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The Political Economy of Long-Run Growth in Angola - Everyone Wants Oil and Diamonds but They Can Make Life Difficult

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Abstract

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Oil and diamond money are at the same time the biggest economic opportunity for Angola as well as being the biggest economic problem. Angola suffers from an extreme case of "Dutch Disease", the common name for the constellation of distortions and problems that often plague oil-rich low income countries, and it is tempting to view its prospects for future development solely through this lens. However, the details of the Angolan case are of particular importance since the interaction of oil and diamond money with existing political and regional divisions in the country magnifies the difficulties of resolving either the economic or the political problems that have prevented progress for the past several decades. This paper discusses the ways in which mineral income not only distorts the economy, but reinforces political divides that have existed for centuries. It is argued that a durable solution to Angola's conflicts requires addressing *all* of these issues simultaneously since they all contribute to the current problems and line up precisely the same groups in opposition to each other. These "axes of polarization" include coastal vs. interior, rural vs. urban/industrial, Mbundu/mestiço vs. Ovimbundu and MPLA vs. UNITA. This discussion sets the stage for consideration of proposals for a way to overcome these problems and achieve sustained long term growth.

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I. Introduction

The extent of oil dependence in Angola is extreme. In fact, it is well beyond that of almost all other oil exporting countries, and is well beyond that of any other oil exporter in Africa. (See Table 1) This, together with the glaringly obvious economic distortions that come from the high levels of oil-funded spending, makes it superficially attractive to attribute to oil the primary causal role not only in Angola's short run economic problems, but also in its long term growth and development prospects as well.

While it would be silly to deny that oil (and to a lesser extent, diamonds) play a dominant role in the country's macroeconomy, it is also true that this income, when viewed in a longer historical perspective, can be seen as reinforcing regional and political divisions some of which have been evident since the earliest days of Portuguese conquest and colonization. These long run features of the Angolan political and economic landscape have interacted with the oil syndrome in a way which has resulted in a far more pronounced case of oil-induced economic distortions than would otherwise have resulted, and also in a far more vicious and destructive civil conflict than might otherwise have occurred.

Students of the Angolan agony of the 1980's, 1990's and thereafter cannot help but conclude that a substantial share of the blame for the constant relapse into war and destruction lies in a simple power struggle over oil and diamond money. Hodges (2001) and Malaquias (2001) are persuasive discussions of this, and it is clear that to a great extent, this is true.[1] Additionally, there is also the issue of the personal quest for power on the part of Jonas Savimbi, an observation that is borne out by the extreme repression that has existed within UNITA and the personality cult that has been cultivated in the party and the areas it controls. However, it is likely that even if the "one bullet solution" that some advocated to end Savimbi's career had been implemented successfully, there would have been no lack of candidates to succeed him given

UNITA's control during the 1990's of an estimated $380 million/year of diamond income[2] and its position as the primary political party of the millions of Ovimbundu who comprise nearly one third of the Angolan population. Indeed, though UNITA appears to be in danger of fragmentation following Savimbi's death, there are numerous aspirants to his role as leader of UNITA and spokesman for the Ovimbundu people.

Thus, it is very difficult to separate the current conflict from oil and diamond money and it is not the intent of this paper to try. Rather, it is argued here that any solution to the overall situation in Angola must take into account the fact that the economic distortions caused by the oil and diamond money (and here we can include the political power struggle that it engenders) have a mutually reinforcing relationship with other polarizing forces of long standing historical duration in the country. That is, even if the problems of disposing of mineral wealth are dealt with (or the oil runs out eventually) the pre-existing historical animosities and tensions that exist in the country will remain, and will have to be dealt with at the same time if a truly sustainable solution is to be found. To deal with only one of the dimensions of the current polarized situation is a recipe for failure since the remaining tensions will tend to reignite the conflict if they are not addressed also. Angola is not unique in having historical tensions and dichotomies. Other countries around the world and in Sub Saharan Africa suffer from many of the same issues to a greater or lesser degree. However, what is striking in the Angolan case is that these pre-existing divisions are all aligned in such a way as to cause the polarizing forces to line up precisely the same groups in opposition to each other over each of these issues.

The most obvious of these divisions is that between the people dwelling on the coast and those in the interior. In the simplest geographical sense, those who control access to foreign markets exercise, in <u>any</u> country, economic power over those in the interior. In the Angolan case, this power resides in coastal cities, particularly Luanda and Benguela, through which foreign trade occurs.

The second "axis" of polarization exacerbated by oil and diamond income is that between agricultural populations and urban/industrial populations. This is a division that has analogues in virtually every country that has undergone economic structural transformation from a low income and predominantly agricultural economy to a high income industrialized one. In the United States, for example, this tension was exemplified in the late 19th century by William Jennings Bryan and the Populist movement, which based itself primarily in agricultural areas of the Midwest, in opposition to Eastern urban industrial interests. In Angola, a similar division exists, and it is aligned so as to place in opposition the same people who find themselves on opposite sides of the port/interior dichotomy above.

The third division is ethnic - The inland Ovimbundu planalto vs. the mainly Mbundu and mixed blood urban industrial elites. As in many parts of Africa, ethnic or tribal allegiances and identities are often more important than national ones, and this is as true in Angola as it is elsewhere. Both groups are linguistically and culturally distinct from each other, and often view themselves as historically opposed, as indeed has been the case for centuries. As in the above two axes of tension, this one lines up in precisely the same geographical and economic manner, thus providing yet another mutually reinforcing support to the overall nexus.

It should come as no surprise that internal political alignments reflect the three dichotomies above. Indeed UNITA has long has its base in the agricultural heartland of the country, the mainly Ovimbundu areas of the central highlands while the MPLA has as its primary base of support the urban/industrial areas of the coast. However, this divide has been exacerbated by the superimposition of geopolitics - UNITA has been for many years supported by the United States and South Africa, while the MPLA with its avowedly Marxist origins, was supported by the USSR and its proxy, Cuba. It is clear that oil has played a major role in the importance assigned to this particular internal conflict in the eyes of the superpowers - other Sub-Saharan African countries without oil have not merited anything like the level of attention and support accorded Angola even though many have had similar political dynamics at work.

The real exchange rate distortions inherent in Dutch Disease together with the enclave nature of offshore oil production serve to make each of these divisions more contentious than they would naturally be (not to deemphasize how bad that can get - civil wars are routinely fought over such issues). In a nutshell, these distortions tend to penalize sectors that produce "traded" commodities (i.e. the agricultural areas of the interior) and to reward those who can control the revenue streams generated, (i.e. the urban areas and the central government apparatus).

