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## **Oil Revenue, Non-Oil Trade and Poverty Alleviation in Angola**

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## **ABSTRACT**

This paper presents a brief overview of Angola's international trade and the prospects for diversification on the export side as well as reactivation of traded goods production to replace the current near total reliance on imports for all consumer and producer goods. It is striking that trade policy per se is not the most important barrier to achieving these goals – rather, the most important are the poor state of infrastructure in the aftermath of the long civil war, the poor conditions for doing business, and the chronic problem of real exchange rate appreciation due to large inflows of oil and diamond receipts.

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## **Introduction**

It is perhaps common for economists when thinking of international trade in Sub Saharan Africa to jump to the conclusion that the typical country is insufficiently integrated into the world economy and therefore should try to promote a greater degree of involvement with the global marketplace. Such a preconception would be misplaced in the case of Angola – Coastal regions are virtually 100% integrated with the world economy and these areas dominate the aggregate statistics that are reported for economy wide performance. Nevertheless, there remain large parts of the interior which are virtually divorced not only from the world economy but from the larger national economy as well.

So, any effort to “further integrate” Angola into the world economy must come with very huge caveats. First, the issue isn’t so much one of increased integration as it is of trying to achieve a very different structure of integration. And it is also important to use a rather different typology in the Angolan case as compared to what is typically used in such analyses. Normally, one would speak of export sectors and import sectors. In the Angolan case it is more important to speak of the supply or production side and the demand side. This is because it may well be the case that Angola continues to be nearly 100 dependent on oil exports for the foreseeable future. But it may nevertheless make significant progress toward increased production of traded goods even though those goods may not be actually exported.

This is because Angola’s coastal regions are not only nearly 100% dependent on oil revenues on the production side; they are also virtually 100% dependent on imports to satisfy demand for almost every single consumer item needed from food to machinery. Though this has changed somewhat since the signing of the peace accord in 2006 it is still

the case that Luanda and other coastal areas depend far more on imports for goods than on domestic production. Indeed, one would not be far off base in viewing the coastal economy as an enclave isolated from its own hinterland but well connected to the rest of the world. Thus, the problem is not so much integrating Angola with the world economy so much as it reconnecting the coastal oil-fueled production/consumption enclave with the economy of the rest of the country.

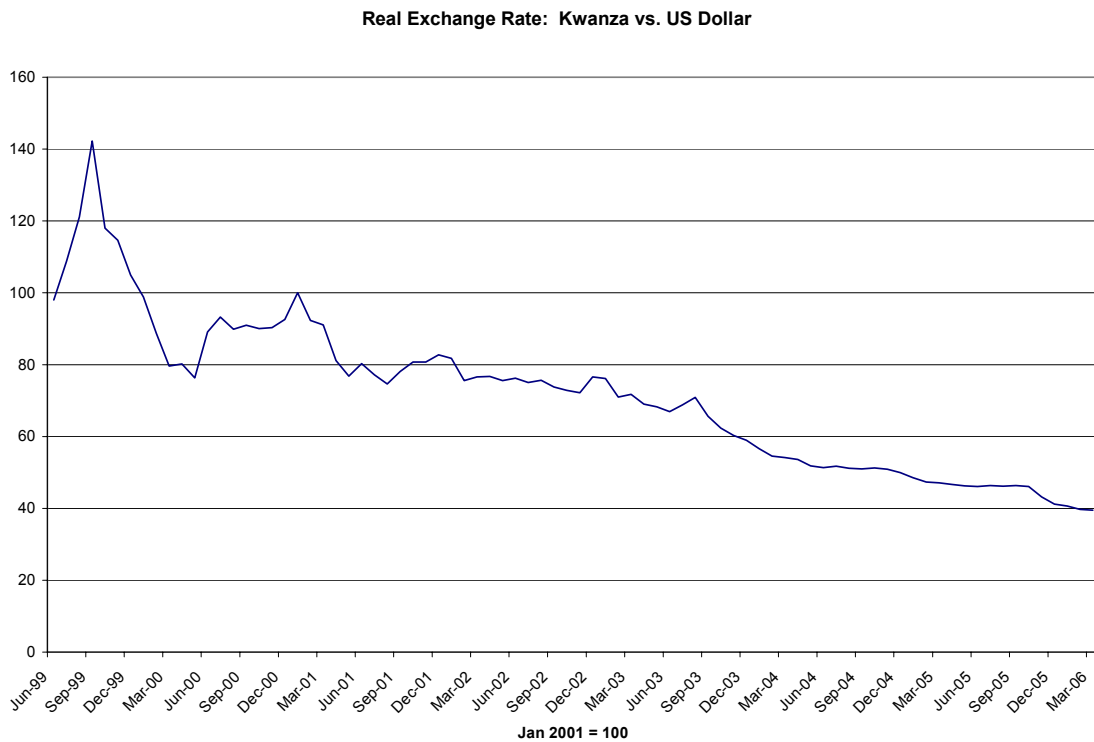
One could well ask why we should bother with even trying to do this. If oil is such a lucrative sector why not simply depend on it and let the non-oil sectors wither? There are two reasons not to pursue such a “Kuwaiti” strategy:

