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Angola: Causes and Implications of Economic Decline

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An Intelligence Assessment

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Angola: Causes and Implications of Economic Decline [redacted]

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An Intelligence Assessment

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This paper was prepared by [redacted] Office of African and Latin American Analysis, with contributions by [redacted] Office of Central Reference, and [redacted] Office of Soviet Analysis. It was coordinated with the Directorate for Operations. [redacted]

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Comments and queries are welcome and may be directed to the Chief, Africa Division, ALA, on [redacted]

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Angola: Causes and Implications of Economic Decline [redacted] 25X1

Key Judgments

Information available as of 25 November 1983 was used in this report.

Apart from the oil sector, the Angolan economy has hit rock bottom. Growing security and financial problems in recent years have deepened the decline that began with the abrupt departure of the Portuguese in 1976 and the onset of civil war:

- Stepped-up Angolan military activities since 1981 to counter South African attacks and the growing UNITA insurgency have forced the government to boost defense expenditures.
- Agriculture has reverted largely to a subsistence level, as the fighting has cut off major producing areas in southern Angola from key urban centers.
- Shortages of imported spare parts and other inputs have cut industrial output to around 20 percent of capacity; many plants have shut down altogether.
- World prices for the country's major exports—petroleum, coffee, and diamonds—have dropped, depressing foreign exchange earnings. [redacted] 25X1

These pressures have drained Angola's foreign exchange resources and made Angolan President dos Santos more dependent on Soviet military assistance and economic concessions. The problem came to a head in 1982 as burgeoning investment costs in the petroleum and diamond sectors and a heavy debt service obligation for foreign military supplies and technicians consumed almost all of the country's hard currency earnings. [redacted] Luanda could not manage to meet its remaining obligations to the West or to the Soviet Union and its allies in 1982 or this year. Angola would welcome Western assistance in revitalizing its economy, but these financial problems make an expansion of Luanda's ties with private Western interests increasingly difficult. [redacted]

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In our judgment, Luanda's balance of payments will not improve significantly next year, although we estimate that increased oil production will boost export revenues by 10 to 15 percent—to around $1.8 billion. [redacted] we believe that the additional oil-generated revenues will be used primarily to reduce outstanding financial obligations rather than to increase imports substantially. [redacted]

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We doubt that the Soviets will offer Angola much of the new financial support it needs over the coming year. The $2 billion economic agreement that Moscow and Luanda signed in 1982 will provide no significant relief because it is earmarked for large public-sector projects that probably will take almost two decades to complete. 25X1

We expect that Moscow will continue to press Luanda to pay for Soviet and Cuban personnel support, spare parts, and repairs. Moscow almost certainly realizes that Luanda is not in a position to pay hard currency, but we believe that Soviet officials will insist on access to future oil production below market prices. This will make it even more difficult for Angola to boost trade with the West. Moscow probably will also demand repayment of at least part of Angola's commercial debt. Although the Soviets may squeeze Angola financially, they will not do so to a point that threatens the economic viability of the country or Luanda's longer range ability to repay the USSR or serve purposes useful to Moscow. 25X1

In our view, there is no hope for economic growth in 1984. We predict that overall GDP will drop at least another 5 to 10 percent because of Luanda's inability to increase imports needed to revitalize domestic production and a probable steady decline in economic activity as UNITA's sabotage teams move farther north. This will cause painful adjustments, including a need to use scarce resources to import food for urban consumers. The general public's preoccupation with economic survival, however, will probably continue to limit active opposition to the regime. 25X1

We believe that dos Santos and Moscow are betting that increased Soviet military assistance will enable the regime to survive politically at least until 1985 when they foresee an increase in oil revenues large enough to allow some economic breathing room. We, too, expect oil revenues to increase substantially beginning in 1985:

- Development of new oilfields in Cabinda will probably increase petroleum production by around 50 percent.
- Commercial exploitation of several of Angola's other oil-rich offshore blocks is also likely to begin. 25X1

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In our judgment, economic factors alone will give Washington little leverage on the Angolan situation so long as the regime is threatened by UNITA and South Africa. We do not anticipate that economic conditions will deteriorate between now and 1985 to a point where the regime would be willing to give up the security protection that the Communists are providing—even in exchange for massive Western financial aid. If dos Santos accepted such an offer—particularly if it were contingent on a Cuban withdrawal—he probably would be overthrown by pro-Soviet hardliners within the regime. As long as oil production remains at current levels, however, we believe that Luanda will have enough funds to provide a sufficient level of imports to keep the economy from becoming a threat to the regime. 25X1

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Angola: Causes and Implications of Economic Decline

Introduction

The Angolan economy has suffered for a long time from the effects of a disruptive independence process, which led to the exodus of almost all of the 400,000 Portuguese in the country and left an inexperienced government to cope with massive economic and security problems. These difficulties have intensified during the 1980s because of falling world prices for Angola's major export commodities and the deteriorating security situation caused by the South African–assisted UNITA insurgency. Although President dos Santos has made overtures to the West for diplomatic and economic assistance, Luanda has grown increasingly dependent on the Soviet Union and Cuba for military hardware and manpower.

