Angola: Drivers of change

Position Paper 1: Economic Change and Reform

THE ROYAL INSTITUTE OF INTERNATIONAL AFFAIRS

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POSITION PAPER ONE: ECONOMIC CHANGE AND REFORM

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ANGOLA: ECONOMIC CHANGE AND REFORM

1.1 INTRODUCTION

1. Angola produces around a million barrels of oil per day[1] and the oil sector makes up roughly 90% of exports, half of GDP and 75% of government revenues. Angola also exports around $1bn worth of diamonds annually (although some of this is smuggled out). Only 0.4% of Angola's $9.5bn exports in 2003 were outside the petroleum and diamond sectors; most of this was granite and timber. Despite this endowment, however, it is hardly fair to say Angola is rich: oil revenues currently work out at under $500 per person per year[2] (overall GNI per capita is $740, at market prices[3]).

2. After independence from Portugal in 1975, Angola was in the Soviet orbit, and Marxism-Leninism was official policy until 1990. During timid liberalising reforms in the following decade, members of the political élite amassed wealth and consolidated their hold on the Angolan state and its resources, with state assets falling into private hands in "Russian-style" privatisations, turning the reform project to their personal advantage. Many of these people remain politically powerful today.

3. In a sense, the post-independence state was constructed on foreign exchange receipts from oil and diamonds in a context of war, and this has fundamentally determined the evolution of economic and political power. The economic and political system – including opposition parties and civil society – is highly dependent on the state, owing to a dearth of opportunities outside the state's orbit, and oil and diamond resources further strengthen the state relative to the non-resource private sector.

4. The war has conditioned the economic structure. In some instances during the war, economic interests produced incentives to prolong the fighting. For example, army and UNITA forces in the diamond zones sometimes mined side by side in the 1990s, with local non-aggression pacts allowing uninterrupted mining and trading across the frontlines; kickbacks on arms procurement were another route for amassing personal wealth. Such arrangements may have played a part in prolonging the war, but it would be

[1] According to Revista Energia, the average for 2004 is likely to be closer to 950,000 b/d, though the daily rate exceeded 1 million from late 2004 onwards.
[2] This figure is derived by calculating a million barrels per day of production at an optimistic price scenario for 2004 of $40/b, of which the Angolan government will probably receive 42–43% as net revenue. The population is 13–14 million.

exaggerating to say the war was fundamentally driven by economic interests. However, the government's reliance on offshore oil, which enabled it to supply and defend provincial urban centres (often entirely surrounded by UNITA in the countryside) sharpened an urban/rural divide and helped UNITA leader Jonas Savimbi define UNITA as a movement of oppressed Africans fighting an oil-rich and often light-skinned élite in Luanda. This divide, if softening, remains meaningful.

5. According to government data in 2000, households in the richest decile of the population earned 27 times more than the lowest decile and accounted for 42.5% of household expenditure, up from 31.5% in 1995,[4] while the poorest decile's share fell from 7.0% to 4.4%. The rural/urban income gap is also huge and, despite rising oil production and the end of the war, desperate and widespread poverty endures.

1.2 NATIONAL DEVELOPMENT VISIONS

6. A good starting point for seeking ways to influence pro-poor change in Angola is to examine visions of national development.

7. A dominant vision exists in the ruling structures, which could be described as one of top-down accelerated, economic development, with heavy emphasis on external borrowing and government investment to build infrastructure: a focus especially on the *hardware* of development. It is a vision of master planning resting on a premise that the state, with the help of natural resources, can solve the nation's ills. Higher education and technology transfer, along with a strengthening of the state's efficiency, are central. In this framework, however, there is little room for the poor, who are often seen as an obstacle, rather than essential contributors, to national development; their route out of poverty is seen through their entry into the formal sector. For example, holders of this view would argue that large agribusiness projects are preferable to programmes to foster small-scale farming. A recent speech by President dos Santos to the MPLA,[5]outlining his vision for development, provides an example. He emphasised national reconstruction through "the reparation of infrastructure destroyed in the war, the building of new structures, projects, and the most modern institutions" and yet failed to mention poverty or the poor once in his

[3] World Bank data. Or, if calculated using the Purchasing Power Parity (PPP) measure used in the UN Human Development Report, GDP per capita of $2,130.
[4] The 1995 and 2000 surveys were based on similar, but not identical, constituencies.
[5] "Discurso pronunciado pelo Camarada José Eduardo dos Santos, presidente do MPLA, na abertura da reunião do Comité Central do partido", Luanda, 18 Februay 2005.

speech. A statement from one of our interlocutors, a senior industry representative, is also illustrative.

8. "I am against current forms of trade in the informal markets here. It does not give dignity. They sell everything that is of poor quality, and it is dirty. The people who make money in these markets are the big sharks. Those traders do not pay their taxes or their rates – so they can sell goods more cheaply than the formal sector. This is disloyal competition from the informal market. A better way to do things would be to create industries, large agricultural projects, where these people could get their employment … it would be better if these traders moved away from here."

9. The vision we describe is something of a caricature, and it would be a gross over-simplification to say it is held uniformly through government, the MPLA, and the presidency. The vision is not even explicitly stated as such, so is hard to discern directly. However, it finds substance in government policies and outcomes, such as the forced removals of shanty dwellers in Luanda's Boa Vista suburb, allegedly to make way for modern developments. This vision has endured in its core form from the days of central planning through the waves of privatisation of the 1990s, when rural policy aimed to create an entrepreneurial agricultural élite that would serve as "an engine to modernise agriculture," through to the present day. Plans now exist, at various stages of formulation, for a 200,000 bpd oil refinery, for refurbishing three railway lines stretching east from Luanda, Lobito and Namibe, linked by further north-south rail links; for an aluminium smelter, for fertiliser factories and intensive agricultural projects billed as having the potential to feed the nation, and for an international airport in southern Angola as a hub for air traffic between Asia and the Americas. Angolan officials have even suggested that Angola might, in the medium to long term, consider developing nuclear power.[6] Early drafts of the PRSP also reflect this vision, although later versions, influenced by donor criticisms, moved slightly away from it (though at the expense of losing relevance as a policy tool). This vision is driven most strongly by the presidency; somewhat less emphasis on it is seen in the Finance Ministry. Different actors stress different aspects of it. In the MPLA, for example, central planning is seen as especially important. In the Public Works ministry, borrowing to fund infrastructure is especially supported. Even in the intellectual classes outside the ruling structures, aspects of this vision – especially on the overriding importance of physical infrastructure – are commonly expressed, even by people who also hold alternative views about the importance of civil society and more subtle ways to tackle poverty. Overall, while specific instances reflecting this vision do get media attention, there is no coherent, sustained critique of it.

[6] "Angola expresses nuclear energy ambitions", Xinhua news agency, 22 March 2005.

10. This vision clashes with an alternative one advocated by donors (the term is used here to mean many of Angola's bilateral and multilateral partners, including the World Bank and IMF), for whom this vision is reminiscent of policies last advocated widely in the 1970s. The donor view holds that while infrastructure, foreign investment, higher education and improving the efficiency of the state are of course essential, they are insufficient, and that borrowing to spend excessively on infrastructure, especially if it comes at the expense of human capital and private productive potential, can store up trouble. Donors advocate a heavier focus on the *software* of a nation – such as recognition of occupants' rights, independence of judiciary and regulatory authorities, the media and economic agents, and the importance of a strong and independent civil society as a means by which society's needs and concerns are transmitted to decision-makers and into the public domain. In this vision the poor, who (in Angola's case) form the large majority, are essential contributors to, and indeed the primary focus of, development.

11. Several factors help explain this divergence of visions. First, war destroyed so much that it is easy to sell a vision with physical rebuilding as the primary focus of development. Although the vision outlined above is held most strongly inside the ruling structures – more so by "old-guard" conservatives and less by economic reformers – it is not limited to them: it also partly suffuses the intellectual classes and even "civil society" and beyond, into the wider population. The idea that it is the state's job to solve social problems and that it can do so primarily through large-scale projects and big industry carries resonance far beyond the ruling structures.

12. Second, Angola is living, in a sense, in a time warp. Having just emerged from an on-off war since independence from Portugal in 1975, this is perhaps the first time policy-makers have had to think seriously about long-term development since Portuguese colonial times in the 1960s and 1970s, when the economy, and the development vision, were predicated on big agro-industry, oil, diamonds and manufacturing. Western thinking at that time also favoured a similar approach: developing countries should borrow heavily to build infrastructure for long-term growth. This view fell out of favour in the West from the 1970s, when it became clear that investment was not delivering growth and indeed that over-borrowing had created debt traps from which many have not yet emerged. The vision of master-planning persisted in the Soviet bloc, however, and although the leadership of Soviet client states in Eastern Europe and elsewhere has mostly been swept away, this is not true in Angola's case, where many senior officials from Marxist-

Leninist times (including President dos Santos) remain in positions of power. One of our respondents explained:

13. "In some cases in Angola they have physically pulled out development models designed with Bulgarian technical assistance in the 1970s and dusted them off. Current land policy, including clearing people out of urban marketplaces, comes from these models. This is based on the idea that government can, with the right tools, plan their way out of the mess the country is in. I do not think it has crossed the minds of planners in many cases to consult the people."

14. A dearth of experience in development means that a sophisticated overview of international best practice is rare, even in "civil society".

15. Another reason for the persistence of this vision is that vested interests in Angola can profit from infrastructural opportunities it offers, and are untroubled by (and can even profit from) Angola's lack of absorption capacity. These interests are commonly found in sectors such as construction and import businesses. The vision provides them with a quasi-ideological underpinning to justify processes from which they can profit. Amid high oil prices, which magnify the state's spending possibilities, these drivers are all the more powerful. What is more, the internal logic of the patronage-based system favours current expenditure over future expenditure (as explained below), increasing pressures to borrow.

16. It is also in the interests of Angola's favoured partners – especially Brazil, Portugal and China, which have enormous economic stakes in Angola's reconstruction drive – to encourage this vision. What is more, given a history of thorny relations between Angola and those Western donors (such as the UK and the US) that most strongly argue for an accommodation with the IMF to precede large donor engagement (see Section 1.8, below), these alternative partners are especially influential.

17. Another factor is that state delivery of healthcare and education functions poorly, because of war, corruption, skills shortages and mismanagement. However, Angola's leaders have designed home-grown mechanisms, often through oil-backed credit arrangements (see Section 1.11, below), which are more effective, especially for big infrastructural projects. In a sense, it is *easier* for Angola's leaders to build bridges or pay for foreign bursaries than to create an effective national health system.

18. The top-down approach is advanced, too, by a policy of extremely high government spending – the 2005 budget boosted capital spending, for example, from 5.8% of GDP in

2004 to a remarkable 13.0% of GDP, contributing to a budget deficit of 8.9% of GDP.[7] This is also extremely high by regional and international standards. High oil prices and borrowing allow the government to keep spending while preserving an informal "Hard Kwanza" policy (see box 3, below) making the currency appreciate in real terms. These policies not only increase the economic (and thus political) weight of the state *vis-à-vis* the private sector through large spending, but also can hurt the poor by making their agricultural and other produce less competitive against imports.

1.3 THE PATRIMONIAL SYSTEM

19. Angola's economy is under strong central control by the president and his entourage who wield power through personalised networks. As in many African and other countries, formal state institutions (such as ministries) do have some relevance but are subverted by informal power networks. Citizens often feel less allegiance to the sense of the "nation" (whose borders were drawn by colonial powers) than to their own social or ethnic groups. This increases the importance of vertical, rather than horizontal, links; leaders are accountable not so much to the nation but to their *clients* in a more traditional sense. Formal leadership positions are often used to fulfil unofficial obligations to clients, and activities that would be seen in the West as corrupt (diverting resources away from the nation towards narrower, personalised networks) have some legitimacy, at least in the eyes of clients who benefit. Competition for licences, subsidies and other favours means that all the big economic operators, including international oil companies, operate to a degree as elements of the patronage network. Subsidies are a big part of the system – as, in a sense, is the entire civil service – but there are other mechanisms, including over-invoicing, direct diversion of oil and loan financial flows, and monopolistic or oligopolistic control over import and other operations by élite networks. These networks are expensive to the state and increase fiscal deficits, but do not solve nationwide poverty and inequality. As an academic observer, writing generally about Africa, describes it:

20. "The logic of the political system, therefore, does not correspond to its western guise. Bureaucrats, for instance, are seen not primarily as the impartial servants of public service but as putative, if not actual, links in the patrimonial chain. … Political accountability rests on the extent to which patrons are able both to influence and to meet the expectations of their followers (or 'constituents') according to well-established norms of reciprocity. The quest for political legitimacy thus requires the fulfilment of particularistic obligations that have nothing to do with the emergence of a public sphere transcending subnational identities. …

[7] See "Aprovados Programa do Governo e Orçamento de Estado", 14 December 2004, on *http://www.minfin.gv.ao/noticia/outra040.htm*.

