The (non)-Impact of Democracy on Levels of Political Risk. An Evaluation of the Relationship between Levels of Democracy and the Political Risk facing the Oil and Gas Industry in Angola

By

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Declaration

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Abstract

In a world where emerging markets are increasingly driving the world's economic growth, and an increasing part of the world's energy supply comes from politically unstable or undemocratic countries with less developed institutions and inadequate rule of law, the field of political risk has acquired especially great significance. In order to keep up with international and domestic demand, as well as maintain profit levels, there has been and will continue to be a search for new sources of petroleum reserves. This has pushed the extractive industries to invest in new territories, some of which pose potential risks for new investments. These trends are changing where and how oil and gas companies conduct their business, as many of the political risks that face the extractive industries stem from the political, institutional and structural framework of the host country.

The core of this study has been the investigation of the assumption that high levels of democracy constitute low levels of political risk. The assumption that high levels of democracy constitute low levels of political risk implies, conversely, that low levels of democracy constitute high levels of political risk. The debate around this assumption is an essential part of this research study; its validity was tested through conducting an industry-specific political risk analysis, using the case of Statoil's operations in Angola. Angola poses an interesting case for analyzing political risk in the oil and gas sector, as it exhibits many of the qualities that are found amongst these "new" actors in the oil industry. Furthermore, additional and new research on the risk of investing in these emerging markets is more relevant than ever before. The stipulation of the relevance of this research study is based on the following two main points: firstly, the general decline in the level of democracy in Sub-Saharan Africa; secondly, the fact that many of the current oil and gas resources are located in these very areas, i.e. in undemocratic and unstable countries. Moreover, there is little research on the effects the level of democracy has on the industry-specific risk, in this case the oil and gas industry. Hence further research on this area is both relevant and necessary.

The political risk analysis shows that the political risks that face Statoil in the undemocratic nation of Angola are in fact not high. The analysis concludes with a result that indicates that investment in Angola poses a medium level of political risk. This challenges the abovementioned assumption, as the political risks are not necessarily higher in an undemocratic country. This study finds that the political risk associated with Angola is in the short- to mid-term seen as stable and medium; however, there are simmering tendencies and trends that currently point to a different long-term political risk picture.

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Opsomming

In ‘n wêreld waar opkomende markte die ekonomiese groei van die wêreld toenemend voortdryf en ‘n toenemende deel van die wêreld se energie voorraad van politiese onstabiele of ondemokratiese lande met minder ontwikkelde instellings en onvoldoende regering kom, het die veld van politieke risiko groot waarde gekry. Om by te hou by die internasionale en plaaslike vraag, sowel as om winsvlakke te handhaaf, is en sal daar altyd ‘n soektog na nuwe bronne van petroleum reserwes wees. Dit het die ekstraksie industrieë gedruk om in nuwe gebiede te belê waarvan sommiges potensiële risiko’s het vir nuwe beleggings. Hierdie neigings verander waar en hoe olie- en petrolmaatskappye hul besigheid doen omdat baie van die politieke risiko’s wat die ekstraksie industrieë moet hanteer voortvloei uit die politieke, institusionele en strukturele raamwerk van die gasheerland.

Die kern van hierdie studie was die ondersoek van die aanname dat hoë vlakke van demokrasie aanleiding gee tot lae vlakke van politieke risiko. Die aanname dat hoë vlakke van demokrasie aanleiding gee tot hae vlakke van politieke risiko impliseer dat lae vlakke van demokrasie aanleiding gee tot hoë vlakke van politieke risiko. Die debat rondom hierdie aanname is ‘n noodsaaklike deel van hierdie navorsingstudie; die geldigheid daarvan is getoets deur die uitvoering van ‘n industrie-spesifieke politieke risiko analise, deur gebruik te maak van die geval van Statoil se operering in Angola. Angola is ‘n interessante geval vir die ontleding van politieke risiko in die olie en petrolsektor, omdat dit baie van die kwaliteite toon wat onder die “nuwe” rolspelers in die olie-industrie gevind word. Verder is bykomende en nuwe navorsing op die risiko van belegging in hierdie opkomende markte meer relevant. Die stipulasie van hierdie relevansie van hierdie navorsingstudie is gebaseer op die volgende twee punte: eerstens, die algemene afname in die vlak van demokrasie in Sub-Sahara Afrika; tweedens, die feit dat baie van die huidige olie en petrolbronne in hierdie areas geleë is, d.i in ondemokratiese en onstabiele lande. Daar is ook min navorsing oor die uitwerking wat demokrasie het op die industrie-spesifieke risiko, in hierdie geval die olie en petroleum industrie. Daarom is verdere navorsing in hierdie area beide relevant en noodsaaklik.