The next section of the paper discusses the economic distortions that occur in oil exporting countries and how this syndrome has manifested itself in Angola. This is followed by a discussion of each of the four axes of polarization above : port vs. interior, rural/agricultural vs. urban/industrial, Mbundu vs. Ovimbundu and MPLA vs. UNITA. The next section discusses the intersection of these with oil-induced distortions and the prospects for a sustainable growth strategy.

II. Oil Money, Macro Distortions, and the Angolan Economy

______This section first provides a brief overview of the Angolan economy in order to lay the foundation for a discussion of the role of oil and diamond money in producing the extreme economic dislocations of the past twenty years. The second part of this section builds on this discussion to discuss the major policy options open to the government for dealing with these problems.

An Economic Overview - Where is the Angolan Economy Now?

Prior to independence in 1975, Angola was better known as a coffee exporter than as an oil exporter. Agriculture in general was the base of the Angolan economy, and food crops as well as cash crops played an important role in the country's domestic economy as well as in its balance of payments. Angola was not only the world's fourth largest coffee exporter, but also exported over 400,000 MT of maize annually, making it one of the largest staple food exporters in Sub Saharan Africa. Oil, while having been discovered prior to independence, had not yet achieved the high production levels that would be seen in the 1980's and thereafter.

The massive inflow of oil receipts since that time (amounting to more than half of GDP) has caused distortions typical of oil exporting economies, and commonly known as "Dutch Disease". This refers to the problems of exchange rate overvaluation and relative price distortions that result in strong urban bias and stagnation of non-oil exports and import competing sectors. Diamonds constitute an additional factor exacerbating the already strong effects from oil. The activities most adversely affected are those most exposed to competition from abroad, in this case, agriculture and light manufacturing and agro-processing sectors which have been virtually 100% replaced by imports in the large urban markets on the coast. Angola's exports of both of its major pre-oil export crops, maize and coffee, are now near zero.

The enclave nature of oil production is especially pronounced in Angola, where oil literally never touches the territory of the country apart from the Province of Cabinda which is separated from the bulk of the country by Congo. Offshore production is increasing with additional exploration continuing in order to expand output substantially over the next few years. (Production is expected to expand from a current level of approximately 750,000 barrels/day to 1 million barrels/day) Virtually all inputs used in production are imported by the concessionaires, including the majority of oil company workers.

The production enclave is matched by a consumption enclave in that oil receipts are used primarily to service foreign debt and to support the government budget which is expended mainly on defense, debt service and maintenance of the central government apparatus in Luanda. The resulting boom in spending has resulted in a highly inflationary economy in Luanda in which many of the traditional links to productive areas in the interior have been broken. In effect, Angola has two economies, one reliant on imports financed by oil receipts, while the bulk of the population lives in abject poverty divorced from the formal economy. In spite of the fact that most of the windfall has been spent on imports, and so has not directly affected the real exchange rate, enough of the additional demand has fallen on non-traded sectors to create a chronic problem of overvaluation, which has proven particularly hard to deal with given the difficulties in reestablishing domestic productive capacity.

Government expenditures have exceeded oil receipts, due both to large military expenditures necessitated by the war and more recently by the military expeditions sent to support factions in the conflicts in the two Congos, and the need to make payments on the external debt, which stood at approximately $10.3 billion by the end of 2000[3]. At present, a substantial part of oil production is devoted to debt service, though there are more new fields scheduled to enter into production in the near future. This will avoid a crisis in the near term by allowing financing gaps to be covered, but will merely postpone the inevitable adjustment to a later date at which time the gaps will be larger, the imbalances more severe, and the debt larger.

The government has periodically announced reform programs designed to end the periods of hyperinflation that have plagued the country since the end of the command economy at the beginning of the 1990's. Unfortunately, none of these has proved successful for a sustained period of time, with control measures which are capable of repressing inflation for a time but which do not address underlying problems of fiscal imbalance and money creation to finance the resulting deficits. This pattern has continued to the present, with the latest IMF Article IV consultation of February 2002 calling a decline in inflation to 116%/year in 2001 “an important achievement”. However, even this has only been possible at the cost of substantial arrears in government payments to workers and has still left the government deficit at 7% of GDP.[4] Table 2 shows the evolution of Angolan economic growth and inflation over recent years, illustrating some of the extreme dislocations that have recurred during that time.

Table 3 shows trade figures for Angola in recent years, in all of which oil has accounted for 90% or more of exports. In terms of imports, food and other consumer goods have grown to a dominant position, squeezing out imports of intermediate and capital goods which previously were the dominant import items. Overall, the merchandise trade balance shows a large surplus due to the large exports of oil. In spite of this large positive merchandise trade balance the balance on current account has been negative in every year since 1987. This is largely due to the large payments to oil companies and for interest on the foreign debt.

Oil Economies and Growth - How to Avoid Major Distortions from a Major Inflow of Money

The section above documents both the extreme nature of oil dependence in Angola and the severe nature of the economic dislocations that have resulted from it. At the most general level, there are two main issues involved with this income:

1. How fast to exploit the various mineral resources.
2. How to spend the money.

How Fast to Exploit the Oil

With regard to the first issue, there is an extensive literature on the dangers of excessively rapid exploitation of oil reserves and expenditure of the funds in ways that do not contribute to long run growth and welfare. In particular, Gelb et. al. have shown in numerous case studies, including several directly relevant to the Angolan case, that the distortions which result from large expenditures in the near term can in the end leave a country worse off than it was in the beginning. Given Angola's markedly greater dependence on these revenues than any of the countries whose experience forms the basis for these observations, there is good reason for caution.

Essentially, the issue is this: Large inflows of foreign exchange have the potential to generate highly undesirable effects on the domestic structure of production and consumption due to the short run incentives to capture the large rents available. However, distortions in the domestic economy can be avoided if the foreign exchange bonanza is spent on imports rather than domestically produced goods and services. In the Angolan case, this is what has for the most part been occurring to date on both the input side of oil production and on the expenditure side once receipts have been received. Even so, a substantial amount of the demand created by the oil windfall has fallen on non-traded goods, particularly in urban areas, where services and housing account for a large share of expenditures by the rich.