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This paper analyzes Angola's economic problems and longer term economic prospects and estimates the economic course that the government is likely to follow. It also analyzes the implications of these prospects for the United States.

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The Legacy of Independence

The departure of most of the Portuguese in 1975-76 triggered a deep decline in the economy. The Portuguese had occupied almost all managerial, technical, and professional positions, made up most of the skilled labor force, and—along with consumers in Portugal—represented the bulk of the middle-class market.

- Commercial agriculture was hardest hit as seasoned Portuguese plantation owners emigrated, and the colonial marketing and distribution system collapsed.
- Manufacturing, the fastest growing economic sector prior to independence, began operating well below capacity, primarily because of the evaporation of Portuguese skills and purchasing power.
- Mining was crippled by the loss of technicians as well as equipment, including vehicles and aircraft, taken by the Portuguese.
- The Western-run petroleum industry was the only sector to remain largely unaffected because of the continued operations of Western oil companies.

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The situation was made worse by the new government's drive to socialize most factories, banks, mines, processing plants, refineries, and plantations abandoned by the Portuguese. Committees of largely unskilled workers complicated the difficult job of inexperienced and untrained managers. Bureaucratic inefficiency, corruption, and chronic shortages of raw materials, fuel, and spare parts also undermined productivity.

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The continuing guerrilla war also hindered economic recovery. In the late 1970s guerrillas increased attacks on bridges, railbeds, trains, roads, vehicular traffic, and government installations. The fighting was most intense in southern Angola, where much of the country's food production is concentrated. Farmers began cutting back plantings to avoid harassment from insurgent, government, and Cuban forces.

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The introduction beginning in 1976 of several thousand Communist civilian economic and technical advisers, mostly Cubans, failed to revive the economy. Although occupying key advisory positions in almost every economic ministry, they were too few and too lacking in familiarity with local conditions, management techniques, and Western machinery to fill the void left by the Portuguese.

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As a result, toward the end of the 1970s the Angolans increasingly began to turn to Western capital, technology, and manpower to revive the economy and as an alternative to exclusive reliance on the Soviets, Cubans, and East Europeans, with whom they were already growing disenchanted. The government adopted a liberal investment code in 1979. Because of dos Santos's economic overtures to the West, Angola received strong non-Communist official assistance—primarily from European and Arab donors—and attracted considerable private investor interest.

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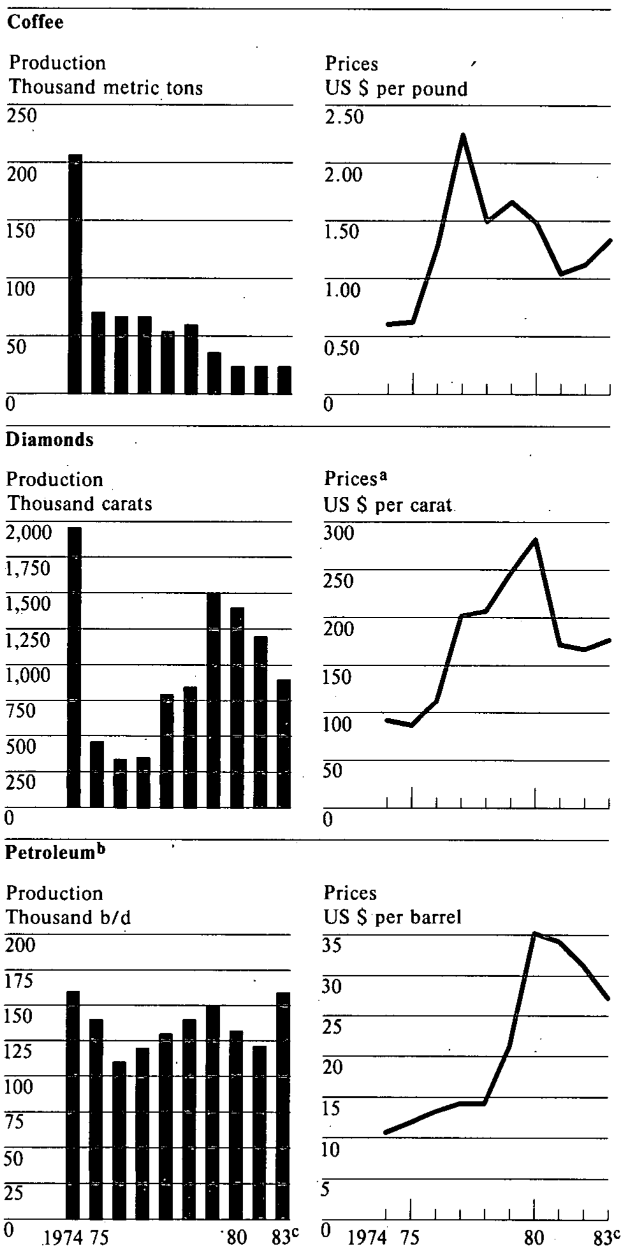
Angola: Commodity Prices and Production Trends



[a] Data reflect average prices for South African diamonds.
[b] Pegged to official Nigerian sales prices.
[c] Estimated.

