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Angola's incomplete transition

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Angola's Incomplete Transition

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Abstract

Angola's difficulties in achieving macro-economic stability and economic liberalization have serious implications for private-sector development. Hyperinflation, and frequent policy reversal, constrain and distort investment in both the informal and formal parts of the private sector. But macro-economic instability arises in part out of mechanisms that subsidize powerful oligopolies, enabling them to capture a portion of the large oil rents. These subsidies, together with market controls, enable the oligopolies to profit at the expense of small- and micro-enterprises, thereby hindering the creation of more employment for Angola's poor. Therefore the new private sector that is evolving in Angola owes its character to three factors: the course of the war; the country's natural resource windfall; and the way in which liberalization and privatization have been pursued.

Keywords: Sub-Saharan Africa, Angola, conflict, economic reform

JEL classification: O1O, O55

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1 Introduction

Angola has suffered conflict for over thirty years: a bloody struggle for independence was followed by recurring civil war. The contest for Angola's natural resource wealth is central to the conflict and to the seemingly impossible task of establishing peace (see Addison 2001b and Le Billon 1999). The war has devastated the country, shattered communities, and caused immense human suffering: community reconstruction is urgent (see Adauta et al. 2001). But in addition to achieving peace and reconstruction, Angola needs to complete its economic transition. Successive reform programmes have repeatedly broken down, and economic management has been chaotic. In part this reflects the strength of reform's opponents—many of whom personally benefit from market controls. However, it also reflects the macro-economic challenges involved in managing the country's vast and growing oil wealth.

Angola's difficulties in achieving macro-economic stability and economic liberalization have serious implications for private-sector development. Hyperinflation, and frequent policy reversal, constrain and distort investment in both the informal and formal parts of the private sector. But macro-economic instability arises in part out of mechanisms that subsidize powerful oligopolies, enabling them to capture a portion of the large oil rents. These subsidies, together with market controls, enable the oligopolies to profit at the expense of small- and micro-enterprises, thereby hindering the creation of more employment for Angola's poor. Therefore the new private sector that is evolving in Angola owes its character to three factors: the course of the war; the country's natural resource windfall; and the way in which liberalization and privatization have been pursued. This paper mainly focuses on the last of these forces, whereas Le Billon (1999) discusses the first two.

We begin, in section 2 with a brief overview of Angola's economy and the country's economic transition. The reasons for the repeated breakdown of reform programmes are highlighted. Section 3 discusses the roots of macro-economic disequilibrium, and their origin in the power of vested interests. We show how mechanisms involved in the distribution of the oil rents lead to a budget trap, which in turn creates high inflation and undermines economic transition. Section 3 also discusses the difficulties encountered in financial reform, including the creation of a private banking system. Section 4 discusses the implications for private-sector development, and the power of the oligopolies. Section 5 concludes by contrasting the interaction of economic reform and war in Angola and Mozambique. Therefore the paper forms a bridge between issues of private-sector development and issues of the state. The analysis shows that private-sector development in Angola is intimately related to the dynamics of the state itself, in particular the interests of powerful actors who straddle both the private sector and the government.

Before we begin our analysis, a word or two of caution is appropriate. First, information is scarce. Indeed, 'non-transparency' has been a feature of the state's operations and its relationship with private actors. Hence, any study of Angola must be an 'exercise in scepticism'—there is little that is entirely indisputable (Wheeler and Pélissier 1971).¹ Second, at the present time (September 2000) Angola remains at war. How that war

¹ Useful statistical sources for Angola include those of the National Institute of Statistics (INE 1996, 1997a and 1997b), as well as the IMF (1997, 1999) and UNDP (1997).

evolves—and whether peace can be achieved in the immediate future—will inevitably affect some of the conclusions of this analysis.

2 Angola's economy in transition

When the Portuguese withdrew from Angola in November 1975, they left a country rich in potential—colonial investment had focused on natural resources and agriculture—but poor in institutional structures and human capital.² For the MPLA, Marxism-Leninism appeared to provide the key to rapidly overcoming underdevelopment and the party officially adopted the ideology in 1976. The influence of Marxism-Leninism was further strengthened by the close political relationship that developed with the Eastern Bloc countries, a consequence of the decisive role of Soviet assistance and Cuban forces in defending the MPLA against UNITA and South Africa (MacQueen 1997). Therefore, the Soviet model of central planning inspired the new government to enforce wide-ranging price controls, to fix the exchange rate, and to nationalize large- and small-private enterprises together with land and the financial system (Aguilar and Zejan 1993). Moreover, Portuguese settlers—who abandoned their property in the mass exodus from the country—had owned most of the colonial private sector. Therefore nationalization was practically the only means for the new government to maintain economic activity and prevent an employment collapse (also the situation in Mozambique—see Castel-Branco et al. 2001).

The attempt to create a centrally planned economy was doomed by the state's lack of institutional capacity and skills together with the ongoing war with UNITA which increasingly disrupted agriculture and trade. Moreover, since prices were frozen at mid-1970s levels, extensive rationing evolved, leading to the growth of parallel market activity from which state functionaries derived considerable personal profit (by 1990 parallel-market prices were twenty to forty times higher than in the formal market). As inflation accelerated, so barter became increasingly important in economic activity. As the economy contracted, so the tax base declined, putting pressure on the fiscal deficit that was then monetized, thereby creating fresh inflation. A severe balance of payments deficit also resulted from the collapse of exports—the result of the real exchange rate's appreciation—which further intensified foreign exchange rationing, and the growth of rationing in goods markets (with associated rent-seeking). Although oil output increased with foreign investment, the decline in oil prices and the contraction of agriculture meant that by 1987 GDP was around half its 1974 level (Aguilar and Zejan 1993).

