution network is limiting and in poor condition. The expansion in capacity will only bring about greater regional water provision if the current distribution network is improved and expanded.
- Urban population does not complain about the services provided by the company; no manifestations against increases in charges or in favor of improving water quality are observed.
- People in rural areas typically pay more for water services.
- Retail businesses should not benefit from price subsidies.
- Water tariffs should be differentiated according to ability to pay, with the rich paying more than the poor for the same service and same quality.
- The company is currently preparing a report, to be submitted at the end of March to the Ministry of Finance, in which it proposes differentiated tariffs.
- The company faces some very serious managerial problems: (i) it lacks resources to commercialize and distribute its products; (ii) lacks skilled and motivated human resources in key areas, such as accounting and management; and (iii) it employs more workers than it needs.
- Unskilled and skilled workers alike are unmotivated. There is a general perception that salaries are low, although they are higher than the average salaries paid in the public sector as a whole. Salaries paid by other public companies, however, are perceived to be higher.
- Most employees belong to a politically active labor union.

#### 7. Ministry of Energy and Water

- The ministry is currently studying alternative ways to reduce the gaps between marginal costs and prices of utilities, in an effort motivated by the government's orientation in reducing subsidies.

- There does not seem to be logical to subsidize retail and service sectors, since these sectors are modern and competitive.
- There is, perhaps, justification to keep price subsidies in utility services delivered to consumers.
- It is common knowledge that the public utility companies are not efficient.
- In the energy sector, privatization is thought to be a good strategy for development.
- 20% of the Angolan population is estimated to have access to electricity.
- Current average electricity consumption ranges between 90 to 100 Kw/h. There is a goal to increase this consumption level by 100% by 2015. However, new investments are needed in order to reach this target.
- As for the water sector, there is a strategic program already in place and which should last until 2016.
- Water treatment and distribution should be handled, perhaps, by a private company.
- Water business is very lucrative. The informal sector raises annual revenues of about US\$ 100 million. EPAL's annual revenues, on the other hand, are around US\$ 10 million.
- Shock treatment does not work: effective and sustainable price increases have to be gradual and of small magnitudes.
- New investments in capacity expansion are sometimes fruitless because the new added capacity ends up retiring previously built capacity and the net effect is nil.

The main issues raised during the meeting with the various civil society organizations are summarized below.

#### Non-Governmental and Civil Society Organizations

- Water and energy companies are inefficient. Clients find it difficult to make payments.
- Access to water and energy sources is a problem of gigantic proportion, since it affects all social levels. The problem is more serious for the poor. There are, for example, people in Luanda that have not had access to either water or electricity over the last three years.

- Even the rich have private water tanks at home, purchase water from water trucks and have electricity generators at home. Public utility services are of poor quality. Much of the problems in poor service delivery are generated by the public companies themselves.
- Price increases for utilities can be counterproductive in that only a few honest people would pay. In any event, prior to increasing tariffs, service quality must improve.
- The inefficiencies created by the public utility companies in service delivery generate high costs in the production of goods and services in the private sector. New ventures in the private sector can only be realized if entrepreneurs are able to finance the costs of acquiring water tanks and electricity generators for their businesses.
- Luanda's population has been growing at a very high rate. The public utility companies are unable to meet the demands of the expanding population.
- The chaotic situation observed in Luanda caused by its rapidly growing population should be the focus of a study, which investigates the conditions that should be created to induce those who migrated to the city from rural areas to return to their original places of residence. Subsidies should be directed to rural development.
- The production of a new demographic census is of extreme importance. The World Bank could help the Angolan government in this enterprise.
- Fuel price subsidies favor only a small segment of society. Hence, the subsidies should be eliminated and hence fuel prices increased. The governmental resources saved with the elimination of fuel price subsidies should be used to: (i) invest in priority areas such as education; (ii) subsidize student transportation; and (iii) develop agriculture and industry.
- Fuel price increases can have very detrimental effects on education, as transportation costs faced by students are high. Schools in Luanda are all located in the center of the city. Students often have to travel long distances to attend school. As fuel price increases generally cause increases in transportation fares, students may decide to quit attending school in order to avoid the larger transportation cost burden.
- Current governmental policy provides subsidies to transportation companies. These subsidies are misguided, since they should be directed to consumers, not the firms.
- There is no current effort in coordinating the actions of federal, provincial and municipal levels of government. Some of the problems encountered in water

provision stem from this lack of coordination, since EPAL is a branch of the federal government while the sewage system is responsibility of the provincial government.