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Even these actions allowed only a brief respite from the country's downward economic trend. The increase in oil revenues associated with rising world oil prices and Western aid did provide a temporary improvement in living standards as food and other badly needed consumer imports rose by 20 percent. The increased availability of goods did little for agriculture and mining, however, which continued to suffer from the fighting. Moreover, with the exception of the petroleum industry, investors were jittery about making large long-term commitments because of the insurgency. As a result, most contracts stipulated that projects would begin only after the security situation improved. 25X1

Economic Pressures in the 1980s [1]

Setbacks in 1981

A sharp decline in the economy in 1981 was triggered by the fall in world demand for petroleum, which cut the revenues on which Luanda had become heavily dependent for its foreign exchange earnings. There were, however, other setbacks:

- A plunge in the prices of Angola's other major exports—coffee and diamonds—further depressed foreign exchange earnings.
- A second consecutive year of drought forced Luanda to increase imports of food at the expense of needed machinery and spare parts.
- Stepped-up attacks by South Africa and UNITA forced the government to boost defense expenditures.
- The migration of farmers to urban areas to escape both drought and the chaos caused by UNITA placed added pressure on the government's limited resources, according to the press and other sources.

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Bases of Soviet Influence in Angola

Moscow's Military Role

Moscow's influence in Angola rests largely on its military assistance role. After helping the Popular Movement for the Liberation of Angola (MPLA) to consolidate its grip on power at Angolan independence in 1975—through the rapid airlift of Cuban troops and supplies—the USSR formalized its relationship with Angola by signing a 20-year Friendship Treaty in October 1976 and promising additional military supplies. [redacted] 25X1

The annual increments of Soviet military aid to Angola declined after 1976, partly because Angola's military services needed additional time to absorb the equipment already received. Moscow's decisions to reduce even further its military shipments in 1980 and 1981 probably were designed to signal Soviet displeasure with Luanda's failure to pay for spare parts and repairs. Even so, by the end of 1981 Moscow and its allies had concluded a total of almost $1 billion in military agreements with Angola. [redacted] 25X1

The USSR sharply increased its arms shipments to Luanda in 1982 largely in response to attacks by UNITA and South African military incursions into southern Angola. We believe that Luanda's willingness to talk with the West—and with Pretoria—about a Namibian settlement was also instrumental in the decision by Moscow to upgrade its commitment. The Soviets introduced more advanced weapons to shore up Luanda's air and coastal defenses, boosting the annual level of arms shipments to Angola to record levels. Havana augmented its military presence to stiffen the government's defenses and to man some of the new, more advanced equipment. [redacted] 25X1

The Soviet military commitment in Angola is continuing to increase. Since February 1983, Soviet SA-6 and SA-8 surface-to-air missile systems and MI-24 helicopter gunships arrived in Angola for the first time. [redacted] 25X1 *There are also 1,000 to 1,200 Soviet military advisers and at least 25,000 to 30,000 Cuban military personnel in Angola, including about 20,000 Cuban combat troops.* [redacted] 25X1 25X1

Moscow's Economic Role

The Soviets extended about $430 million in economic aid to Angola from 1975 to 1982, of which only $32 million was drawn. Questions about types of projects, the quality of Soviet assistance and advisory support, and the quantity of actual Soviet aid disbursements have been a constant source of friction in bilateral relations since the mid-1970s. [redacted] 25X1

Early in January 1982 Angola received a significant new Soviet commitment that eventually could provide up to $2 billion in credits for economic development over a 10- to 20-year period. The agreement followed several years of feasibility studies and negotiations—a typical feature of Soviet economic programs. The accord probably will provide credits on near commercial terms. It calls for the USSR to construct heavy public-sector infrastructure and industrial projects that have become its specialty in the Third World:

- *Moscow has signed a contract to provide $400 million in equipment credits for the Kapanda hydroelectric dam and power plant, which will be Angola's largest construction project.*
- *The Soviets plan to construct a 990,000-acre irrigation system, bridges, and other projects in Malange Province.*
- *Luanda and Moscow are discussing the construction of an oil refinery.*

The agreement will not meet Angola's current economic needs, however, because it does not provide financial support for badly needed imports or highly skilled technical services needed to revitalize plant and equipment. [redacted] 25X1