1. Oil revenue, though large and expected to grow substantially larger over the next few years, will not last indefinitely. In fact, even the most optimistic projections of production and prices predict a peak between 10 and 20 years from the present time. That means a child born today will spend his or her entire economically productive life in an economy where the oil sector is declining.
2. The benefits of oil revenue have been extremely concentrated in a very small part of the population. The vast majority of Angolans get none of the benefits and many are in fact harmed due to the adverse macroeconomic distortions caused by large inflows of oil (and diamond) money. Indeed, almost two thirds of Angolans rely either directly or indirectly for their livelihoods on agriculture, which is a sector that is very exposed to competition from imports made artificially cheap by oil revenue-induced appreciation of the country’s real exchange rate.

The extent to which the real exchange rate has appreciated is shown in Figure 1 below. It can be seen that the current level of the index shows that the profitability of domestic production of traded goods is in effect only about 40% of what it was in January of 2001. This is perhaps the biggest obstacle to the reactivation of trade exposed sectors in Angola. Every farmer wishing to produce maize for the coastal urban market has been effectively taxed over the past year by the real appreciation. To date, farmers in the

interior have been protected by virtue of their very isolation. In addition, casual evidence indicates that they are still competitive in the inland provinces even at current exchange rates, but this will change if inflation continues while the exchange rate remains stable. Manufacturing in coastal cities is already in a precarious situation given the lack of transportation barriers for import competition together with the still poor state of utilities and other services necessary for production.

Figure 1



This reactivation is the only feasible way to ensure that growth over the short to medium term is shared by the bottom half of the income distribution. This diversification should occur primarily in the agricultural and some light manufacturing sectors which were once a mainstay of the Angolan economy and which still retain the potential to replace imports in a cost effective manner. Given the competition from cheap imports there is a strong presumption that the most likely candidates for the near term are traded goods whose physical qualities (e.g. perishable, bulky goods such as fruit and vegetable

crops) make long distance transport from abroad expensive. The challenge to policy makers is to implement a set of interventions that can rehabilitate the physical and institutional infrastructure needed to achieve these goals.

## **II. Trade and Growth Performance**

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

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

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

Angola has a relatively open trade regime with a rating of 3 on the IMF's trade restrictiveness scale ranging from zero to 10, 10 being the most restrictive. The simple average of applied most favored nation (MFN) tariff is 17 percent<sup>2</sup>. The ad valorem tariff

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

<sup>2</sup> A new tariff regime was introduced in March 2005. The details of this regime were not available to us at the time of writing. Some of the expected changes are as follows: reduction of the maximum rate from 35 to 30 percent; increase in tariff rate for products that Angola has

comprises 6 bands: 2, 5, 15, 20, 25, and 35 percent. Tariff rates for agricultural and food products are 5 percent or less providing inadequate protection for these products. An additional fee of 2 percent is charged for all imports to cover clearing costs, raising the average MFN rate to 19 percent. A consumption tax that varies from 2 to 30 percent is also levied on both imported and domestically produced goods.

**Table 1: Trends in Merchandise Trade**

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

Source: IMF Direction of Trade, Comtrade

comparative advantage; reduction of tariff rates for raw materials, and intermediate and capital goods; and, elimination of tariff on exports.

**Table 2: Destination of Exports (percent)**

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

Source: IMF Direction of Trade

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



warehousing, export processing zones, etc.) but investment goods in the oil and mining sectors are exempted from import duties.

