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Angola: Struggling With Declining Export Earnings

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An Intelligence Assessment

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Angola: Struggling With Declining Export Earnings [redacted] 25X1

An Intelligence Assessment

This paper was prepared by [redacted] 25X1
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Angola: Struggling With Declining Export Earnings 25X1

Key Judgments

Information available as of 21 July 1987 was used in this report.

Angola is being economically and socially buffeted by the combined impact of lower oil prices and the indirect costs of fighting an internal war. The steep decline in world oil prices in 1986 has cut oil earnings to Angola's oil-dependent economy by one-third. At the same time, attacks by UNITA, while not affecting the oil industry to date, have cut production of diamonds—formerly a distant second to oil in export earnings—by three-fourths, causing further foreign exchange losses. Domestically, the drop in foreign exchange earnings is being compounded by the already high costs of battling the UNITA insurgency while driving home the effects of serious management deficiencies stemming from socialist policies. Growing shortages—particularly of food—are raising concerns among Angolan leaders over the potential political consequences of economic decline. 25X1

The Soviet Union, however, has kept the decline in oil earnings from endangering the security of President dos Santos's regime. A large increase in credit by Communist suppliers, particularly the USSR, has more than balanced the impact that reduced foreign exchange earnings could have had on Angola's military capabilities. We calculate that Moscow delivered more than $1 billion in military equipment in 1986. Hardware deliveries ranged from tanks and trucks to MIG fighter aircraft and SAM air defense systems. At the same time, Luanda—unable to meet repayment schedules to the Soviets—asked for and received from Moscow a three-year moratorium on repayment of principal on its $3.3 billion debt to the USSR. 25X1

Payments difficulties extend beyond the Bloc. Angola has fallen 6 to 8 months behind on scheduled debt repayments to Western creditors, according to sources of varying reliability. Arrearages, however, have not discouraged Western financial institutions from making loans in excess of $900 million for oil exploration and development in 1987. In addition, Angola is attempting to negotiate new payment terms for about $1 billion owed to Western lenders, in part by pledging future oil production as collateral, according to untested sources. Angola also is trying to attract Western aid and investment funds and is formulating economic reforms designed to increase domestic market incentives and economic growth. 25X1

Against this financial backdrop, Angolan officials appear to be increasingly concerned that deteriorating living conditions could provoke domestic unrest, according to reports from the press and sources of varying

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reliability. Foreign exchange shortages have forced Luanda to cut commercial food imports by more than one-third and have stimulated an active black market for basic goods. The government has sought foreign aid for the first time to meet food requirements in cities as well as in rural areas. Although we have no evidence of civil unrest over shortages, Luanda recently purchased riot control gear from Europe, signaling growing official concern, in our view. [redacted] 25X1

We do not believe, however, that Angola's economic slide alone will lead to regime-threatening infighting among the political elite or to increased flexibility on issues of importance to the United States, such as talks with UNITA or Cuban troop withdrawal. President dos Santos has been able to maintain consensus within the Politburo on most key issues, appears to have the backing of Moscow and Havana, and, in our view, is in a stronger political position now than at any time since assuming power in 1979. Luanda's military dependence on Communist largess and its difficult security situation will limit its flexibility on Cuban troop withdrawal. We believe that Moscow would rein in Luanda if economic ties appeared to be yielding appreciable Western gains in political influence. [redacted] 25X1

Looking further down the road, the combined effect of budget and foreign exchange shortfalls, UNITA attacks, and socialist management deficiencies virtually rule out chances for significant improvement in economic conditions outside the oil sector during the next few years. Unless world oil prices unexpectedly rebound to pre-1986 levels, relief from foreign exchange shortages will be limited to little more than the measured pace of increases in oil production, now projected by industry experts to rise from 280,000 b/d in 1986 to about 310,000 b/d in 1987, and to no more than 400,000 b/d by 1990. While Luanda probably will be able to cope with the dislocations generated by its present financial bind, the growing array of economic problems are likely to intensify Luanda's internal security and political problems over the longer term. [redacted] 25X1

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Scope Note

This Intelligence Assessment is part of a major research effort on economic, social, and political conditions in Angola. It expands upon a study of the critical role played by oil production and the revenue it generates [redacted] 25X1 [redacted] 25X1 [redacted] Forthcoming 25X1 papers will include assessments of the new information on Angola [redacted] 25X1 [redacted] the leadership dynamics of the Angolan regime, and the demographic and social changes provoked by the protracted civil war. [redacted] 25X1

Angola presents an extremely difficult collection environment because of the lack of US and IMF representation there, as well as poor collection and reporting of economic data by the Angolan Government. Consequently, reporting on basic economic statistics, such as national accounts, balance of payments, and budgets, is often sketchy and inconsistent. Economic reporting [redacted] 25X1 [redacted] has improved over the past year, however, providing enough 25X1 information to analyze major economic trends. Recent reporting [redacted] 25X1 [redacted] has furnished credible data on the balance of 25X1 payments, foreign borrowing, and economic reform. [redacted] 25X1 [redacted] 25X1 information on foreign borrowing and on some commercial relations with Cuba. [redacted] 25X1