Moscow has some 1,500 civilian advisers and economic technicians in Angola, many of whom are attached to various government ministries and state industries. In addition, there are some 7,000 to 8,000 Cuban and East European civilian advisers. [redacted] *Soviet advisers work with the Finance Ministry, the Central Bank, and the fishing and mining industries.* [redacted] 25X1 25X1 25X1 25X1

The large contingent of Cuban technicians is a particular source of friction with the Angolans. As food and consumer goods shortages became more pronounced this year, Angolans became increasingly restive over what they saw as a Communist monopoly of the few remaining imported food and consumer items. Luanda has even threatened to cut back on the number of Cuban civilians because of frictions over their salaries and working conditions. [redacted] 25X1

As a result of these factors, the government faced a financial crisis. Although previously a conservative borrower, Luanda substantially increased its foreign debt exposure in an effort to meet its foreign currency commitments. External public debt doubled from $1.1 billion in 1980 to $2.2 billion in 1981, [redacted] For the first time, Angola entered the Eurocurrency market to meet short-term borrowing needs and began requesting extended trade credits in lieu of making cash payments for imports. [redacted] we estimate that the trade balance deteriorated from a $471 million surplus in 1980 to a $5 million deficit in 1981 as the government stepped up imports by 15 percent. [redacted]

Spending pressures also caused the government's budget to soar. Public expenditure jumped by 25 percent from $2.8 billion in 1980 to $3.5 billion in 1981, according to a French press report. Defense spending rose to more than 50 percent of the budget, [redacted] Meanwhile, the gap between state revenues and expenditures widened to over $1 billion because of the drop in revenues from the petroleum sector. The government used the printing press to cover the deficit, causing inflation to rise to a 40- to 45-percent annual rate. [redacted]

Financial Crunch, 1982-83

The 1982 Financial Crisis. Angola's foreign currency problems worsened in 1982 as burgeoning investment costs in the petroleum and diamond sectors and a heavy debt service obligation for military supplies and technicians consumed almost all of the country's hard currency earnings. Investment costs in the petroleum sector doubled from the previous year to about $260 million in 1982 as the country began investing in new oilfield development in Cabinda [redacted] hard currency expenditures in the diamond industry exceeded export earnings because of both continued theft and low world prices. Debts incurred to the Soviets and Cuba for military purchases and services also started piling up. [redacted] these commitments absorbed nearly all of the country's resources, causing the government to resort to commercial credits to buy food and medicine and to meet other basic needs. [redacted]

By mid-April 1982 the country had fallen behind in payments to all creditors. The Soviets and Cubans insisted that Luanda stem the backlog on its short-term debt to them, which caused officials to forgo payment to Western petroleum companies and to banks on letters of credit. By midyear, the country was almost six months behind in payments to Western creditors, despite a 30-percent cut in imports. [redacted]

Efforts to boost output of Angola's major exports in 1982 brought few results:

- Petroleum production and prices both fell as world demand slackened further.

- Official diamond output fell 15 percent because DeBeers evidently lowered the quota of Angolan production that it would buy and because of widespread corruption involving senior government officials.

- Coffee volume remained stagnant because of marketing problems and the poor security situation in coffee-growing regions. In many areas farmers pulled up coffee trees, planting subsistence food crops in their place because government purchasing agents failed to appear. [redacted]

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Table 1
Angola: Current Account Estimates [a]

Million US $

	1980	1981	1982	1983	1984 [b]
Current account balance	−259	−705	−750	−630	−525
Trade balance	471	−5	−10	100	200
Exports (f.o.b.)	1,997	1,745	1,400	1,600	1,800
Of which:					
Petroleum	1,450	1,260	985	1,200	1,600
Coffee	106	49	58	57	30
Diamonds	315	182	156	130	100
Imports (f.o.b.)	1,526	1,750	1,410	1,500	1,600
Of which:					
Military equipment and spare parts	175	110	210	420	450
Net services and transfers	−730	−700	−740	−730	−725
Of which:					
Communist military and economic support [c]	−300	−300	−325	−325	−330
Soviet repair charges	−30	−30	−30	−30	−40
Petroleum transfers	−232	−208	−200	−200	−260
Demurrage charges	−60	−60	−60	−40	−40

[a] These data are presented primarily to highlight the character, scale, and direction of Angola's payment problems. Because we cannot specify with any certainty what level of current account deficit the Soviet Union was prepared to underwrite for Angola in any single year, line entries—especially for nonmilitary imports and for services and transfer transactions with Communist countries—should not be ascribed a high degree of accuracy. They are largely estimates based on statistics of trade partners and on fragmentary reporting. We used world market prices to calculate the value of exports.

[b] Projected.

[c] These figures represent estimates of hard currency obligations. We do not have adequate information about how much was actually paid. We excluded obligations for Angolan military training in foreign countries.