Elections, the measure of accountability in Western polities, have become in Africa one of the many instruments of factional mobilisation.” [8]

21. Since political legitimacy requires patrons to feed the personalised networks continuously, leaders lack incentives to defer spending on “their” networks today on behalf of longer-term and more ephemeral goals of “national” development. This makes it harder to institute measures such as taking depletion of oil reserves into account when calculating national wealth, or operating saving funds for future generations. It favours consumption over investment (rent-seeking brings immediate gains, while wealth creation yields later gains and, by expanding competition, potentially restricts rent-seeking opportunities.) Favouring consumption over investment exacerbates “Dutch disease” effects (by hampering efforts to increase the domestic supply of goods) and so tends to further worsen the plight of the poor. In fragmented societies in Africa and elsewhere, whose governments depend on natural resources, this tends to foster an environment where macroeconomic stability is most easily achieved during times of high resource prices; but this state of affairs is temporary, and tends to be followed by crisis when oil prices fall, as subsidies in systems based on patronage tend to rise steadily to meet revenues. Ongoing improvements to macroeconomic management, and the end of the war which has increased politicians’ time horizons somewhat, are mitigating, but have by no means eliminated, the problem of short-termism. It is worth noting that in this particular respect, if not in others, government political strength can potentially be a good thing as it curbs the ability of vested interests to push spending higher.

22. Because of the factional nature of power, national and group identity is crucial when examining “corruption”; so efforts to transplant Western notions of transparency onto Angola may have less impact than hoped. Some respondents said the notion of accountability is more usefully wrapped up in a wider concept of *cidadania (*citizenship) which also encompasses ethnic, regional, family, locational and even urban-rural aspects.[9] As another interlocutor put it:

23. “The IMF presents its model and says Angola should become this. It is looking at an economic model, when it should be looking at a political model. This has nothing to do with a capitalist system. This is not about production, but about a cake to fight for. If one type of rent-seeking activity disappears, another will appear.“

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[8] Patrick Chabal, “The quest for good government and development in Africa: is NEPAD the answer?”, *International Affairs*, vol. 78, no. 3, July 2002, pp. 447–62.

[9] The quest for national identity is reflected in many discourses. For example Jonas Savimbi, before his death, called several times for a “profound discussion of all the causes of war”. Several respondents also felt that the ceasefire did not mean peace had arrived, because there had been no proper national debate on what it means to be an Angolan.

24. The more actors perceive a system to be corrupt, the more each sees the pointlessness of not diverting resources, as they would expect those resources to be appropriated by someone else anyway. Poor government credibility can make matters worse, as can more layers of administration (reducing the risk that any individual in the chain might be held accountable) and ethnic or regional fragmentation (individual actors may be even more reluctant to pass up money for national development that could end up in the hands of a different, disliked group), as well as inequality and poverty, which increase the cost of not diverting money. These negative factors create vicious circles, which affect Angola to a significant extent.

1.4 ECONOMIC AGENTS

25. The main economic agents can be summarised as follows.

The Presidency

26. This contains powerful unelected officials whose positions, amid weakness in the rule of law (relative to Western countries), provide opportunities for personal enrichment through influencing government policy. The officials do not generally take orders from formal state structures. A small number of people with foreign passports and foreign business connections are considered part of this group. The president takes advice from two main areas: first, from advisers at the presidency who tend to give policy advice based on the requirements of the patronage system, and secondly from the MPLA, which has more hands-on experience with government. A few government ministers are also influential. Advice from these different arenas is often conflicting, and President dos Santos often plays one side off against the other to advance his strategies. At the end of the day, the president has the final say.

Sonangol

27. The national oil company has operated for years as a state within a state, serving not only as overseer, regulator and concessionaire for the upstream and downstream oil and gas industry (and more recently as an operator in its own right), but also as a "black box" which has made possible enormous secret revenue flows controlled by the presidency. Under economic reforms, these revenues are now being made somewhat clearer. Partly because of a better salary structure, Sonangol contains some of Angola's most skilled technocrats, and is far more powerful than the oil ministry.

Endiama

28. The state diamond company is the concessionaire for diamond operations, as well as an equity partner and operator of some diamond ventures. Unlike in the energy sector, there are no signs to date of serious improvements in transparency in the diamond sector, although the absence of war since 2002, and measures to crack down on illegal diamond diggers, have attracted a number of investors. Foreign operators have historically leveraged their access to international diamond trading and financing networks to gain real power in the diamond sector.

The MPLA

29. Though nominally a political party, the MPLA has important stakes in private companies, which provide it with an income stream that supplements money it (and other parties) receives as its official allocation from the state budget.

The Economic Team

30. The lead role in economic management has alternated between the finance ministry and the planning ministry,[10] partly depending on the personality of the minister in power at the time. Currently it is the finance ministry. The leading operators are Deputy Prime Minister Aguinaldo Jaime (a reformist former central bank governor) and Finance Minister José Pedro de Morais, a former IMF executive director and also a reformer. These two represent a position that is closer to the views of the IMF than many in the MPLA. Another key person is President dos Santos's unelected economic adviser at the presidency, who provides an alternative view of the economy which emerges from the mediation of numerous interests within the overall patronage system.

Other Ministries

31. Many other ministries are less effective because of corruption and weak capacity, and because their powers are subservient to presidential interests that capture a share of ministerial resources. In several cases, ministerial decision-makers have stakes in companies executing ministerial decisions. Important ministries, such as oil, answer directly to the presidency, while lesser ones, such as tourism, tend to answer to the prime minister, who in turn answers to the president.

[10] See, for example, Tony Hodges, *Angola: Anatomy of an Oil State* (James Currey, 2004), Chapter 5.

International Oil Companies (IOCs)

32. Despite their huge economic weight, and Western diplomatic support, the IOCs compete for licences and approval for development plans. So they do not often act as a significant source of Western pressure on Angola. Instead, the leverage generally works in the opposite direction. As an example, Angola recently did not renew some expiring oil licences held by France's Total (they have reportedly been awarded to China's Sinopec), apparently because of corruption proceedings in France involving senior Angolan figures; this created significant political pressures inside France.

"The Generals"

33. In the war some generals made fortunes, mostly in diamond mining or military procurement, using the military infrastructure to support their enterprises. Now some are entering construction, in partnership with foreign firms. Although it might seem that wealthy military figures might be an alternative power centre and a potential threat to the president, the reverse is probably closer to the mark: their ability to earn depends on presidential approval, so they have a stake in preserving the current power relations. This set-up has been actively encouraged by the president, as a way to accommodate these powerful figures.

Empresários de Confiança[11]

34. These are private business people, mostly from old MPLA families, who grew up on state subsidies (publicly legitimised as pro-poor but which tend instead to enrich big firms that capture them.) These politically influential people also profit from import operations, infrastructure and other contracts, and have used political connections to obtain monopolistic or oligopolistic powers and special tax exemptions. Their profiting from multiple exchange rates (see Section 1.8, below) and other distortions made them an obstacle to reform in the past, and although their influence in this particular respect is diminishing (see below), their ability to make profits remains undiminished. Several foreign players active in Angola (with large Angolan shareholdings), such as in Portuguese construction firms and Lebanese importers, could be included loosely in this category. There is occasional official recognition of the problems of monopoly and oligopoly; President dos Santos in November 2004 identified "three or four large commercial groups, controlled by foreigners, (which) dominate wholesale trade and manipulate prices" and warned they should "co-operate more" with the government.[12] The finance minister has encouraged government projects to try to boost competition in

[11] See Renato Aguilar, "Angola's incomplete transition", UNU/WIDER, August 2001.
[12] Speech by President dos Santos on 11 November 2004, on 29th anniversary of independence.

the market for basic goods, and in January 2005 described the market for basic goods as having an “oligopolistic structure, dominated by four or five large companies”. However, despite the rhetoric, this market structure remains largely intact.

1.5 THE NON-OIL, NON-DIAMOND ECONOMY

35. For years war restricted most non-resource economic activity to a coastal enclave, especially Luanda, with urban centres sustained by oil money and donor assistance, and surrounding UNITA-held areas mostly relying on subsistence agriculture. In some areas less affected by war, such as Huíla province in the 1990s, some agricultural activities and small businesses emerged. The large weight of economic activity is still in Luanda, however.

36. Formal and informal private-sector employment grew after reforms in the late 1980s but the non-resource economy was savaged by war, economic instability, poor infrastructure and education, weak contract security, corruption and a heavy bureaucracy from colonial and Marxist-Leninist times. Resource dependence has fostered a “Dutch Disease” effect resulting in a shift from tradable to non-tradable activities and higher overall cost levels (according to one estimate, infrastructural project costs are three or four times higher than elsewhere in sub-Saharan Africa.) Oil revenue volatility also generates uncertainty and damages the economy. Skilled cadres are lured from state institutions and the non-oil private sector by high salaries in the oil and diamond sectors, and individuals in ministries and other government bodies often prefer to lobby for state favours than to focus on productive enterprise. All these factors, plus corruption highlighted in high-profile Western transparency campaigns, have badly damaged investor confidence and help explain why Angola was ranked 103rd out of 104 countries in the World Economic Forum’s business competitiveness rankings in 2004.[13]

37. Non-resource activities are geared heavily towards servicing the state and the import and retail trades, with relatively few productive industries outside agriculture. Construction is large and growing, but depends on state contracts. Some small factories produce heavy or bulky products such as beer and cement, for which import costs would be prohibitively high. A plan announced in January 2005 for a plant to assemble Volkswagen cars in Luanda might appear counter to this trend; however, as has been outlined in detail in the independent press, local value added will be minimal and the plant will enjoy customs

[13] See *http://www.weforum.org/site/homepublic.nsf/Content/Global+Competitiveness+Programme%5CGlobal+Competitiveness+Report*

and other privileges and political protection.[14] The agricultural sector is growing after the war despite land mines, although production of maize, the main cereal crop, was little more than 700,000 tonnes in 2004 – under half the national requirement (but up from 460,000t in 2001 and a low point of 250,000t in 1994). This is striking, given that before independence Angola was one of the most dynamic agricultural producers and exporters in Africa. Most agriculture is small-scale, but big producers are expanding fast. The expansion would undoubtedly be far greater if the real value of the Kwanza were to be allowed to depreciate. Other formal-sector activities outside the state's orbit are concentrated heavily in Luanda and in the service sector – restaurants, car dealerships, retail outlets and others. Mobile telephony and retail banking are expanding especially fast, though costs are very high.

38. Big foreign and national firms typically enter into partnership with well-connected Angolans; they normally do not supply their share of capital or expertise yet enjoy a share of the proceeds. This adds to the cost base, making it hard to compete with companies with a more traditional Western shareholding structure. So, to compete on price, companies must ensure that competitors are similarly structured, or they use political connections to crush them, or they enforce oligopolistic co-operation, or they must acquire state subsidies. This shareholding structure curbs the chances of foreign investment leading to a genuinely independent business class. It also helps insulate the élites from macroeconomic mismanagement, reducing their incentives to push for better government economic management. Oligopoly and monopoly raise price levels, exacerbating Dutch disease effects and boosting prices not only of non-tradables but also of tradable goods.

39. The financial sector is growing explosively owing to high oil prices, economic reform, and the end of the war, which has spurred expansion into the provinces. Savings are growing but credit to the economy remains tilted towards short-term import operations instead of longer-term productive investments, partly because of weak property rights and the patronage-based nature of the system. This is improving somwehat, as the government reforms economic registration procedures. The private Portuguese/Angolan Banco do Fomento Angola has the largest share of retail deposits and is expanding into credit cards and mortgage finance, the state-owned Banco de Poupança e Crédito, which manages the state budget, and Banco Africano de Investimentos (BAI) an Angolan private bank part-owned by Sonangol. BAI and, to a lesser extent, the

[14] See, for example, "Carros 'Made in Angola' são projecto empresarial políticamente perverso," in Semanario Angolense, 26 February–4 March 2005.

Portuguese/Angolan Banco Espírito Santo benefit from especially good access to state contracts. More competitive South African banks want to enter, despite resistance from incumbents, and South Africa's Absa bank (itself likely to be bought by Britain's Barclays bank) will now enter Angola by buying the small private Banco Comercial Angolano. Micro-finance exists, and is growing, but its impact is limited. Angola has announced plans to open a stock exchange in late 2005.

40. Non-Western foreign traders, such as the Lebanese have carved out significant niche markets. (The Chinese are likely to follow this trend.) Tight intra-group solidarity allows them to build networks of trust that largely overcome the deficiencies of the judicial system, and their international networks enable them to procure goods at competitive prices.