By the mid-1980s, the MPLA was actively debating the desirability of economic reform. Aside from the economy's decline, developments in the Soviet Union encouraged more internal debate (Webber 1992). In addition, elements within the party and the government believed that some aspects of reform (for example privatization) offered more scope for personal wealth accumulation. Accordingly, the MPLA's second party congress in 1987 decided to initiate economic transition. The *Programa de*

² Large-scale Portuguese immigration to Angola meant that settlers held most of the formal-sector jobs, including some of the most menial. In general Portugal's ex-colonies inherited weaker institutional structures and lower stocks of human capital than most other SSA countries (see Kovsted and Tarp 1999 on Guinea-Bissau as well).

Saneamento Económico e Financeiro (SEF) was launched in 1987, with major measures announced in 1989, but aside from preparations to join the IMF and the World Bank, reform did not progress—privatization stalled for example. Implementation was entrusted to a special secretariat but opposition within the party and the state bureaucracy quickly paralysed their efforts. Major reforms such as devaluation were shelved, and by the end of the 1980s the economy was still in dire shape (Aguilar and Zejan 1993). In particular, external debt (including that owed to the Soviet Union) had grown enormously.

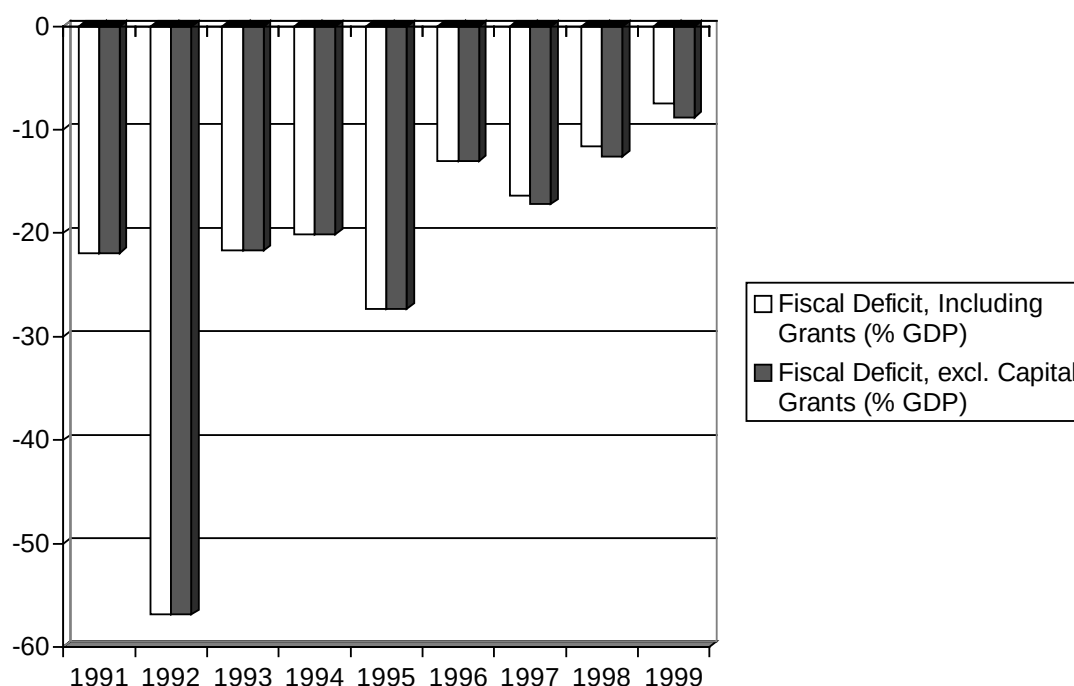
2.1 Economic reform in the 1990s

Marxism-Leninism was abandoned by the MPLA at its third party congress in 1990, and the 1991 constitutional revisions introduced a multi-party system. Political liberalization thereby set the scene for restarting economic transition. Prompted by a deteriorating financial situation, the government embarked on its most serious attempt to reform the economy. Under the *Programa de Acção do Governo* (PAG) the kwanza was devalued in 1991. This initially corrected the currency's overvaluation, but failure to reign in the fiscal deficit—which was above 20 per cent of GDP in 1991 and went above 50 per cent in 1992 (Figure 1)—and its monetization meant that inflation (which rose from 160 per cent in 1991 to 246 per cent in 1992) quickly eroded much of the gain in competitiveness resulting from the devaluation (Figure 2). After the 1991 Bicesse Accords (which resulted in the suspension of hostilities until late 1992), reform began again. Technocrats in the Ministry of Finance and the central bank, *Banco Nacional de Angola* (BNA), pushed for exchange-rate reform to replace the non-transparent administrative mechanisms for allocating foreign exchange. The first foreign exchange auction (a measure successfully used elsewhere in SSA to correct overvaluation) was held in 1993 (for details see Aguilar 1992, Aguilar and Stenman 1993, 1994).

