Angola: Options for Prosperity

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Introduction

It is now thirty years since the liberation of Angola from colonialism. For nearly all of that time the economy was held back by rebellion. It is not possible to develop in conditions of civil war. At last the society is free of this burden. Times are propitious. Not only is Angola at last post-conflict, it has a new oil bonanza. Where will Angola be in another thirty years? What will the society look like in 2036?

The best way to answer this question is to look at other societies that have faced this combination. The most useful investment the government of Angola can make is to purchase the entire cabinet two sets of airline tickets: one to Nigeria, the other to Malaysia. See where they are now, and then realize that thirty years ago they were where you are now.

Nigeria in 1973 was post-conflict and the oil was starting to flow. What then happened?

By 1983 the first oil boom had been wasted and the government was ousted in a coup d'etat.

By 1993 the second oil boom had been wasted and there had been two further successful coups d'etats.

By 2003 the economy was as poor as it had been before $200bn of oil money, and reform had just started.

Malaysia in 1973 had just emerged from devastating inter-ethnic riots. It was starting to get large natural resource revenues.

By 1983 there was already broad-based prosperity, with explicit arrangements for all ethnic groups to share in the gains from resource revenues.

By 1993 there had been spectacular progress. Malaysia was attracting by far the highest investment inflows per capita in the world.

By 2003 Malaysia was a world-class economy; Kuala Lumpur had the tallest building in the world; and the President was able to hand over power in a smooth and stable transition.

These two countries started more-or-less from where Angola is now and thirty years later could not have been more different. Your choices now will determine which of these routes you follow.

These examples illustrate a more general phenomenon. Both post-conflict periods and oil bonanzas are times when policy choices are far more important than usual and also far more varied. Some societies get them right, others get them wrong, and the consequences are spectacular. The choices that will be made in the next couple of years will shape the society for decades to come, for good or ill.

Unfortunately, the 'default option' is that Angola will follow the path of Nigeria. Lagos now is the best predictor of Luanda in 2036. This is because there are strong economic and political forces that take a society down this route. Nigerians in the 1970s were not fools. It would have taken exceptional skill and foresight for Nigeria to avoid what happened. Your massive advantage over the Nigerians of the 1970s is that you can learn from their mistakes, just as Nigerians have now learnt from them. You do not need to waste the next three decades.

So what choices really matter now? Of course, everything matters, but if you try to do everything you will fail at everything. So what really, really matters now? I am going to limit myself to five things.

1. **Get the macroeconomic basics right (this is easy)**

Getting the macroeconomic basics right should not occupy much of the government's attention because they are very straightforward. You do not need anything fancy.

1. ***Run a fiscal surplus***

   Over the next three years or so, you should be running a fiscal surplus. This is prudent twice over. You do not know how long high oil prices will last, and more importantly, you do not yet have in place systems to spend public money well and so you should defer some spending until your systems are better.

2. ***Set a medium-term smoothing rule***

   The government should establish a medium-term smoothing rule for natural resource revenues. Since you can only establish such an arrangement while you are facing the prospect of a temporary surplus, now is the time. The objective would be to smooth expenditure not to reduce it. For example, you could spend according to a five-year moving average of the world oil price. Such an arrangement is not to be confused with a 'Future Generations Fund' which I regard as seriously mistaken. Such Funds invariably get dismantled after a few years and so are merely transfers from prudent ministers of finance to their more profligate successors. Worse, even if they were maintained, they would be utterly inappropriate for a poor country such as Angola: you need to build up capital investments within the country, not financial assets in New York.

3. ***Lock-in to Low Inflation***

   As a by-product, a fiscal surplus will end your inflation problem. As inflation reaches single figures this would be a good time to establish an independent central bank with a simple mandate to keep inflation low. The Governor of the newly independent central bank should be given a ten year mandate with a clause saying that he faces dismissal if inflation rises above 15% in any year. This should be heavily publicized.

2. **Put three vital systems in place for public spending (this is pretty hard)**

The central focus of government efforts should not be on saving oil revenues but on spending them. Public spending should rise, and rise quite rapidly. This is not even a policy choice: politics will most surely propel spending increases. The vital policy issue is to manage this spending well. I think that three distinct new spending systems need to be put in place.

1. ***Create evaluation and procurement systems for infrastructure***

Angola needs infrastructure and oil should finance it. In post-conflict societies public spending on infrastructure is usually highly productive. However, usually, post-conflict infrastructure is managed by aid donors and this usually sets satisfactory standards. In Angola it must be managed by the government. To an extent the Chinese can do this management for you, but don't become over-reliant on them - their record is pretty bad. A much better approach is to set up a 'double-hurdle' system of project approval. The first hurdle assesses the economic rate of return on a project. Botswana owes much of its prosperity to its government rule that it would only approve a project if the independently estimated rate of return exceeded a critical threshold (which should probably be around 10%). All proposed projects should go through this process, *without exception*. You can easily buy in expertise to conduct these independent analyses and it will save you billions of dollars. Once it is in place, the really foolish projects will not even get proposed, so the politics will rapidly become easier. The second hurdle assesses the honesty of the procurement process. This is much easier. Nigeria has recently established a rule that all public projects must be put out to competitive tender. This is an elementary minimum.