41. Small formal-sector and informal-sector agents are weak by comparison with the *Empresários* and Sonangol, which have better political connections, foreign networks, access to subsidies, foreign and domestic capital, and expertise. Informal traders are also vulnerable in a state which often sees them as a social menace. While macroeconomic and political distortions and instability hurt smaller players, they have provided opportunities (such as benefiting from very high consumer imports exacerbated by exchange rate appreciation, or from multiple exchange rates) for the *empresários de confiança*, so furthering their dominance.

42. Another factor in the non-oil sector (large and small) is a lack of horizontal linkages, which mirrors problems faced by civil society actors. Such linkages are discouraged; this is illustrated by a statement in the June 2004 edition of *O Empresario*, the newsletter of an industrial association in Huíla province, outlining why it had not expanded further: "Weak associative culture on the part of many economic agents who see, in associations, a form of opposition to the government".[15]

[15] Associação Agro-Pecuária Comercial e Industrial da Huíla (AAPCIL)

43. The informal sector is dominated by small-scale retail and agricultural activities, and is where most economically active Angolans work. Small-scale traders do not generally compete directly with the *Empresários* but instead depend on them for supplies: the big firms extract the main profits (through monopolistic or oligopolistic powers), then smaller players compete for the remainder. The smaller players' huge number and the fluidity of their activities make theirs an arena of strong price competition, sharply curbing their profits.

44. Post-war trade in agricultural products from the interior and population displacement have strengthened urban-rural trading links – and this has reduced, but not eliminated, dependence on the *Empresários*. Despite the intense competition, uncertain incomes also force informal-sector actors into local solidarity groups, as social insurance. The state runs rudimentary licensing in many markets but otherwise has little control. Disorganised inspections by different ministries and provincial bodies are typically aimed at extracting bribes but are not centrally controlled. Because smaller traders depend less on the state than bigger operators, and this sector is expanding fast with high oil prices and the end of the war, they provide a source of alternative – though weak – economic power in Angola.

1.6 THE OIL SECTOR

45. Angola is Africa's second oil producer after Nigeria. Output, at around a million barrels per day currently, is expected to double by 2007 or 2008, and Angola is planning production of Liquefied Natural Gas (LNG) and a large oil refinery. The IMF sees government revenues (after deducting oil company revenues) rising from $5.5bn in 2004 to $10.3bn in 2008, assuming an oil price then of $33 per barrel (/b).[16] This will keep rising, even after production hits a plateau, as investment costs are paid off and the state share increases. Almost 97% is produced offshore, minimising community conflict (as found in, say, the Niger Delta). Most discoveries were made by just four operators: ExxonMobil, Total, ChevronTexaco and BP. The sector is capital-intensive, with relatively few linkages to other sectors of the economy.

Box 1: The structure of Angola's oil industry

Over 40% of Angola's oil comes from joint venture contracts (under a tax and royalty regime) in Block 0 in shallow waters off Cabinda and some minor onshore licences near Soyo, although this

[16] See *Angola: selected issues and statistical appendix*, IMF, April 2003, p. 18.

share is falling as other fields start up elsewhere. Under the Joint Ventures, state oil company Sonangol shares profits (41% in Block 0) but provides its share of funding. The rest of Angola's oil comes from shallow and deep water permits governed by production sharing contracts (PSCs, also called Production Sharing Agreements, or PSAs.) Sonangol has equity shares in some, but not all, of these. Under the PSCs, the (usually foreign-led) contractor group bears the up-front costs and recoups its money later. If the field is commercial, it is developed, and the oil is split as follows:

Cost oil is paid, in oil, to the contractor group, to recoup its investments. Under deep water PSCs, this tends to be 50-60% in early years. The contractors recover capital costs on deep water PSCs with an "uplift" factor of 40-50%, independent of how long it takes to recover it. So for an investment of $500m, the contractor group may eventually receive $700-$750m in cost oil. If oil prices rise, the costs are paid off faster. The remaining "profit oil" splits between Sonangol and the contractor group under a sliding scale: in older PSCs, it is linked to cumulative production; in newer PSCs the scale is linked to internal rate of return. For the deep water PSCs, the 40-50% of oil that is "profit oil" in the early years is typically split 80:20 in favour of the contractor group; then this share shifts in Angola's favour as investment costs are paid off. The contractor group must then pay 50% tax (not in oil, but in cash) on its share of profit oil. However, financial flows within the Angolan financial system have been complex: KPMG, in an oil "diagnostic study" in May 2004, noted that while export sales should by law flow through the BNA, this has not been the case and Sonangol has failed to pass on all its cash calls or taxes.[1]

The split of revenues between Angola and foreign contractors shifts over time. Without taking into account the complicating factor of oil-backed borrowing (see below), assuming an average oil price of $30/b and with oilfields at current stages of development, it is estimated that Angola currently receives 42-44% of the value of each barrel, down from 53% in 2000.[1] This share will probably dip more over the next three or four years, depending on oil prices, towards the high 30s as an increasing proportion of Angola's oil comes from new fields. (However, it is important to note that while Angola's revenue share will fall as new oilfields come on stream, the absolute value of its oil revenues will rise continuously.) Towards 2007-10, Angola's share of revenues will rise sharply again, over time towards and even beyond 65% of the value per barrel.

46. The structure of the industry has several important implications for poverty:

- Oil contracts tend to increase revenue volatility for Angola in the sense that a change in oil prices tends to produce a disproportionately larger change in Angolan revenues. This has damaging economic and political effects (see Section 1.12 below). This has hardly been debated from a poverty perspective.[17]

- Oil firms pay large "signature bonuses" to win licences; oil companies eventually recoup this money by reducing Angola's share of profits in later years. This is another aspect of a

[17] See Nicholas Shaxson, "New approaches to volatility: dealing with the 'resource curse' in sub-Saharan Africa", *International Affairs*, vol. 81, no. 2, March 2005.

growing tendency to stress up-front revenues at the expense of later ones. There was a strong military imperative in 1999 behind the payment of over $900m in signature bonuses for ultra-deep licences 31-33, but no such imperative existed with the extension in May 2004 of the Block 0 concession, which commanded $300m). In past decades signature bonuses were minimal: Sonangol argued it would be better to put this money into exploration instead.

- The uplift factor (and large signature bonuses) gives contractors incentives to develop fields quickly, which means large revenue surges. This may create problems of revenue absorption, which are unlikely to be in the interests of efforts to fight poverty.

- Sonangol can elect to receive much of its revenues (both from joint ventures and PSCs) as physical oil cargoes, which it can use as collateral for borrowing (see Oil-backed Borrowing, below). Past efforts to use the oil taxes as collateral against loans were not successful, however.

- Sonangol dominates the oil sector, while the oil ministry has a relatively junior role, restricted to little more than forming policy, regulation, inspection and statistics. Sonangol is the sole concessionaire, an equity partner, and an operator (Sonangol P+P recently started overseas exploration with a stake in Gabon); it also has numerous joint ventures (sometimes called Sonaventures) in the oil sector and beyond, in banking, manufacturing, air transport and telecoms. In many cases Sonangol has strong conflicts of interest.

- The salary scales in Sonangol and the IOCs, combined with an "Angolanisation" programme driven by the ministry of petroleum, mean that the non-oil sector and civil service are leached of many of their best cadres. This can damage wider economic management, although Sonangol is trying to tackle this, up to a point, through that insisting oil companies train Angolans and use local supply chains. Senior Sonangol staff have occasionally been seconded to the public sector; for example, the vice governor of Malange is on the Sonangol payroll.

- Because of its unparalleled access to capital, skilled personnel and political connections, Sonangol dominates the sectors in which it operates, squeezing out competitors and so serving as an indirect tool of presidential control. It seems likely to give up some of its joint venture stakes eventually to Angolan business interests. Its commercial and quasicommercial objectives, and quasi-fiscal operations,[18] are not always aligned with those of the finance ministry.

- Nearly all activities carried out by oil firms, including corporate social welfare programmes, need Sonangol approval. So IOCs are unlikely to be useful partners for any civil society activities which involve “controversial“ components such as advocacy.

- Calculating government revenues from the oil sector is very complex: there is a mix of different types of contracts; revenue shares are calculated separately for each field, change over time and vary with oil prices; the terms of oil contracts are confidential; and oilfields produce different types of oil. Sonangol also commingles revenues from upstream and downstream operations, service sector joint ventures, signature bonuses and future projects such as LNG. All this is further complicated by the fact that Sonangol’s shares accrue as a result of its role as concessionaire and equity partner. KPMG describes the Angolan fiscal regime as “particularly complex”.[19]

- The elements of “cost oil” are hard to monitor, even by Angola: the oil service companies involved have only an indirect relationship with the country, as their main interface is with foreign operators. However, the Sonaventures (Sonangol pressures IOCs to use them) means Angola has significant direct stakes in the “cost oil”. Transparency initiatives such as the Extractive Industries Transparency Initiative (EITI) and Publish What You Pay (PWYP) do not currently envisage probing the constituent parts of “cost oil”, leaving an arena involving several billion dollars that would lie outside public scrutiny, even if Angola were to sign up to EITI.

- Oil-backed borrowing adds a thick further blanket of complexity, making it even harder to understand state revenues.

- Oil company interests are also not especially aligned with those of the poor, or donors, or of the Angolan government. For example, in June 2004 Angola announced it wanted oil companies to route their finances through domestic, rather than foreign, banks; this would theoretically boost bank credit to the economy. Some Angolan officials also assert that it is a way to monitor better the constituent parts of “cost oil,” arguing that it is

[18] For example, the IMF said in 2003: “Sonangol has in some areas functioned as a treasury outside the Ministry of Finance”. The 2002 quasi-fiscal expenditure was spent on: subsidies (46%); delivery of petroleum products (24%); UNITA relocation camps (1%); state enterprises (10%); government ministries (17%); and others (1%). In addition, Sonangol paid 1.2 billion USD in debt services on government loans.

[19] See Ministry of Finance, *Assessment of Angolan Petroleum Sector – Final Report, Volume 1b – Executive summary*, p. 13. Published on *http://www.minfin.gv.ao/economia/exppetromenu.htm*

hypocritical of the West to ask Angola to be transparent while potentially hiding such information from Angola. IOCs united against this move, potentially an unprecedented threat to the profitability of their operations in Angola, and though they appear to have thwarted it for now, the episode will reinforce investor concerns that Angola will move the goalposts when it wants. This could have negative effects on investor sentiment inside and outside the oil sector.

Box 2: The Extractive Industries Transparency Initiative (EITI)

Rising awareness of corruption in Angola's oil industry in the late 1990s, alongside broader growth in international awareness of the importance of tackling corruption, led to new transparency campaigns. As in the "blood diamonds" campaign (see Section 1.7, below), Angola was a central part of an initial push on transparency, on which groups including Human Rights Watch and Global Witness published scathing reports. The Publish What You Pay (PWYP) campaign, launched in 2002 by George Soros, recognised that it would be hard for oil and mining firms competing for producer government favours to disclose data against the wishes of a government like Angola's, and cited the case of BP, which was severely reprimanded for promising in February 2001 to publish details annually about its net production, aggregate payments to Sonangol, and taxes and levies paid to the government. So PWYP advocated levelling the playing field by pushing for mandatory disclosure: for example, by making publication of oil data a condition for firms to list on Western stock exchanges. The campaign served as a political spur to the development of a largely complementary (though some might say rival) campaign, the Extractive Industries Transparency Initiative (EITI) promoted by the UK government. EITI advocates engagement with producer governments such as Angola's to get them to publish the data themselves. Angola opposes PWYP but has indicated an interest in EITI; although it has not formally signed up, it now publishes significant oil data on the Finance Ministry website.[1]

It is worth examining the merits and failings of EITI and PWYP in more detail.

PWYP has the advantage of advocating a mandatory approach by home countries such as the UK, which means that governments such as Angola's could not censor publication. Mandatory publication would provide significant new information about the Angolan oil industry, as shown in a new and detailed report by a group of NGOs.[1] PWYP has disadvantages, however. First, it cannot capture all of a government's revenues: it would not be even theoretically possible, for example, for a Western regulator to make Sonangol declare its cash flow and tax payments. So a large piece of the revenue puzzle would be missing. Second, there is a competition argument: Western firms fear that corrupt nations might favour companies from, say, Russia or China, which need not disclose data, over Western firms that must. Third, oil and mining contracts are confidential. Fourth, the campaign for mandatory disclosure is European-led and supported by George Soros, a sponsor of the controversial Angolan activist Rafael Marques.

EITI has technical advantages over PWYP. By bringing host governments on board EITI fills the gaps: countries declare revenues under carefully constructed templates. The competition argument is not applicable with EITI, and it would presumably not be hard to persuade IOCs to override confidentiality clauses if the Angolan government were willing. Many Western policy-makers conclude that, for these reasons, EITI is the way to go, and that PWYP should be ignored.