We believe, [redacted] that the financial squeeze caused dos Santos to scale down economic targets in 1982. Setting a ceiling of $72 million for the 1982 budget deficit, the government decreased subsidies on food and other basic consumer goods, terminated all investment in new development projects, and, for the first time since independence, began collecting income taxes from private individuals. In late 1982 the Central Committee of the ruling party gave dos Santos special powers to deal with the deteriorating security situation and to enact emergency measures giving priority to expanding food and key industrial production and to raising exports. [redacted]

Continuing Squeeze in 1983. We believe that foreign lending to Angola in 1983 has fallen significantly below the levels obtained in previous years, although Luanda has searched East and West for assistance. Pleas to French and Soviet officials for large-scale balance-of-payments support have drawn negative responses. Portugal, Spain, and Italy mustered only a few small export loans. A recent Brazilian offer to extend medium-term trade credits and to swap food for petroleum has not been adequate to meet Angola's growing import requirements. [redacted]

The Political Context of Economic Decision Making

We believe that dos Santos has delegated day-to-day responsibility for managing the economy to Minister of Planning Lopo do Nascimento, an extremely capable technocrat who also controls the National Bank of Angola, the country's central bank. [redacted] *do Nascimento is a political opportunist who comes across as a pragmatist, particularly in contacts with Westerners. He has hinted broadly* [redacted] *that he wants Angola to move away from close ties with Moscow and has expressed concern that the Angolan economy is too centralized. He has also said that Angola wishes to establish diplomatic relations with the United States.* [redacted]

Neither do Nascimento nor dos Santos can make major policy decisions, however, without the collective agreement of other key leaders in the ruling party. The political balance within the leadership as a whole is delicate and tense, and decisions on key issues are subject to considerable factional pulling and hauling. A hardline faction generally holds the upper hand, favoring inflexible policies and strong ties with Moscow and Havana; the Soviets and Cubans influence the policymaking apparatus through the hardliners as well as through direct contacts with dos Santos. A weaker, relatively moderate faction led by black nationalists has a more pragmatic outlook, particularly on questions of political and economic dealings with the West, but it remains on the margins of decisionmaking. [redacted]

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In policy debates, dos Santos has tended to comport himself with the caution and indecisiveness of a compromise leader, generally favoring a moderate approach but acting as if he doubts he is strong enough to challenge the hardliners. In order to strengthen his position vis-a-vis both factions, over the past year or so he has removed some of the hardliners and some of the most strident black nationalists from positions of power. This has not won him solid support in either group, however, and has created instead a three-way standoff that has worked against major policy departures.[a]

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[redacted]

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Similarly, appeals to foreign bankers and investors have generated few results. [redacted]

The only glimmer of relief comes from the oil sector. Petroleum production rose 30 percent by the end of the first half of 1983 to about 160,000 barrels per day (b/d), owing to the start of production from the offshore Takula oilfields. The rise in export volume has been partially offset, however, by declining prices for Angolan oil. We estimate an increase in oil receipts this year of around 20 percent. [redacted]

Despite doubled purchases of military equipment to cope with the insurgency, we expect Angola's current account position to improve because of the higher oil earnings and tight controls on imports of food, raw and intermediate goods, and capital equipment. Moreover, based on our analysis of data on Angolan trade with the West, we estimate that imports of basic food items such as cooking oil and cereals were further eroded by a progressive rise in the inflow of meat, processed foods, and luxury consumer goods to satisfy the elite of the ruling party and Soviet, Cuban, and East European personnel in Angola. [redacted]

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Gromyko, Ustinov, and the other Soviet leaders greeting dos Santos in Moscow in May 1983 [redacted] 25X1

Rather than risk another sharp rise in inflation, Luanda has sought to try to rein in public spending even further in 1983. This will not be easy, however, because the upsurge in UNITA activity will, in all likelihood, drive defense expenditures in 1983 above last year's 50-percent share of the budget. [redacted] 25X1

Faltering Economy and Growing Malaise. The performance of the economy has given Luanda little cause for optimism. Agriculture—which employs about 80 percent of the population—has recovered only marginally despite the return of normal rainfall. According to press reports, sabotage by UNITA in central Angola has destroyed almost all of the modern farms in what was once the country's breadbasket. The expanding insurgency reportedly now also endangers farms in Malange Province close to Luanda. Much of what is produced is intercepted by insurgents. A shortage of parts for machinery and a lack of seeds and fertilizer add to farmers' problems. As a result, most rural Angolans rely on subsistence agriculture to satisfy immediate family needs, leaving Luanda little choice but to continue to import food to meet the needs of urban consumers. [redacted] 25X1

Slashes in food imports and budget cuts have hit lower class Angolans the hardest. According to press notices [redacted] long food lines occur daily in the capital city at government-run stores for the general public. Lack of food at official prices has driven most Angolans to the black market where they pay many times the regulated price or often resort to barter. Even then, there is rarely enough food to go around. [redacted] 25X1