On the production side, the offshore nature of Angolan production today, and the original location of much of the production in the physically separate province of Cabinda, have reinforced the oil companies' historical inclination to extract the oil with 100% imported technology operated virtually 100% by expatriate workers, who live in contained facilities with virtually no linkages with the domestic economy. Accordingly, there are no significant effects in terms of 'resource pull' from the rest of the Angolan economy since the oil sector makes almost no use of any domestic capital, labor, or even consumption items for its work force. It is likely that this situation will persist in the future given the fact that Angola continues to contract extraction out to various foreign oil companies which operate their concessions as enclaves. In the case of diamonds, the sector is not physically isolated as is the case for oil (diamonds are located primarily in the northeastern provinces) but the production process provides little opportunity for significant backward linkages to the rest of the economy.

On the expenditure side, all of the oil money has accrued to the central government apparatus, which has spent by far the largest part of its income on imports. During the height of the civil conflict this was largely unavoidable, as large purchases of weapons were needed. In terms of consumption items, the physical barriers to trade between the large coastal urban centers and the rest of the country made it extremely difficult for any of the expenditures to translate into demand for domestic products. Everything from clothes to food to consumer durables has been imported.

While there is some apparent tendency toward the "normal" Dutch Disease pattern of high levels of expenditures on labor services, this is not primarily a product of bloated government wage bills as is the case in some other countries. Though the government labor force is clearly larger than warranted, the vast majority of these functionaries are so underpaid that salaries in fact constitute a relatively small share of the government budget compared to other countries at a comparable level of income. Insofar as there are greater expenditures on services in urban centers such as Luanda, this has occurred via the personal consumption decisions of those segments of society benefitting from the bulk of the oil revenue. In addition, it is also important to bear in mind the large military establishments maintained by both sides in the civil conflicts of the past years.

What this means in terms of the internal and external balance of the Angolan economy is that the balance of payments has remained severely in deficit while pressures on the real exchange rate have been far less than would be the case if some of the oil funded demand had fallen on domestic production. Even so, it is clear even to a casual empirical observer of the urban economy in Luanda and other cities, that prices are quite high by international standards. Even at black market exchange rates, Luanda is a very expensive city, comparable to large cities in Europe and North America, which is a testament to the high levels of demand resulting from mineral income.

So, if one of the basic problems is the inability of the economy to absorb the large sums of money spent in the short run without detrimental distortions, then one possible solution would be to save some of the money offshore, or to simply pump the oil out at a slower rate. The first option is one that has not been achieved with any great degree of success by any oil exporting country to date. There are simply too many pressures on the government officials both personally and in their official capacities to spend the money when it becomes available. Even so, the government can achieve much the same effect by using revenues to pay off past foreign debt to the extent possible. So far, this has not occurred, both because of political issues surrounding debt repayment and because the government has in fact been dedicating future oil production to servicing current debt obligations to such an extent that most of the revenue has gone to this end.

This is an important reason why the present situation offers some opportunities which have not been possible in the past. Given the large new oil fields coming on line now and in the near future, there is a window of opportunity for the government to use the additional windfall to make the adjustments needed to get out of the vicious circle of mortgaging increasing amounts of current production to future debt service. The alternative is to spend the money now and continue the pattern of the past, but at a higher level of debt.

How to Spend the Mineral Revenues

The basic problem of oil economies, that of a highly overvalued exchange rate, has the effect of imposing high implicit costs on those sectors most exposed to international trade, either because they produce export products, or because they face actual or potential import competition. Accordingly, the factors of production employed in these sectors suffer, and to the extent they are able, migrate toward uses in which they can earn greater rewards, in this case the urban centers where oil money is received and spent.

In the Angolan case, it is clear that the hardest hit sector is agriculture, together with associated processing and transforming industries. Angola has historically demonstrated a strong comparative advantage in agriculture (see above) and this sector provides employment and income for the majority of the population. Therefore, from a the point of view of both poverty and equity, there is a powerful case to be made to avoid overvaluation to the extent possible to avoid penalizing this sector.

Even if exchange rate overvaluation persists to some degree, the strong underlying comparative advantage in agriculture suggests a government investment strategy directed toward provision of infrastructure and public goods which can help lower costs of production in this sector. Obvious candidates are rehabilitation of the country's transportation system, including roads, ports and railroads, as well as investments in agricultural research and extension. All of this is, of course, predicated on a successful continuation of the peace process and resettlement of rural populations in producing areas. In addition, lack of public services such as water and sanitation, as well as electricity and other utilities are a serious constraint to industrial investment and rehabilitation. Investment in human capital, especially primary education, is another area where high long term returns can be gained.

In summary, the experience of other oil countries, and the theoretical literature on Dutch Disease effects, show that the distortions induced, particularly via the exchange rate, create very adverse conditions for other sectors. As noted above, in the Angolan case agriculture is the most important of these, both in terms of its share of the labor force and due to the well demonstrated comparative advantage enjoyed by the country. There are also a range of light manufacturing activities which would be rapidly developed by the private sector given appropriate conditions. Accordingly, some clear long term policy prescriptions emerge from this analysis:

1. Maintenance of an appropriately valued exchange rate is paramount. As argued above, this will depend to a great extent on the ability to control inflation which in turn depends on fiscal control.

2. Free access to foreign exchange and ease of international trade (i.e. elimination of bureaucratic barriers.

3. A program of investment in public goods necessary to the agricultural sector and rehabilitation of manufacturing.

4. A program of investment in human capital via rebuilding of schools and basic social services.

All of these conditions are important to maintain incentives for foreign investment, which will itself help speed the process of rehabilitation of the economy and achieving a sustained growth in non-oil output. However, the most important factor, indeed a prerequisite, for reactivating foreign investment even given the most liberal law possible, is the level of confidence in the government and the credibility of its policies in terms of maintaining a stable and favorable environment for business.

The stop-go reform and retreats of the past years have not helped create a feeling of confidence - some degree of constancy is imperative if the government is to hope to attract any substantial investment outside of the oil and diamond sectors.

Finally, it needs to be recognized that all of the discussion about Angola's future depends on the assumption that peace can be maintained and that the process of political reconciliation continues. Without this, and without a continuation of the mine clearance and resettlement which began after the signing of the Lusaka Accords, there is little basis for any progress.

III. Historical Axes of Polarization in Angola from Colonial Times to the Present

Section II above documents the way in which oil dependence has affected Angola and the nature of the economic imperatives that this generates. This section discusses four major pre-existing axes of polarization in Angola: Port vs. Interior; Rural/Agricultural vs. Urban/Industrial; Mbundu vs. Ovimbundu; MPLA vs. UNITA. This last section also discusses the role of external geopolitical influences in reinforcing internal political divisions.