Die politieke risiko ontleding wys dat die politieke risikos wat Statoil in die gesig staar in die ondemokrastiese nasie van Angola nie hoog is nie. Die ontleding sluit af met ‘n gevolgtrekking wat toon dat belegging in Angola ‘n medium vlak van politieke risiko toon. Dit daag die bogenoemde aanname uit, omdat die politieke risiko’s nie noodwendig hoog is in ‘n ondemokratiese land nie. Hierdie studie vind dat die politieke risiko wat met Angola

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geassosieer word in die kort tot middel termyn is en as stabiel en medium beskou word; daar is egter neigings wat dui op ‘n ander langtermyn politieke risiko prent.

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List of abbreviations

ANIP: National Agency for Private Investment

BBC: British Broadcasting Corporation

bbl/d: Barrels per day

BNA: Banco Nacional de Angola

BP: British Petroleum (formerly)

CL: Civil Liberties

CNE: National Electoral Commission

CPLP: Community of Portuguese-speaking Countries

CSO: Civil Society Organization

EIA: Energy Information Administration

EKN: Swedish National Export Credits Guarantee Board

FDI: Foreign Direct Investment

FNLA: Frente Nacional de Libertação de Angola

GDP: Gross Domestic Product

HIV/AIDS: Human Immunodeficiency Virus/Acquired Immune Deficiency Syndrome

HSE: Health Safety and Environment

IMF: International Monetary Fund

KPMG: Klynveld, Peat, Marwick, Goerdeler

MPC: Monetary Policy Committee

MPLA: Movimento Popular de Libertação de Angola

NGO: Non-Governmental Organization

NOC: National Oil Company

NOK: Norwegian Kroner

OPRR: Overall Political Risk Rating Score

PR: Political Rights

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PSA: Production Sharing Agreement

PWC: PricewaterhouseCoopers

Sonangol: Sociedade Nacional de Combustiveis

S&P: Standard & Poor's

T.I: Transparency International

U.S. United States of America

UN: United Nations

UNITA: União Nacional para a Independência Total de Angola

WTI: West Texas Intermediate

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Chapter One: Introduction

1.1 General introduction

Political risk[1] matters. In a world where large parts of the global energy supply comes from politically unstable and undemocratic countries, the field of political risk has become more significant than ever before. The world's economic growth is increasingly driven by emerging markets, that is, countries with less defined rule of law, less developed institutions and greater political instability. These new trends demand a shift in the way that companies operating internationally conduct their business. Companies need to understand and analyze these risks, and understand how politics affects the markets in which they operate, if their business is to flourish (Bremmer and Keat, 2009). Companies have always faced different types of political risks, such as terrorism, corruption, civil unrest, government policy change, and seizure of assets. According to Christina Davis from the Aon Corporation, such exposure to risk has never been as great as today: "people are doing business in more countries and in a more diverse range of countries than ever before" (Davis in Wood, 2009: 1). Political risk is everywhere and, in the words of Ian Bremmer, president of the Eurasia Group: "There has never been a time in the post-war period when political risk has mattered more" (Bremmer in Wood, 2009: 1).

Oil is considered the most viable source of energy available and it has become one of the basic building blocks of modern society. The global economy is completely dependent on the oil and gas industry, and access to oil has consequently become a matter of national security for the industrialized world (Shelly, 2005: 1-2). There is an increased flow of foreign direct investment (FDI) globally, and the extractive industries are among the key contributors to this trend. Multinational companies (MNCs) across the world compete to capture an early market share in the oil and gas industry as the gap between supply and demand is getting smaller (Shelly, 2005: 1-2). The extractive industries, oil in particular, have been the most sensitive area for foreign involvement, particularly in emerging markets (Lax, 1983: 30). The current trend is that these oil reserves are being extracted from emerging markets, and often unstable and undemocratic places in particular such as Nigeria, Algeria, Libya, Angola, and Ethiopia; this makes further research into the political risk tied to such investments essential.

The core of this study is an examination of the assumption that high levels of

[1] The term 'political risk' is used broadly in this study, incorporating socio-political risks as these pose industry-specific risks for MNCs (Frynas and Mellahi, 2003:547). This will be outlined further in Chapter Two in section 2.3.3.