Some prices were liberalized although administrative control was retained over the prices of utilities and petrol. Small shops were quickly set up to take advantage of this liberalization. However, the supply response was otherwise weakened by unresolved problems in ownership rights, including land ownership and the economy slumped (Figure 3). Limited privatization accompanied the partial price-liberalization, and a number of small- and medium-sized enterprises were transferred to private ownership in a non-transparent process that largely benefited people in the party and the government (see section 4).

A currency reform in which new notes were issued was also undertaken. In the ensuing confusion, many people were unable to convert their old money and the reform effectively destroyed much of the country's savings. The government made vague promises of future restitution, but these were worthless given an inflation rate that rose to 1,236 per cent in 1993). The government has never clearly explained why it implemented currency reform in this way. One explanation is that the government feared a sharp rise in inflation after the price liberalization. By confiscating cash balances and savings, the currency reform sharply reduced aggregate demand and thereby curbed inflation (although only temporarily given the failure to reduce the fiscal deficit and its monetization). Both the problem and its 'solution' are quite similar to events in the early years of the transition in the former Soviet Union (FSU).

Figure 1
Angola: fiscal deficit



Note: the 1999 data are estimates. Since Angola has not received large aid inflows, the fiscal balance before grants is generally equal to fiscal balance after grants.

Source: World Bank (2000c).

The resulting unrest and the resumption of war in late 1992 favoured reform's opponents—the auction system was abandoned and the currency was revalued—and the finance minister and central bank governor were sacked.³ After a period of policy drift and continued economic decline, technocrats temporarily gained the upper hand with a new set of reforms in the *Programa Económico e Social para 1994* (PES 94 succeeded by PES 95-96) (GOA 1994, 1995). The signing of the Lusaka Protocol in November 1994 and the end of the so-called 'third war' favoured reformers.⁴ The official exchange rate was devalued in stages (Table 1) resulting in a substantial narrowing of the gap between the official and parallel rates and in 1995 agreement was reached on an IMF 'shadow' programme (under which the Fund would monitor progress on key policy changes but without committing resources). This appeared to mark a significant policy shift (Aguilar and Stenman 1995). But the Achilles heel of Angolan economic management—control of the fiscal deficit—undermined reform yet again. Hyperinflation reached 5,421 per cent in 1996. Conservatives gained ascendancy in the new government and the resulting *Vida Nova* (New Life) programme of 1996 sharply

³ On the breakdown of the peace and the return to war see Brittan (1998), Le Billon (1999), and Tvedten (1997).

⁴ For further discussion of events and policy changes during this period see Aguilar (1995), Aguilar and Stenman (1993, 1994) da Rocha (1996), and McCormick (1994).

reversed the PES: the exchange rate was fixed, and many administrative controls were reintroduced (Aguilar and Stenman 1996).⁵

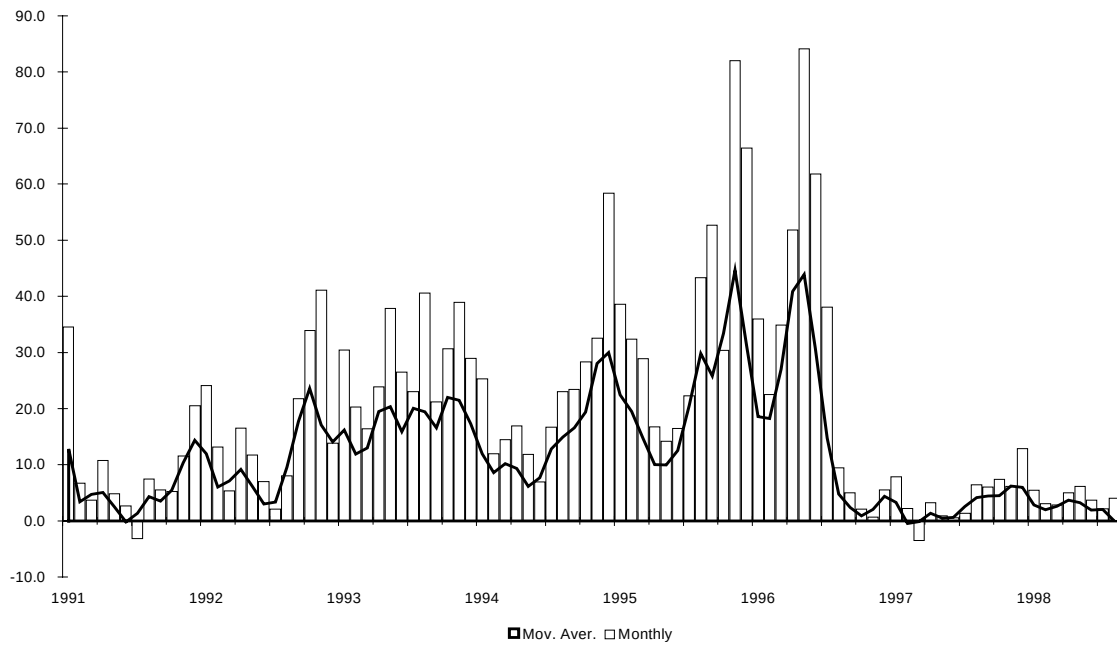
Not surprisingly, *Vida Nova* proved to be fruitless and liberalization restarted in early 1998 (under the *Programa de Estabilização e Recuperação Económica de Médio Prazo*). The currency was devalued in steps and negotiations with the IMF restarted. However, the collapse in the world price of oil over 1997-98 sharply reduced public revenues thereby undermining control of the fiscal deficit (see Figure 1) and the contraction in foreign exchange reserves left little scope for defending the fixed exchange rate or supporting a stepped devaluation. So, in May 1999 the currency floated. This took place against a background of increasing fighting, and the eventual return to all-out war.