[1] *www.minfin.gv.ao*

[1] "Beyond the Rhetoric: Measuring transparency – company performance in the oil and gas industries", www.savethechildren.org.uk/mt/Linkage.pdf

However, EITI suffers from two main drawbacks. First, although Angola has tentatively expressed interest, there is no guarantee it will sign up to meaningful disclosure and remain committed. Angola is wary of Western initiatives that would tie its hands. Second, a key criticism of PWYP - that it would not provide a full picture of government revenue flows – also applies in a different way to EITI, especially in the light of the issue of "cost oil", which might easily involve over $20bn in capital expenditures in Angola in the next five years.

This is not to say at all, however, that either approach is without merit. The Angolan government is not a monolithic entity but a mix of factions of reformers and conservatives. In the past, even the Angolan finance ministry has been unable to access some information about large extra-budgetary revenue flows; both EITI and PWYP would provide finance ministers, and civil society, with major new information.

Two remaining arguments could still stand in the way of advocating PWYP: the competition argument and the confidentiality argument. Not enough independent research has been done on these. It is likely that confidentiality of PSCs – ostensibly enforced to protect a negotiating position – is only legitimate during a licensing round; confidentiality loses importance after that. This exposes another reason why governments are so keen on confidentiality – it covers nefarious financial flows. With regard to competition, the argument is weakened by the fact that (in Angola's case) the main licences have already been awarded. What is more, there are signs that Western oil firms' main competitors for licences, including Chinese and Russian companies, are actively seeking Western listings. Smaller firms that avoid Western listings are unlikely to threaten the oil majors because they cannot compete on capital or expertise. More independent research is also needed here.

It is also worth noting that although EITI is supposed to target all extractive industries, in Angola's case it has only been discussed in the context of the oil sector. Diamonds have hardly been considered.

1.7 THE DIAMOND SECTOR

47. Diamonds were discovered in Angola in 1912, and output from the 1920s to independence in 1975 averaged just under a million carats per year. Current output from official and unofficial mines is worth around $1bn per year, but the data are very opaque. Angolan deposits have an unusually high proportion of gem diamonds, typically worth $100–300 per carat. Production is growing sharply as the end of the war allows foreign operators, in partnership with the state diamond mining company Endiama and private Angolan interests, to invest in one of the world's last major diamond provinces where modern exploration techniques have not yet been widely applied, but severe contract insecurity is still a deterrent. The main diamond areas are in the northeastern Lunda Sul and Lunda Norte provinces, but smaller deposits have been found elsewhere. Angola has primary kimberlite deposits (volcanic source rocks, potentially containing huge diamond deposits which are mined intensively with very large investments in very small areas) These are easy to control, unlike Angola's secondary alluvial deposits, which are the result of river action that has deposited the diamonds over large areas and which UNITA

was able to exploit during the war. Government diamond revenues are low as a share of exports, perhaps partly because it is hard to extract rent from widely dispersed activities. The government is now asserting more formal-sector control over its diamond zones, however, and its share of revenue should now consequently rise.

48. As support from Western powers ebbed after the end of the Cold War, UNITA increasingly relied on diamonds. Legislation in 1991, originally aimed at buying votes from the Lunda provinces ahead of elections, to legalise possession of rough diamonds helped UNITA and attracted several hundred thousand Angolans and other expatriate Africans into the diamond zones as *garimpeiros,* or small-scale diggers. UNITA's military advance into the Cuango valley in 1992 reinvigorated its war effort and marked a northward shift in its focus and an expansion of its alliances with leaders of countries to the north, particularly Mobutu Sese Seko of then Zaire, and Pascal Lissouba of Congo-Brazzaville. So diamonds played a part in Angola's decision in the late 1990s to intervene militarily in those countries. Angola also accused de Beers, which then operated sub-regional buying offices, of buying UNITA stones; this has been a big factor in the company's recent difficulties in Angola. As mentioned earlier, mining activities partially distracted army forces in the diamond zones from military objectives, and this may have played a role in prolonging the wars of 1992–4 and 1999–2002.

49. After the return to war in 1992 Angola signed a contract with Executive Outcomes (EO), a mercenary outfit of former apartheid-era soldiers (who had previously fought alongside UNITA). After the 1994 Lusaka peace deal Angola awarded diamond interests to Diamondworks, which had corporate links to EO, but mining operations were shelved after UNITA overran its heavily guarded Yetwene mine in 1998. The mercenary operations, which were not restricted to the diamond zones, also led to the award of stakes in the oil industry by a Canadian company with business links to EO.

50. During the shaky 1994–8 peace, Defence Systems Ltd established a big presence, providing security for diamond mining (and other) operations. However, a perception that it had grown too big in Angola led to the stifling of its operations in 1997, again allowing central structures to reassert control and letting members of the military secure profitable diamond security contracts. Control over diamond security has since become somewhat more fragmented, in line with the politics of patronage which does not favour the emergence of large, dominant and therefore potentially autonomous groups.

51. In the war of 1999–2002 Western NGOs, led by Partnership Africa Canada and Global Witness, pioneered a "blood diamonds" campaign, heavily influenced by events in Angola. This led to the "Kimberley process", seeking ways to make it harder for military rebels such as UNITA to sell their diamonds. This campaign was widely supported by Western governments concerned about stability in Angola and, more generally, in the sub-region, especially the DRC. The diamonds campaigns, together with UN sanctions on UNITA supplies, made it more expensive for the rebels to operate, and may have helped hasten the end of the war.

52. After the war re-started in 1999, a new industry shake-up occurred. Angola cancelled several marketing licences, including one held by de Beers (who subsequently went to arbitration over contract-breaking), and reduced the maximum size of mining licences. This latter move was partly a response to a military imperative, to let in more private operators under government control who would boost revenues and provide an extra bulwark against UNITA. At this point Lev Leviev, a rising rival to de Beers, gained a stake in the new diamond marketing monopoly Ascorp, in partnership with state diamond marketing company Sodiam, Belgian interests, and members of the presidential circle and family. The stated purpose was to push out UNITA diamonds from official channels. The shift to Ascorp was billed as a move to regain military control over the diamond zones, but it had another purpose too: to centralise the hitherto chaotic patron-client relationships in the diamond zones, which had developed significant autonomy from Luanda. (In fact the process of recentralising control probably began earlier, when the international status of regional airports was ended in 1996). As one analyst put it:

53. "The noble pretext of preventing UNITA rough [diamonds] from tarnishing Angola's legitimate diamond trade has enabled the central élite to dominate the legal diamond sector and expand control over informal diamond networks. The monopoly seems to be aimed more at co-opting or incorporating financially rebellious generals."[20]

54. Leviev entered with the help of a Moscow-based businessman, Arkady Gaidamak, who was instrumental in arms deals and financing arrangements in the early 1990s and in renegotiating Angola's Russian debt in a series of deals from 1996 involving oil-backed repayments, which caused significant friction with the IMF. Again, as in the case of Diamondworks, leverage in one sector was used to obtain leverage in another, a common feature of the wider business climate in Angola. The move also had a powerful commercial objective: to use the monopoly to pay below-market prices to diamond

[20] Christian Dietrich in J. Cilliers and C. Dietrich (eds),*Angola's War Economy: the role of oil and diamonds* (Pretoria: Institute for Security Studies, 2000).

producers, and thus multiply profits. Since 2003, the government has forcibly expelled over 200,000 *garimpeiros* from the diamond zones, leading to accusations of widespread human rights abuses. The main aims of the clean-out are to make concessions more attractive to investors, to raise state revenues and to tie the diamond zones more closely into the patronage networks.

55. Ascorp's monopoly practically ended in April 2004 when US-based LKI diamonds signed a marketing contract with Sodiam. Diamond data remain highly opaque and there is a suspicion that amid a clean-up of the oil sector, the diamond industry is acquiring increased importance as a way of hiding private revenue flows.

56. It is not clear whether contract security is likely to improve significantly in the diamond sector to attract more foreign investment; a measure of uncertainty in this area makes operators all the more sure to be obedient to the wishes of Angola's rulers, and contract security in the oil sector appears to have deteriorated somewhat since 2004.

57. Leviev now promises a diamond polishing plant in Angola. It is not immediately clear how this could be profitable, given high operating costs, low skills, and fierce competition from India and elsewhere, but this employment creation enterprise will undoubtedly find favour with the authorities, perhaps helping him with other long-term goals in the diamond sector.

58. Although lucky local diggers can make profits, and informal digging is one of the few trades in Angola that offers significant employment opportunities, human indicators in the diamond zones are no better than elsewhere in Angola. This is partly because the diamond zones are unusually repressive, but also because coercive control over the trade also allows the partial monopolisation of other economic sectors, including consumer goods, transport and the like. This raises general price levels, entailing an additional transfer of resources from the poor to elites, and aggravating poverty.

1.8 ECONOMIC REFORM, TRANSPARENCY AND THE ROLE OF THE INTERNATIONAL COMMUNITY

59. Angola embarked on its first liberalising economic reforms in 1987, before formally abandoning Marxism-Leninism in December 1990.[21] The currency was devalued from

[21] The first reformist programme was the *Saneamento Economico e Financeiro* programme of August 1987, which aimed to start the transition to a market economy, although little was done in practice.

1991 and price controls started to be removed the following year. The openings were gradual and driven by three main factors: politically damaging economic crisis, huge changes in the international context, and realisation by members of the élite that they might profit from the reforms.

60. The reforms failed to generate improved prosperity, however, largely because of the renewed outbreak of war in 1992. Reforms were at least partially reversed, the exchange rate was revalued, and privatisation was abandoned, as the president sought to reassert control through older mechanisms with which he had grown comfortable.

61. During the 1990s poor budgetary management led to huge deficits which reached 21% of GDP in 1993. The deficits, caused by military and extrabudgetary spending, and the internal logic of the patronage system, stoked runaway inflation and rapid currency depreciation. The deficits were financed by accumulating arrears and credits from the Banco Nacional de Angola (BNA, the central bank) and led to increasing reliance on oil-backed borrowing, which helped in the short term but complicated budgetary management later: effectively, Angola (like the neighbouring Congo Republic) gradually developed a virtual addiction to oil-backed loans, as repayments for previous loans starved the government of current revenues, leading to a constant requirement for new loans. Payment obligations were achieved by printing money – effectively enabling decision-makers to cover their Kwanza spending priorities at the expense of other domestic Kwanza-holders, who saw the value of their currency holdings fall. This was especially damaging for the poor.

62. Beyond the war, the problems stemmed largely from Angola's fragmented approach to economic management. Deficits grew as the result of piecemeal measures, hostage to whimsical interventions from the presidency that made policy incoherent. The central bank and treasury were politically too weak to resist demands for Kwanzas from powerful vested interests, for whom inflation and Kwanza devaluation also provided opportunities. And, as one observer put it:

63. "Macro-economic instability arises in part out of mechanisms that subsidize powerful oligopolies, enabling them to capture a portion of the large oil rents. These subsidies, together with market controls, enable the oligopolies to profit at the expense of small- and micro-enterprises, thereby hindering the creation of more employment for Angola's poor."[22]

[22] Renato Aguiar, *Angola's incomplete transition*, UNU/WIDER, August 2001.

64. Multiple exchange rates, whose spreads between official and parallel rates were widened by devaluation on the parallel market, enabled certain players with access to the official exchange rate to extract arbitrage profits from "round-tripping" operations from Kwanzas to dollars and then back again. These and other players also obtained bank loans whose real value was eroded over time by inflation. These were just two ways in which the patronage system operated, involving players who appropriated rents through entirely legal means yet without investing their money, or hard work. As expenditure spiralled out of control, annual inflation reached 3,000% in 1995 and kept rising, briefly touching a high of 12,034% in July 1996. Amid rising urban social tension, the president approved new administrative measures to curb the deficits, and though they fell short of being serious liberalising reforms, inflation fell a little. However, the renewal of the war in December 1998, amid a collapse in oil prices, plunged Angola into extreme crisis.

65. At this point President dos Santos appointed a new reformist team led by Joaquim David as finance minister and Aguinaldo Jaime as central bank governor. This marked a sea change in political will, and unprecedented economic reforms began. In May 1999, widely divergent dual exchange rates were brought together; in November 1999 the currency, the Kwanza Reajustado, was replaced with the Kwanza, in preparation for a long-term assault on inflation; in April 2000, after months of effort by reformers in the face of vested interests, Angola signed a Staff-Monitored Programme (SMP) with the IMF.

66. Then, in a landmark for transparency, Angola signed a deal with KPMG in November 2000 (to start in January 2001) for a limited "diagnostic study" to probe the finances of the oil sector and help Angolan policy-makers build a clearer picture of oil revenues.

67. The reformists faced extreme difficulties during the 1999-2002 war. The SMP did not lead to a more comprehensive Poverty Reduction and Growth Facility (PRGF) which would have disrupted power networks and pushed far past the limits of gradualism during the war. In any case, the available concessional financing would have been tiny compared with oil revenues.