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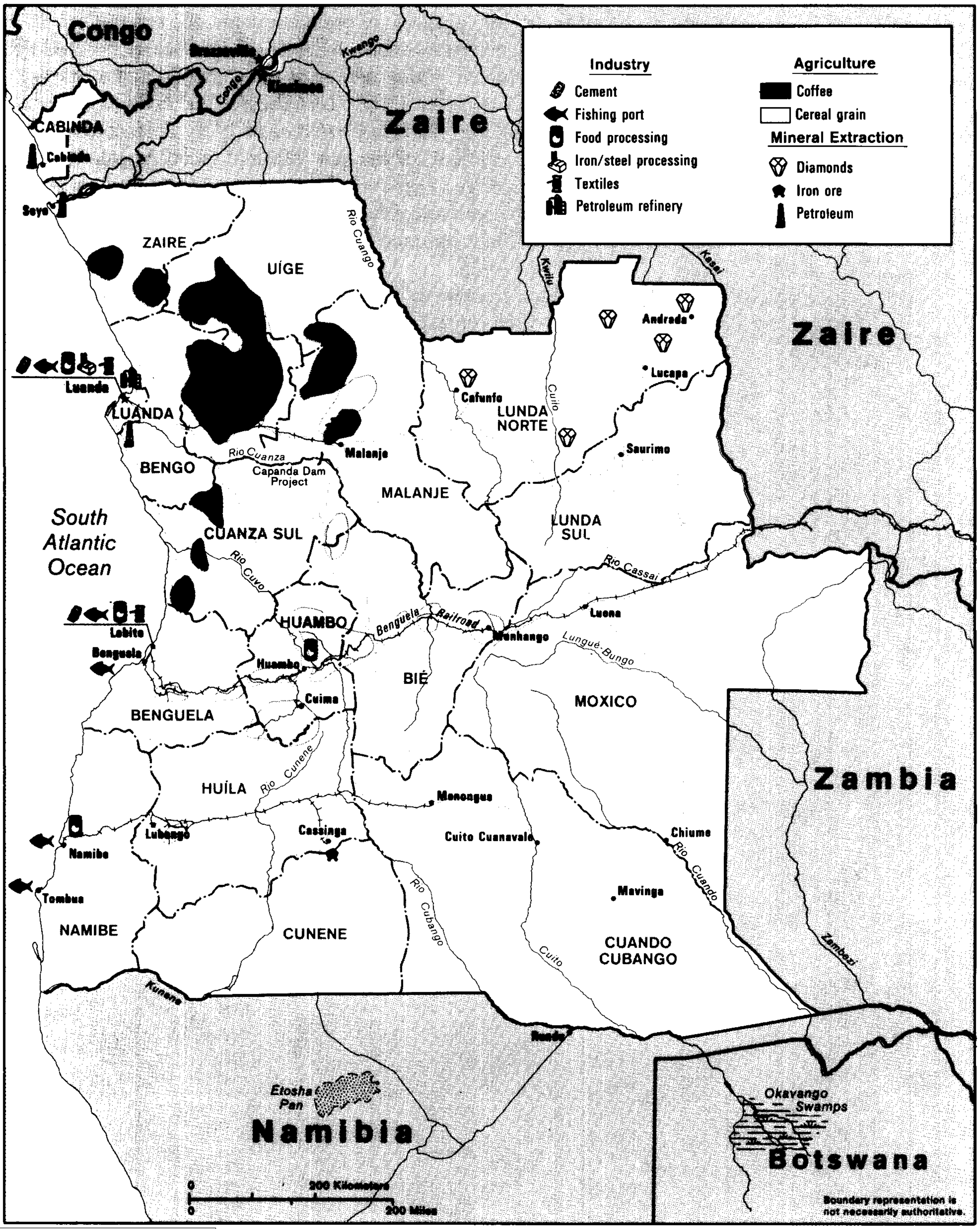
Figure 1
Selected Economic Activity in Angola



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Angola: Struggling With Declining Export Earnings [redacted] 25X1

Introduction

The steep decline in world oil prices in 1986 has profoundly affected Angola's already shaky economy. According to a review of [redacted] Angola's earnings from oil exports have declined by one-third despite steady increases in the volume of oil production and exports. Domestically, oil production accounts for about one-third of GDP, over 90 percent of exports, and more than one-half of government revenues. Taking both oil and other nonoil export losses into account, the decline of export revenue is translating into economic contraction, growing shortages, and sharply increased debt for Soviet and Cuban military aid. [redacted]

This paper analyzes the causes of Angola's current economic problems; examines measures taken by the government to offset the impact of reduced foreign exchange earnings, such as budget and import reductions and increased foreign borrowing; and assesses prospects for economic recovery. In addition, the paper looks at the domestic political implications for Angola of these economic changes, the role of the Soviet Union and Cuba in offsetting the impact of the decline in foreign exchange earnings on Angola's military situation, and assesses the implications for the United States. [redacted]

Increasing Financial Squeeze

Angola was hurt disproportionately when competition in Western markets by Saudi Arabia and other Middle Eastern oil-producing states pushed average international oil prices down from about $27 per barrel in 1985 to $15 per barrel in 1986. Luanda earned even less—an average of $14 a barrel, according to our estimates—because it was forced to cut prices for more than 40 percent of its oil exports to about $12 a barrel, according to data compiled by Angola's state oil company (SONANGOL), to prevent sales from lagging behind production. As a result, earnings from oil exports fell by one-third to about $1.3 billion last year, despite an increase of one-fourth in the volume of oil exports. [redacted] 25X1

Nonoil exports also fell sharply in 1986, according to reports from the press [redacted] as diamond production plummeted. A large-scale attack by UNITA (National Union for the Total Independence of Angola) in March 1986 virtually shut down Angola's principal diamond mine at Andrada. Efforts to reactivate a mine at Cafunfo during the summer to offset the loss of Andrada's production proved futile because of sporadic attacks by UNITA against resupply aircraft. A devastating attack by UNITA last December also destroyed mining facilities at Cafunfo and forced the evacuation of mineworkers. As a result, diamond production fell by three-fourths from 1985 levels to only about 180,000 carats in 1986. The impact of this decline on the value of total exports was offset, only in part, by small increases in coffee exports and in coffee and diamond prices, and by a sharp rise in the export of fish to more than $80 million. [redacted] 25X1

Economic Impact

The loss in export revenue, regardless of the source, has had a profound effect on the Angolan economy and the government budget. According to press reports, Luanda calculated that the export decline translated into a shortfall of about $600-800 million in budget revenues during 1986, compared with initial budget projections approved by the Angolan People's Assembly. Although Luanda was able to trim back its outlays by 15 percent from planned levels, [redacted] the budget deficit, compared with 1985, jumped by 25 percent to about $500 million. The cuts in budget revenues coupled with the foreign exchange shortfall in turn translated into an economic contraction of about 9 percent in 1986, [redacted] 25X1

The Economy at a Glance

As in most African countries, subsistence agriculture provides the main livelihood for 80 to 90 percent of Angola's population, but accounts for only about 10 to 20 percent of GDP. Oil production is far and away the most lucrative industry. Fish, coffee, and diamonds rank a distant second, third, and fourth, respectively, among exports. Angola's manufacturing sector accounts for 10 percent of GDP and includes about 180 companies in food processing, textiles, cement and other construction materials, assembly of imported machines and vehicles, and oil refining. [redacted]

Except for the oil sector, economic trends have largely been downhill since independence in 1975. GDP plummeted during and immediately after the transition to independence, according to our estimates, because of the mass emigration of 300,000 to 400,000 Portuguese residents, which depleted not only managerial, technical, professional, and skilled labor positions, but also the middle-class market. [redacted]

The economic decline was exacerbated over the first several years of independence by the government's drive to implement a socialist system, including nationalization of abandoned coffee plantations, mines, factories, banks, and the oil refinery. The introduction, beginning in 1976, of several thousand Communist 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 unfamiliar with local conditions, management techniques, and Western machinery to fill the void left by the Portuguese. [redacted]

The economy continued to contract during 1981-83, according to a government report, because of a combination of decreased world demand for petroleum, a plunge in world coffee and diamond prices, drought, and stepped-up attacks by UNITA. Guerrilla attacks against bridges, railroads, trains, roads, and vehicular traffic have strangled internal distribution systems. Fighting destroyed crops, prevented planting and cultivation, and caused shortages of seed, fertilizer, and parts for machinery. [redacted] 25X1