In summary, early macro-reform was marked by incorrect policy-sequencing—devaluation but no supporting monetary and fiscal restraint—and botched currency reform with often chaotic policy shifts (in turn interacting with the war). The average Angolan therefore suffered the worst of both worlds: a large price shock but no compensating improvement in growth and employment. People lost confidence in the currency and in the nascent financial system, including the newly created central bank. Inflation fell towards the end of the 1990s but growth—with the exception of offshore oil—has remained low and constrained by the uncertain periods of peace and, eventually, the return of war.

Angola's experience with transition revealed a number of problems common to transitions elsewhere, including those in Eastern Europe and the former Soviet Union (EE-FSU) as well as Vietnam. First, there was no clear border between the state and the party. This resulted in erratic decision-making that made the task of implementing the plan—a very difficult job in the best of times—totally impossible. Therefore it became very difficult for technocrats to control the economy using their planning mechanisms while simultaneously introducing gradual liberalization. Second, it became clear that many institutions critical for the efficient operation of markets simply did not exist. The financial system was unable to offer even the minimal financial services necessary to a market economy (see section 3) and there were no mechanisms capable of regulating the liberalized economy in the public interest. The legal framework was totally inadequate and contract-enforcement was weak, a problem shared by many of Africa's transition economies. The country lacked the resources and skills necessary to set up the necessary institutions—a problem that remains to this day. Many of these difficulties parallel those found in the EE-FSU transitions, especially the lack of an appropriate institutional framework, which is a pre-condition for markets to operate efficiently (North 1997, Stiglitz 1998).

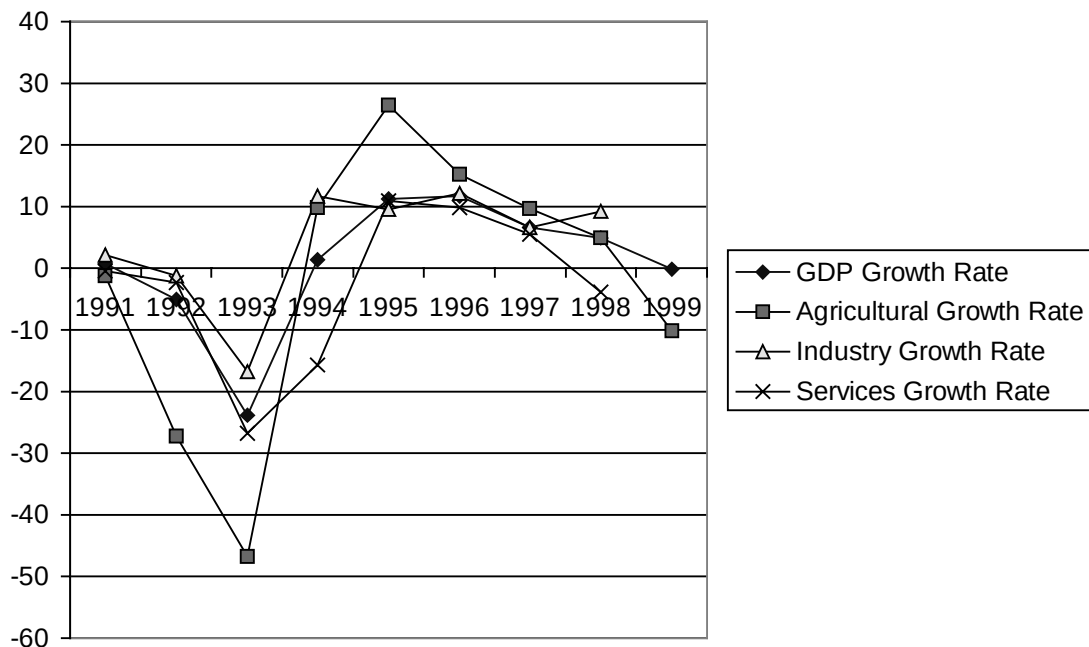
⁵ Relevant government documents covering this period include GOA (1997a, 1997b, 1997c and 1997d).

Figure 2
Angola: inflation (monthly percentage change)



Source: IMF (1999), World Bank (2000a), authors calculations.

Figure 3
Angola: growth rates of GDP, agriculture, industry and services



Note: the 1999 data are estimates.

Source: World Bank Africa (2000c).

Table 1
Angola: exchange rate trends

	1993	1994	1995	1996	1997 (estimate)
Official exchange rate (dollar terms, end of period)	6.5	509	5,692	201,994	262,376
Nominal effective exchange rate (annual percentage change)	624.3	913.0	3,729.7	2,238.1	618.6
Real effective exchange rate (annual percentage change, increase = appreciation)	65.5	-86.8	216.3	-51.1	100.00

Source: IMF (1999).

