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## **The Angolan Economy – Diversification and Growth**

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## **ABSTRACT**

The high degree of oil dependency in Angola and the stop/go pattern of economic growth that results from fluctuation in oil prices has led to increased desire for diversification of the economy's export structure and productive base. The most obvious candidate for diversification is agriculture, with large areas capable of supporting rainfed production of a wide variety of crops. However, the real exchange rate distortions caused by large inflows of oil and diamond income make it difficult to promote agricultural development. Imported substitutes for local production are cheap due to exchange rate appreciation, depressing the rate of return on investment in these sectors.

# The Angolan Economy – Diversification and Growth<sup>1</sup>

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Even a decade after the end of the civil war, Angola remains very much in the shadow of the destruction caused by the long conflict as well as the extreme dependence on oil revenues (and diamonds to some extent) that grew during those years. The vast majority of exports and government revenue are funded from oil and diamond receipts and these, together with the economic distortions caused by the huge size of the foreign exchange flows, continue to be the dominant features of the economy. As can be seen in Table 1 oil accounts for about half of the total GDP – a bit more when oil prices are high and a bit less when they are low. Figure 1 shows the high volatility in oil prices over the past decade, accounting both for the stop/go nature of Angolan growth and the strong desire to generate more diverse income streams in order to move away from the volatility.

There are three main questions related to diversification and growth – First, are there viable opportunities for diversification? Second, does the government have the means and the will to promote broader based growth? Third, regardless of opportunities and means, how much success can be expected given Angola’s economic situation and the context of the world economy?

The first question can be answered with an unambiguous “yes”. Angola has an excellent resource base for agriculture, particularly in the Planalto Central and in some of the more humid lowland areas in the North where rainfed agriculture has long been practiced. Suffering from destruction of infrastructure that bordered on near total elimination of roads and bridges not to mention warehouses and other structures, production ground to a halt in many areas. Reactivation of production is eminently possible, indeed is well under way, but is still hampered by lack of adequate transport and communications between productive areas and major demand centers in the cities. Equally important is the near total decapitalization of farmers themselves, millions of whom fled to refugee camps during the war years, losing all of their livestock, implements and homes. Indeed, there are even now large numbers of “rural” young people who did not in fact grow up on farms and are still in the process of learning how to farm. Human capital accumulation takes time; Physical capital can be replaced more readily but is constrained by primitive credit institutions and the relatively slow natural rate of increase of large animals used for traction.

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<sup>1</sup> An earlier version of this paper was presented to the State Department’s National Intelligence Council on January 17, 2012.

An additional benefit of agricultural investment and diversification is the clear poverty alleviation effects that derive from it. Most of the poorest segments of the Angolan population are rural – Increases in output of staple grains and other products can do more to increase their incomes than anything else. Further downstream, supply increases to urban centers will help to keep food prices down for urban poor.

In addition to a strategy of investing in rural smallholders, there are numerous opportunities for commercial farm development both in the interior and on the coast. With major demand centers in Luanda, Benguela and other coastal cities, production of fruits, vegetables, dairy and poultry can be viable in peri-urban areas. Unlike smallholder agriculture, these can grow more quickly given the existence of adequate infrastructure, markets and manpower, and the lesser need for external financing in ventures that can generate profit in the near term.

Another candidate for diversification is the development of manufacturing and processing in Luanda and other cities. The most obvious early developers are those industries using the raw materials produced locally – i.e. processing food and other agricultural products produced domestically. Import competition is a major constraint to these industries and is likely to remain so for the foreseeable future (see discussion of real exchange rates below) but there are nevertheless opportunities in various areas, particularly those feeding into the construction sector which is booming as the government continues to fund massive infrastructure rehabilitation.

This leads to the second question – the will and the means to diversify on the part of the government. Here it is obvious that the government is determined to rebuild the country as quickly as possible and it has the means to do so in its large stream of oil revenues and its newly restored ability to borrow on international markets. There are, however some major potential pitfalls in this as local absorptive capacity cannot easily deal with the volume of investments contemplated, and a reliance on borrowing to supplement oil revenues (large parts of which are pre-committed to repay previous borrowings) can lead to future debt problems.