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Investment in expansion of the oil industry, spurred by the rise in prices through the early 1980s, began to pay off during 1984-85. Increases in oil production to 230,000 b/d in 1985 pushed up total exports by more than one-third over 1983 levels to $2.2 billion. Nevertheless, the current account deficit, which had declined to $67 million in 1984, according to press reports, nearly doubled as a result of increases in imports of food and other nonmilitary commodities, while foreign debt grew to about $2.7 billion by the end of 1985. [redacted] 25X1

Although the booming oil sector had reversed chronic economic contraction in 1984-85 for the first time since independence, according to an Angolan Government report, data in the press and from various sources indicate that all nonoil sectors continued to decline. Agricultural production equaled barely one-fifth of preindependence levels in 1985, according to press reports, and manufacturing output fell to less than 40 percent of capacity. Production of diamonds and coffee continued to fall, and by 1985 equaled only one-third and 5 percent, respectively, of preindependence levels. [redacted] 25X1

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Figure 2
Angola: Commodity Production and Price Trends, 1973-86

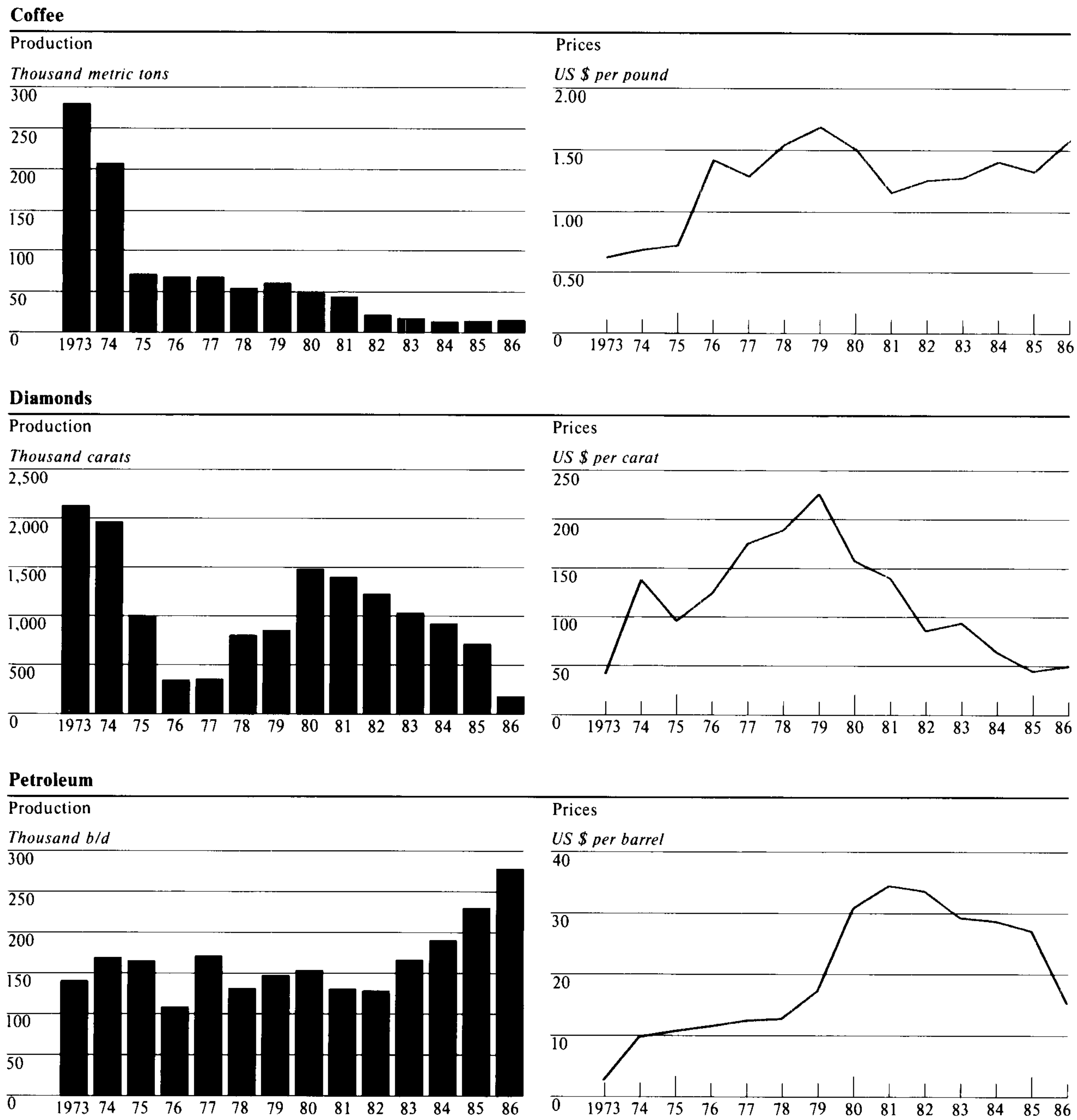

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Table 1
Angola: Government Budget, 1984-86

Billion US $

	1984	1985	1986 [a]
Revenue	2.5	2.6	2.3
Oil taxes	1.8	1.9	1.2
Other	0.7	0.7	1.2
Expenditures	2.7	3.0	2.8
Defense	1.1	1.1	1.2
Investment	0.7	0.8	0.5
Services	0.9	1.1	1.1
Deficit	0.2	0.4	0.5

[a] Because of rounding, components may not add to the total shown.

[redacted]

Deteriorating Living Conditions . . .

Regardless of the exact rate of economic decline, it is clear that living conditions, particularly in the cities, have seriously eroded in the past year. A variety of reporting, [redacted] indicate that the decline in foreign exchange earnings has brought increasing hardships, rising black-market activity, and severe shortages of most goods. In addition to longstanding complaints about shortages of water, electricity, and transportation services, travelers note increasingly inadequate supplies of imported consumer goods in urban markets, especially medicines [redacted] Cholera has become a serious problem in shantytown areas because of contaminated water [redacted] A wide assortment of imports, such as shipments of batteries from Japan and poultry from Hungary, have been canceled because of Angola's inability to pay, [redacted] Observations [redacted] corroborate press accounts depicting soaring prices in the black-market system as well as increased barter of consumer goods because of shortages and the government's inefficient and corrupt system of rationing. [redacted]