3 Macroeconomic disequilibrium and its causes

The Ministry of Planning, the Ministry of Finance, and BNA are formally in charge of designing and implementing economic policy. But all three are institutionally weak and, despite donor efforts in capacity building, short of professional staff capable of collecting data and formulating economic policy. The skill shortage is partly due to the collapse in real wages in the public-sector. Yet, although both Eritrea and Mozambique suffer from similar skill shortages, their governments are better at using the professional staff that is available (on Eritrea see Hansson 2001). In contrast, professional skills are not effectively used in the Angolan state, the division of responsibilities is unclear (and shifts frequently depending on the political situation), and co-operation within and between government agencies is poor. High levels of uncertainty together with corruption have undermined the creation and deployment of institutional capital, and Angola is very far from having a ‘development state’ of the kind defined by Addison (in 2001a).

Furthermore, many decisions are taken by a council of advisors at the presidency known informally as the *Homens de Futungo* (‘group at Futungo’) named after the site of the presidential palace, *Futungo das Belas*. This group reports directly to the president, bypassing the three institutions formally responsible for economic management, and often reversing their decisions. As a result, ministries are very cautious in making policy (thereby slowing the process even further) and the private sector has little confidence in measures that are not openly supported by the president and his advisors.

Angolan policy making can best be described as following a cycle of activity, passivity and crisis. Every year, often in March, the government presents a new programme, often initiated after some crisis sparks criticism by the president. Until 1993, these programmes were often rich in philosophical reflection but thin on concrete measures or data. The technical quality of the programmes improved with the PES—the result of donor capacity-building in the core ministries—but policy recommendations are most often vague or inconsistent. Eventually, after much delay, the programme is approved.

This is especially serious for the public investment programme run by the Ministry of Planning. A long list of projects is presented with little regard to their feasibility, finance or social value. Ministries put forward projects with almost no screening by the Ministry of Planning, and social cost-benefit analysis is not used. Political influence rather than economic rationality drives implementation. The group at Futungo frequently imposes decisions that contradict the programme's orientation. Of the few projects that are eventually executed, most have very low social returns and high-return projects—such as investment in basic social infrastructure—languish on the shelf (one reason for the collapse in social spending). The programme is usually abandoned by the middle of the year, and policy-making becomes paralysed. The year ends with a deep financial crisis and fresh criticism by the president. The cycle then restarts.

This cycle also affects relations with the IMF and the World Bank for, as discussed in section 2, the government and the IMF engage in periodic discussions, the former declaring its interest in co-operation, but policy changes frequently contradict Article IV Consultations, and relations with the Fund then cool. The group at Futungo has been openly opposed to an IMF deal. Although there are certainly legitimate concerns regarding IMF programmes—the results in SSA countries have often been meagre—opposition also arises because some aspects of reform would reduce the income of the country's elite. For example, the state elite often argues that the market, if left to itself, will import too many luxury goods such as cars, and too few basic goods such as food. In fact under the dual exchange-rate system, most luxury cars were imported with foreign currency obtained at the official exchange rate and food was most often imported using foreign currency obtained at the more expensive parallel market rate. Therefore, in contrast to Mozambique—where successive IMF programmes have been implemented—Angola has never received an IMF adjustment credit. Indeed, Angola is almost unique among transition countries (both in Africa and elsewhere) in its limited borrowing from the Fund (another shadow programme was announced in early 2000, but as yet there is no IMF lending programme).

Clearly the continuation of war limits private investment and broad-based growth. But the limited credibility of economic management further constrains private investment in sectors in which returns are long-term (manufacturing and agriculture especially) and for which the costs of policy-reversal to investors are therefore high. As a result, private investment remains distorted towards sectors in which returns are immediate (retail trade especially) and in which political interests provide some protection for investors (see Addison 1998, for further discussion of this point).

3.1 Oil rents

The oil sector became the main source of foreign-exchange earnings as agriculture and industry declined. Much of the oil is offshore and is therefore largely safe from war. The state-owned company, SONANGOL, which has the sole concession for oil exploration and production, dominates the oil industry. SONANGOL operates by means of joint ventures and production sharing agreements with foreign partners. Transnational oil companies such as *Chevron* and *Elf* constitute the largest private-sector operations in Angola; foreign investment in the oil sector is between US\$ 8 billion and US\$ 10 billion and Angola is now Africa's largest oil producer after Nigeria (Le Billon 1999).

Although the war played a large part in undermining the non-oil tradable sectors (agricultural output is probably less than 5 per cent of its pre-war level), the Dutch Disease effects associated with Angola's oil boom also played their part. The overvalued currency (discussed in section 2) shifted production incentives away from the tradable sectors—agriculture in particular—and in favour of non-tradable activities, including commerce. The oil sector took much of the economy's scarce skilled labour. The extensive system of price and import controls adopted after independence has further encouraged rent seeking (a non-tradable activity). Hence, the macro-economic effects of the oil windfall have added to the contractionary effects of the war, particularly on the agricultural sector. Agriculture's decline began to reverse in the mid 1990s as devaluation made domestic agriculture more competitive vis-à-vis imports, but the real value of output by the end of the decade was still only 64 per cent of its level at the start of the 1990s and will not recover until peace is established (see Table 2).