A. Port vs. Interior

In any part of the world, those who control coastal areas and/or ports exercise a degree of control over interior landlocked areas by virtue of their ability to control or charge for access to outside markets. Indeed, major conflicts in world history have revolved around just such access to the sea - one need only look at the centuries-long Russian goal to control the Dardanelles, which constitutes a choke-point for its warm water southern ports, or the long running European debates over the "Polish Corridor" and the status of the port of Gdansk (Danzig). In the developing world, just such considerations motivate the long term tension between landlocked Bolivia and Chile, which wrested Bolivia's coastal provinces away in the latter half of the 19th century.

There is a real economic foundation for these conflicts: whoever controls access to outside markets can charge a price for the privilege. That means a markup on every import item transshipped to the interior and a tax on every export item that exits the country through the port. The importance of free access to a port has been shown empirically by Bloom and Sachs (1998) who analyzed the growth records Sub- Saharan African countries and found that geographical access to a port was a significant determinant of growth prospects.[5] The same logic applies to landlocked areas within a country, particularly when the country in question is composed of provinces which have some degree of de facto autonomy, or the central government apparatus uses control of ports to generate revenue for its own use.

This is no different in Angola than it is elsewhere, with the major ports of Luanda and Lobito/Benguela playing the most important role, but also to some extent the lesser ports of Namibe, Porto Amboim, Ambriz and others. In colonial times as well as more recently, the central government (be it Portuguese or Angolan) has explicitly and implicitly taxed both agricultural exports (particularly coffee through the government marketing board) and imports of all descriptions, through tariffs and import quotas.

These direct controls and taxes have been supplemented with indirect methods such as foreign exchange controls which have over various periods been used to deny foreign exchange to disfavored individuals or activities, surrender requirements which have forced exporters to exchange foreign currency for domestic currency, and exchange rate overvaluation, which penalizes exporters and importers who cannot get access to foreign exchange in favor of those who the government chooses to give access to its limited supplies. In Angola this category has most often been comprised of government officials and coastally based trading, processing and manufacturing activities which have operated to the benefit of coastally based people.

Historically, the importance of controlling access to foreign markets first arose after the arrival of the Portuguese in the late 15th century. This is due to the fact that prior to this time the most important trading routes in Angola and the Congo Basin in general were overland trade routes to the East rather than seaborne trade, as was the case in other parts of Africa.[6] The arrival of the Portuguese signaled the opening of these areas to international trade - Indeed, this was the entire raison d'etre of the Portuguese colonial project in the first place - efforts to colonize in the 1400's and later were better characterized at efforts to either cart off riches such as gold, ivory and slaves or, if military superiority could not be brought to bear, to trade for these items so that they could be brought back to Lisbon and used to support the expenditures of the crown and of the nobility. Early efforts met with success. The Portuguese succeeded in trading for gold in West Africa, (given their inability to conquer the well-organized kingdoms of Mali and Ghana) and were also successful in promoting a large trade in slaves from other parts of Africa, particularly the Congo Basin and Angola, to the islands of São Tomé e Príncipe as well as the

Gold Coast and also to Portugal itself.

The earliest records of the Portuguese occupation of Angola bear out the discussion above: conflict between the coast and the interior has been recorded as early as 1506 when the outward-oriented future King Afonso of the Kongo defeated the reigning monarch and initiated a period of active participation in the slave trade which dominated European/Kongo relations throughout the early colonial period.[7] In return, the King received exotic trade goods and other foreign items which enhanced his prestige and control over his dominions.[8] The rapid growth of the slave trade had terrible consequences for the interior of the country. By the 1560's the hinterland of the coastal slave ports had become so depopulated and weakened that it was relatively easy for invading hordes of primitive and reportedly cannibalistic tribal peoples called Jagas from the east to topple the King and, at least temporarily, put a halt to the previous royal trading structure.

The Portuguese response was to give up the old colonial model of trading through the King and to try to impose their own military control directly with a Portuguese army in control of a restored puppet Kongo monarchy. This was coupled with attempts to control areas to the South of the Kongo Kingdom, that controlled by the "Ngola", which provided a source of slaves which bypassed the export taxes imposed by the Kongo monarchy. This proved more difficult than had been foreseen, and the invading army took months to advance to the mainland from their first landing place on a sandy island just off the coast at Luanda. Even then it was more than 50 years before any progress at all was made in penetrating the interior of the country - this was eventually accomplished not as conquerors, but as traders working with coastal allies.[9] This pattern of coastal control by the Portuguese, and domination of external trade with interior regions which they could not control directly was to continue for the next three centuries - It was not until the end of the 1890's and the emphasis on direct control in the Scramble for Africa among the various competing European colonial powers that Portugal could be said to have truly "occupied" the Angolan hinterland.[10]

This history bears out the longstanding nature of coast/interior tensions that date back at least to the 1600's, if not earlier. The monopolization of trade with the exterior by the Portuguese on the coast was a fundamental basis of their ability to expropriate economic surpluses, something that has continued in post-colonial times by the Portuguese speaking coastal elites who have replaced the colonialist Portuguese themselves.

B. Rural/Agricultural vs. Urban/Industrial

In Angola, the coast is not only a gatekeeper, as described in the section above, but it is also the location of the major urban/industrial centers, particularly Luanda, while the interior is also the location of the most productive agricultural areas, particularly the central planalto where the principal grain supplies of the country are (or could potentially be) grown. Even in countries where this alignment of coast with cities/industries and interior with agriculture doesn't exist there remains the tension of agricultural interests versus urban/industrial ones by virtue of the fact that what one party buys, the other one sells and vice versa.

To be specific, urban/industrial interests depend fundamentally on two agricultural outputs:

1. Food is the primary determinant of urban/industrial real wages since it constitutes the bulk of expenditures for poor working class people. Indeed, food prices have often been cited as the most important single determinant of welfare and income distribution in a country.[11]

2. Industries, and particularly the early developing light industries of textiles and food processing, need agricultural raw materials as inputs.

Rural/agricultural interests depend fundamentally on urban/industrial outputs in two ways:

1. Rural populations buy consumption items that they cannot produce themselves from the manufacturing sector. In all but the most primitive subsistence economies, this will include items such as clothing, fuel, utensils, transportation, etc.

2. Farms that have advanced beyond the earliest self sufficient shifting cultivation will typically by inputs and implements from the manufacturing sector, beginning with such items as hoes, scythes and plows, but progressing to more complex machinery such as tractors, pumps, etc. In addition, to the extent that fertilizers or other purchases inputs such as pesticides are used, these too will come from manufacturing sectors.