68. Economic reforms have deepened since 2002, with the help of a new finance minister, José Pedro de Morais, who has brought annual inflation down: it was 28.5% by February 2005, and is falling.

69. It is easy to get the impression that it was the end of the war that delivered the political will necessary for sustained reform. However, this was not the primary driver. It was in

1999 that the reform process started in earnest (inflation fell from around 300% to 100% between the start of the war in 1999 and the 2002 peace agreement), and the absolute key was a desire by the president to regain control over the economy following the economic disasters of the 1990s, and the new economic crisis brought by the onset of war. It was also important to remain on good terms with the West at a time of great military uncertainty and economic and political weakness, which coincided with low oil prices.

70. Macroeconomic reform, then, is the result of a slow learning process after a decade of disastrous trial and error by the Angolan leadership; President dos Santos has realised that economic stability needs a holistic approach. So the economic team, led by Deputy Prime Minister Aguinaldo Jaime and Finance Minister José Pedro de Morais, have been given unprecedented autonomy. The end of the war has also removed the sense of emergency and uncertainty. The authorities are better able to understand the factors behind monetary instability and to remove excess liquidity from the system. They have set about tightening control over spending.

71. The *Tribunal de Contas,* a court of auditors for all government contracts over $350,000, was set up in 1996 but only started functioning with the appointment of its president in 2001. This is now an important tool for budgetary discipline, although it is not in practice independent from presidential control (so it is not just a reformists' tool but also a mechanism for operating the patronage system more efficiently). Revenues and expenditures are being integrated into a unified system which appears to be more resistant to random predation from vested interests; Angola is increasingly using international auditing and monitoring to disentangle complex revenue flows at Sonangol and the central bank.[23] New domestic capital market tools such as treasury and central bank bills mean the government no longer has to monetise its fiscal deficits not covered by borrowing, and this has helped tame inflation. The latest reforms since 1999 have delivered not only better macroeconomic stability, falling inflation and a stable Kwanza, but also some improvements in transparency in the management of public revenues, and rapid growth in the financial sector and some other parts of the economy. A public comment on 22 July 2004 by the head of the IMF's mission to Angola, Jonathan Shields, illustrates what has been achieved.[24]

[23] Most notably an oil "diagnostic study" (carried out by KPMG as part of an IMF staff-monitored programme (SMP) signed in April 2000, which later collapsed.)
[24] Interview on IRIN.

72. “There have been considerable advances made over the last year or two in the information provided by Angola to the rest of the world, and the way they present and use that information themselves. In the context of Angola, obviously the critical element has been revenues from the oil sector. A couple of years ago it was quite difficult to disentangle the flows in and out of the national oil company Sonangol and to determine what part of the revenue flowing through them was actually the government’s and what was necessary for their own operations and to be sure that all the revenue was properly accounted for and well used. It is still the case that there’s a bit of an interlocking web between Sonangol’s activities and the rest of the economy including the finance ministry. But evidence is being produced of how the pieces of the web fit together. Flows in and out of Sonangol are more clearly identified than they used to be. It’s reasonably straightforward now to look on the one hand at production flows in the oil fields and the revenue generated from those production flows and on the other hand to look at the government accounts including payments made to (it) for royalties and tax and to see the relationship between those two elements.”

73. Angola now seeks a new IMF SMP, perhaps in the first half of 2005, An interim arrangement would entail 6-12 months of economic monitoring, hopefully followed by a more rigorous PRGF, triggering Paris Club debt rescheduling and concessional financing. This objective remains in place even though relations currently appear to be in a periodic trough, partly because the Angolan leadership, fortified by high oil prices and the new alternative partner of China, believes it is in a stronger position to negotiate less stringent IMF conditionality than before.

74. Despite the improvements, the IMF still identifies major deficiencies in transparency, and weak ongoing monitoring and control of public expenditure remained a cause for concern.

75. Thus the broad permitted limits of reform seem clear. On the one hand, the economic team has been allowed to push through deep structural reforms, including an overhaul of the financial sector and integration of revenues and expenditures into a unified system in the Ministry of Finance: the Sistema Integrado de Gestão Financeira do Estado (Sigfe, Integrated State Financial Management System) reinforced by legal instruments to enforce better control such as the *Tribunal de Contas* (Court of Accounts). Better control, combined with improvements in transparency, may risk upsetting some mechanisms for the redistribution of rents, but the stabilisation is also delivering growth and hence new opportunities for private accumulation in more sophisticated ways that are still partly controllable. In large measure, there has been a shift of rent-seeking activities away from revenue-side activities (such as through ending multiple exchange rates) and towards expenditure-side activities, which require more forensic effort to monitor and control. This provides another explanation for the leadership’s desire for gradualism in economic

change: it takes time to negotiate and work out new and acceptable rent-seeking relationships.

76. On the other hand, the team has not achieved the fiscal consolidation and reduction of non-oil deficits necessary for long-term stabilisation. Though short-term spending pressures have been contained, long-term planning has not. Overall, President dos Santos has authorised a policy, which originated in the party, of growth through gradualism, flexibility and increasing sophistication, while retaining a large measure of control. Borrowing is a way for the government to postpone reform and keep spending high, much of it on consumption. Debt, estimated at $9.5bn at end 2004 (around 48% of GDP)[25] is $2.2bn higher than in 2002; around 37% is owed to commercial banks. The 2005 budget forecasts a deficit of 8.9% of GDP.

Box 3: The "hard Kwanza" policy

The IMF and others[1] have expressed concern about an apparent (though not publicly stated) "hard Kwanza" policy since September 2003 when the governement took measures to stop the Kwanza depreciating against the dollar in nominal terms.[1] This was primarily done to tackle inflation, a political hot potato given memories of the hyper-inflation of the 1990s. The Kwanza has since ranged mostly between 80 and 90 to the dollar.

The policy was supposed to have been accompanied by spending restraint but instead spending has remained high (8.9% of GDP in the 2005 budget)[1] and the difference is filled instead by borrowing and higher than expected oil revenues. Inflation has fallen sharply (though inflation in non-tradable goods has remained high), but the policy creates other serious real and potential problems. First, it requires massive central bank purchases of Kwanzas to keep it stable; the IMF estimates Angola spent $1.2bn above normal needs buying Kwanzas in the year from September 2003, despite low foreign exchange reserves. This may not be sustainable, especially if oil prices fall.

Second, amid high spending money growth remains high; this has kept price levels rising, despite the stable Kwanza, meaning the Kwanza has appreciated powerfully in real terms.[1] This exacerbates Dutch Disease effects caused by resource dependence: a strong currency damages agriculture and other productive non-resource activities by making them less competitive against imports, and Angola's degraded social, human capital makes it hard to counter a loss of competitiveness with improvements to productivity.

A stronger Kwanza also means any investments that are made are likely to be more capital-intensive than labour-intensive, with negative effects on employment levels. It is especially worth remembering the effects of the 1970s oil boom in Nigeria, when agriculture suffered catastrophic contraction, almost certainly from currency effects. By hurting agriculture, a strong Kwanza also favours urban over rural populations, deepening an already severe divide. However, the policy is in the interests of Angolan élites: the state delivers Kwanzas to its clients through high spending, and the strong Kwanza makes consumer imports cheaper for them. High spending and the consequently increased weight of the state also fit the national development vision, described in section 1.2, above.

A more sustainable pro-poor strategy would be to curb spending (and, by extension, to operate a good oil savings fund), shifting resources away from government, and allowing domestic agricultural and other private sector production to rise amid a more appropriate real exchange rate. It would be unrealistic, however, to expect a deep and rapid fiscal contraction ahead of an election.

77. Aspects of wider accountability are not being addressed: the approval of the renewal of the ChevronTexaco block 0 licences did not pass through parliament, for example, while the capture of rents by vested interests is not being seriously tackled.

78. In addition, the end of the war has not been accompanied by an obvious shift to dramatically and explicitly increase the focus on poverty reduction. It is worth remarking that the six general policy principles[26] outlined in the background to the government's 2005-6 government economic programme do not explicitly mention poverty reduction as an objective; indeed the word "*pobreza*" (poverty) does not appear once in the document.

79. The continuation of huge non-oil deficits reflects, in part, the logic of the patronage system (see section 1.3, above), which prioritises current expenditures over future ones (combined with the fact that Angola's oil enables large external and internal borrowing). However, it also reflects a genuine quasi-ideological difference between the IMF and the Angolan authorities, who assert that a programme of fiscal austerity is inappropriate for a country just emerging from a war, with urgent reconstruction needs. This latter view fits the vision of national development described above, and echoes an international debate, with thinkers such as former World Bank chief economist Joseph Stiglitz arguing publicly that the IMF has pushed for needlessly contractionary policies in several poor countries, and that the IMF is promoting not only its stated goal of enhancing global stability but also the interests of the financial community.[27] A recent editorial about a visit to Angola by IMF Deputy Managing Director Takatoshi Kato highlights the ease with which high[28] government spending can be publicly justified:

80. "Kato ... put forward the orthodox economic analysis that fiscal deficits had to be reduced to remove market distortions and provide room for private sector growth. In contrast, the Angolan government has been increasing the fiscal deficit by promoting state-funded reconstruction, which greatly expands the economy and is providing many jobs."

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[25] For a discussion of Angola's debt sustainability, see *Angola: selected issues and statistical appendix*, IMF, April 2003, p. 41ff.
[26] Relatório de Fundamentaçao do Orçamento Geral para 2005, on http://www.minfin.gv.ao/oge/oge2005.htm. The principles outlined are: Consolidation of peace and national reconciliation; Creation of a foundation for a self-sustained economy; Re-establishment of state administration across national territory; Development of human resources; Harmonious development of the territory; and Consolidation of the democratic process.
[27] For example, see Joseph Stiglitz, "The IMF's other agenda", Chapter 8 in his *Globalization and its Discontents* (Norton, 2002).
[28] *Angola Peace Monitor*, 23 February 2005.

81. The Angolan government accepts this alternative view also because it is in the interests of the élites to do so; however this argument was not developed specifically for resource-dependent economies such as Angola's, and appears to be problematic here. Given Angola's history of relations with the West, it is unsurprising that such alternative views find a ready audience. In the words of a senior Angolan decision-maker:

82. "We cannot demand that fiscal receipts serve to pay international creditors and not give the population the opportunity to live. The idea is for Angola to submit to a programme of structural adjustment for three years, in which the population would die of hunger, instead of a programme of reconstruction. This would lead to social conflicts, and no political leader, from the MPLA or UNITA, would accept this. … Angolans should get the benefits of peace, and the international community has rejected this; it wants us to pay governments before the banks. We pay the banks because this gives us a permanent cash flow. We don't pay the governments because the international system for repaying debts would promote an aggravation of the situation. The date from which debts can be rescheduled is very old: July 1989, and all the accumulated debts would have to be paid immediately. This does not serve Angola's interests. There should, in the end, be ways to pay this, but the system is not flexible enough to accommodate our needs. The Paris Club criticises the accords with Portugal: a 27% downpayment, with the rest repaid over 30 years – but it is the best Angola has managed in current conditions. In my opinion the principal shareholders of the IMF have a mandate to establish programmes with debtor countries so that they service the debt. This makes them lose perspective."

83. So there is a strong Angolan perception that the bilateral debt reduction mechanisms that would be made available to Angola through the Paris Club are not competitive, even on purely economic terms, with the bilateral debt reduction mechanisms achieved with partners such as Russia and Portugal,[29] which have opened the door to new investments, including through Portugal's Companhia de Securos de Crédito (Cosec). These bilateral mechanisms have been fairly opaque and have generated friction with the IMF and some donors because they are seen to have undermined pressure on Angola to seek an IMF SMP and eventual PRGF which could trigger alternative concessional financing.

84. Several additional drivers lie behind the current reforms. Change is clearly influenced to some extent by the general international climate, as was evidenced by the rapid abandonment of official Marxism-Leninism after the Berlin Wall fell (although economic crisis amid low oil prices in the mid-1980s also drove reforms). The experience of President Lula da Silva in Brazil (who himself has influence in Angola) is illustrative of a

[29] The Russian debt restructuring, which in fact involved a series of deals dating from 1996, has been highly criticised by the donor community. However, it involved forgiving 66% of Angola's debts to Russia (dating from old arms and other supplies when Angola was a Soviet client,) and the repayment of the rest in 31 promissory notes after a five-year grace period, in six-monthly instalments from 2001 to 2016.

broader and more recent global trend that has been assimilated by the Angolan leadership. Whereas in the 1980s and 1990s populist policies in countries such as Brazil were linked with fiscal irresponsibility, it is now more generally recognised that the costs of reckless spending outweigh the political benefits.