The rate of spending on infrastructure should be limited by absorptive capacity as measured by forecast rates of return. Hence, having allocated money to infrastructure, the amount that is spent in any year should be determined by these absorptive limits. There is thus a need for an ***infrastructure fund*** in which money that has been allocated for infrastructure is parked until it can be spent productively. This is distinct from a macroeconomic smoothing fund; it is determined by the microeconomics of project approvals. This is indeed a core message: *the rate at which Angola should spend its oil revenues should be determined by the rate at which productive uses for the money can be well-formulated*.

The processes of project preparation and procurement are about the authorization of a project. When you have the time you should also set up an economic evaluation unit that draws lessons from completed projects, and an audit unit that hunts out corruption during construction. However, these can wait for a while.

2. ***Massively increase the size and accountability of social spending***

If ordinary people are to benefit from oil the main way they will do so is from better public services. Spending should sharply increase, but extra money is not enough. Tracking surveys of social spending around Africa have found that most of the money does not reach the intended recipients. It is therefore vital to build better delivery and accountability systems. Part of the solution is to bring ordinary users onto the supervisory boards of public services at a local level. For example, schools should be run by boards on which parents of schoolchildren are a majority. The board should have control over the finances of the school. Boards should then know that their school has a defined entitlement to money, which will be sent at regular intervals and the board informed of these releases. I also favour the creation of new public agencies responsible for contracting for basic services, supervised by a board on which both government and civil society are represented. The function of the agency is to buy services such as primary schooling from a wide range of providers: churches, local authorities, NGOs, - whatever is shown by evaluation to be cost effective.

3. ***Distribute some oil money directly to households***

Angola is in an extraordinary transition from an $800 per capita economy about two years ago, to a $2,400 per capita economy in around two years time. It is inconceivable that the best use of this huge increase is to spend all of it through the government. Even if public spending is brilliant, the result would be an absurd imbalance between public consumption and private consumption. No society on earth has public consumption per capita higher than private consumption. So, the government of Angola needs to channel some of the oil money directly to households so that they can spend the money on private consumption. Any such arrangement must be administratively very simple to avoid corruption. Probably the easiest arrangement is to offer monthly payments to all children as long as they are in school. This would be a marvellous incentive to move to universal primary education. As long as it was widely publicized it would be self-enforcing: parents would demand that schools receive the money. The actual level of payment could start modestly, such as $2 per child per month, and build up as revenue growth permitted.

3. **Constrain the prospective emergence of political patronage (this is very hard)**

Angola is in the process of gradual transition to democratic politics. Obviously, this is an important part of developing Angolan society. However, electoral competition can drive oil-rich societies into major problems. Often, the winning political strategy to attract support turns out to be private patronage to core supporters rather than delivering proper public services to the many. This is what happened in Nigeria during civilian as well as military rule. As politicians compete with each other through rival patronage networks, such politics devours oil revenues without productive return. An epicentre of patronage becomes the creation of jobs in the public sector. The more that public employment is used for patronage the more difficult it is to get public employees to deliver a proper service to the public. Hence, the common paradox of a public sector that is at the same time overstaffed, yet unproductive.

How can patronage politics be avoided? There are three complementary approaches.

1. ***Set up checks and balances***

   Globally, oil-rich countries have weaker checks and balances on how public revenues are used. This is a major reason for why they do not grow more rapidly. Growth in oil economies is strongly positively related to the strength of checks and balances on public spending. Those oil-rich societies with strong checks and balances grow much more rapidly than those with weak checks and balances. Checks and balances are partly formal institutional arrangements. However, many are informal such as a free and informed media, and engaged groups from civil society. Government cannot be the only source of checks and balances. Transparency in oil revenues is the necessary input into transparency in expenditures.

2. ***Limit campaign finance***

   Once political campaigning gets going, unless the amount that can be spent on campaigns is legally restricted, there will be a 'race-to-the-bottom'. In Nigeria the average cost of winning a seat in the Senate rose to around $500,000. Once having spent this sort of money senators are driven into corruption in order to recoup it. Avoid this deeply unhealthy process before it gets started.

3. ***Improve citizen information***

   The better informed are citizens about their rights and about the potential of oil for public service provision, the less effective is private patronage in winning support. Patronage thrives on the ignorance of citizens. Both domestic processes of educating the population, such as think tanks and media discussion, and international processes such as the internet are hugely important in building an informed society.

4. **Manage Post-Conflict Divisions (this is moderately easy)**

All post-conflict societies have deep social divisions. Often these produce further violence. The risk that divisions will re-open is highly sensitive to policy choices. Three policies can be shown to be effective globally in securing a peaceful and more unified society.