The position of the central planalto (including the provinces of Huambo, Bie, parts of Benguela, Cuanza Sul and Huila) as the "breadbasket" of Angola is well documented historically, and has been also demonstrated in various analyses of comparative advantage in the country.[12] It is from this area that pre-independence grain export surpluses where taken, and where most of agricultural GDP originates. While there are certainly some agricultural activities that can be pursued in coastal areas, the generally arid conditions in these areas are a barrier to major agricultural development.

The observation that the principal geographical location of agricultural comparative advantage lies in the interior has a very important corollary: In order to maximize the return to this comparative advantage it will be necessary to invest in this area. While it is not the purpose of this paper to enumerate the investments necessary for Angolan agricultural investment, it is safe to say that the needs (as in any country at a similar level of per capita income) are large and include both on-farm investments that are properly the province of the private sector and large public sector investments such as roads, extension systems and research.

These investment needs have the potential to be contentious since at first blush the money would be going to one area of the country seemingly at the expense of other zones. However, the experience of many other countries has demonstrated that to attempt to pursue industrialization without investing in increased agricultural productivity is a self limiting strategy. As the urban/industrial needs for agricultural outputs grow, the agricultural sector must be able to keep pace since the alternatives are either higher agricultural prices and stagnation or else ever increasing imports to supply what domestic producers cannot. Thus, investment in agriculture is a prerequisite for success for all regions, and not just the agricultural sector alone.

Tension between agricultural interests and urban/industrial interests are part and parcel of the politics of countries transitioning from low per capita income to high per capita income. Every country which has undergone the structural transformation involved has confronted these issues, including those countries which are currently classified as “developed”.[13] Examples include the period in Britain when the “Corn Laws” where debated by David Ricardo and others, or the United States during the populist era when William Jennings Bryan, representing agricultural interests, campaigned on his famous slogan “Don’t crucify us on a cross of gold”.

Both of these examples reflect the tension over rural/urban terms of trade and issues of national policy which pit one set of interests against the other. They are inevitable when a country moves from a low income, predominantly agricultural economy with 75% or more of the labor force located on farms, to a higher income, predominantly urban economy with 25% or less of the population on farms. In Angola, these natural tensions are exacerbated because the agricultural interests are at the same time located in the interior, while the urban/industrial interests are primarily located on the coast, and particularly in Luanda. In addition, these agricultural interests are also aligned with one of the main ethnic divides in Angola, which is the topic of the next section.

C. Mbundu/Mestiço vs. Ovimbundu

The ethnic composition of Angola is, as is often the case in Africa, quite heterogeneous, including several major and distinct ethno-linguistic groups. Figure 1 shows the major divisions in the country, where it can be seen that the largest single group is the Ovimbundu, who are a primarily agricultural ethnicity occupying much of the central planalto. As was the case with most of the interior peoples of Angola, the Ovimbundu did not live under direct Portuguese control for most of the colonial period, only coming under explicit Portuguese domination in the waning years of the 19th century.[14]

The Mbundu, in contrast, were the only main ethnic group in Angola that came under direct Portuguese control from a very early date[15]. This has resulted in this ethnicity being far more urbanized and also far more likely to speak Portuguese than are other groups in the country. In fact it has recently been estimated that as only 15% of the Angolan population speak Kimbundu as their mother tongue, in spite of the fact that Mbundu account for nearly a quarter of the total population. Indeed, a growing number of Mbundu are now monolingual in Portuguese, and have no native speaking ability in their own or other African languages. Over the past 20 years this tendency has become quite pronounced in Luanda among all peoples and not just among Mbundu as the city has become increasingly populated with people who are monolingual in Portuguese.[16]

This is also true of the large mixed-blood mestiço population that is located in Luanda and is, along with many Mbundu, a dominant force in the MPLA (see below). This has been one of the (sometimes only implied) bases for the frequent UNITA calls for "Africanization" of the government. UNITA is almost exclusively an Ovimbundu organization, and though it has not explicitly identified itself as such, it has always been nearly 100% Ovimbundu in terms of its leadership, and has made use of its close identification with Ovimbundu people by making its long time "capital" in Bailundo, the seat of the largest of the Ovimbundu kingdoms that lasted through the 19th century.

Evidence of the close association of UNITA with Ovimbundu populations can be seen in the voting of 1992, where UNITA won the presidential race by more than 80% in its three "home" provinces of Bie, Huambo and Benguela, (which include the "breadbasket" interior agricultural areas of the planalto) but failed to outpoll the MPLA in any other province except sparsely populated Cuando Cubango. In contrast, the MPLA had a similarly lopsided margin of victory in its own “home” turf of Luanda, Bengo, Kuanza Norte and Malange, but also polled strongly in other areas as well.

It has been reported that in the violence following the 1992 election, there were overt ethnic elements in the fighting in Luanda itself, with Ovimbundu people singled out as UNITA supporters by the dominant Mbundu and mixed blood population of the city. While such ethnic violence is rather the exception in Angola (in marked contrast to such obvious examples as Rwanda or Zimbabwe) this example does show that there is potential for such problems in the future, particularly if people are confronted with stressful or difficult situations.[17]

It is evident that the Ovimbundu/Mbundu divide lines up quite closely with both the port/interior and the agricultural/urban-industrial divides. The one possible exception to this is the fact that the province of Benguela, which is predominantly Ovimbundu, includes the major port of Lobito-Benguela. However, throughout much of the conflict of the past decades the MPLA has controlled the ports and the coastal areas, though it has never been able to extend its control very far inland. Thus, the mutually reinforcing nature of these various polarizations remains clear.

D. MPLA vs. UNITA and the Geopolitical Influence from Outside

Perhaps the best documented “axis of polarization” is that between the MPLA, historically a Marxist client party of the USSR and its allies, and UNITA, long a client of the US, South Africa and their allies. On closer inspection, however, this axis may well be artificial to some extent, though it is (or at least has been) no less real for having been fueled by external considerations.

The MPLA is today no longer an avowedly Marxist party, though its command and control tendencies continue in virtually unaltered form to dominate the economic policies of the ruling clique. That these tendencies may have more to do with self interested desires to control mineral income than with any real ideological basis is shown by the relatively seamless transition from "Marxism" to "free market capitalism" in the 1990's, a transition that was marked less by fundamental economic change than by fundamental change in political alignments with the US and other large Western powers. While there are no doubt legitimate roots to the MPLA's original Marxist character, it is also true that in fomenting rebellion against a NATO member, Portugal, the MPLA placed itself firmly on the "wrong" side of the great geopolitical divide of the time. That this was more a marriage of convenience than conviction is shown by the fact that the MPLA did not hesitate to use capitalist oil companies to extract its oil, nor did it seriously alter its basic outlook when it switched sides thereafter.