Understanding how the oil rents are distributed and their role in the budget is critical to understanding the macroeconomics of Angola and, indeed, Angolan society in general. In addition to corruption and straightforward grabbing, the rents are distributed in two main ways. The first mechanism is the system of budget subsidies to both private and state enterprises. These are intended to cheapen the cost to consumers of basic goods and public services (such as utilities) but, given the unavailability of basic goods in rural areas and the very limited coverage of public services, the non-poor capture most of the benefits. Moreover, senior civil servants receive direct benefits including petrol and housing allowances, car-purchase subsidies, and subsidized health care. The subsidy system is a major contributor to the large fiscal deficit, it does very little to address Angola's deep poverty problem and it perpetuates Angola's high-income inequality (Adauta et al. 2001 report a Gini coefficient of 0.62 for urban income inequality).

Second, the dual exchange-rate system, which existed until May 1999, overvalued the currency. Foreign exchange earnings (oil being the largest source) are distributed by the state in a non-transparent manner; until 1999 recipients received foreign exchange at the official (overvalued) rate which could then be sold at the parallel market rate—thereby profiting from the large spread between official and market rates. During the period 1992-98, the parallel-market exchange rate was on average 2.9 times higher than

Table 2
Angola: agricultural sector

	1991	1992	1993	1994	1995	1996	1997	1998	1999
Agricultural GDP growth rate	- 1.3	- 27.3	- 46.7	9.9	26.5	15.3	9.7	5.0	- 10.1
Food production index (1989 = 100)	102.9	107.6	105.0	121.0	123.7	134.0	132.7	n.a	n.a
Agricultural GDP in real terms (US\$ millions)	721	524	279	307	388	447	490	515	463
Agriculture as percentage of GDP	24.0	10.1	11.6	6.6	7.7	7.3	9.5	12.3	

Note: 1999 data are estimates.

Source: World Bank (2000c).

the official rate (Gelbard and Nagayasu 1999: 3). This explains why influential groups were able to block unification of the exchange rate system for such a long-time. Once again, this control did nothing for the poor and added to the country's already high-income inequality.

3.2 The budget trap

Currency overvaluation creates a budget trap. About 85 per cent of budget revenues are in foreign currency reflecting the importance of state revenues from oil. However, most recurrent expenditures, for example the government wage bill, are in local currency. Given the country's high inflation, the state's nominal expenditures need to grow at a rate sufficient to match the rising cost of the domestic goods and services bought by the public sector. Devaluation raises the domestic-currency value of export earnings, and therefore the kwanza value of their budgetary contribution. By keeping the kwanza overvalued—as a means of distributing the mineral rents to preferred groups—the government basically undermined its own solvency. One result was the collapse in real public-sector wages, and the accumulation of large arrears on salaries and other payments. In the absence of a domestic capital market, and given difficulties in accessing foreign capital markets, the fiscal deficit must be monetized—thereby sustaining high inflation (Aguilar and Stenman 1996).

With an inflation rate well in excess of the world average, the degree of overvaluation increases over time, thereby maintaining (and increasing) expectations of future inflation since agents assume (correctly) that devaluation is inevitable and a large import-price shock will occur. Some private enterprises—mainly of a speculative nature—thrive under hyperinflation. But generally hyperinflation is highly damaging to private investment, especially in the informal sector. In the absence of indexed financial instruments (such as those which cushioned the effects of hyperinflation in Latin America) and a severely repressed foreign exchange market, only a small group with privileged access to foreign exchange at the official rate can buy adequate inflation protection. The poor are therefore hit hard (Aguilar 1992).

In summary, the oil rents are distributed in a manner that perpetuates macro-economic instability. Domestic purchasing power is rapidly eroded by high inflation, but there are powerful interests in favour of the status quo and against reform. Hence, the issue of controlling the fiscal deficit remains unresolved. Additionally, war has imposed a heavy financial burden on the state, and has exacerbated a critical financial situation. Military expenditures are quite non-transparent in Angola and no reliable figures are available; large expenditures are made off-budget (see Addison and Ndikumana 2001). However, secondary information suggests that the annual direct cost of the war was at least US\$ 500 million over the last decade. Military spending has not only kept the fiscal deficit high, but it has also limited spending on key social and economic infrastructure (Adauta et al. 2001).

3.3 The financial sector

After the large shock caused by the currency changeover of 1990, the long process of reorganization of the financial system began. Today, the financial system consists of the *Banco Nacional de Angola* (BNA), with central bank functions, two state-owned banks, *Banco de Poupança e Crédito* (BPC) and *Banco de Comércio e Indústria* (BCI), the

state-owned *Caixa de Agricultura e Pescas* (CAP) plus three Portuguese private banks, *Banco de Fomento e Exterior*, *Banco Totta e Açores*, and *Banco Português do Atlântico*. This mix of private and public banks is in some ways similar to that found in Ethiopia (see Addison and Alemayehu Geda 2001). The pace of privatization has been much slower than in Mozambique where private banks have been created out of the old state banks (see Castel-Branco et al. 2001).