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democracy constitute low levels of political risk. The assumption that high levels of democracy constitute low levels of political risk implies, conversely, that low levels of democracy constitute high levels of political risk. This research study therefore examines the link between democracy and the political risks for oil and gas companies. The basic notion that FDI and MNCs prefer to operate in democratic conditions and that democratic dispensations appeal to MNCs and FDI is widely debated among scholars (Jakobsen, 2012: 99). Li and Resnick (2003), Jensen (2003, 2006) and Jakobsen (2012) suggest that democracies have qualities that affect foreign investors positively. On the other hand, O'Donell (1978) argues that MNCs in fact can benefit from autocratic regimes, proposing that MNCs have an affinity for authoritarian regimes. Olson (1993) differentiates between long-term and short-term autocratic leaders, who produce different investment climates. Li and Resnick (2003) note that if the regime uses its unchecked power to control labor unions and wages, repress popular criticism of foreign capital, stifle disgruntled opposition parties, offer the MNCs generous rates of return and provide sensible macroeconomic policies, foreign investors may benefit from autocracy, at least in the short run. The assumption that democracies offer the best environment for MNCs and FDI is built on the argument that democracy has a positive effect on a number of segments in a society, which in turn benefits foreign direct investors, such as property rights, rule of law, stability, and the likelihood of expropriation (Jakobsen, 2012: 100). Non-democratic nations have a number of characteristics that tend to make them politically riskier than democratic nations. The study is based on the widely accepted perception among scholars that democratic institutions attract FDI, since there is low political risk associated with investment in democracies. In this study a positive correlation argument is adopted, meaning that high levels of democracy lead to reduce political risk for MNCs. With that as a starting point, the question then becomes: Does this positive correlation still apply when looking at the case of Angola?

As the second largest producer of oil in Sub-Saharan African, and with one of the fastest growing economies on the African continent, the civil-war torn country of Angola has yet to meet its full potential. It is a country in the middle of an oil boom, with multinational companies flocking to get their share, yet there is much more to this country than just a growing economy and vast oil reserves.

According to Freedom House, the democratic developments made in Sub-Saharan Africa through building democratic institutions over the past generation are coming undone. After two decades of significant gains, the continent has experienced a steady decline in

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democracy over recent years. Lack of adherence to the rule of law, violation of the freedoms of expression and association, widespread corruption and discrimination against women remain serious issues in many Sub-Saharan countries (Freedom House, 2012). This research study will offer an extensive investigation into the way that levels of democracy play out as a political risk factor for oil and gas companies operating in Angola, more specifically for the company of Statoil.

1.2 Preliminary literature review

The literature used in this research has been divided into four categories; the texts range from older studies with valuable contributions to this field to new texts with more recent information. The themes are divided into four categories as follows: firstly, political risk theory, analysis, and conceptualization; secondly; the contextualizing of industry-specific risks in the oil and gas industry; thirdly, democracy, its measurement and the Freedom House Index; and lastly, the analysis of political risk for oil and gas companies in Angola.

The first category, political risk theory and analysis, concerns the conceptualization of political risk analysis, the associated theories, and the theoretical framework based on the theories of rational choice and decision-making. There is an immense quantity of literature on political risk; however, one of the main books reviewed here is Brink (2004) *Measuring Political Risk to Foreign Investment*. Brink's book has especially aided the development of the theoretical framework of decision-making theory and rational choice. The conceptualization of political risk itself is largely based on the work of Robock (1971), Korbin (1978, 1979, 1981), Fitzpatrick (1983), Simon (1982), Lax (1983), Alon and Martin (1996), Alon et al. (2006) Brink (2004), Alon and Herbert (2009) and Jakobsen (2012). These scholars have been utilized for their theoretical and conceptual insights into the field of political risk theory and political risk analysis. The authors presented in this section illustrates the evolution of the term 'political risk', as well as the debate in the literature around the lack of consensus on how term 'political risk' should be defined. This will be explored in the second chapter of the research study.

The second category concerns political risk for the oil and gas industry, meaning industry-specific risks. The literature that will be covered in regards to this section includes Lax's (1983) *Political Risk in the Oil and Gas Industry*, Hallmark and Whited (2001), Frynas and Mellahi (2003), Alon et al. (2006), Alon and Herbert (2009), Berlin (2003), and Bremmer and Keat (2009). These articles and books underline the link between the oil and gas industry

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and political risk analysis, which will also be explored further in the Second Chapter of the research study.