1 Broad-based growth

The faster the non-oil economy grows, the more peaceful the society will be. Growth and rising living standards are a sure and tested route to post-conflict peace. Thus, the challenge is to use the oil revenues to promote the non-oil sector, which I take up in my last section.

2. Prioritize social expenditures

Globally, in post-conflict settings social expenditure is atypically important for the growth process. This is partly because it signals to the entire population that the future is going to be one of social inclusion. In turn, this reassures people that violence will not return. It is a good idea to link some of the oil revenues explicitly to specific social goals. The disaffected elements in an oil-rich society invariably accuse the government of failing to use the oil for the benefit of ordinary people. This is true across both Asia and Africa. By having a clear and public link to a nationally inclusive goal, such as getting every child into school and properly immunized, this discourse of disaffection becomes less viable. As a complement to clear uses of oil revenues, it also cuts the ground from under the disaffected if revenues are made transparent. It is not enough for revenues to be well-used. Doubters need to be convinced that this is the case. Many governments in this situation look for convincing 'signals'. By good fortunate, the government of Angola has one available – the Extractive Industries Transparency Initiative. The key value of the EITI for the government of Angola is that it signals to the potentially disaffected that the government is handling oil revenues in a responsible manner. I recommend that the government should sign up to this initiative with as much local publicity as possible!

3. ***Deeply cut military spending***

The most paradoxical evidence on how to build post-conflict peace concerns military spending. In order to win a civil war it is necessary to raise military spending drastically, as the government of Angola did. This was an investment in peace. In post-conflict settings, however, high military spending significantly and substantially *increases* the risk of further conflict. This is a global result for which there is firm evidence. The reason why, uniquely in post-conflict settings, high military spending backfires is that is has the opposite effect to high social spending. Just as high social spending signals inclusion and so reassures people, high military spending unavoidably signals repression. This intimidates some people and arouses others. Even in the David-and-Goliath struggle between Israel and the Palestinians, repression has not been able to deliver lasting peace. Hence, the safest option is to cut military spending decisively, and transfer the budget to social spending.

5. Growing the Non-Oil Economy (this is moderately easy)

Post-conflict societies grow fast as long as policies are reasonable, and the non-oil parts of oil-rich societies grow fast if policies are good. As a post-conflict oil-rich society Angola has the chance for its non-oil economy to outperform China for the next decade. What policies are critical for this to become a reality?

1. ***Deregulate and de-tax the non-oil economy***

The private sector in Angola remains excessively regulated by international standards. Angola does not need to raise tax revenue from its non-oil economy other than diamonds and the other natural resources. Because much regulation is there in order to facilitate taxation, Angola should have one of the least regulated non-oil economies in the world. The switch from above-average to below-average regulation would be a huge spur to growth, especially to small firms that often face the most burdensome petty regulations.

2. Encourage small-scale construction

If Angola uses its oil resources wisely it will experience a large and sustained construction boom. Construction can be labour-intensive, creating masses of jobs for ordinary people. This should be one of the main transmission mechanisms by which oil spending translates into income for ordinary people. The design and choice of infrastructure projects should accommodate this, encouraging small, local firms to build using labour-intensive methods. For example, rural road-building can inject jobs into local economies as well as producing new roads.

3. Help agriculture to adjust to Dutch disease

Oil is going to appreciate the exchange rate and squeeze out those agricultural products that are easily imported. In Nigeria groundnuts and cocoa disappeared within a decade of oil exports. In Angola coffee and maize will probably go the same way. Rather than resist these changes, it may be better to help farmers to adjust to them by switching into produce which is less readily imported such as cassava, vegetables, and poultry. This is the job of an agricultural extension service. It will also help if peasants have a plentiful access to jobs in local small towns rather than all flooding in to Luanda. This requires public spending to be decentralized, with a rising share going to the peripheral regions.

Dutch disease can also be moderated. Since oil represents an increase in the supply of imports, the appreciation of the real exchange rate can be contained if there is an equivalent increase in the demand for imports. This can be achieved by liberalizing import restrictions, and by improving their distribution. Other ways of increasing the demand for imports are by having a high import content to public expenditure, which will happen automatically with a push towards infrastructure.

Conclusion

Angola is at a decisive point in its history. Choices now will determine whether over the next thirty years your country follows the well-worn path already trodden by Nigeria, or takes the initially more difficult route that leads to a society like Malaysia. You will decide which of these societies your children inherit.

If I were the Finance Minister of Angola, how would I balance my time between the five priorities set out above? Some are more important than others, and some are easier than others. Here is what I would suggest:

5% - get the macroeconomic basics right

35% - build systems for accountable public spending

20% - constrain political patronage

20% - build post-conflict unity

20% - grow the non-oil economy.

But I am not the Angolan Minister of Finance, I am only a spectator. I hope to live to see what Angola is like in 2036. You are now shaping the future, for good or ill.