Difficulties and delays in closing its commercial bank activities have hampered BNA's focus on its new central bank functions. Moreover, BNA has little (if any) independence from the government. At times, BNA's governor has held the rank of minister and has therefore succumbed to pressure to monetize the fiscal deficit (see section 3). The BNA takes many of its decisions directly from the president, bypassing the Ministry of Finance to which it is formally subordinate. The complicated and non-transparent relationship between BNA, the Ministry of Finance, and SONANGOL has been repeatedly raised in discussions with the BWIs. The last few years have seen some improvement in BNA's technical capacity to focus itself on its central bank functions, but its ability to regulate the financial sector in the public interest is still open to question.

The state-owned banks are weak with large portfolios of bad loans and their activities are subject to minimal regulation. They are slated for eventual privatization but considerable reorganization and re-capitalization will be necessary. CAP has severe problems. It provides soft-credits to the private sector (sometimes using donor funds) and has a very large portfolio of bad loans. CAP was to be wound-up, but periodically the government resuscitates it with further funding, another controversial issue in the government's dialogue with the BWIs. A further shake-up of the CAP was announced in mid-1999, but it remains to be seen how effective this is.

The legal framework within which to enforce financial obligations is weak and most transactions are conducted in cash (a large number of scandals, many involving the state, constrain the use of cheques) and there are periodic liquidity crises when bank notes become scarce. Limited confidence in the financial system reveals itself in low levels of bank activity and deposit-savings (the hundred-dollar note remains the most common instrument for savings). Banks derive most of their profits from international trade and foreign exchange operations. The capital market is virtually non-existent. The informal sector has almost no access to formal financial instruments and the lack of formal credit and savings instruments hinders informal sector investment.

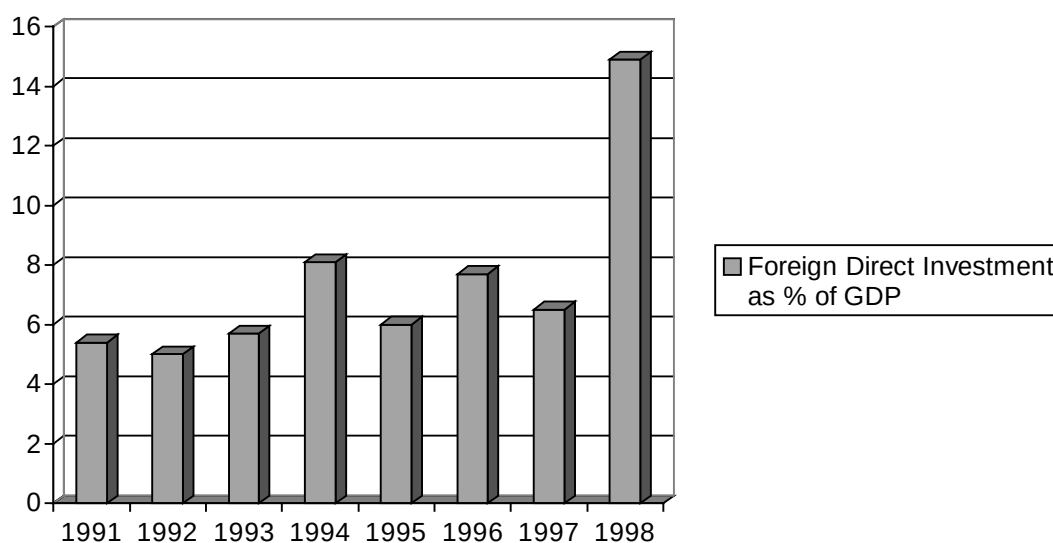
4 Characteristics of the new private sector

By 1990, the formal private sector was exceedingly small, mostly reduced to a few survivors from colonial times and a few foreign entrepreneurs. But this began to change with the start of reform. Two factors were especially important. First, private investment increased after the Bicesse peace agreement and partial demobilization. Former soldiers entered business using military equipment (such as vehicles), with their demobilization benefits providing the financial capital. This use of capital acquired during war to finance 'post-war' private investment was also the case in Mozambique (Castel-Branco et al. 2001 and Wuyts 2001).

Second, privatization laws were enacted, and small- and medium-sized enterprises (which were reserved for domestic investors) were privatized. Estimates of how much privatization yielded for the treasury in the 1990s vary from US\$ 6.2 million (World Bank 2000a) to US\$ 25 million (World Bank 2000b) to US\$ 80 million. The privatization process was non-transparent and a reliable figure is not available. A task force, *Gabinete de Redimensionamiento Empresarial* (GARE), was set up with donor support in order to prepare the privatization of large enterprises. A list of 100 large enterprises slated for privatization or reorganization under continuing state ownership was prepared in 1994 for implementation over 1995-96, but little has been accomplished. The privatization process was dubious in many respects. Therefore, ‘insiders’—those with links to the party, the government and the army—acquired enterprises very cheaply. As in Mozambique, little attention was paid to the interests of communities who cultivated abandoned state farms when these were privatized (see Castel-Branco et al. 2001). The process resembled that in the FSU in the way the old state elite used privatization to acquire wealth. Privatization sometimes amounted to simple akin to the ‘wild’ privatizations seen in transition countries elsewhere (Addison 2001a). As in the EE-FSU, privatization benefiting insiders is unlikely to yield efficiency gains, and it is certainly not good for equity (see Stiglitz 1998).