The third category, the nature of democracy, will firstly look at the concept of democracy, with special reference to the writing of Robert Dahl (1971). Dahl's conceptualization of the concept of is widely accepted as valid. Furthermore the debate concerning the impact that democracy has on MNCs will be elucidated by the articles and books by O'Donnell (1978), Olson (1993), Li and Resnick (2003) Jensen (2003, 2006) and Jakobsen (2012), as these authors cover the main perspectives on the debate itself, as well as by further investigation and illustration of democracy's putative positive impact on the levels of political risk. In order to establish the level of democracy in the case of this study, namely Angola, Freedom House's ranking will be utilized and conceptualized. This third theme will be discussed in the both the second and third chapters of this research study. Freedom House has been chosen as it is an independent organization, whose objective is to promote freedom around the world and to speak out against breaches of democracy (Freedom House, 2014a). Their leading publication, *Freedom in the World*, is widely perceived as a crucial source in the development of democracy; hence their freedom framework has been chosen as the indicator of democracy for this research study. The research study adopts a thick [2] understanding of the concept of democracy as a premise for the research. The link between freedom and democracy, and the measurement of freedom as a measurement of democracy, is discussed in detail in Chapter Three. The study follows the logic of a broader or thicker conceptualization of democracy, where freedom is a necessary cornerstone of any democracy; consequently the measurement of freedom is also is a measurement of democracy.

The fourth category, the applied theory, is covered in the fourth chapter of the study. The model for political risk analysis will be applied in order to assess the political risks that oil and gas companies face in Angola. The model and the methodology that will be used are based on work of Boshoff and Lambrechts (2011) in their article "Investing in Troubled Territories. The Oil and Gas Industry in the Ogden region of Eastern Ethiopia: An Increasing Political Risk to Foreign Investors". This model has been chosen for this research study based on two of its key features. Firstly, it is specifically tailored to measure industry-specific risks; the risk factors of measurement have as such been chosen accordingly. Secondly, the literature used in the development of the model – Lax (1983), Berlin (2003) and Alon et al. (2006) – is key in the industry-specific risk literature, as well as in this particular research

[2] See section 3.3 for the conceptualization of the broader or thick democracy concept.

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study. Furthermore the model, which is built on the model in Alon et al. (2006), is a country-specific analysis and not a firm-specific model. Thus, this model is seen as particularly suitable for this research study. The Boshoff and Lambrechts (2011) model incorporates three types of political risk – host country political risk, company political risk and international political risk. Each of the three risk types contains a set of factors and indicators. The factors are weighed depending on the impact that factors have relative to the analysis and the other factors. The sum of the weighted factors scores provides an overall political risk rating score (OPRR) for the country or region under investigation. The OPRR determines the investment and the political risk indication of the country under assessment, which will be the end result of this specific political risk analysis.

1.3 Research question

The increased interest and activity in emerging markets has made political risk analysis a necessity for companies seeking to establish themselves in less developed and unstable areas of the world. When assessing the risk to possible profits of an investment, it is crucial to conduct a political risk analysis. A risk analysis refers to the entire process from identifying the risks, evaluating them, and to actually responding to the various risks in one way or another (Lindeberg & Morndal 2002: 2).

By researching the link between high levels of democracy and low levels of political risk, the aim is to falsify or confirm this link, with special reference to the oil and gas industry in Angola. Can one assume that high levels of democracy in fact equal a low level of political risk for an investor? Based on the issues that have been raised in this chapter following research questions are presented:

- *Do high levels of democracy constitute low levels of political risk for oil and gas companies?*

In order to answer this question the two following sub-question is posed to complement and support the main research question:

- *What is the level of democracy present in Angola?*

- *What is the level of political risk that Statoil faces in operating in the oil and gas industry in Angola?*[3]

The aim of this research study is thus to conduct a political risk analysis in order to

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[3] The level of political risk found for Statoil in Angola is expected to be translatable to the broader industrial sector within Angola, as there are not any particular company-specific risks tied to Statoil.

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answer the above research questions. A political risk analysis, in its attempt to manage the uncertainties of investments for the investor, can be seen as a rational attempt at problem solving (Brink, 2004: 30). Externally, the analysis examines the environment and, internally, the individuals' understanding of reality in order to comprehend and assist in solving problems that the investor faces (Boshoff & Lambrechts, 2011: 1). Political risk analysis sets out to assess the probability that various factors within a political system will affect business and investment climates in such a way that forecast profit would be negatively impacted (Brink, 2004: 21).