UNITA has an even more opportunistic history, as its leader shifted from a one-time alliance with Communist China to a more lasting alignment with the US and South Africa as it became entrenched as the principal opposition to the MPLA in the 1970's. While paying lip service to free market doctrine it engaged in even stricter control of subject populations than did the MPLA, and can hardly be seen as an exemplar of democratic or liberal economic principles.

Nevertheless, the fact that these ideological splits, however convenient, did exist provided a basis for geopolitical interference that was at its roots fueled by the desire to control oil and diamond sources and to deny them to the other side. This consideration has led to a level of superpower interest in the Angolan conflict that has been absent from other African civil wars. Indeed, it has been argued by Munslow (1999) that this interest has been responsible for the inability of the international community to reach a consensus regarding a way out of the Angolan impasse.[18]

Entirely apart from ideological or geopolitical concerns, the political issues inherent in the MPLA/UNITA split are fundamental to any long term resolution to the Angolan conflict.

First, is the problem of maintaining a viable democracy, as urged by outside powers, in a situation where the two main parties have such a strong regional base. Any victory at the national level by one side or the other will be seen by the loser as a "conquest" as much as an electoral loss. Indeed, given the mutually opposing economic interests outlined above, it is difficult to see how simple majority rule at the national level can ever be seen as legitimate by a large segment of the population.

Such a situation would seem to support the notion that some sort of federal system, where a great deal of power is devolved to the provincial level, would be one possible recipe for a peaceful resolution. However, there are two main problems with this: First is the historical tradition of a unified state under strong central control that is an historical legacy from colonial times and which has been adhered to by both political parties ever since. There is no tradition of power sharing or of division of power in Angola and no political culture of such accommodations upon which to build. Second is the fact that the main prize in the political competition - the billions of dollars of annual mineral income - is not easily divided territorially. In fact, neither the oil, which is located mostly offshore, nor the diamonds, which are located primarily in the northeast provinces of the Lundas, are physically located in the "home turf" of either political party.

What this means is that either a formula for dividing power and income will have to be reached prior to achieving peace, or there will have to be a total military victory by one side or the other. Given that each side represents a large percentage of the total population, it is hard to see how the latter can ever be finally achieved, though the MPLA is certainly trying at the present time. Unfortunately, it is likely that no matter how determinedly the MPLA and the FAA pursue and wipe out remnants of UNITA's guerilla army, the underlying differences that generate the conflict will retain the potential to inspire a resurgence of this activity in the future.

IV. How to Promote Peace and Sustainable Development in Angola

This section first discusses the standard economic prescriptions deriving from Angola's oil-export induced distortions and how these line up with the axes of polarization discussed in the previous section. Second is a discussion of the political realities of reaching a viable solution, both in terms of the regional accommodations that would be required, and the need for ruling elites to be willing to acquiesce in a fundamental change in the current situation.

Dutch Disease and the Axes of Polarization

Over the long run, there are two important areas of potential problems in achieving a national consensus on a macro strategy for growth and development. The first is the issue of mineral rents from oil, diamonds and other sources, and the decision as to how and when to spend the income. The second is the difference in economic interests between agricultural regions and urban populations. However, on closer inspection it apparent that these are really just different facets of the same issue.

The Dutch Disease diagnosis has clear implications for investment and growth over the long term - Given a disease which causes trade exposed sectors in which the country has a potential comparative advantage to stagnate and wither, the prescription for addressing this problem is to invest in these areas so as to prevent their atrophy. The underlying rationale is clear: If Angola is not to place all of its eggs in one (oil) basket, then it is essential that it retain its ability to produce in those other sectors which historically have provided it with the bulk of its exports since these same sectors will constitute the main economic fall back if and when oil revenues decline in the future. In Angola it is obvious that these sectors are found in agriculture and related processing activities.

Additional benefits from such an agriculturally driven investment strategy would be found in the areas of income distribution and poverty alleviation. Development of rural areas would at the same time promote income growth for the poorest segments of Angolan society, discourage urban migration, and help to reduce and eventually eliminate the huge food import bills currently incurred by the large coastal population centers. Unfortunately, it is precisely these characteristics which present some of the biggest potential obstacles to implementation of this plan.

The problem is this: If an agricultural investment strategy is to be successful, then it must focus on the areas of highest agricultural potential, i.e. the agricultural breadbasket of the central planalto, which is at one and the same time an *interior agricultural* region whose core is the homeland of the *Ovimbundu* people and the center of *UNITA* support. In short, this strategy would require the MPLA to focus investment directly on their erstwhile opponents rather than on their own supporters, who live in areas which are largely much less favorable in agroclimatic terms than is the central planalto. Indeed, the coastal regions where MPLA control has been strongest are precisely the areas with the <u>least</u> agricultural potential, having insufficient rainfall to support large scale rainfed agriculture.

An enlightened view of the growth and development prospects for the country might help promote such a strategy. In fact, a concerted program of assistance to the UNITA areas may well be the single most important facet of a true plan for national reconciliation, in addition to having positive benefits for urban areas as well since a resurgent agricultural sector would go far toward lowering food prices throughout the country. The prospects for such a scenario are evaluated in the next section.

<u>Rents, Elites and the Incentive to Reform</u>

It is perhaps a truism that in order for reform to be pursued, it must be perceived to be in the best interests of those who must make the decision to do it. In the case of Angola there are particularly high obstacles to achieving this perception, stemming from the current structure of oil-derived foreign exchange inflows and the distortions they induce.

First and foremost is the fact that the oil rents are controlled by the central government and allocated as dictated by those in charge of it. What this has meant in the past is that the political elite of the MPLA has been insulated from the economic problems afflicting the rest of the population due to their ability to control foreign exchange receipts and purchase needed consumption items from abroad. While most of the population has been suffering from the collapse of domestic production and rampant hyperinflation over the past decades, those in a position of privilege have had preferential access to foreign markets in order to avoid these problems, creating an artificial economy in Luanda which is almost entirely divorced from the rest of the country.

Not only has foreign exchange been allocated on a formulaic, preferential basis, but there has also been a huge problem of preferential exchange rates as well. Government purchases have been made in many instances at an official exchange rate which has been extremely overvalued, providing those with access the opportunity for quick profits on an enormous scale by purchasing goods at official exchange rates and reselling them at parallel market prices. Even now, with the parallel market premium lower than it was, control is instead exerted through import licensing.