85. Another feature of the changing economic landscape since the 1990s has been a move away from obvious rent-seeking activities (such as exchange rate round-tripping) towards more sophisticated kinds of rent-seeking activities which can be more overtly justified. An obvious example would be the enormous state focus on infrastructure projects carried out through companies with powerful Angolan shareholders (usually passive ones) who may provide little or no capital or technical input yet reap large rewards. As one Angolan interlocutor, a senior banker, told us:

86. "People should not forget that Independence for Angola was, above all, a victory for black people. Communism/Stalinism here was not used for the ideology but for black Angolans to get what was theirs from the Portuguese. And today you cannot just have foreign companies coming here and operating; there must be Angolan partners. In South Africa they call this process black empowerment. Here, it is being called corruption. Why do people criticise Angolans for this corruption, but black empowerment in South Africa is not criticised?"

87. Current reforms, then, involve making rent-seeking in the patronage system (the chief tool of political power in Angola) more politically palatable.

88. The landmark award in 2001 of a contract to the UK-based Crown Agents to restructure and modernise Customs, which stood out at the time in contrast to Angola's failure to implement other IMF recommendations, produced spectacular results, with customs receipts officially reaching $828m in 2004, compared with $215m in 2000. However, this measure was not requested by the IMF but was independently chosen by Angola, which had been influenced by the successful experience of Crown Agents in Mozambique. Another key driver was not only that Customs was inefficient, but also that much of the corruption at the ports had passed beyond the control of the authorities. Crown Agents thus enabled the government to reassert control over large revenue flows. (Certain interests, however, have successfully preserved customs privileges.)

89. Western leverage has also been reduced by Angola's use of commercial inducements for political or other ends. For example, after Peter Hain, then UK Minister for Africa in the Foreign Office, signed an air services deal with Angola in July 2000 (to pave the way for an eventual slot for British Airways to fly to Luanda from London), Angolan Foreign

Minister João Miranda said on state radio that the enabling environment for the deal had been created by Britain's support for Angola's position on refusing dialogue with Savimbi. This led to severe criticism of Mr Hain in the Angolan private media.[30]

90. It appears unlikely that high-profile transparency campaigns involving Angola, especially reports by Global Witness and Human Rights Watch, have had a significant *direct* influence on policy. Angolans say these reports – especially those by Global Witness – are poorly researched and not a serious basis for policy. In March 2004 news agency Angop put a headline article announcing a new $2bn Chinese loan next to a story rejecting a Global Witness report. The articles noted that the Chinese loan came "without degrading transparency conditions attached," and that it marked a "turn towards the East" – a clear sign of Angola's explicit use of multilateralism as a way to reduce foreign leverage. (This statement should be taken in context: Angola's leaders will ultimately resist China itself becoming too dominant. The goal is not so much to change foreign partnerships as to *diversify* them.)

91. However, it is likely the *indirect* effects of the campaigns have been more important. In small part this is because the campaigns resonated inside Angola and the urban private media (which may, in turn, have had some influence within the the MPLA; this would be counteracted, however, by efforts to resist foreign "meddling"). More important, however, has been the international effect of these campaigns, in raising the profile of transparency in the minds of donors and the IMF, and, more importantly, in affecting Angola's ability to attract foreign investment and international capital.

92. It is possible to extrapolate this more generally: direct Western pressure has had, at best, mixed results.[31] This is partly because of unwelcome Western interference in recent years (see Position Paper 2: Politics) and because the partial economic reforms of the 1990s failed to deliver stability; also because President dos Santos is known to react against pressure, from whichever domestic or foreign quarter. President dos Santos and others have often expressed exasperation at pressures from donors. A top Angolan official was critical of "excessive conditionality … resulting from a faulty evaluation by, above all, the IMF, of the degree of conditionality to conform to international financial discipline".

[30] It is also worth noting that on p286 (footnote 23) of the March 2005 edition of *International Affairs,* Tom Porteous said that Clare Short felt the FCO was too concerned about getting British Airways flights into Luanda at a time when the humanitarian needs were vast.

93. Some Western donors say major assistance is only possible if Angola reins in corruption and convincingly signs up with the IMF. Donor funds are small compared to national oil revenue – the original 2004 appeal for Angola was for $262m, equivalent to a twentieth of government oil revenue (of which only $116m was eventually raised, after the appeal had been revised downwards during the year to $136m).[32] But the importance of such funds is greater than at first sight, as government service delivery functions poorly, so the executive has few alternative ways of providing efficient services. In a sense donor funds are, like oil-backed credit lines (see below), a way for President dos Santos to bypass his own failed system. What is more, Angola remembers the failed Brussels donor conference of 1995, when around a billion dollars was pledged (but were mostly not delivered because of political, economic and military uncertainty). Angola will have noticed the still larger sums pledged at the Sudan donor conference of April 2005. Angola seeks another donor conference.

94. Important though these funds are, the prospects of attracting more foreign investment and better access to international capital markets appear to be even more crucial as drivers of reform and IMF engagement. President dos Santos said in February 2005:

95. In the last two years we have invested diplomatic effort to convince the International Community to host a Donor Conference to rebuild Angola after the war. The influential countries in this community are still hesitating, and unjustly condition a conference on political and economic prerequisites. Clearly we will persist in our efforts and we will, meanwhile, make better use of bilateral cooperation and private national and foreign investment, to mobilise resources for reconstruction and development. We will not cross our arms. We must take advantage of everything useful to attain this goal. It will be necessary to explain our programmes better and to define clearly the tasks for the different segments of society.[33]

96. Angola is now seeking access to international capital markets and bond financing.[34] This could enable it to move away from expensive and relatively short-term oil-backed borrowing towards less onerous, and potentially longer-term and bigger, financing, and to weaken incentives to engage with the IMF. For President dos Santos, who will probably not be in power beyond the current decade, a large new source of capital would be attractive, while a successor administration would have to deal with the longer repayments. As described above, the improved transparency that bond financing requires would not necessarily disrupt the patronage system too severely as long as the transition to more sophisticated forms of rent-seeking were managed gradually. Such a shift would

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[31] This is in line with recommendations in *Partnerships for Poverty Reduction: Rethinking conditionality*, DFID, March 2005.
[32] An IMF deal would also trigger significant additional World Bank funding.
[33] In speech to the MPLA central committee, 18 February 2005. (Note the last sentence, which reflects the top-down national development vision described above.)
[34] Africa Energy Intelligence reported on 19 January 2005 that Sonangol has asked JP Morgan to advise it on bond issues.

also signal a normalisation of Angola's international economic standing (beneficial for domestic audiences), and be consistent with a policy of diversifying foreign economic partners. A senior Angolan policy-maker told us in October:

97. "If we correct the distortions in our economy, if we are successful in stabilising our economy, then Angola will become a normal country. It will have a rating, the credit rating agencies will come to Angola and assess the risks in the Angolan economy, will assess the foundations of our economy and will provide a rating to us. Based on this rating we will be able to go to the international capital markets and have access to funds. But this is a long process."

98. At this stage it is important to untangle the enticements offered by the IMF and donors, on the one hand, and by international capital markets, on the other, given that each would require far better transparency and economic management. In this context, a statement to us by another of Angola's top policy-makers is revealing.

99. "We want to go to the international capital markets. The IMF seal of approval gives us credibility. But the market can also give credibility to our policies. Perhaps we could arrive at a situation where, for reasons that escape us, the IMF does not give credibility to our policies, but the market does. The IMF then becomes useless."

100. A primary driver of Angola's economic reforms, then, appears to be a desire for access to international capital markets and foreign investment. An IMF deal would provide a crucial credibility boost in this respect, and although it would provide Angola with benefits in its own right, that is only a secondary driver.

101. The Angolan leadership has a preference for dealing with international capital markets because they do not represent "interference" but a more impersonal set of opportunities which Angola's leaders can choose if they wish. Many see the IMF as an irritating prerequisite to achieving these objectives, while also hoping IMF engagement might be bypassed. There is also a widespread perception that the international financial institutions are driven by Anglophones, whom they believe have a poor understanding of Angolan reality and the wider Lusophone world. The possibility of bond financing is also a useful carrot for reformers to show conservatives why transparency and fiscal responsibility are necessary.

102. The drivers behind reform are important for Angola's poor, because while donors and capital markets both require better transparency and fiscal management, the IMF and donors also insist that Angola aim policy more directly at the poor, such as through a Poverty Reduction Strategy Paper (PRSP). This is more troublesome for operating a

patronage-based system, as more pro-poor spending inevitably requires a transfer of resources away from élites whereas transparency, if managed carefully, does not.

103. Angolan officials are also suspicious of the concept of "ownership" attached to the PRSP, however, as early versions, which appeared to encapsulate the Angolan national vision as elaborated above, were rejected or criticised by donors. Now, while Angola has brought its PRSP version closer to the vision espoused by donors, this has been at the cost of reducing its relevance as a planning instrument: many MPLA members dislike the fact that their economic policies should be subject to veto by the IMF board. One policy-maker told us: "The PRSP is financed … by the budget. If the international community decides to finance part of the PRSP, Angola will be more flexible in accepting its recommendations."

1.9 INTERNATIONAL INFLUENCES

104. Several other countries have had some influence on economic policy. The relationship with Mozambique has been important, partly because of cultural and linguistic links and many similarities in their histories, which created long-lasting bonds of friendship. At Angola's request, Mozambique has also advised Angola on reform and on its dealings with the international financial community.

105. A strong competitive element in Angola's regional relations, however, magnified by Angola's oil which has generated aspirations to be a regional superpower, undermines the potential for regional cooperation, especially with South Africa. While relationships between the ANC and MPLA are fairly warm, those between Presidents Mbeki and dos Santos are not. Since the presidents of Nigeria and South Africa are key drivers behind the New Partnership for Africa's Development (NEPAD), this has made Angola only a lukewarm participant. Although Angola signed up in July 2004 to the African Union's African Peer Review Mechanism (APRM), it is unclear where the incentives lie for Angola's leaders to enact far-reaching reforms as a result of its signing. It appears likely that they would like the legitimacy (as they might from EITI) because they want more regional investment, above all from South Africa, and engagement enhances their regional influence. Relations will inevitably improve, driven by commercial links.[35] Regional commercial initiatives, such as that led by Eskom of South Africa to build an

[35] During a visit to South Africa by Angolan Prime Minister Fernando da Piedade dos Santos in February 2005, the two countries, in what was described by South Africa's *Business Day* newspaper as a "great thaw", signed a range of agreements on trade and co-operation, including an agreement to promote and protect reciprocal investments.

integrated sub-regional power grid, are warmly received. Angola's view of itself as a regional power has also created a sense that it will be easy to resist intrusive inspection by the APRM, reducing its effects. Relations with Francophone nations, particularly Gabon and Congo-Brazzaville, have been damaged by the fact that these two countries, especially Gabon, are perceived as conduits for French influence. French historical involvement in local politics in Cabinda, as well as recent difficulties over judicial investigations in France involving Angolan politicians, have not helped.

106. A vital influence is Brazil, which has economic advisers at the finance ministry and central bank. This relationship is unusually influential, partly because Brazil has very special historical, cultural, commercial and linguistic links with Angola, but also because Brazil has been able to impart experience from its own period of high inflation in the 1980s and early 1990s, and its own confrontations with the IMF. Brazil's influence is enhanced by its transfers of technology and skills to Angola, and its deep experience in tropical agriculture, which may form an increasing component of the bilateral relationship now that the war is over.

107. China's influence in economic policy-making is clearly growing fast, in large part because its obvious economic success, combined with its lack of democracy, provides authoritarian tendencies in the MPLA with a successful alternative political/economic model from ones donors relentlessly promote. In addition, the $2bn Chinese loan agreement, unlike Western oil-backed lending, gives China micro-level control over the purse strings of large projects, and hence direct influence in the Angolan patronage system. There is speculation that this has been a factor in Angola's decision to take a more combative approach to the international oil companies.

1.10 PUBLIC FINANCE MANAGEMENT AND THE BUDGET PROCESS

108. Public expenditure in Angola, averaging 59% of GDP from 1992 to 2002[36] (compared with 24.5% in the Southern African region), is among the highest as a proportion of GDP in sub-Saharan Africa. This is partly due to the war, which restricted non-state activity and boosted the relative weight of the state, and partly because natural resources allow the state to expand. Delivery of services comes from several sources: from the ministries, from budgetary and extra-budgetary mechanisms, from donors, from social programmes of oil or diamond firms, from specialised autonomous funds (such as the Oil Bonus fund

[36] *Angola: selected issues and statistical appendix*, IMF, September 2003.

or the *Fundo de Desenvolvimento Éconómico e Social*) and from services provided by mostly foreign private companies serviced by oil-backed bilateral credit lines. In 2002 the IMF estimated extra-budgetary expenditure at 14.7% of GDP,[37] little or none of this is thought to have gone to social sectors.

109. Spending on health and education respectively averaged 3.3% and 5.1% of the government budget from 1992 to 2002, compared with an average 6.7% and 12.7% for Southern Africa (excluding Angola). This results partly from the national vision, outlined above, partly from military spending displacing social spending, and partly from poor delivery, reflecting poor capacity and the extent to which powerful actors capture the rents. A table of social spending from 1997 to 2001 is revealing.