Perhaps the most severe shortages have occurred in foodstuffs. Foreign exchange shortages have cut commercial food imports from 192,600 tons in 1985 to about 120,000 tons in 1986, according to press reports. This has forced the government to seek foreign aid to meet the food needs of the country's cities, in addition to the normal food aid long needed in rural areas. Estimates by the UN Food and Agricultural Organization put the April-June harvest last year at about 300,000 tons, compared with about 500,000 tons annually in the mid-1970s. These estimates put requirements for food imports at nearly 340,000 tons for the period April 1986–March 1987. Government officials told a meeting of foreign donors in Luanda in June 1986 that about 600,000 Angolans were suffering from hunger and malnutrition, according to press reports. An emergency assistance plan presented by Luanda at the meeting included requests for 131,000 tons of cereals as well as $39 million worth of goods, such as blankets, clothing, and medical support. The MPLA (Popular Movement for the Liberation of Angola) government asked the Portuguese Government at the end of last year to arrange for the purchase of 50,000 tons of corn and 30,000 tons of wheat from the United States or West European countries, and in June 1987 Angolan officials visited Maputo to study Mozambique's emergency food assistance program [redacted]

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. . . and the Political Fallout

Growing shortages, particularly of food, have raised sensitivities among Angolan officials to the possibility of civil unrest in Luanda and other urban areas. At the same time, cuts in budget expenditures and foreign exchange earnings have allowed opposition elements in the MPLA Central Committee to delay economic reform, and undermine the positions of fellow officials who want to increase contact with Western countries.[1] Despite the seriousness of these economically induced problems, however, they do not threaten the political survival of the MPLA regime, in our view, and are unlikely to increase Angolan flexibility on key security issues. [redacted]

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Economic Reform

In addition to weighing policies designed to win greater Western investment and aid, Luanda is toying with economic reform ideas that, if implemented, would be aimed at spurring domestic growth. First considered at policymaking levels by the second MPLA party congress in December 1985, economic reform so far has centered around proposals to grant greater responsibilities to local managers in agricultural and distribution enterprises and to shift investment away from large state farms toward peasant farmers. Following the party congress, the land on 13 state farms in Huila Province was distributed among local farmers, according to press reports. [redacted]

Government planners are working on a more comprehensive program, to be initiated in 1988, that will include measures designed to achieve financial reform, monetary stabilization, and economic recovery, according to an untested source. Specific proposals will include:

- *Increases in prices to reflect more accurately scarcities of goods for sale and to improve the profitability of government corporations.*
- *Introduction of personal income taxes and of obligatory personal loans to the government, and reductions in government spending in order to cut budget deficits.*
- *Increases in interest rates to encourage saving, and improvement in accounting procedures and control over the debt of public corporations.*
- *Limitation of government credit to not more than the rate of savings, to limit the growth of the money supply.*
- *Passing of management responsibilities from central planning ministries to individual enterprises.*
- *Reservation of transportation, retail commerce, small and medium industrial and agricultural enterprises, and artisan production for the private sector.* [redacted]

In recent months there have been growing signs that Angolan leaders have become increasingly concerned about the potential consequences of severe food shortages in the capital. Indeed [redacted] 25X1 25X1 food shortages in Luanda have already induced dos Santos to initiate an investigation into deficiencies in the food rationing system. Moreover, reporting [redacted] indicates that 25X1 Luanda recently purchased riot control gear from several European countries. We believe a riot in early 1987 by a religious sect—albeit over noneconomic grievances—that resulted in more than 50 deaths probably has heightened concern among senior government officials that similar disturbances could erupt over economic shortages. [redacted] 25X1

The MPLA's concern with the economic situation has also been reflected in the recent removal of several senior government officials [redacted] 25X1 in early May dos Santos fired the 25X1 Ministers of Foreign Trade and Internal Trade as 25X1 scapegoats for the deteriorating food situation in Luanda and the countryside. Press reports indicate that the Transportation Minister was removed in March because of the poor performance of the distribution system. Economic shortfalls also have fueled charges of corruption and mismanagement at the highest level of the government, leading to the removal of the governor and other top officials of the National Bank of Angola, [redacted] 25X1 25X1 Officials fired so far have been technocrats without significant political bases in the ruling party, and have thus been targets for the senior party officials actually responsible for economic affairs. [redacted] 25X1

In our view, economic setbacks and personal rivalries among key economic ministers have stalled government reform efforts aimed at liberalizing the economy. Steep cuts in budget expenditures and foreign exchange earnings have left the government without the funds needed to implement many of the reforms. Sharp differences between the two most senior economic czars in the ruling party—Pedro van Dunem "Loy" and Maria Mambo Cafe—however, have probably been the primary reason for the stagnation of economic policy. Although ideological differences 25X1 may exist between the two [redacted] Cafe 25X1 is opposed to economic liberalization—we believe that the competition is mainly over political power. [redacted] 25X1 [redacted] the political struggle be- 25X1 tween the two has been expressed through an intense competition over the disposal of foreign exchange available to the regime and over finding sources to refinance Angola's debts on more favorable terms. [redacted]

Despite these difficulties in the economic decision making arena, we believe President dos Santos's political position is secure. [redacted] that there is consensus within the Politburo that the MPLA's top priority is a military victory over UNITA, and that the Soviets and Cubans continue to back this effort. In addition, continued oil revenues—even at reduced levels since the oil price decline—ensure that at least the political elites in Luanda will remain insulated for the most part from the economic hardships in the rest of the country. [redacted]

Handling the Foreign Payments Angle

The impact of the decline in export earnings is affecting not only internal conditions but also an array of external relations. Despite the major cuts in nonmilitary imports reported by the press, a review of trade and profit and dividend remittance data suggests that the country's chronic current account deficit has continued to increase. This, in turn, has generated a number of financial pressures as well as government attempts to find nontraditional solutions. [redacted]

Coping With Arrearages

Angola's most pressing financial payments problem has been its international debt. Despite measures to conserve foreign exchange, Angola has fallen behind on scheduled debt repayments to Western creditors. [redacted] the National Bank of Angola promised West European banks early last year that, despite the decline in foreign exchange earnings, it would honor short-term credits on time, make regular payments on commercial bank medium-term credits, repay all arrears by June 1986 on government-guaranteed medium-term credits—overdue since 1985—and in the future fall no more than five months behind. Nevertheless, Luanda has remained six to eight months in arrears on many short-term loans. Moreover, the National Bank of Angola has explained in a series of messages to the export credit guarantee agencies of Sweden, Italy, Spain, and the Netherlands that it has reduced significantly its outstanding medium- and long-term guaranteed obligations, but has been unable to reduce the delay in repayments to five months as promised. [redacted] 25X1