Urban dwellers have little incentive to work because there is nothing to buy. [redacted] Shortages have become even more acute as stepped-up attacks by UNITA create panic in the interior, adding to the stream of refugees into Luanda. Public transportation is almost nonexistent as buses lie idle for lack of foreign made spare parts. [redacted] most of the factories in Angola are working at only 20 percent of capacity and have an average absentee rate of 40 percent, with some as high as 70 percent. [redacted] many urban workers do not report for duty because they need to spend most of their day foraging for food. In addition, raw material shortages and a lack of spare parts have brought some production units to a complete standstill. [redacted] 25X1 25X1 25X1 25X1 25X1 25X1 25X1

Corruption has grown as the country's economic woes have deepened, according to press reports. These sources also cite burgeoning overseas bank accounts of high-ranking Angolan military officers and government officials as signs that many leaders are preoccupied with protecting their assets in case they decide to flee. [redacted] it has become obligatory in business dealings to pay a certain percentage of each contract into the personal overseas accounts of public officials. Even though the government has initiated an intensive anticorruption campaign and hired a Swiss firm to supervise all contracts, the practice has become so blatant [redacted] 25X1 25X1 25X1

The limited information available to us suggests that opposition to the regime over economic issues remains diffuse. Although we have reports of isolated strikes and work slowdowns, we have no indications that these generated any widespread support. We believe that opponents of the regime's current policies have

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ties to poor urban blacks, but they do not appear to be able at this point to turn discontent into open unrest. [redacted]

In our view, most urban Angolans are too preoccupied with economic survival to oppose the government actively. [redacted] the prevailing attitude is apathy, not rejection of dos Santos or the ruling group. [redacted]

Outlook for 1984

We expect the insurgency to put increased pressure on the regime in 1984. UNITA probably will continue to spread its activities into the northeastern diamond-producing area and into the north, particularly around farming areas near Malange. [redacted] guerrilla operations have already begun to intensify in these areas. We believe the government will continue to hold the country's key urban centers, but that its control of the countryside will erode further. [redacted]

In these circumstances, we would expect foreign investors and domestic producers to avoid new commitments in Angola. Although some foreign businessmen may sign new investment contracts, few will be willing to commit funds until the security situation improves. Farmers will continue to flock to the cities or resort to subsistence agriculture, while many of the few remaining expatriates are likely to abandon their farms because of harassment by UNITA. As anxiety grows in Luanda, members of the Angolan elite will probably continue to send their money outside the country. [redacted]

Balance-of-payments problems will continue to plague Luanda even though petroleum export revenues are officially projected to rise by about one-third in 1984 to around $1.6 billion as new oil production becomes marketable.

- Luanda recently committed itself to begin delivering to the USSR and Eastern Europe in early 1984 slightly over half of its 50-percent share of crude oil production from Cabinda (the other 50 percent belongs to the Gulf Oil Corporation) to pay for Communist military and economic assistance, [redacted]
- Most of the remainder of oil revenues has already been mortgaged to cover petroleum investment costs for a gas-injection project in Cabinda, [redacted] 25X1 25X1
- Mounting creditor demands to stem the burgeoning backlog on short-term debt are likely to result in additional foreign exchange outflows as Luanda tries to keep its credit lines from being cut. 25X1 25X1
- Coffee and diamond earnings will contract further as the security situation worsens. Even major government attempts to secure diamond and coffee-producing regions probably would not succeed in increasing exports. 25X1 25X1
- Even if the Soviets are lenient on some repayment terms, the worsening security situation will probably boost war-related costs, particularly for food, clothing, spare parts, and equipment repairs. [redacted] 25X1 25X1

Continued Aid Shortfalls

Over the coming year we do not expect the Soviets to offer much economic relief. Funds from a $2 billion Soviet-Angolan economic agreement in 1982 will continue to be reserved for large infrastructure projects such as the Kapanda Dam and a new oil refinery, which probably will take almost two decades to complete. [redacted] 25X1 25X1

Luanda will probably continue to look to the West for financial relief. In our view, however, private creditors will be reluctant to extend new loans until Luanda makes some headway in reducing the backlog of its commercial debt. Almost all potential Western donors—including France, Brazil, Portugal, Italy, and Spain—have their own economic problems. These countries have indicated that their support to Angola will be limited to government-guaranteed trade credits, a few investment loans, and some food aid, [redacted] 25X1 25X1

In the absence of any substantial aid, we expect Luanda to ask Moscow for greater concessions in their bilateral military and economic relationships.

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Capitalizing on Oil 25X1

The US Economic Stake

Oil is Angola's key economic link with the United States. The United States buys about two-thirds of Angola's oil, and American oil companies play a major role—in partnership with the Angolan Government—in exploiting Angola's resources.