Table 1: Social sector expenditure

Year	**1997**	**1998**	**1999**	**2000**	**2001**
Social sector expenditure* %	11.5	11.5	6.0	11.1	18.5
% of education budget on scholarships	18.7	10.7	35.7	14.5	9.3

*% of total government expenditure, including extra-budgetary expenditure

Source: Public Financing of the Social Sectors in Angola, UNDP/WHO/UNICEF/OIM/Ministries, August 2002.

110. Social-sector spending not only fell overall during the severe economic crisis in 1999, but its *share* of spending also fell, while the proportion of spending on scholarships – which benefit overseas students who are often children of wealthy Angolans - rose. (Over the five years, spending on foreign scholarships, at 18%, was higher than on domestic higher education, at 11%.) This trend suggests the possibility that at moments of severe stress, it may be easier for vested interests and the military to assert claims on the government at budget level.

111. A third factor limiting service delivery is the budgetary process itself. Budget planning involves the planning ministry (which receives requests from provincial governments and sectoral **ministries and is heavily involved in capital projects)** negotiating with the finance ministry (which decides on funding ceilings). The relative weight of those two ministers also changes over time.[38] Currently, the finance ministry has the lead role; this is probably because the current finance minister is strong. Partly owing to poor technical capacity, sectoral ministries have little influence, although certain ministries can, at different times, be influential, depending on the political strength of leading individuals appointed by the president (at present, Public Works is especially influential). There have been ten different finance ministers since 1990, partly because of a desire to find

[37] IMF, September 2003.

scapegoats for failures. This damaged long-term planning and increased incentives for economic team members to divert revenues, to “make hay while the sun shines”.

112. A positive dynamic has recently emerged, whereby improvements such as falling inflation boost reformers politically. Macroeconomic stability and some limited improvements to areas such as property rights are attracting new allies; for instance, parts of the financial sector see profitable opportunities from the ability to provide more personal mortgages. These factors point to likely improvements in the budget process now the war has ended. However, caution should be exercised in forecasting continuity in the economic team, given the turbulent history of political appointments in Angola, which militates against allowing one single figure to become too powerful.

113. Other, more technical processes have also produced positive changes. During a period of limited deconcentration during the 1990s, provincial governments were generally strengthened at the expense of central ministries, which saw their provincial structures converted to *direcçoes provinciais*. Only the finance, justice, interior and defence ministries retained central control. Deconcentration also took place at municipal level. This reorganisation saw a sharp rise in the number of budget units, which are responsible for managing funds and answer directly to the finance ministry. For example, the change between 2000 and 2001 meant that **provincial hospitals**, which had previously received funds directly from the health ministry’s budget (in the case of **national hospitals)** or the provincial governments (in the case of provincial and municipal hospitals), were converted into budget units, so they are now classified as receiving their funds directly from the finance ministry. This transfer of responsibilities significantly improved their funding.[39] However, funding for health posts and health centres was still channelled through several layers, from the finance ministry through the provincial and then municipal health directorates, and the funding of these structures did not improve significantly.[40] In addition, a fall in expenditure (see Table 2, below) on medium-level education in 1999 was reversed in 2000 and 2001, in absolute and relative terms. This was not only because of improvement in oil prices and the military situation, but also partly because the medium-level education institutes obtained financial autonomy in 2001, becoming budget units. (A potential downside of this process has been that the

[38] For example, see Tony Hodges, *Angola: Anatomy of an Oil State*, Chapter 5.
[39] See *Public Financing of the Social Sectors in Angola*, UNDP/WHO/UNICEF/OIM/Ministries, August 2002
[40] Ibid.: „The creation of the new budget units at this level improved the availability of resources ... by contrast, basic social services were not covered by this change. The schools of Ensino de Base and the primary network of health posts and health centres have remained without their own budgets... Being at the end of the chain, and with little bargaining power within the system, the schools of Ensino de Base and the health posts and health centres hardly receive any resources, apart from salaries.“

ministry of finance takes decisions on the intra-sectoral distribution of resources, though it does not have the tools to do so properly.)

Table 2: Education expenditure

Year	**1997**	**1998**	**1999**	**2000**	**2001**
Total education expenditure $m	96.7	93.6	30.9	104.7	192.8
Basic education	9.1	2.9	0.9	7.3	21.0
Medium-level education	9.6	8.0	4.1	15.1	33.8
Higher education	42.6	22.1	59.9	53.5	59.8
Central structure and general expenditure	58.6	40.2	112.3	118.1	109.0

Source: Public Financing of the Social Sectors in Angola, UNDP/WHO/UNICEF/OIM/Ministries, August 2002.

114. A similar experience is found with the payment of salaries, which is undertaken directly by the finance ministries and their provincial counterparts. Salaries are generally given higher priority than goods and services, because they have direct beneficiaries with political sensitivities (for example, teachers in Huíla province were allowed to demonstrate in September 2004 about salary arrears).

115. One factor increasing the difficulty of monitoring budget processes is the split between spending at the provincial level and that carried out by nation-wide institutions, which is classified at a central level. For example, the 2003 budget classifies expenditure as follows:

Table 3: Regional distribution of expenditure

Location	**% share of total budget**
Bengo	0.55
Benguela	1.86
Bié	0.81
Cabinda	1.94
Huambo	1.25
Huila	1.49
Kuando Kubango	0.32
Kunene	0.59
Kwanza Norte	0.48
Kwanza Sul	0.74
Luanda	5.87
Lunda Norte	0.73
Lunda Sul	0.64
Malange	0.51
Moxico	0.63
Namibe	0.45
Uige	1.21
Zaire	0.71
Exterior	1.49
CENTRAL STRUCTURE	77.73

Source: Finance Ministry

116. The central structure undertakes expenditure at a provincial level too, but this classification creates overlap, mis-classification and hence poor accountability. The low percentage allocated to each province is also a problem from the point of view of poverty reduction (and centralisation of resource allocation is replicated at a provincial and municipal level, with most expenditure directed to the provincial or municipal capitals.) This stems from a "central planning" mentality and means that provincial and municipal authorities have little say in budget formulation, beyond making requests for funds. As a senior provincial official told us: "If the ministry of finance sends us money, and it is not enough, the matter is closed. What more can we do?"

117. Provinces also routinely receive substantially less than what is promised in the budget. It has not been possible to get audited budget execution survey data on a national level, but anecdotal data suggest that the public investment programme at provincial level often receives half or less of what is earmarked in the budget, and the percentage of actual budgetary execution on current expenditure programmes is typically even smaller than that. It is not possible to say with any clarity to what extent the lack of services reflects the non-receipt of funds by the provinces, or the misuse of funds once they have arrived.[41]

118. Public funds can be diverted many ways, divorcing budgets from policy. It is the "upstream" diversion of budget revenues, roughly corresponding to the "revenue" side of the budgetary process, that has attracted most attention from donors in Angola. Many of these routes have been closed with the end of multiple exchange rates in 1999 and the winding up of the Caixa de Crédito Agropecuaria e Pescas (CAP) Bank from 2000. Some, but not all, discrepancies have been cleared up by audits of Sonangol and the production of a series of reports by KPMG in an "oil diagnostic study", along with limited audits of Sonangol and the central bank, and the reconciliation of external debt data, including from oil-backed loans.

119. However, while these changes bring hundreds of millions of new dollars into the budgetary process, and high oil prices and new loans are boosting revenues, it is surprising there has been no impact of anything like this size on the end results – i.e. delivery of services around the provinces. The main impact that can be seen is on physical rebuilding. (This conclusion is reached not from analysis of our provincial data,

[41] One example was given to us in Huíla, where the provincial government only received 52% of the funds earmarked for the public investment budget in 2003, and in the first three months of 2003 it only received 19% of its official allocation for the recurrent budget.

which are too sparse to allow meaningful conclusions, but from the accumulation of anecdotal evidence.)

120. So there are grounds for believing that reform has not fundamentally disrupted the patronage system, and has certainly not made it obviously more “pro-poor”, but instead it has shifted diversion of revenues downstream, towards the “expenditure” side of the process and more invisible forms. Many other mechanisms for diverting revenues exist, including kickbacks, the award of public works contracts to companies in which officials have a large stake, overbilling, the capture of revenues from subsidised state companies by private officials, the sale of state assets below market value, etc. Anecdotal evidence also suggests that while oil revenue transparency has improved, diamond data have not.

1.11 OIL-BACKED BORROWING: AN UNUSUAL TOOL

121. In the late 1980s, Angola needed financing for Sonangol’s share of developments off Cabinda, but could not do so quickly from current revenues. International lenders did not trust guarantees offered by the Angolan central bank, so a new solution was designed that enabled Angola to borrow money from international financial markets to pay for its share of developments. Loans were paid back in oil.

122. Over time Angola established a track record, allowing it to borrow increasing amounts not just for Sonangol but also for general government use. After the return to war in 1992, these arrangements allowed Angola to raise cash quickly for arms.

123. The secret of Angola’s success is partly the very secure contracts involving physical oil delivery, and partly the authorities’ awareness of the importance of credibility. Oil-backed borrowing payments happen offshore so there were few incentives to integrate them into the budget, especially when international pressures for transparency were weaker than today. Secrecy was seen as essential for another reason: it hid information about arms procurement from the enemy. Secrecy also, of course, provides opportunities for corruption.

124. Oil-backed borrowing became an increasingly effective tool by which the presidency could secure spending priorities, not just for arms, by bypassing the inefficiencies of the traditional financial system; they have become central to the exercise of power. This had severely negative effects on Angola’s fiscal stance and inflation; and oil-backed arrangements have also been central in the famous “missing billions” in Angola’s

accounts in past years,[42] and thus a source of donor suspicion. Despite a perception, particularly in Western media, that the "missing billions" were stolen – and there is no doubt some was diverted in this way – plenty was used for legitimate or quasi-legitimate state projects, such as arms deals or other state projects under direct presidential control.

125. Different repayment arrangements have different effects on state finances. Until 2002, several older oil-backed loans until 2002 were repaid in oil at a fixed barrels-per-day rate. A rise in oil prices in this case would not lead to more money for Angola, but accelerated repayment of the loans instead, so they would be paid off faster. Lower oil prices would have the opposite effect, but Angola generally hedged (in effect, bought insurance) against large price falls. When paid off, the oil stream used becomes available for new loans.

126. Oil-backed borrowing has been used for other purposes, including in debt renegotiations. The largest was the renegotiation of $5bn in Angolan debts to Russia, a complex series of arrangements which began in 1996[43] and involved payment in oil. Angola also recently rescheduled $2bn in debts to Portugal and Portuguese companies, partly with the help of a $2.25bn oil-backed loan arranged by Standard Chartered Bank.[44] This loan (a smaller $1.15bn loan was also arranged in 2003 by a consortium also led by Standard Chartered) has a somewhat different repayment profile: above a reference price of $26.5/b (which is also the reference price for the 2005 budget approved in October 2004), Angola will receive the excess as revenue to the budget (instead of seeing it going into loan repayment as had been the case with some previous oil-backed loans.)

127. The loans are expensive, typically commanding two or three percentage points above the benchmark Libor interest rate, plus the costs of hedging, which vary widely but might amount to $1/b. Currently about a third of total oil exports are available for borrowing against (the rest accrues to the companies to repay investments and for profits), and in recent years typically 80–90% of this has gone to loan repayments.

[42] In a confidential staff report on 18 March 2003, the IMF recorded discrepancies (reflecting an excess of inflows over recorded expenditure) of $2.46bn from 1999 to 2001, equivalent to an average 11.3% of GDP.
[43] Under the Russian debt deal, two thirds of Angola's $5bn debt to Russia was forgiven, then the remainder was converted into 31 promissory notes each worth $48.3m, to be repaid over a 15-year period from 2001 to 2016 after a five-year grace period. Angola then used oil-backed borrowing mechanisms to redeem at least some of these notes in advance, in a form of prepayment.
[44] See "Angola's state oil group seeks $2.5bn syndicated loan,", Financial Times, April 21, 2004. The Economist Intelligence Unit's Angola country report for the first quarter of 2005 reports that another $1bn loan is now being sought from another consortium, again led by Standard Chartered.

128. In effect, Angola has exchanged a smoother cargo-by-cargo revenue stream for a lumpier one, with periods of relative scarcity interspersed with huge windfalls. This adds to the damaging effects of oil price volatility.