Despite these problems, Luanda has been able to arrange some financial relief. In addition to oil-related borrowing [redacted] press reports indicate that Angola has renegotiated repayment terms for $600 million in overdue debt to Brazil and Portugal; acquired $185 million in new credits and a six- to nine-month moratorium on repayment of principal from Spain; received loans of $140 million and $100 million, respectively, from Portugal and East Germany; and won $12 million in insured export credits from France for food imports. [redacted] 25X1 25X1 25X1

The government also has a number of arrangements still in the works that would provide further, albeit limited, relief. [redacted] for example, Luanda is working on a $75 million loan from Spain for a series of cold storage plants as well as $20 million in guaranteed credits by French banks for agricultural goods and services. Senior Angolan economic officials also are attempting to renegotiate repayment terms on about $1 billion owed to nine West European countries—Spain, France, Sweden, United Kingdom, Belgium, Netherlands, Yugoslavia, Italy, and Portugal— [redacted] Using an assortment of bonds and notes guaranteed in part by future oil deliveries, Angola hopes to bypass Paris Club rescheduling that would raise pressures to gain IMF approval. Without these new loans, debt service would absorb one-fourth to one-third of annual export earnings through 1990, according to projections by the National Bank of Angola. [redacted] 25X1 25X1 25X1 25X1

Oil as Collateral

Angola increasingly has tried to obtain new Western loans and export deals by promising future oil deliveries as collateral. Luanda, [redacted] is working on a deal, for example, whereby 2.2 million barrels of Angolan crude will be stored in Portugal as advance payment for Portuguese exports to Angola. In another oil collateral deal, [redacted] 25X1 25X1 25X1

Table 2
Angola: Balance of Payments, 1981-86 [a]

Million US $

	1981	1982	1983	1984	1985	1986 [b]
Current account	−287	−240	−34	−67	−110	−450
Trade balance	86	367	593	695	725	400
Exports	1,600	1,490	1,583	1,960	2,100	1,500
Oil	1,250	1,265	1,400	1,680	1,985	1,300
Diamonds	178	103	90	64	32	15
Coffee	96	94	70	79	54	60
Other	76	28	23	37	29	125
Imports	−1,514	−1,123	−990	−1,275	−1,375	−1,100
Service balance	−423	−633	−660	−787	−885	−900
Exports	207	131	76	98	120	100
Imports	−630	−764	−736	−885	−1,005	−1,000
Net transfers	50	26	33	35	50	50
Capital, medium and long term	237	100	55	203	224	300
Basic balance	−50	−140	21	136	114	−150
Financing	50	140	−21	−136	−114	150

[a] Data probably exclude military imports.
[b] Data for 1986 are estimated.

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[redacted] the French export credit bank has agreed to accept crude and fuel oil export contracts from Angola to finance a $25 million loan to cover arrearages and to apply against future debts. In a more ambitious scheme, SONANGOL has tried to convince the Chevron and Mitsubishi corporations to put up $75 million worth of non-Angolan oil as partial collateral for a $200 million loan, [redacted] To encourage their backing, Angolan officials claimed the loan would relieve pressure on Luanda to seek Paris and London Club rescheduling agreements. The officials argued that such reschedulings would restrict SONANGOL's access to Western money markets and force it to cut back on joint ventures with the two companies in Angola. [redacted]

In another large "oil for finance" deal, Angola is increasing oil deliveries to Brazil to pay for a planned $1.2 billion hydroelectric dam at Capanda, on the Rio Cuanza. The Capanda dam, to be designed and built by a Brazilian company using Soviet construction and power generation equipment, is Angola's largest non-oil capital construction project. The government estimates that the dam will cost at least $100 million a year until 1993. [redacted] Brazilian and Soviet estimates indicate, however, that delays caused by UNITA attacks on initial construction of access roads and other support facilities have already increased costs and delayed work by about one year. We believe that the dos Santos government is afraid that canceling or delaying the project would risk forfeiting as much as $750 million in up-front payments made for Soviet equipment. As a result, Luanda capitulated to Brazilian pressures to increase oil deliveries to the Brazilian contractor from 10,000

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Oil Exploration: A Source of Funds

Arrearages have not precluded substantial new borrowing by Luanda and by Western firms for oil exploration and development in Angola. Western banks and export credit agencies have approved at least $650 million in oilfield development loans over the past several months, and Luanda is completing negotiations on another $250 million, [redacted]

- *The French export credit insurance agency approved in January 1987 a $250 million line of credit by French banks for drilling 15 to 20 new wells by Chevron in Cabindan offshore fields.*
- *Angola is completing negotiations for about $250 million in loans to cover its share of development costs and to restructure payments on earlier loans for offshore oil development.*
- *The French oil company Elf-Aquitaine has approved a $100 million oilfield development loan to SONANGOL secured by promises of future oil deliveries as collateral.*
- *British banks have received approval from Britain's export credit agency for $300 million in credits for sales to Angola of machinery and equipment, primarily for the oil industry.* [redacted]

b/d to 30,000 b/d to compensate for the decline in oil prices and the added cost imposed by UNITA attacks, [redacted]

Other Measures

Luanda also continues to use an array of other measures to garner hard currency. Government programs include directives to foreign companies to pay hard currency for residential rental fees, hotel bills, and salaries of Angolan employees, [redacted] Since the oil price fall, the MPLA Central Committee has suspended hard currency allocations for foreign travel by Angolan Government officials, students, and cultural and sport delegations, according to press accounts. It also has directed nonmilitary government departments to postpone expenditures and reduce expatriate labor associated with foreign technical assistance contracts. The government has limited the distribution of ration cards to Angolan employees of government corporations, thus forcing private firms, foreign companies, and diplomatic offices to pay for imported goods with foreign exchange. [redacted] 25X1 25X1 25X1

In addition to these piecemeal measures, the government has been working to attract greater Western investment in Angola and to increase Angolan shareholdings in foreign companies. [redacted] 25X1 25X1 Angola has conditioned the renewal of oil development contracts on investment by foreign oil companies in nonoil-related social services. Chevron, for example, has agreed to build roads, an electrical distribution system, a television station, and new water and sewer systems for Cabinda, and Texaco is developing an agricultural project and training center. [redacted] 25X1

The Military Spillover

Despite the decline in Luanda's foreign exchange earnings, and thus in its ability to pay hard currency for military imports, both the USSR and Cuba have increased military aid flows to Angola. While Bloc military deliveries have continued apace, growing arrearages by Angola as oil prices declined generated considerable pressure on Luanda by Moscow and especially by Havana to catch up on repayments.[2] Evidence of Soviet pressures consists mainly of scattered remarks by Angolan officials about Moscow's 25X1 25X1

[2] Repayment pressures and dissatisfaction with Soviet Bloc trucks have encouraged Luanda to turn to Brazil for a portion of its military trucks. Dos Santos approved in March 1986 a $130 million contract to buy more than 2,000 trucks from Brazil, and chose Brazil over the USSR in December 1986 to [redacted] 25X1