- *Production by Gulf, established in Cabinda since 1957, accounts for about 60 percent of Angola's total output.*
- *Texaco participates in several joint ventures, including one in the Congo basin which provides almost 30 percent of national production.*
- *Mobil has joined ELF Aquitaine, a French oil company, in an exploration and production-sharing venture that has resulted in a find off the coast of northern Angola.* [redacted]

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Other Western Interests

Other Western companies have a sizable stake in Angolan oil. Private and official Western loans and export credits provided the capital in 1981 to fund a $168 million gas injection project to boost output in the Cabinda oilfields. US and French banks recently offered Luanda financing to develop the rich Takula oilfields off Cabinda. [redacted]

Despite the worsening security situation and the drop in oil prices, Western oil companies have indicated a willingness to stay in Angola because they like doing business with Luanda. [redacted]

- *The Angolans with whom they deal are businesslike and anxious to see that companies realize acceptable profits.* 25X1
- *The government does not interfere in day-to-day company operations.*
- *There is constant communication between responsible Angolan officials and company representatives, which has resulted in satisfactory contract negotiations.* [redacted] 25X1

Angolan officials so far have managed to keep on track Western investment programs for developing new oilfields, despite the reluctance of oil companies to step up production in the midst of a world oil glut. The Angolans realize the need to work with the West and, [redacted] *they are able to separate oil issues from political concerns.* 25X1

[redacted]

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We believe, however, that Moscow will continue to press Luanda to pay for Soviet and Cuban technical and military personnel support, spare parts, and repairs. Moscow almost certainly realizes that Angola is in no position to pay hard currency, but the Soviets stand to receive about $400 million in oil next year if Luanda honors the recent agreement to turn over half of its share of oil from Cabinda. Moscow probably also will insist on repayment of at least part of Angola's commercial debt. Although the Soviets may squeeze Angola financially, they will not do so to a point that threatens the economic viability of the country or Luanda's longer range ability to repay the USSR or to serve purposes useful to Moscow. [redacted]

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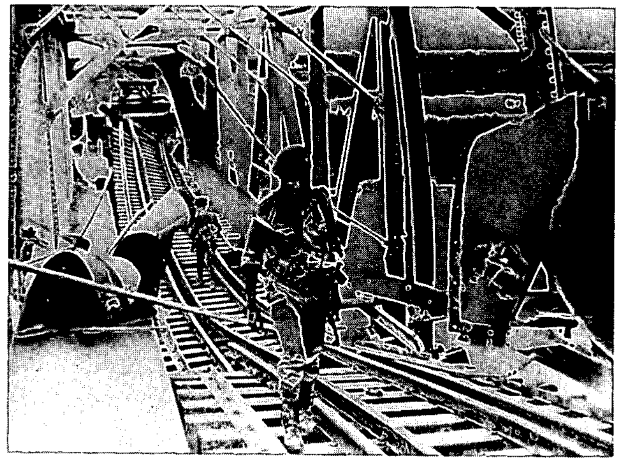
Short-Term Implications

In our view, there is no hope for economic growth in 1984. Just to restore depleted stocks of industrial raw materials, intermediate goods, fertilizers, machinery, and spare parts would require a 40-percent increase in imports, according to our analysis. We doubt Luanda's ability to finance even a small portion of this amount.

We predict that overall GDP will drop at least another 5 to 10 percent next year as a result of Luanda's inability to increase imports of goods needed to support domestic production and the steady drop in economic activity as UNITA's sabotage teams move further north. Heightened guerrilla disruption of the remaining food-growing areas is bound to cause a further decline in agricultural output next year. Most factories probably will either remain closed or continue operating at low levels of capacity. There will continue to be shortages of spare parts and intermediate goods—such as yarn for textile factories—and a low employment participation rate as searching for food becomes a full-time occupation for many and a growing number of workers are conscripted by the military to fight against UNITA.

Painful adjustments will be widespread, particularly among consumers.

In our view, however, urban consumers are used to commodity shortages, and only a massive shortfall in food supplies—a development we do not foresee at this time—could provide government opponents with the popular support needed to make a move against the regime. Moreover, we believe that dos Santos also is aware of this possibility and will do what he can to ensure adequate food supplies in key urban centers.



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UNITA soldiers examine bridge destroyed on Benguela railroad

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The Longer Term

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The two most important factors in determining the long-term future of the Angolan economy will be the oil sector and the insurgency. We expect oil to play an increasingly important role in 1985 and beyond so long as Luanda is able to bring its rich oil reserves into production. The level of the insurgency will largely determine whether vital foreign exchange earnings from the petroleum sector go to rebuild Angola's war-torn economy or to pay for more Communist military hardware and personnel support.

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Prospects for development of the oil sector will remain good as long as the insurgents do not attack the oilfields. We believe that crude oil exports in 1985 probably will rise about 50 percent above the current 1983 level, from 136,000 b/d to 200,000 b/d, based on information provided by the Angolan state oil company, Sonangol, and Western oil companies operating in Angola. Most of the increase will come from newly developed fields off the coast of Cabinda. We also expect commercial exploitation of several of Angola's other rich offshore oil sites to begin by 1985.