That there is a will to rebuild is very clear from even the briefest visit to Angola. New buildings are rising all over Luanda while road reconstruction continues on primary and secondary roads throughout the country. The most important development with a potential for diversifying exports is the reopening of the Benguela Railroad in August of 2011, linking the major interior city of Huambo with the coastal cities and ports of Benguela and Lobito. There is now a reliable link between world markets and the most productive areas and also between those areas and the coastal cities. Too new for its full effects to be felt yet, the rehabilitation of the railway is scheduled to be extended to the eastern border by the end of 2012, where it can provide an export route for Zambia's copper belt and the mines in Katanga in southern Congo. Receipts for transport services accordingly can be expected to grow substantially in the next few years. This and earlier rehabilitation has been financed and implemented by China.

However, to date the government has seen agricultural development less as something based on smallholders but rather as something more based on mechanization and commercial ventures. This is not to say that smallholders have been entirely neglected but the emphasis in expenditure and investment is less on the mass of small farmers than it is on larger projects, both in terms of farm units and infrastructure. This means that this potential source of diversification is not one that is being pursued to the extent that it could be.

The volatility of oil revenue has led to a stop/go pattern not only in Angolan GDP growth but also in a more exaggerated pattern in government revenue and therefore in infrastructure funding. This has negative implications not only for progress in rebuilding the country but also in terms of employment and growth. Access to world capital markets can smooth this out somewhat but it is likely to remain a feature of the Angolan economy for some time to come.

Finally, there is the third question of the overall economic context for diversification both inside and outside of the country. Some previous export products will encounter markets that are much changed from colonial times. Coffee in particular, where Angola was a major player in the international market in the 1970's, now has substantially greater competition, decreased relative demand for Angola's *robusta* varieties, and has lost its earlier forced labor force. While some rehabilitation is certainly possible, a return to earlier market shares seems unlikely. Fishing is another area where rehabilitation is possible, but where needed capital investments are huge and where the resource itself is less abundant than it once was. However, prices for such staples as maize are well above historical trends and Angola is well endowed to take advantage of this. Primarily a small holder crop, maize is perhaps the single most important determinant of welfare in the central regions of the country where it is the staple grain.

Perhaps the most important caveat in this entire discussion is the distortion of the real exchange rate caused by the large inflows of foreign exchange. The appreciation of the real exchange rate of about 70% since the end of 2001 indicates the potential of this problem to dampen incentives for reactivation of agricultural production.

The standard economic advice to countries with real exchange rate problems is to allow the nominal exchange rate to depreciate in line with domestic inflation. In Angola the government has been reluctant to do this because the high import content of urban consumption means that depreciation is almost immediately reflected in domestic prices and inflation. Figure 2 shows that domestic inflation, while relatively contained in the past few years, is nevertheless well above that of major trading partners (EU and US). The nominal exchange rate has been kept relatively stable for long periods of time (Figure 3) with the consequence that the real exchange rate has appreciated continuously throughout the past decade. (Figure 4)

Given the likelihood of some significant currency appreciation regardless of government

attempts to maintain a flexible policy, the economics of the resource curse also suggest that it is essential to invest in those non-mineral sectors in which the country has a (perhaps latent) comparative advantage. In the Angolan case, the obvious candidate is agriculture. Accordingly, as Angola seeks to reestablish the ability of domestic producers to supply national food needs and to export surpluses, it will be necessary to ensure that adverse exchange rate movements do not undermine the competitiveness of the newly reactivated agricultural sector.

The newly reopened transport routes (road and rail) are of course part of an overall strategy to reduce costs for potential exporters. However, it must be noted that these transport routes can just as easily be used to move imported foodstuffs and manufactures to the interior as they can to move potential export products to the coast. The experience of Nigeria during its episode of massive overvaluation demonstrates that it is possible to generate a situation where imported staple grains can be sold in farm areas themselves for a lower price than farmers can produce them. This gives special importance to efforts to invest in areas capable of lowering costs at the farm level, such as improved varieties, recapitalization, and input supply systems.

In summary, the key to Angolan diversification is investment. The pattern and scope of government efforts to rebuild public capital will strongly condition the way in which private capital is itself allocated across the economy. All of this will occur in an atmosphere inevitably influenced by the huge flows of mineral income. The basic problem is that these flows generate economic distortions which depress the profit margins in exactly the sectors where export diversification is potentially viable given underlying comparative advantage. The unfortunate fact is that these inflows of mineral revenue are at the same time the biggest potential stimulus to diversification and growth as well as the cause of the economic distortions which are the biggest potential obstacles. Managing the balance between these two opposing forces is the most difficult task facing the government.