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unhappiness with tardy payments. Cuban pressure, however, apparently was more heavyhanded. Last October, Cuba confiscated an Italian shipment of rice to Angola, asserting that the rice could serve as partial payment of Luanda's debts [redacted] Moreover, a Cuban freight enterprise operating to and from Angola threatened in late 1986 to end services unless Luanda paid $1.2 million in freight and charter expenses owed since 1 January 1986. Luanda finally paid this debt in January 1987. [redacted]

Cuba has also pressured Luanda to provide crude oil as partial compensation for services. Despite objections by SONANGOL and the Angolan Ministry of Energy, the Cuban state oil company conducted negotiations in mid-1986 to sell Angolan oil to firms from France, Switzerland, and the United Kingdom, and delivered cargoes of oil during the third quarter of last year [redacted]

President dos Santos persuaded Moscow during a visit in May 1986 to defer further payments on principal to the USSR until 1989 and to continue interest charges at 3 percent. [redacted] Angola's inability to stay current on repayments, moreover, did not discourage Moscow from continuing deliveries of military equipment, which totaled slightly more than $1 billion in 1986. As a result, estimates by the National Bank of Angola indicate that by October 1986 the Soviet portion of Angola's foreign debt had jumped to $3.3 billion from about $2.1 billion at the end of 1985 [redacted]

Outlook and Implications

Angola's economic situation is unlikely to improve significantly through the rest of this year or in 1988, in our judgment. At prices projected by industry experts—$17.00 to $17.50 a barrel—oil export earnings will total roughly $1.8 billion in 1987, still substantially less than the $2 billion earned in the peak year of 1985. Oil production is projected by the Angolan Ministry of Petroleum and SONANGOL to rise about 10 percent—from 280,000 b/d in 1986 to about 310,000 b/d in 1987, according to industry data. [redacted] 25X1 25X1

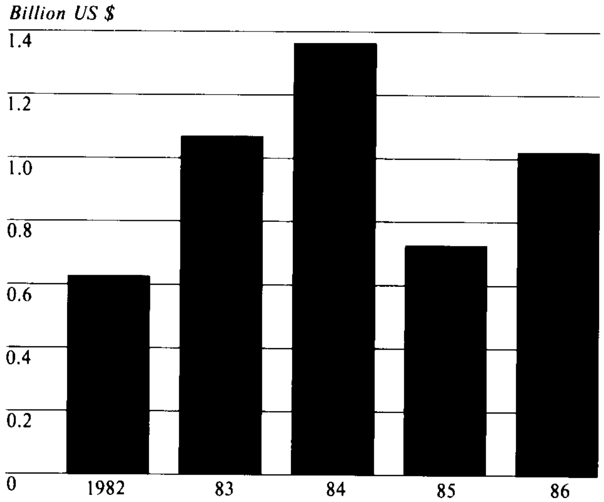
Even if oil prices unexpectedly rebound this year or in 1988 to $25 or $30 a barrel, a decline in the pace of oil exploration, in our view, has undercut Angola's potential for economic growth. SONANGOL officials said in January 1987 that they had reduced exploration plans because of financial limitations caused by low oil prices [redacted] These cuts plus disappointing results from two large offshore oil development projects, headed by AGIP of Italy and PETROBRAS of Brazil, have caused SONANGOL to cut its projections for oil production in 1990 from 500,000 b/d to 400,000 b/d. [redacted] 25X1 25X1 25X1 25X1 25X1 25X1

Angola's economic picture is further clouded by the likely failure of nonoil exports to rise above $100-200 million annually, according to our estimates based on a variety of reporting. UNITA attacks probably will thwart efforts to increase diamond production. Increases in coffee exports will be small, despite Brazilian aid and a large new concession to a Swiss coffee firm, because of the five-year maturation period required by coffee plants. Exports of fish, aided by Soviet technicians and equipment, also are unlikely to show further large increases, in our judgment, and other nonoil exports are unlikely to rise at all. An Austrian construction company, for example, has completed rehabilitating iron ore mining and exporting facilities at Cassinga that had been closed since independence, but UNITA attacks on the railroad link to loading facilities at the port of Namibe will prevent renewed exports [redacted] 25X1 25X1 25X1 25X1 25X1 25X1

Debt negotiations, even if successful, will not reduce problems significantly. We believe that most benefits will be offset by disruption to transport and distribution systems caused by insurgent attacks. In addition to direct damage to farms and crops by UNITA

[3] See the appendix for a detailed discussion of Angolan payments to Cuba. (S NF)

Figure 3
Warsaw Pact Military Deliveries to Angola, 1982-86



attacks, transport and distribution problems will cause shortages of imported seed, fertilizer, and machinery that will stall efforts to expand agriculture. Manufacturing output will remain depressed by raw material and spare part shortages, as well as by management deficiencies. While beneficial in the long run, the country's two major nonoil foreign investment projects—the Soviet- and Brazilian-sponsored Capanda hydroelectric dam and the Brazilian military truck repair facility near Luanda—both rely almost exclusively on imported technicians, workers, and supplies, and thus will provide very few new employment opportunities or spur demand for Angolan goods and services for the next few years. 25X1

The extent of the financial shortfall is reflected in the skyrocketing budget deficit—from $10 million projected before the oil price decline in 1986 to $780 million this year—despite a cut in budgeted expenditures from $3.4 billion to $3.1 billion, according to press reports. We see little prospect, however, that Luanda will be able to tap domestic and foreign lenders for sufficient funds to cover the deficit. After covering military outlays, which probably will equal or exceed the $1.1 billion budgeted for 1986, Luanda may be left with little more than $1.2 billion covered by budgeted revenues for nonmilitary spending. 25X1

All of these factors taken together have a number of serious short-term implications for the economy:

- The expansion of oil production will not be great enough to offset the negative impact of the UNITA insurgency on major economic sectors, such as agriculture, manufacturing, and distribution, and, as a result, the economy is likely to continue to contract, or at best stagnate, through 1988.
- Servicing foreign debt will remain a major foreign exchange drain, and will again become unmanageable when the Soviet moratorium on repayments ends in 1989.
- Growing shortages and hardships, particularly in Luanda and other urban areas, will increase the potential for civil unrest. 25X1
- Budget and foreign exchange shortfalls, disruption from UNITA attacks, and opposition among some government officials will continue to forestall significant progress on economic reform.
- Growing economic troubles will spur greater efforts by the dos Santos government to win Western aid and investment, which may in turn lead the USSR and Cuba to use their leverage to curtail Luanda's ties. 25X1