Prior to meeting with the donors, the team had the opportunity to meet with Mr. John Thompson, the British Ambassador. Mr. Thompson raised the following issues:

- Prices of fuels have dramatically increased over the last nine months and yet no negative public reaction has been noticed. This is true even for kerosene, which is widely used in the countryside.
- The study should not ignore the water sector; the poor are likely to be more affected by lack of access to water than to energy sources. The secondary water market makes the price of water prohibitively expensive.
- Due to the logistic difficulties generated by the raining season in accessing the countryside, he suggested that Luanda should be the focus of the study. The problems facing the poor population in Luanda regarding lack of access to public services and hefty prices paid in secondary markets are exemplary of the rest of the country.

At the meeting with donors, the following points were raised.

#### Donors

- Some thought that having Luanda as the focus of the study would be quite limiting, since the economic characteristics of the provinces are quite distinct from the ones in Luanda. Others argued that Luanda is in many ways representative of the whole country, especially if one considers the social aspects involving lack of access to water and energy sources.
- As for the questionnaire to be used, some cautioned that in many of the households interviewed people cannot read or write. Some of the households also may not speak Portuguese. It may be necessary to have a team of Angolan interviewers that are able to communicate with the various ethnic groups residing in Luanda.
- When conducting this study, one should consider human rights issues. It is commonly said that “education is free,” but this is not really true. Hence, what are the effects of phasing out subsidies on the human rights situation and on the quality of services provided? These are questions that need to be addressed.
- How should the governmental resources saved be used? Policy recommendations are needed.

- One should understand the managerial and operational issues facing the public utility companies. Are there alternative solutions for the provision of services? Should they be privatized? How can the services be made viable? These are issues that should be addressed in the study.
- Is there a connection between the rationale for existence of subsidies and the prevailing salaries in the public sector?
- Political questions must be addressed, since policy sustainability is highly dependent on political considerations.
- Given that current demands for services have been conditioned on supplies available, one must be careful in drawing conclusions for future policy making.
- The economic and social environments in peri-urban Luanda are the most important ones for this study.

The main issues raised during the consultations with Professors Justino Pinto de Andrade and Manuel Alves da Rocha were as follows.

- There is no economic justification for fuel price subsidies in Angola, since they do not spur economic growth or increase the competitiveness of the productive sectors in the economy.
- Fuel prices should rise, but gradually rather than at once. Such price increases should be accompanied by economic stabilizers in order to reduce the social and economic negative impacts.
- The government currently has a policy program to gradually adjust fuel prices. The target is to periodically increase the price of gasoline, for example, so as to reach 77 Kwanzas per liter in October 2005.
- Politicians are more inclined to be motivated by ideological questions than by practical issues facing the society.
- Bureaucrats are typically unmotivated to change the *statuts quo*.
- Throughout Luanda one finds rich and poor people living side by side. After the Portuguese left, many households invaded the residential buildings that were previously occupied by the Portuguese families. The Angolan occupants were typically poor. Some of them, however, have been fortunate enough to get quite rich since then. Although there is now substantial difference in terms of wealth among some of the originally poor households, their cultural backgrounds have remained the same. It is this common cultural background that enables them to coexist peacefully with each other.

- Macroeconomic stability is of fundamental importance in Angola. As the government is not self-disciplined in its control of fiscal and monetary policies, a set of rules imposed by the IMF, which diminishes governmental policy discretion, is highly welcome.