What this means is that those currently benefitting from the present situation <u>will not be better off in the short run</u> after implementation of a reform program which eliminates these preferences and distortions. It is simply not accurate, and certainly not persuasive, to attempt to make the case for reform on the basis of a supposed improvement in the situation for the political elite because it will not happen. Rather, a case for reform must rest on the fact that the problems afflicting the Angolan economy are well known, and the trajectory of the economy, and that of the elites who benefit from the current situation will inevitably result in a less favorable situation <u>in the long run</u> if reforms are avoided in the short run. In addition, there are real questions as to whether political and social stability can be maintained if the situation for the general public continues to deteriorate. At some point it becomes difficult to hire and pay enough police to contain unrest if urban poor are continually subjected to a worsening economic situation while those in powerful positions are so obviously wealthy. If reform is avoided, there will be another period of prosperity for those with preferential access to oil receipts as the new production areas come on line. However, this strategy merely perpetuates the pattern of mortgaging oil production to pay off debt, a pattern which can only continue as long as oil production growth continues to outpace the growth of foreign debt and the cost of servicing it.

This point is extremely important; foreign debt, if it is never paid down (as has been the case to date) never stops growing. Oil production growth does. While the outlook at the present time may appear favorable due to the imminent opening of new production, there is no reason to believe that current growth rates in output can be maintained forever. If, in fact, oil production growth cannot be maintained forever, then the day will inevitably come when oil output must once again be dedicated in its entirety to service foreign debt, as would have been the case in a very few years if the new oil fields had not been discovered.

It is useful to emphasize that every single country which has enjoyed an oil windfall has suffered from these problems to some degree. Angola is in fact a more extreme case due to the higher degree of oil dependence as compared to other countries. Even Saudi Arabia, where oil discoveries were so huge relative to the economy and the population that it seemed that they were inexhaustible, is now facing the fact that oil production growth cannot remain higher than expenditure growth forever, and that even in this case, adjustments are needed at some point. The key is that it is clear that adjustments taken early are far less painful and have far greater potential to result in a greater level of welfare in general than would be the case if they are delayed.

One fortunate aspect of the political economy of reform is that there are very few adverse implications for poverty or other social dimensions. The benefits from the current situation are concentrated in a relatively few hands, so removal of them will not affect the vast majority of the population in the short term. In effect, they have little to lose and a reform of investment policy and/or mineral income flows will not make their situation any worse than it already is. In the long run, an adjustment/investment program has substantial potential to improve the situation of these segments of society, as they can take advantage of growth in such trade exposed sectors as agriculture.

A Way Out?

It is dangerous for any observer of the Angolan situation to pretend to have found a solution that can bring sustained peace with any certainty. However, the discussion presented here does suggest several possible elements of a long term solution.

1. First and foremost would be to recognize the fact of the regional split that is so obvious by allowing political power to mirror these realities. This would imply providing for strong provincial governments with substantial power over affairs within their borders. A federal system, with powers of defense and authority over inter-provincial and foreign trade (among others) reserved to the central government would help promote a feeling of ownership in the system on the part of the various factions involved while at the same time allowing each to express itself politically. This last point is particularly important, and is a strong reason to allow provincial governors to be elected locally rather than being appointed from Luanda since this would allow each faction to be ruled directly by members of their own group while maintaining the integrity of the nation as a whole.

2. Second, it is important to achieve an agreement regarding an appropriate formula for dividing the mineral revenue accruing to the government. Fighting over these riches has been at the root of much of the conflict, and a feeling of being cheated out of one's "rightful" entitlement is the single biggest potential spark for future conflicts. The outlines of one such potential formula seemed to be visible at one point in the past when it appeared that UNITA would largely control diamond income while the MPLA would control oil income. Lopsided though such an

arrangment would be, it would still allow each faction the wherewithal to make investments in its own area without requiring renegotiation at each new expenditure. Indeed, this or any other formula for dividing mineral rents would, if mutually agreed to, eliminate the biggest obstacles to a workable solution while at the same time promoting economic growth in a sustainable and viable manner. It might be argued that UNITA, having been militarily defeated to a large extent, has lost the leverage it once had to force such an agreement. However, as this paper has made clear, though UNITA may have been defeated militarily, the interests of its supporters and their importance in the Angolan population remain, and will provide the basis for their political strength in any form of future political system if it is based on democratic principles.

Table 1: Oil Dependence of Selected Developing Countries

Country	Oil Windfall as % of Non-Mining GDP
Algeria	27.1%
Angola	**49.0%**
Ecuador	16.8%
Indonesia	15.9%
Nigeria	22.8%
Trinidad & Tobago	38.9%
Venezuela	10.8%

Source: Alan Gelb et. al. *Oil Windfalls: Blessing or Curse?* Oxford University Press 1988 and Tony Hodges *Angola from Afro-Stalinism to Petro-Diamond Capitalism* Indiana University Press 2001 p 132.

Table 2. Economic Performance, 1995-2000

	1995	1996	1997	1998	1999	2000
Real GDP (Millions of 1995$US)	NA	9,192	9,918	10,531	10,862	11,092
Total Population (Millions-Mid Year Average)	NA	9.437	9.557	9.736	9.927	10.145
Real GDP Per Capita (1995$US Per Capita)	NA	974	1,038	1,082	1,094	1,093
External Debt	11,515	10,541	10,160	10,903	10,915	NA
Debt Service	463	832	841	1,118	981	NA
Exports*	3,852	5,406	5,308	3,666	5,467	NA
External Debt/Exports %	298.9%	195.0%	191.4%	297.4%	199.7%	NA
Debt Service/Exports %	12.0%	15.4%	15.8%	30.5%	17.9%	NA
Consumer Prices, Period Average: 1995=100	NA	4245.2	13550.1	25327.3	97807.0	415713.0
Annual % Growth	NA	9953.0%	219.2%	86.9%	286.2%	325.0%