**TABLE 1 - Angolan GDP (Current Prices)**

<b>GDP at Current Prices (Billions of Kwanzas)</b>	<b>PERIOD</b>				
	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Agriculture	247.1	351.8	405.6	596.5	729.0
Fish and Derivatives	10.3	12.6	13.9	14.5	16.9
Oil	1,876.8	2,537.2	3,569.4	2,661.6	3,395.9
Diamonds and Other Extractive Industries	78.6	80.4	66.1	53.7	71.1
Manufacturing	162.8	241.2	303.1	363.8	464.2
Energy	3.1	3.8	5.4	7.4	9.5
Construction	146.3	224.1	318.6	449.6	601.6
Mercantile Services	564.7	768.8	1,104.1	1,240.4	1,555.1
Others	279.1	326.0	375.9	454.0	548.2
<b>GDP at Factor Cost</b>	<b>3,368.9</b>	<b>4,545.9</b>	<b>6,162.1</b>	<b>5,841.5</b>	<b>7,391.8</b>
<b>GDP at Market Prices</b>	<b>3,358.5</b>	<b>4,636.8</b>	<b>6,316.2</b>	<b>5,988.7</b>	<b>7,579.5</b>

Source: *MINIPLAN*

**TABLE 2 – Angola GDP (Structure)**

<b>GDP – Sector Shares in Percent</b>	<b>PERIOD</b>				
	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Agriculture	7.3	7.7	6.6	10.2	9.9
Fish and Derivatives	0.3	0.3	0.2	0.2	0.2
Oil	55.7	55.8	57.9	45.6	45.9
Diamonds and Other Extractive Industries	2.3	1.8	1.1	0.9	1.0
Manufacturing	4.8	5.3	4.9	6.2	6.3
Energy	0.1	0.1	0.1	0.1	0.1
Construction	4.3	4.9	5.2	7.7	8.1
Mercantile Services	16.8	16.9	17.9	21.2	21.0
Others	8.3	7.2	6.1	7.8	7.4
<b>GDP at Factor Cost</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