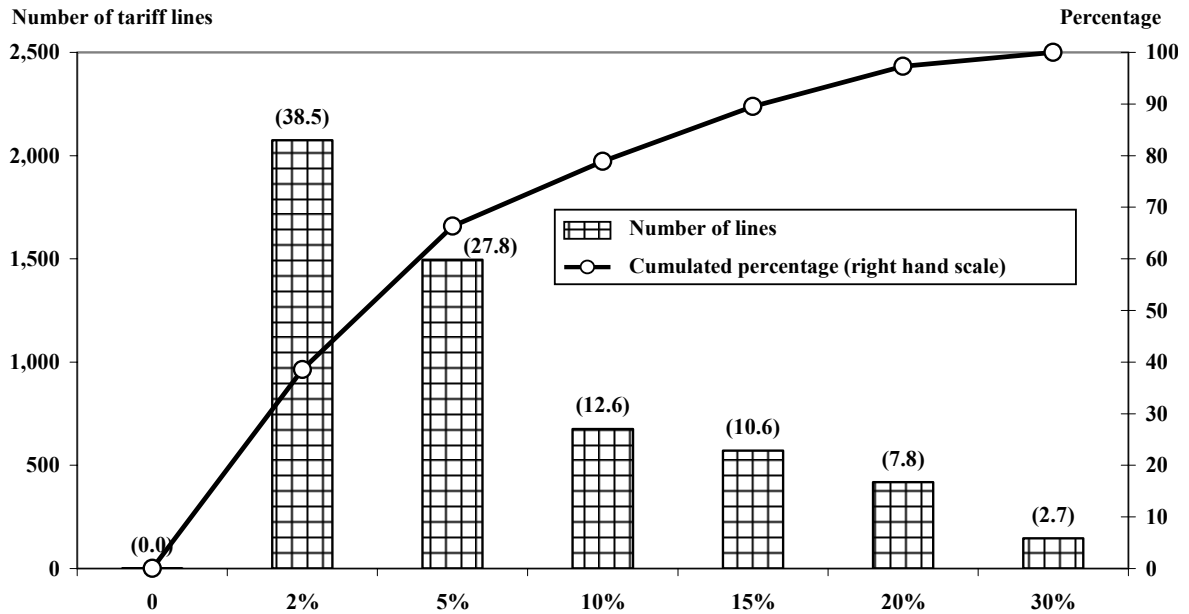
**Table 3: Sources of Imports (percent)**

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

Source: IMF Direction of Trade

Figure 2 shows the structure of Angola’s existing tariff schedule. It is clear that a large number of tariff lines are at what could be considered “nuisance” levels of 2% and 5%. Overall, very few items are taxed at the highest levels. This, together with the lack of quantitative restrictions noted above, indicates that trade policy is not a major impediment to Angola’s integration into the world economy.

Figure 2



Source: WTO

Growth in GDP over the past 10 years (See Table 4) has been anemic at best, and negative in many years. Only when oil prices and/or production rise does growth rise as well, reflecting the extreme oil dependence of the Angolan economy. This situation was in fact almost inevitable over the many years of conflict, when production in rural areas was virtually impossible and cities were cut off from both sources of supply and potential markets for manufactures. Now that hostilities have ended, growth in non-oil sectors has slowly started to rebound but oil remains dominant. Recent oil price increases to more than \$60 per barrel will provide additional growth if they are sustained.<sup>3</sup>

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

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

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

### **III. What To Do With the Oil Receipts?**

Clearly, Angola's exports will be dominated by oil and oil products (and diamonds to a lesser extent) over the next decade. However, current reserves and production trends indicate that there will be a peak in production at some point in the decade between 2010 and 2020. (See the World Bank's 2006 Country Economic Memorandum for Angola and supporting analytical work for details). This indicates that the most immediate task is the definition of an optimal policy for extraction of mineral wealth and for the disposition of the revenue generated from them.

Several recent examples of petroleum revenue funds designed to optimize the intertemporal profile of revenue generation and expenditure exist in the literature and have been discussed at some length in the 2006 Angola CEM as well as in various other publications such as various studies published under IMF auspices. (See for example, Menachem Katz, Ulrich Bartsch, Harinder Malothra and Milan Cuc "Lifting the Oil Curse – Improving Petroleum Revenue Management in Sub Saharan Africa, IMF 2004)