*Includes Goods and Services

Source: Country Review 2001-2202, CountryWatch.com

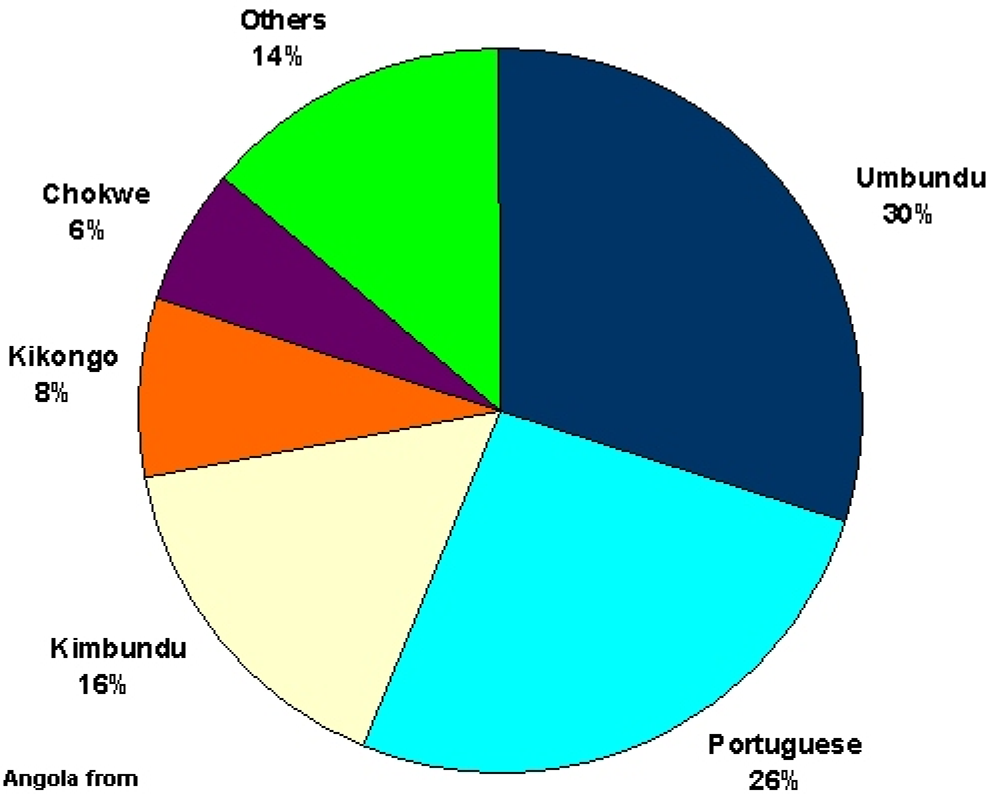
Table 3. Trade Balance, 1995-1999

($US Millions)

	1995	1996	1997	1998	1999
Exports	NA	4,473	4,157	3,542	3,930
1. United States	2,173	2,596	2,696	76	2,337
2. Belgium	NA	NA	255	317	482
3. China Mainland	124	222	549	140	323
4. Taiwan	85	272	72	287	280
5. Germany	232	140	28	60	95
Imports	NA	2,038	2,275	2,243	1,909
1. Portugal	379	437	508	451	324
2. United States	286	295	309	390	278
3. South Africa	149	380	209	215	208
4. France	422	168	130	129	162
5. United Kingdom	54	79	145	76	118
Trade Balance	NA	2,435	1,882	1,300	2,021

Source: Country Review 2001-2202, CountryWatch.com

Figure 1. Distribution of Languages, 1996
(% speaking as mother-tongue)



Source: Hodges, Tony, Angola from
Afro-Stalinism to Petro-Diamond Capitalism, 2001

NOTES

1.See Tony Hodges, *Angola from Afro-Stalinism to Petro-Diamond Capitalism* Indiana University Press 2001, and Assis Malaquias "Making War & Lots of Money: The Political Economy of Protracted Conflict in Angola" *Review of African Political Economy* Vol. 28 No. 90, December 2001, pp. 521-536. It is also true that oil and diamond income have themselves directly contributed to the war effort, often determining the extent and timing of military activity. See Jedrzej George Frynas and Geoffrey Wood, "Oil and War in Angola" *Review of African Political Economy* Vol. 28 No. 90, December 2001, pp. 587-606.

2. See Hodges, op. cit. p. 65.

3.See World Bank Development Indicators http://www.worldbank.org/cgi-bin/sendoff.cgi?page=/data/countrydata/aag

4. See the IMF document "Preliminary Conclusions of the IMF Mission, February 19, 2002", available at www.imf.org.

5. See David E. Bloom and Jeffrey D. Sachs, "Geography, Demography, and Economic Growth in Africa", *Brookings Papers on Economic Activity*, Vol. 1998, No. 2. (1998), pp. 207-273.

6.See J. Vansina "Long distance trade routes in Central Africa" *Journal of African History* 3:3 (1962) pp. 375-390.

7. See Birmingham, David *Trade and Empire in the Atlantic, 1400-1600* , Routledge, 2000, especially pp. 45-47.

8. See Birmingham, op. cit. p. 77.

9.See Birmingham, op. cit. pp. 80-88.

10. See Henderson, Lawrence, *Angola: Five Centuries of Conflict*, Cornell University Press, 1979. See also Boxer, C. *The Portuguese Seaborne Empire*, Knopf, 1969.

11. See, for example, Maurice Schiff and Alberto Valdes *The Political Economy of Agricultural Pricing Policy Vol. 4: A Synthesis of the Economics in Developing Countries* Johns Hopkins University Press 1992.

12. See Steven Kyle "Development of Angola's Agricultural Sector" <u>Agroalimentaria</u> No. 4, June 1997, pp. 89-104 for a discussion of the relative comparative advantages of coastal vs. interior areas. See also "Angola: Strategic Orientation for Agricultural Development - An Agenda for Discussion", World Bank, June 1994

13.For a discussion of structural transformation and the changes that this entails, see Chenery, H. Robinson, S and M. Syrquin *Industrialization and Growth - A Comparative Study*, Oxford University Press, 1986. Part I "Structural Transformation" pp11-118.

14.See R. Chilcote, *Portuguese Africa*, Prentice Hall 1967, p. 73.

15. Though it took the Portuguese more than forty years to conquer Ndongo, the most important of the Mbundu kingdoms, this was finally accomplished by 1621. The final destruction of these kingdoms was accomplished by 50 years later. See Birmingham, D, *The Portuguese Conquest of Angola*, Oxford University Press, 1965 pp. 24-42.

16. Hodges, op. cit. reports that almost half of today's children are brought up speaking Portuguese as their first language. (p. 26)

17. Zenos is quoted by Hodges op. cit. (p. 28) as documenting the ethnic bases of conflict in Luanda in 1992.

18. See Munslow, Barry, Angola : The Politics of Unsustainable Development, *Third World Quarterly* 1999 20(3) pp 551-68.

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