#### **IV. Revised Scope**

The main lessons learned during the consultations are as follows:

1. There are serious obstacles in implementing a countrywide study within the timeframe for this project. The raining season makes access to the countryside extremely difficult.
2. The population currently living in urban and rural vicinities of Luanda is estimated to be around 4 million, which is likely to represent one third of the Angolan population.
3. Luanda's economic characteristics are not representative of the country's economic characteristics. However, the social indicators for Luanda are likely to be very representative of those for the country as a whole.
4. The inadequacies associated with water provision in Luanda appear to generate social problems of large magnitudes, since a small fraction of households have access to the publicly provided water services, and those who consume water at home may face severe disease problems associated with contamination from the sewage system. The informal water markets are highly lucrative.
5. Many households have electricity generators at home or share them with neighbors as a result of the unreliable electricity service provided by the electricity companies.
6. There is a high degree of public discontentment with the qualities of water and electricity services provided by the public utility companies. General opinion is that qualities would have to improve prior to the elimination of price subsidies present in water and electricity tariffs.
7. Public utility companies are criticized for being inefficient. Employees of such companies are thought of being unmotivated and to shirk their responsibilities. Some claim that the salaries paid by the public sector are low. However, the salaries paid by public enterprises are, on average, higher than those paid in the public sector as a whole.
8. There appears to be general agreement that fuel prices subsidies should be removed. However, some indicate that such removal may adversely affect the poor because of the implied increases in the cost of the basic basket of goods and

services (i.e., transportation services, food, energy and water services). Palliative measures would be needed to counteract these negative effects.

In light of these lessons, as well as of the other issues and concerns raised during consultations, the following modifications to the original scope of the study appear to be highly desirable:

1. The microeconomic and social portions of the study should be focused on Luanda, encompassing its urban and rural areas.
2. The study should investigate the impacts associated with the removal of price subsidies for fuels and utilities alike, paying close attention to the linkages there exist among all the goods and services (i.e., fuels, electricity and water) examined.
3. The study should also consider the inefficiencies associated with the current supplies of water and electricity. The managerial and operational deficiencies of the public enterprises should be examined and potential solutions proposed.

The macroeconomic portion of the study should be maintained intact.

## **V. Methodology**

There are two main parts to the study: (i) the macroeconomic portion; and (ii) the microeconomic and social portions. As for the macroeconomic portion, the study will mainly investigate the likely effects of subsidy removal on the fiscal finance and inflation. An analysis of official macroeconomic data will be conducted in order to complete this part of the study. The data analysis will also estimate the likely impacts of price increases for fuels and utilities on the basic basket of goods and services in Luanda.

As for the second part of the study, both the demand and supply sides of energy and water markets will be considered. A theoretical model will be used to derive the testable hypothesis. The demands will be estimated with the data gathered through a survey of a sample of households located in Luanda's urban and rural areas. The estimation will also allow us to derive the welfare impacts associated with various hypothetical situations concerning the rates at which subsidies are removed.

The questionnaire which will be used to gather household data is ready.

## **VI. Timeline for the Remainder of the Project**

Survey Questionnaire: Contains questions pertaining to urban and rural households' water and energy consumption, expenditure, access to water and energy sources and their perceptions about the quality of the products and services consumed.

Dataset: Data collection will be carried out by an international firm in conjunction with an Angolan expert to assist it with sampling design and logistics as well as Angolan interviewers. The international firm will also be in charge of processing the data and generate the dataset in appropriate format for analysis. Collection efforts should start at the end of March 2005.

Draft Report: Upon delivery of a satisfactory dataset, Emilson Silva will prepare a draft report that incorporates the qualitative information learned in the stakeholder analysis into the theoretical models, derives new testable hypotheses, estimates the welfare impacts of the reform under different policy scenarios, examines the likely implications of rising fuel prices on inflation and on the government accounts, analyses the results and provides policy recommendations. The analysis and recommendations will also address the likely effects of the reform on utility pricing and provision and be inclusive of the issues listed under the seven sub-titles listed in Section II above. The draft report should also be discussed in Luanda with the authorities and stakeholders by the end of May 2005.

Final Report: Incorporates feedback from the second round of consultations with the Government and stakeholders. To be concluded by the end of June 2005.