Although the government probably will weather these short-term problems caused by the decline in oil prices, the array of policies designed to improve longer term prospects—increased oil production, limited economic reform, and greater Western aid and investment—will prove insufficient to ease economic problems significantly, in our judgment. We believe that the costs of fighting the UNITA insurgency—direct 25X1 damage, indirect costs caused by interrupted transport and distribution, and budget drains for military expenditures—will continue to forestall economic recovery. [redacted]

Implications for the United States

Angola's economic problems are unlikely to lead to increased flexibility on key security and political issues such as reconciliation with UNITA or Cuban troop withdrawal. The large Soviet and Cuban military inputs over the past several years, which have bolstered Luanda's military capabilities, have increased its confidence that it can cope with the insurgency, and will not have to seek reconciliation. Moreover, Luanda's dependence on Soviet and Cuban military support makes it vulnerable to pressure from Moscow and Havana to limit its flexibility on the issue of Cuban troop withdrawal. [redacted]

Luanda's desire for Western aid and investment also is unlikely to lead to greater Western political influence. Angola's economic problems have significantly increased the cost to the USSR of its relations with Angola, and, in our view, Moscow may calculate that greater Western economic involvement will reduce the growing Soviet burden. We believe that Moscow will monitor closely Angola's dealings with the West, however, and pressure the Angolan officials with which it has close ties to work against Western gains in political influence that could undermine Soviet or Cuban interests. [redacted] 25X1 25X1

In our view, additional US economic sanctions on Angola would have little impact on the economic or political situation and gain the United States little additional leverage. In our judgment, new loans from European banks and export credit agencies and investment by European oil firms have offset the impact on Angola of current US commercial restrictions, such as the ban on US Export-Import Bank credits and on US company tax exemptions for operations in Angola. Similar adjustments could be expected if the United States cut off trade with Angola or forced Chevron and other US companies to pull out. [redacted] 25X1 [redacted] European or Brazilian oil com- 25X1 panies would quickly move in to fill the gap left by 25X1 Chevron and Texaco, and European, Asian, and Brazilian companies would supply equipment currently acquired from US firms. [redacted] 25X1

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Appendix

US and Cuban Interests in Angolan Oil Production

The interests in Angola of US companies, UNITA, and Cuba converge on the oil industry:

- US companies account for almost three-fourths of Angolan oil production and four-fifths of oil exports.

- UNITA President Jonas Savimbi has long seen the oilfields as a potentially lucrative target in his campaign against the MPLA, but has inflicted only minor damage because of UNITA's military weakness in the north where the oilfields are located, its inability to mount strikes against offshore rigs, and strong government defenses—manned partially by Cubans—around onshore oil facilities.[4]

- The flow of Angolan oil earnings to Cuba in return for military support provides a significant source of hard currency for Havana. [redacted] 25X1

Following are industry data on the physical distribution and ownership setup of the Angolan oil industry, and our estimates [redacted] of Angolan foreign exchange earnings from US companies and hard currency payments to Cuba. [redacted] 25X1 25X1

Geographic and Ownership Features
Angola's oil wells are concentrated in three areas, according to oil industry data:

- Approximately 200 Chevron-Gulf wells in nine oilfields off the coast of Angola's exclave of Cabinda exported about 200,000 b/d in 1986 through the Malongo and Takula loading terminals.

- About 15 wells operated by Texaco and by Elf-Aquitaine (French) in three oilfields off the northwestern coast of the Angolan mainland (about 230 kilometers northwest of Luanda) exported roughly 50,000 b/d in 1986 through the Quinfuquena and Palanco terminals.

[redacted]

- Over 80 small, onshore Petrofina (Belgian) wells in northwestern Angola and around Luanda produced about 30,000 b/d in 1986, which were processed for domestic consumption and bunkering ships by the country's only refinery near Luanda. [redacted] 25X1 25X1

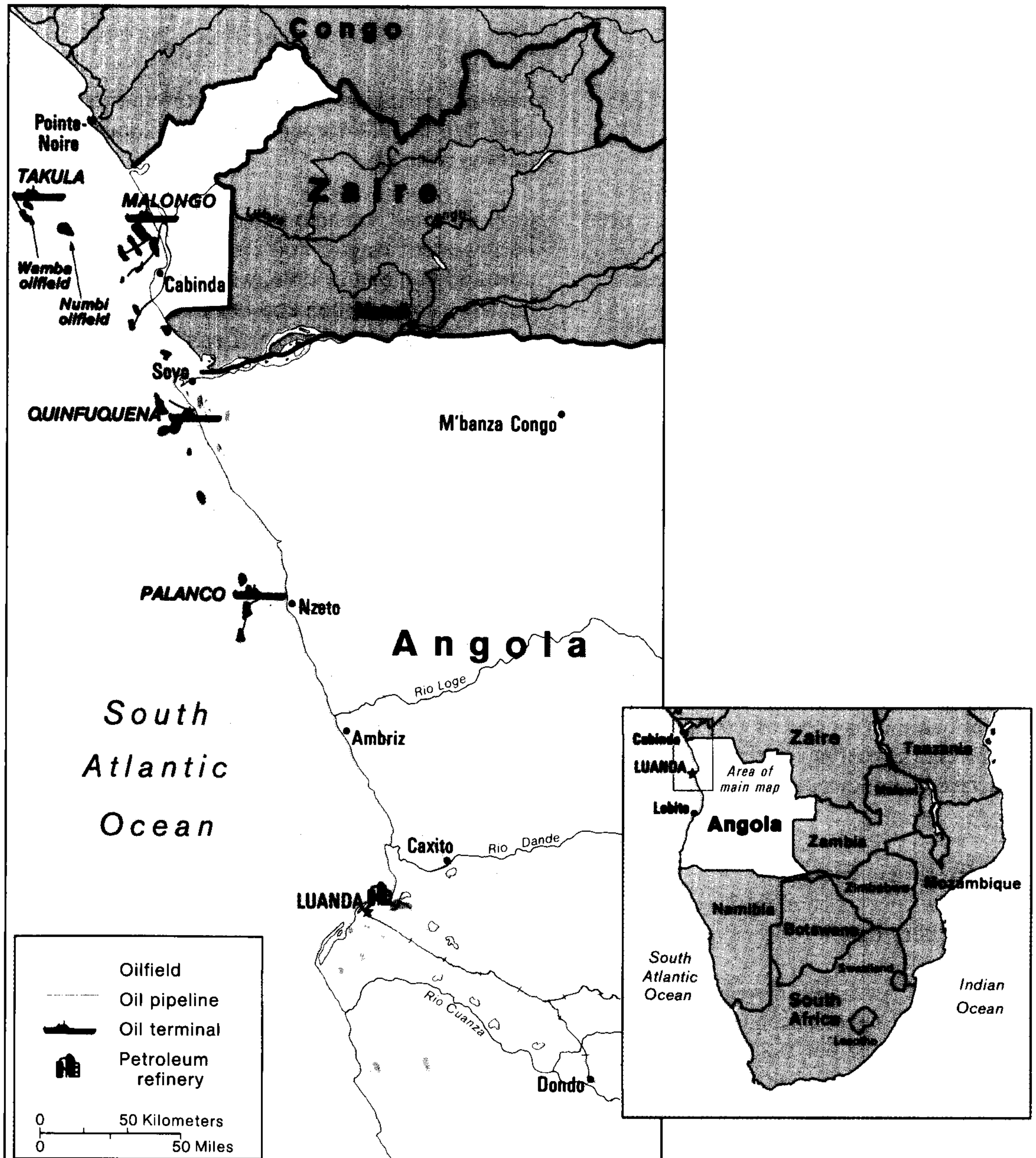
SONANGOL controls exploration and production through a combination of joint-venture agreements with companies that were operating before independence in 1975 and production-sharing agreements with companies that have begun operation since independence. SONANGOL is a 51-percent participant in joint ventures, and shares that percentage of investment expenses and petroleum output with its partners. In production-sharing agreements, foreign companies serve as contractors to SONANGOL, make the necessary investments, and are compensated by shares of proceeds from oil sales: 25X1