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Prolonged War

If, as we expect, UNITA tightens its hold over the countryside, eventually isolating the country's diamond, agricultural, and other outlying regions and confining the government's area of control to the major cities, we believe the regime would become almost totally dependent on oil revenues to meet current operating and defense costs. Oil probably would represent over 95 percent of foreign exchange revenues and almost all of Luanda's budget.

In the event that sabotage of the petroleum sector drives away Western petroleum companies, we believe that the Soviets would press to take over the fields themselves. While damage such as ruptured pipelines or destruction of the single mooring buoy used to export oil would be relatively easy to fix if replacement equipment were available, we believe that extensive damage to offshore oil platforms would cause costly and longlasting damage. Soviet offshore technical expertise and operating equipment are very limited so that, in this contingency, Moscow probably would have to depend on Western technology for construction of offshore facilities.

Should the cost of the war continue to escalate in the face of a cutoff in oil revenues, the Soviets could be forced to underwrite the war completely. While pressing financial problems at home and heavily extended commitments in other parts of the world would make such an outcome unwelcome in Moscow, Angola has become an important symbol of the USSR's ability and willingness to project its power to distant areas and of its determination to support the national liberation struggle in southern Africa. Failure to back Luanda would damage Soviet credibility among its other clients. Thus we would not foresee the Soviets pulling out even in this extreme circumstance.

A Peaceful Solution

In the less likely event that dos Santos or a successor reaches an accommodation with UNITA or South Africa, it would still take time, money, and a vast infusion of foreign technical expertise to turn the economy around. There would be a substantial lag before Angolans dislocated by the war could return to productive tasks and before foreign businessmen could make new investments. The country would still be plagued for years by a lack of skilled local managers and workers. 25X1

Under this scenario, Angola's lack of skilled managers and workers probably would cause Luanda to build on the steps that dos Santos and Minister of Planning Lopo do Nascimento have already taken to expand the country's economic links with the West. Luanda would be likely to increase the Western advisory presence in the fields of education, port administration, rail transport, industry, and mining. Luanda would also be likely to encourage Western—particularly US, Portuguese, French, and Brazilian—investment and technical and services contracts. We doubt, however, that the government would move far from its commitment to a largely government-run economy. 25X1

As financial priorities shifted to peacetime development, Luanda's foreign exchange requirements would increase. The reconstruction of the mineral, industrial, and agricultural sectors would consume vast amounts of foreign currency for imports of vital producer goods. Pressures to increase food and consumer goods imports would also rise as Angolan expectations of a postwar peace dividend rose. At the same time, Luanda would still be strapped for repayment of investment loans for the petroleum sector and burgeoning arrearages on its short-term debt. 25X1 25X1

During this fragile transition period, Angola would be largely dependent on anticipated large increases in oil revenues. In addition, if the regime were able to keep the austerity lid on as export revenues climb, Luanda could pay off much of its overdue debt. We believe that this would improve Luanda's credit rating and enhance its eligibility for greater European aid, especially if the world economy had picked up momentum by then. 25X1

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Implications for the United States 25X1

In our judgment, economic factors alone will give Washington little leverage on the Angolan situation so long as the regime is threatened by UNITA and South Africa. 25X1

Dos Santos and do Nascimento both claim that they would personally prefer to end the war and turn to the West for aid to rebuild their country, but we doubt their ability to remain in power for long if they 25X1 accepted an offer of large-scale US economic assistance—particularly if it were conditioned on a Cuban withdrawal. In that contingency, dos Santos probably would be ousted by pro-Soviet hardliners within the regime for agreeing to such terms, or by UNITA if they were implemented. We believe that neither dos Santos nor do Nascimento nor any other possible successor would see much wisdom in throwing out the Communists unless their own security were guaranteed. 25X1

Even without major US or other Western aid, American oil companies probably will continue to operate profitably in Angola—unless UNITA attacks the oilfields. Luanda has often stated that it regards Western expertise as superior to anything the Soviets offer, and it will continue to try to attract other potential Western investors. 25X1

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Angolan Economic Activity and Major Oilfields

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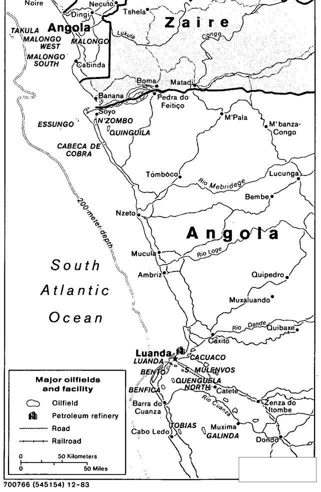

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