Despite the adverse investment environment (including high communication and transport costs) there has been substantial foreign investment, particularly in the oil sector—see Figure 4 (and Le Billon 1999). Projects worth US\$ 800 million were approved over 1990-97; more than half are small projects with an investment level below US\$ 1 million. About 75 per cent of the investment originates in Europe, mainly Portugal. Foreign investors include West Africans (principally Nigerians) and investment from South Africa is growing fast. Many investors keep offices open in Luanda, and foreign investment can be expected to accelerate if peace can be achieved—as it has done in Mozambique.

Figure 4
Angola: foreign direct investment as a percentage of GDP



Source: World Bank (2000c).

4.1 The few trusted enterprises

The development of Angola's private sector is constrained by a number of factors: skilled labour is scarce, infrastructure and services are deficient, and formal financial services are practically non-existent. But in addition, both production and distribution are characterized by monopoly and oligopoly, the result of preferential business licensing, biases in the award of large import contracts by the state, and privileged access to foreign exchange at the official exchange rate.⁶ For example, in the retail trade, one or two large firms typically dominate the import of goods and their wholesale distribution. A fringe of smaller traders—who compete vigorously among themselves—depend on these large oligopolies for their supplies.

The oligopolies are known as the *Empresarios de confiança* ('the few trusted enterprises'). They are dominated by a few extended families with roots in the colonial administration, the independence struggle, and the public service during the socialist period. They have close connections with the government and the party, and benefit from their ability to mobilize foreign commercial and political contacts; often the extended families owning these enterprises have members living permanently in Portugal or holding dual citizenship. This group's influence is such that even a change of government would probably cause only a minor alteration in its composition. They have a strong lobby, known as AIA (*Associação Industrial de Angola*), which favours protectionism and is generally hostile to reform.

The oligopolies emerged partly as a result of the state's intention to hold 'strategic reserves' of basic goods in order to maintain adequate supplies, especially in the provinces (an objective that was never in fact met). Import of such goods on behalf of the Ministry of Commerce and the local governments was handed over to the *Empresarios de confiança* on the grounds that other private-sector participants were excessively orientated to speculation and this would achieve an equitable distribution of the goods without 'speculative' profits. They are also prominent in trade with the oil sector, especially through SONANGOL.

The informal private sector grew rapidly in the 1990s to account for the largest share of the workforce; the contraction of agriculture, massive internal migration, the demobilization of the army, and post-1990 liberalization all contributed to its expansion. The informal sector is presently a survival strategy for many but it could be a major source of employment growth, including livelihoods for demobilized soldiers, if peace can be secured. However, informal entrepreneurs are constrained by the activities of the *Empresarios de confiança*. The latter dominate the wholesale market and can dictate prices to informal retailers, therefore keeping their profits low and limiting informal-sector growth. Moreover, informal entrepreneurs have little access to financial services and they operate in an uncertain legal environment; government tends to see street vendors as a social menace and they are often the targets of police action. In addition, the uncertain macro-economic environment negatively affects the informal sector.

⁶ In recent years it has been possible to import using 'non-budgeted resources', a euphemism which denotes foreign currency bought in the open market, the supply of which includes foreign currency that has leaked from oil-export earnings and, most probably, from UNITA's illegal diamond operations.

Transaction costs are high given the weak—and sometimes non-existent capacity—of the state to enforce contracts. Hence, the Portuguese and African traditions of the extended family are very important for business success in this environment. These networks provide information flows as well as mechanisms of contract enforcement and an internal capital market—thereby partially overcoming the weakness of the legal, regulatory, and financial frameworks. Although these informal networks have enabled entrepreneurs to take advantage of the economy’s gradual liberalization, private sector development—particularly among small and medium-size enterprises—would accelerate if the state started to invest in supporting institutions. Therefore, as in the FSU itself, the development of appropriate institutional frameworks is urgently needed. However, at present the *Empresarios de confiança* are closely connected to state actors (again a parallel with Eastern Europe and the FSU) enabling them to bypass institutional impediments that block the development of the rest of the private sector. Hence, they have little interest in pressing for institutional reforms that would facilitate the entry of potential competitors.

5 Conclusions

War has certainly damaged the development of Angola’s private sector by disrupting markets, changing the allocation of resources in arbitrary ways, and creating high levels of uncertainty. Peace, if it can ever be secured, would provide many profitable opportunities for domestic and foreign investment, both of which have surged in Mozambique. The oil sector, which is today only weakly linked to the rest of the economy, could develop many more profitable backward and forward linkages thereby creating the employment growth that Angolans desperately need.

But war is not the only factor hindering (and distorting) private-sector development. Macro-economic instability—in particular the persistence of high inflation—has also undermined the growth of private investment, especially in the production sectors which are most likely to generate employment growth. High inflation is in part due to the war, but it also reflects the hesitant character of Angola’s economic transition from state socialism. In particular, the design and implementation of macro-economic policy has been haphazard, reflecting severe institutional weakness and opposition by powerful vested interests. Reform’s opponents have used the war as an excuse to delay much-needed policy change. Angola’s experience therefore stands in strong contrast to that of Mozambique, which began extensive reforms during the war itself. Although there are legitimate disagreements about the design and implementation of reform—the sequencing of reforms in the financial-sector in particular—the economy will not deliver poverty-reducing growth until economic transition is achieved and unless it is accompanied by large-scale investment in the capabilities of Angola’s poor.

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