- The most important joint-venture agreement is with Cabinda Gulf Oil Co. (CABGOC)—now owned by Chevron—for Cabinda's offshore operations. Other joint ventures are with Petrofina for onshore production.

- Elf-Aquitaine and Texaco are the operating companies in production-sharing agreements for the two producing offshore areas outside Cabinda. Other members of these two consortiums and of other exploration groups with production-sharing agreements include AGIP (Italy), Petrogal and Braspetro (Brazil), Total (France), Mitsubishi (Japan), British Petroleum, Inanaftaplin and Naftagas (Yugoslavia), Hispanoil (Spain), Svenska (Sweden), Cities Service, Marathon, and Conoco. [redacted] 25X1

25X1

Figure 4
Angolan Petroleum Facilities and Oilfields



25X1

25X1

Four development projects by CABGOC will bring Cabinda's offshore production to about 230,000 b/d by mid-1988 [redacted]

- An artificial lift platform at Takula field will become operational in the fourth quarter of 1987.
- A production platform at a new field, called Numbi, will be completed by the first quarter of 1988. Production at Numbi is expected to peak at 65,000 b/d.
- A production platform at Wamba field, producing 15,000 b/d, will be completed in mid-1988.
- A water injection platform at Takula will be completed by late 1988.

Development by Texaco and Elf-Aquitaine will push non-Cabindan offshore production to about 110,000 b/d by mid-1988. [redacted]

Foreign Exchange From US Oil Companies

Chevron and Texaco are the only producing US oil companies in Angola. Other US oil companies there—Cities Service, Marathon, and Conoco—are involved in exploration in offshore Angolan waters but have not yet struck oil. Although we do not have hard data on payments by US companies to the Angolan Government, we believe that Angolan revenues come exclusively from production and exports. Angola apparently does not tax prospecting activities by foreign companies. [redacted]

Operations by Chevron from offshore wells owned jointly with the Angolan Government yielded about 200,000 b/d in 1986, about 70 percent of total Angolan production and 80 percent of oil exports. Production by Texaco, in partnership with a Brazilian company and the Government of Angola, equaled less than 10,000 b/d. [redacted]

We estimate that hard currency paid directly by Chevron and Texaco to the Angolan Government in royalties and fees totaled about $400-500 million in 1986, mainly from Chevron. In addition, Angola earned about $500-525 million in hard currency from sales of its share of oil produced by Chevron and Texaco.[5] We arrived at these estimates as follows:

- Chevron and the Angolan Government divide their oil production roughly in half—about 100,000 b/d to each partner, according to the terms of their partnership agreement. We assumed that Chevron paid Angola at world average prices—$15.35 per barrel—minus an operating fee reported by a reliable source to equal $2.00 a barrel. (100,000 b/d × 365 days × $13.35 per barrel = $487 million.) 25X1
- Angola sold its half of Chevron production for about $14 a barrel, according to our estimates. (100,000 b/d × 365 days × $14.00 per barrel = $511 million.)
- Under the terms of a production-sharing agreement, we believe that Angola sells all oil produced by Texaco—10,000 b/d—and pays Texaco and its Brazilian partner a fixed fee for costs, estimated at $10 a barrel, plus an estimated one-third of any earnings in excess of $10 a barrel. (10,000 b/d × 365 days × [$14 per barrel − $10 costs × 70 percent] = $10 million.) [redacted] 25X1 25X1

Hard Currency Payments to Cuba

[redacted] we estimate that Angola's hard currency obligations for the 37,500 Cuban military troops and 6,000 civilian technicians there equal roughly $300 million annually, about $150 million for each group.[6] Although [redacted] figures ranging from zero to $700 million annually for Angolan payments to Cuba, we have chosen [redacted] the most credible because of their specific mention of hard currency payments—as opposed to costs in local currency—and their accordance with our judgments about what annual costs would most likely run—about $25,000 per man for civilian engineers, doctors, and technicians, and $4,000 per man for combat troops: 25X1 25X1 25X1 25X1 25X1 25X1

- [redacted] January 1983 that, [redacted] Angola paid Cuba $15.6 million a 25X1 25X1 25X1

[5] Angola also earned about $300 million—minus operating fees—from oil produced by a consortium of companies headed by the French oil firm Elf-Aquitaine [redacted]

[6] In addition, we estimate that Angolan expenditures in local currency to defray the cost of Cuban combat troops total about $100 million a year. [redacted] 25X1 25X1

month—$187 million a year—for military and civilian aid and materiel, and that Havana insisted on payment in US dollars.

- [redacted] indicated that Angola paid Cuba $120 million annually in foreign exchange for commercial transactions and military and civilian cooperation.

- The [redacted] Angola paid $2,000 per man per month for Cuban civilian technicians—about $144 million annually for the estimated 6,000 technicians there.

- Angolan payments to Cuba were estimated by Western bankers in early 1987 at $150-175 million per year, about $4,000 per year for each of the 37,500 Cuban troops in Angola [redacted] 25X1

[redacted] 25X1 25X1 25X1

that Angola is incurring hard currency obligations to Cuba. Adjusting the information [redacted] 25X1 for increases in manpower levels since 1983 25X1 would bring hard currency obligations for civilian and 25X1 military aid to more than $250 million—a figure close 25X1 to our estimate of $300 million. [redacted] 25X1

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