**Table 4 ANGOLA: Gross Domestic Product, 1997-2002 (annual rate of change)**

|                                   | 1997                         | 1998   | 1999   | 2000  | 2001  | 2002  |
|-----------------------------------|------------------------------|--------|--------|-------|-------|-------|
|                                   | <i>Annual Rate of Change</i> |        |        |       |       |       |
| Agriculture, Forestry and Fishing | 10.2                         | 5.2    | 1.3    | 9.3   | 18.0  | 12.1  |
| Mining                            | 6.5                          | 8.1    | 4.7    | 2.0   | 1.8   | 22.0  |
| Crude and Gas                     | 4.7                          | 3.5    | 1.0    | 0.4   | (1.0) | 25.0  |
| Other                             | 53.4                         | 90.2   | 39.5   | 13.3  | 19.5  | 6.6   |
| Manufacturing Industries          | 9.3                          | 4.9    | 7.1    | 8.9   | 9.8   | 10.1  |
| Electricity Industry              | 9.4                          | 14.5   | 1.3    | 0.8   | 10.0  | 10.0  |
| Construction                      | 13.0                         | 10.0   | 5.0    | 7.5   | 8.5   | 10.0  |
| Trade Services                    | 9.4                          | 5.0    | 4.4    | 3.4   | 6.0   | 11.6  |
| Non- Trade Services               | 5.5                          | 0.0    | (7.5)  | 1.5   | 1.0   | 2.5   |
| Impor customs duties              | 5.0                          | (30.0) | (10.0) | 0.0   | 2.5   | 5.0   |
| GDP at Market Prices              | 7.7                          | 5.5    | 2.7    | 3.6   | 5.2   | 15.5  |
|                                   | <i>Index (1992=100)</i>      |        |        |       |       |       |
| Agriculture, Forestry and Fishing | 89.2                         | 93.9   | 95.1   | 104.0 | 122.6 | 137.5 |
| Mining                            | 127.6                        | 137.9  | 144.4  | 147.2 | 149.9 | 182.9 |
| Crude and Gas                     | 129.4                        | 133.9  | 135.3  | 135.8 | 134.4 | 168.0 |
| Other                             | 102.4                        | 194.8  | 271.7  | 307.8 | 367.8 | 392.0 |
| Manufacturing Industries          | 103.0                        | 108.1  | 115.8  | 126.0 | 138.4 | 152.4 |
| Electricity Industry              | 116.6                        | 133.4  | 135.2  | 136.3 | 149.9 | 164.9 |
| Construction                      | 89.1                         | 98.1   | 103.0  | 110.7 | 120.1 | 132.1 |
| Trade Services                    | 101.9                        | 107.0  | 111.6  | 115.4 | 122.3 | 136.5 |
| Non- Trade Services               | 71.3                         | 71.3   | 66.0   | 67.0  | 67.6  | 69.3  |
| Import customs duties             | 53.9                         | 37.8   | 34.0   | 34.0  | 34.8  | 36.6  |
| GDP at Market Prices              | 102.2                        | 107.8  | 110.7  | 114.7 | 120.8 | 139.5 |

Source: Banco Nacional de Angola.

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

In the Angolan case there are several areas where there is potential for investment in efficient import substituting domestic production, given the virtual total collapse of many parts of the domestic economy during the recurrent periods of conflict after independence. Replacement of destroyed or degraded infrastructure is obviously high on the list, and is in fact already underway in many parts of the country. In sectoral terms it is apparent that Angola can produce far more of its food and fiber needs than was possible during the war years. Similarly, restoration of peace and basic infrastructure and utilities will enable the rehabilitation of light manufacturing in many areas where imports are currently dominant.

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

It will be argued by some that this protection is necessary for the country to avoid a future in which oil revenues start to decline while no other export sector is capable of generating needed revenue. History and economics both suggest that a far more desirable outcome would be the preservation of incentives via avoidance of adverse macroeconomic incentives rather than the institution of narrow protection through taxes on international trade.

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

#### **IV. Policy Recommendations**

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

Once production for the domestic market has been reactivated production for the regional or global market will be the next step. The emphasis on eventual export-led growth is essential in Angola because with more than two-thirds of the population living on less than \$1.70 a day<sup>4</sup>, Angola's domestic market is too small to support the sustained high growth in production and employment necessary to make a marked reduction in poverty. Therefore, export growth and diversification must be the focus for generating growth in Angola in the medium to longer-term.

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<sup>4</sup> Estrategia de Combate a Pobreza, page 2. Based on 2001 survey

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

As noted above, Angola's trade policy is not really a major barrier to implementation of this policy given the already relatively low tariffs and the lack of any quantitative restrictions. However, a comprehensive reform package is needed which would include limiting overvaluation of the exchange rate to the extent possible, rehabilitation of infrastructure, further stabilization of the macro economy, the strengthening of sector-specific policies, and improvement in the private sector enabling environment to encourage private investment in import-substitution and export-oriented sectors and a more effective supply-side response to trade policies. A competitive real exchange rate would be the single most important instrument to bring back the diversity of production and exports. While some real appreciation is inevitable given the size of oil flows, any steps that can be taken to ameliorate pressures in this direction will be helpful to the long term task of maintaining productive capacity in the non-oil sectors.

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