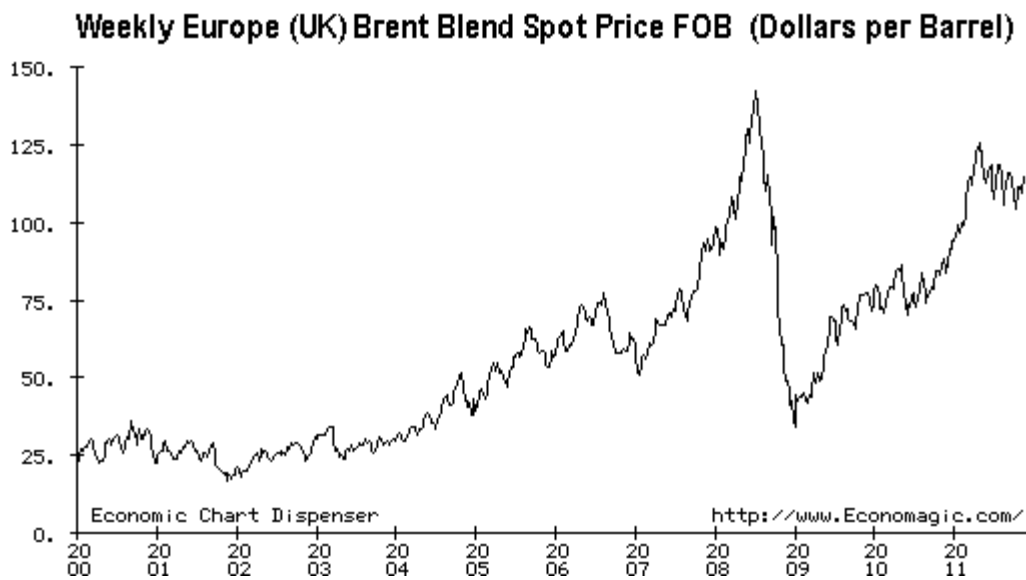
Source: *MINIPLAN*

**TABLE 3 – Angolan GDP (Growth Rates)**

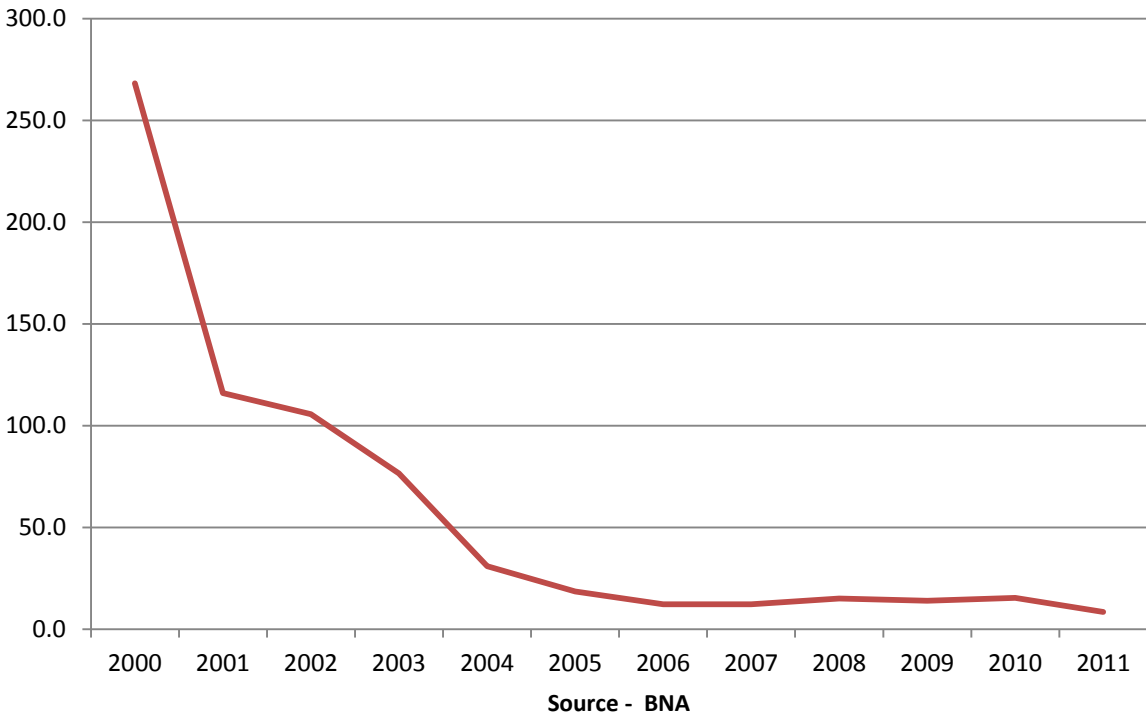
Real Growth Rate of GDP	PERIOD				
	2006	2007	2008	2009	2010
Agriculture	9.8	27.4	1.9	29.0	6.0
Fish and Derivatives	9.1	9.7	-2.4	-8.7	1.3
Oil	13.1	20.4	12.3	-5.1	-3.0
Diamonds and Other Extractive Industries	30.9	2.7	-8.2	4.6	-10.3
Manufacturing	44.7	32.6	11.0	5.3	10.7
Energy	13.2	8.6	26.1	21.3	10.9
Construction	30.0	37.1	25.6	23.8	16.1
Mercantile Services	13.2	8.6	26.1	21.3	10.9
Others	38.1	21.8	26.9	-1.5	8.7
<b>GDP at Market Prices</b>	<b>18.6</b>	<b>23.2</b>	<b>13.8</b>	<b>2.4</b>	<b>3.4</b>
<b>Non-Oil GDP (%)</b>	<b>25.9</b>	<b>25.4</b>	<b>15.0</b>	<b>8.3</b>	<b>7.8</b>
<b>Oil GDP (%)</b>	<b>13.1</b>	<b>20.4</b>	<b>12.3</b>	<b>-5.1</b>	<b>-3.0</b>