129. Such arrangements have also been useful in securing credit lines from countries such as Portugal, Brazil and Spain, and more recently China, providing security for their companies operating in Angola. For example, Brazil for years enjoyed an oil-backed credit arrangement backed by 20,000 b/d of oil (less than 2% of total production). Under this, Angola provides Brazil with a flow of oil cargoes; in exchange, the *Banco do Brasil* provides payment guarantees directly to Brazilian companies such as Odebrecht which carry out projects in Angola, such as the giant Kapanda dam project near Malange and large irrigation and urban construction projects. The new Chinese loan will provide Angola with a similar tool, whereby Angola will supply China directly with oil and the Chinese government will pay Chinese exporters and construction companies for work and supplies in Angola. Here again, because payments are routed outside the inefficient Angolan financial system, delivery of projects is more effective.

130. The Chinese loan marks a dramatic expansion of Angola's use of such arrangements, partly because of its sheer size: $2bn, disbursed from September 2004 onwards as tied aid, and the supply of Chinese goods and services, with some Angolan local content. This compares to just $441m over three years for the last Brazilian oil-backed credit arrangement signed in February 2001.[45] Also, the Chinese terms are more concessional than previously: less Angolan oil is needed as collateral, and repayment periods are longer – up to 12 years, following a grace period. And, unlike commercial loans, none will be used for refinancing earlier loans, so it is all fresh money. What is more, since such bilateral credit arrangements tie procurement to a single country, China is extremely competitive because it produces a wide range of cost-competitive goods. China's chief incentives in securing this deal are to assist long-term energy security, and to get its companies more closely involved in Angola, which is becoming increasingly important in the world oil industry. The Chinese loan will be a central part of the government's 2005 and 2006 economic plan, ahead of elections.

131. In all these arrangements, Angola has had to be accountable only to the lenders, without having to provide wider accountability to the IMF or the Angolan people. This may be encouraging an expectation among the Angolan leadership that they might achieve the same through bond financing.

132. Western donors and the IMF tend to reject oil-backed arrangements as abnormal, unacceptable tools of financial management. They say such deals are opaque,[46] lack public accountability, and involve the state's subversion by the presidency; some past loans have been surrounded by evidence or suspicion of high corruption. The IMF has also expressed concern about the sustainability of such expensive borrowing.

133. However, although Angolan officials have often said they wish to replace this kind of borrowing with less expensive mechanisms,[47] this has not happened, for several reasons. No strong incentives currently exist for Angola to curb these practices: the strong internal dynamic of the patronage system always favours immediate revenues over future revenues; and the commercial oil-backed loans are generally oversubscribed by international banks, so there appears to be a ready supply of new loans. Perhaps new players such as India, also worried about energy security and keen to gain a foothold in Angolan oil, may start to consider similar schemes. Many agents involved in past oil-backed borrowing arrangements remain powerful today.

1.12 OIL REVENUE VOLATILITY

134. State revenues fluctuate wildly because of oil dependence and gyrating oil prices. Revenue volatility damages the economy and hurts the poor: boom-bust cycles are inimical to planning and transparency, and frequent adjustments of government spending hurt the private sector, especially those not insulated by their political connections. Windfalls tend to generate "lottery-winner" effects, fostering inefficiency. It is politically easier to raise spending when prices rise than to cut back when prices fall. This asymmetry has a ratchet effect which worsens deficits; this can generate further borrowing, higher arrears and inflation. Curbing expenditure can thus be politically dangerous. In Angola the oil price crash of the late 1990s coincided with resumption of the war at the end of 1998; this, combined with the costs of servicing previous oil-backed credit arrangements taken out at times of higher prices, sharply exacerbated a full-scale political, economic and military crisis, with terrible social effects.

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[45] The team obtained a document outlining the terms of the deal, which followed an earlier deal in August 1995
[46] Although the size of recent loan deals have been published by the authorities, a large portion of many of these loans is earmarked towards refinancing earlier oil-backed loans, which makes it hard to know the true extent to which Angola is receiving a new infusion of money.
[47] For example, deputy Prime Minister Aguinaldo Jaime said on September 2004 that "If things go well, probably there will be no more need for oil-backed loans" following the Chinese loan arrangement; Angola also promised in 2000 to restrict oil-backed borrowing to $269m (this figure was based on a benchmark oil price and oil production rate).

135. World oil prices fell to around $10/b in 1998 and currently stand at over five times that level. Such wild swings, if reversed, could easily overwhelm the huge production increases Angola currently expects; the fact that oil contracts tend to translate price swings into even wilder revenue swings makes this even more of a risk.

136. Orthodox solutions involve economic diversification (to curb oil dependence), using oil funds to smooth out the spikes and troughs or to provide a savings mechanism and curb "Dutch Disease" effects from large foreign exchange inflows. Some advocate hedging mechanisms (which are like insurance policies against price falls) to smooth revenue flows.

137. A successful oil fund could have dramatic positive effects on poverty. However, although oil funds have worked well in countries such as Norway that are already well managed, they have not yet been effectively used in Angola[48] (and in many other countries in the developing world), because the incentives to do so are lacking.

138. Two main difficulties exist with oil funds. First, the logic of a patronage-based system (see above) militates against deferring current spending to channel money into an oil fund; a finance minister would need to fight debilitating political battles to do so. Second, even if such a fund were set up (and deputy Prime Minister Aguinaldo Jaime promised on 10 September 2004 that a special reserve fund would be set up to accommodate a price windfall), politicians might still try to access the fund's money. Oil funds in other developing oil-producing countries such as Nigeria have a poor track record.[49] In addition, even with Angola's recently announced savings mechanism, its overall foreign asset position will not have improved because of this year's large borrowing; indeed questions over the announced fund arrangement have contributed to problems with the IMF.[50]

139. Hedging mechanisms are also problematic: they can be expensive and are generally unavailable for more than five years, whereas large oilfields can have lives of twenty-five years or more. Also, if policy-makers hedge, and prices move in the wrong direction, they risk being criticised and possibly ousted. If, however, the output is not hedged and prices

[48] Angolan deputy Prime Minister Aguinaldo Jaime promised to store excess cash from the 2004 [price windfall in a special reserve, although this has yet to materialise, and the claim should be treated with considerable scepticism, given that a track record of any kind in this respect has yet to be established, and it is not clear what incentives exist to manage this windfall wisely. Some other countries with somewhat similar incentive structures in public management (notably the existence of a strong patronage-based system) have attempted to set up oil funds which have then been raided by politicians.
[49] Nigeria has set up "oil funds" in the past, but the proceeds have been embezzled.
[50] See Economist Intelligence Unit, *Angola Country Report*, March 2005, Economic Policy section.

fall, it is easy for policy-makers to shift the blame for the fall in revenues onto the international oil price, which is beyond their control.

140. Rapid swings in international oil prices are outside Angola's control (it is not even a member of OPEC). However, three other factors, over which it does have a measure of control, lie behind revenue volatility.

141. First, high oil prices make Angola more creditworthy, increasing its capacity to borrow, while low oil prices do the opposite: borrowing reinforces the cyclical nature of oil prices. It is no coincidence that, at a time of extremely high oil prices, Angola managed to agree the $2.25bn Standard Chartered loan (described higher up in this section) – the country's biggest ever single oil-backed loan arrangement by far –and an unprecedented $2bn credit facility from China.[51]

142. Pro-cyclical borrowing patterns are the result of Angola's interaction with international market forces. It might be worth considering how multilateral institutions could play a role in altering the incentive structure in Angola's borrowing patterns, either through helping alter Angola's creditworthiness at different points in the price cycle, or through influencing the ways in which repayment structures are set up, so that they are more counter-cyclical to oil prices. It may be possible to intervene in a way that is welcomed by Angola's government.

143. The pace of oil production growth is clearly important too; this could also be an area of engagement. For a period in 2000, Angola said it was adopting a "Norwegian"-style policy of slowing some oil developments to preserve reserves for future generations.[52] There were several other reasons for this, however. First, Angola considered it did not have the depth of capacity at Sonangol and the oil ministry to cope with and properly monitor such a large workload of huge and simultaneous oil developments. Second, slowing oil developments was a way of putting pressure on oil firms in order to achieve other goals, as any delays to oil projects have significant impacts on oil firms' profitability. However, pressure from the IOCs, combined with internal pressures to speed up developments so as to be able to access oil money as soon as possible, appears to have led to the abandonment of such plans for moderation. It is unclear how much influence the

[51] See section 1.11: oil-backed borrowing, for details on the structures of some of these loans.
[52] The then oil minister José Botelho de Vasconcelos said in a *Financial Times* interview: "We have to define our maximum production in the coming years, and not just keep developing fields so they get exhausted as fast as possible …we need production rates which mean we have the oil for much more time, to guarantee the well-being of future generations."

international community could have on altering the incentive structure here, beyond promoting national debate on the issue.

144. Another factor rarely considered is that the contracts between Angola and the IOCs (both the Cabinda joint venture contract and the Production Sharing Contracts) tend to exacerbate revenue volatility from Angola's point of view (see section 1.12, above).[53] This results from negotiations between oil companies and the government which have produced the worst of all worlds, especially for the poor: IOCs (for which the effects of revenue volatility are measured only in financial terms) get a low share of volatility, while Angola (for which the effects are measured in terms of economic, political and military crisis, corruption and debt) gets the most volatility. Though it might be hard for actors with a poverty perspective to gain influence in contract design, this is an area which has seen almost no serious debate outside the oil industry; a long-term engagement might have an effect.

1.13 CONCLUSIONS

145. Angola has made an incomplete transition from a Marxist-Leninist system of central planning towards a market economy. The economic system is still very tightly controlled by President dos Santos who has used Angola's growing oil industry as a central tool of political and economic power, and this has sharply constrained the leverage of the international community, and especially Western countries perceived as having interfered harmfully in Angola in the past.

146. Extreme oil dependence has severely distorted the economy and had especially harmful effects on the poor. The system is based heavily on patronage, where political power is exercised through allocating resources to clients in exchange for political support.

147. A dominant national development vision exists which often sees the poor as obstacles to, rather than the primary focus of, development. This has occurred for historical and institutional reasons but there is scope for this to change over time now that the war is over.

[53] In an article in the Luanda-based *Revista Energia* in 1999, Jorge Vandeste, Sonangol's director of negotiations, gave several examples from Areas A, B and C of the Cabinda Block 0 Joint Venture contract. In one example, a rise in the oil price from $10/b to $25/b (a 150% rise) would boost government tax receipts by 245%, while profits of the contractor group would increase by just 27.5%.

148. Economic reform is progressing, although its pace and direction is heavily influenced and constrained by élites and a policy of gradualism which is aimed at avoiding a repetition of the destabilising shocks of the 1990s and at enabling president dos Santos and the ruling MPLA to control the pace of change so as to remain in power for many years to come. The primary driver of economic reform is a desire to create a more dynamic economic system providing new economic opportunities -- above all for the élites. The credibility associated with a possible future IMF deal would provide a useful tool in this respect, and this provides an entry point, but it is important to remember that this is only a secondary driver, and sections of the leadership believe and hope that it might be possible to attract new economic opportunities while bypassing the IMF.

149. In general, the leverage of the international community has been higher at times of government weakness (low oil prices, low oil revenues, or war). At times of high oil prices, it is likely that more consensual solutions (e.g. capacity-building) might be more effective. Even the expected dramatic rises in oil output will not necessarily stop oil price falls causing future crises, because spending will always tend to rise to meet revenues, no matter how high, and revenue falls will require spending cuts which are likely to cause political problems in a patronage-based economic system. Future entry points should be considered in this light.

150. Angola's oil-backed borrowing are generally regarded with great suspicion by Western donors. However, it would be very difficult to pressurise Angola's leaders to put an end to such practices as they are seen as very useful alternative tools of economic management, private accumulation, and even political power. They have provided entry points for countries such as Brazil, Portugal and China to exert influence, but less so for Western donors.

151. Angolan officials claim that terms offered by the international financial community (such as a possible Paris Club debt rescheduling deal) are not competitive with what has been obtained from commercial partners; this further reduces Western leverage. Several ways to increase influence over Angola's behaviour would entail costs to Western countries, such as offering better terms for debt relief. Engagement on this level might provide new avenues and entry points.

152. Other aspects of the oil industry, such as the structure of oil contracts, are decided purely by politicians and oil industry specialists. There has been very little input from a pro-poor perspective, and this could be a useful avenue of future research and engagement.

153. Strong presidential control and the dominant development vision means that many economic reforms are out of the question for now. So it is essential to consider change in Angola in the longer term, and in particular with regard to inflection points. The evolution of the natonal development vision will be especially influential in this respect.

154. Although capacity-building at a state level is essential in many developing countries, it is especially important in Angola's case, first because of the recent end to the war, which opens up many new opportunities, and secondly because the West has relatively little leverage in Angola so consensual approaches are likely to have more impact.

155. Though donor funds are very small compared to oil revenues, their importance to the Angolan leadership is larger than may be supposed in this respect. This is because donors provide alternative ways to bypass the inefficiencies and corruption inherent in the Angolan financial system, a problem the Angolan leadership wishes to tackle. Donor funding therefore provides another – albeit limited – avenue for influence, and especially ahead of elections.