Source: *MINIPLAN*

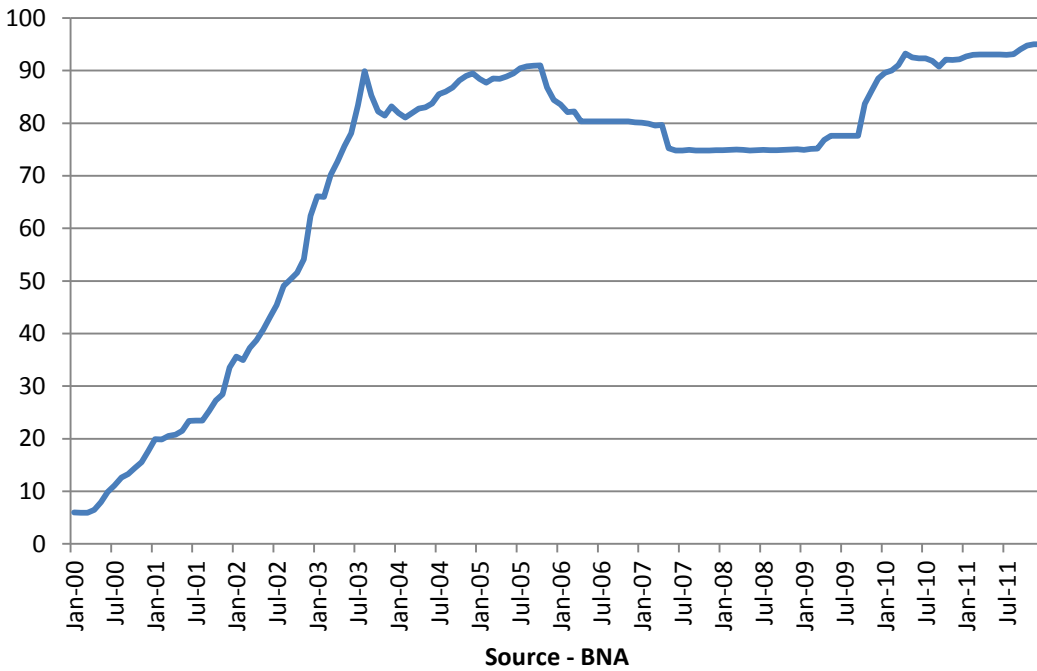
**Figure 1**



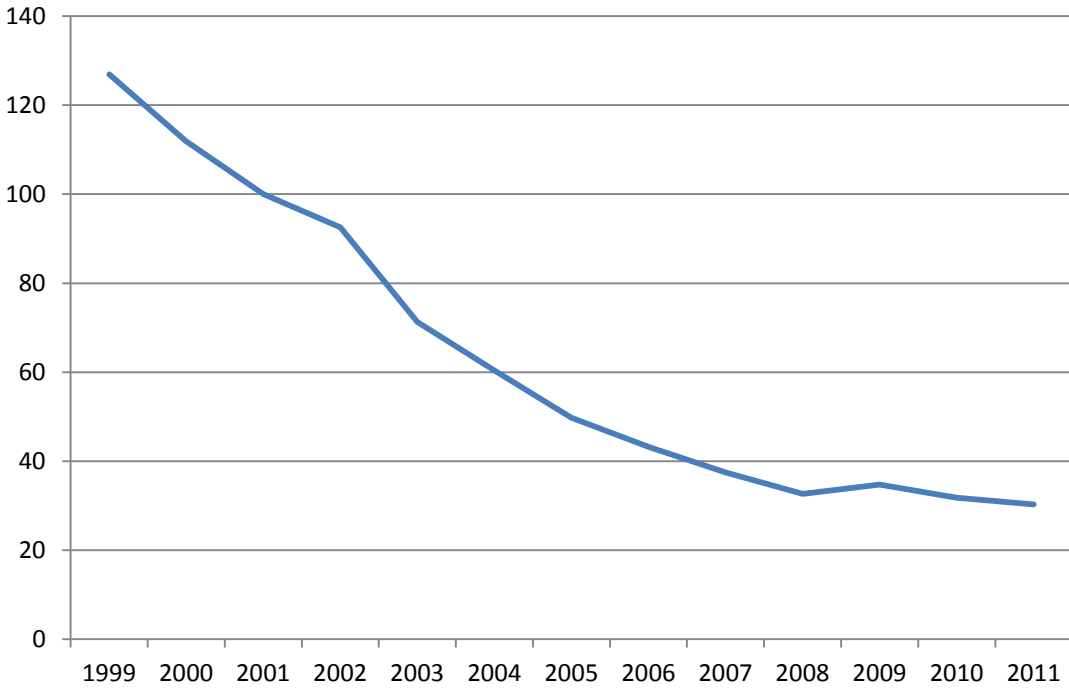
**Figure 2**  
**Angola - Inflation 2000-2011**



**Figure 3 - Exchange Rate - Kwanza/ US\$**



**Figure 4 - Real Exchange Rate 1999-2011 - Kwanza vs. \$ US**  
Dec. 2001 = 100



Source - BNA

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