1.4 Relevance and objectives of the research study

This research study has two main objectives. The first objective is to test the assumption that high levels of democracy imply low levels of political risk. Establishing the present level of democracy in Angola will test this assumption, and subsequently conducting a political risk analysis of a company operating within that context will establish how the level of democracy affects the level of political risk. The second objective is to analyze what the actual level of political risk is for Statoil operating in Angola by using the risk model developed by Boshoff and Lambrechts (2011).

MNCs around the world realize the importance of an early market share, even in locations that may seem to have high-risk prospects (Alon et al., 2006: 623-624). Thus, companies can be said to be "forced" to engage in markets that are not classified as democratic, in order to get their share of the market. Undemocratic institutions and authoritarian leaders characterize many of these emerging markets, where much of the new oil and gas reserves are to be found. These tendencies are also seen in Ethiopia and Algeria, nations with oil and gas reserves, which also are classified as undemocratic by Freedom House (Freedom House, 2014a). As such Angola poses an interesting case for analyzing political risk in the oil and gas sector, as it exhibits many of the qualities that are found amongst these "new" actors in the oil industry. Furthermore, additional and new research into the risk of investing in these emerging markets is more relevant than ever before. On the one hand, these markets are new investment opportunities in countries where it has not been possible to invest in before while, on the other hand, one can observe a process whereby the level of democracy is declining in Sub-Saharan Africa in general. This is the paradox of the Angolan case: a flourishing oil nation on the one side, and what is described as an authoritarian and corrupt regime on the other side by multiple Norwegian NGOs criticizing Statoil's involvement (Skedsmo, Bade & Lunde, 2013; Aftenposten, 2014). Yet MNCs with

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high ethical and moral codes of conduct for their own companies choose to invest in Angola. As mentioned, one example of this is Norway. Angola is the most important African country for Norway, because Norway's nationally owned oil company (NOC), Statoil, controls 10 percent of the total oil production in Angola, as well as being Statoil's largest oil producer outside Norway (Statoil 2014; Hanssen 2012). This paradox brings us to the debate about the concept that high risk equals high turnover, also called the risk-return trade-off principle: "The principle that potential return rises with an increase in risk. Low levels of uncertainty (low-risk) are associated with low potential returns, whereas high levels of uncertainty (high-risk) are associated with high potential returns" (Investopedia, 2014). As Frynas (1998) writes in his article "Political Instability and Business: Focus on Shell in Nigeria", the apparent contradiction arises where Shell invests in what have been labeled as highly unstable and high-risk areas, such as Nigeria, Angola and Somalia, and choses to accept more risks in order to obtain higher profits (Frynas, 1998: 462-475). This debate is important, because it questions the ethical and moral codes of conduct that these MNCs adopt. Although this research issue extends beyond the scope of this study, it is nevertheless essential, as reputational mechanisms need to be taken into consideration. The issue will accordingly be kept in mind throughout this study. Western companies from well-established democracies, where the rule of law prevails, property rights are respected and the government fulfills its obligations to their citizens, "blindly" invest in undemocratic and corrupt regimes, where the oil revenues fall into the hands of the rich and, in the Angolan case specifically, the coffers of the presidential family. This research study does not investigate reputational risks, but acknowledges the concept and the relationships. The Angolan case will be further contextualized and outlined in the third chapter of the study.

The stipulation of the relevance of this research study is based on the following two main points presented in this section: firstly, the general decline in the level of democracy in Sub-Saharan Africa; secondly, the fact that much of the current oil and gas resources are located in these very areas, i.e. in undemocratic and unstable countries. Moreover, there is little research on the effects the level of democracy has on the industry-specific risk, in this case the oil and gas industry. The literature rather deals with MNCs in general, and is to a large extent not focused on a specific industry. Hence further research into this area is both relevant and necessary, which reinforces the relevance of this research study.

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1.5 Research design and methodology

The starting point is to design a feasible research strategy so that the research can be conducted according to the nature of the research questions. The research design provides the framework for the generation and analysis of data according to the priorities set by the researcher (Bryman, 2001). Thus, to be able to establish the result of the research, the research design and methodology will stipulate how the data will be collected, organized and integrated into the study.

This is a qualitative, single-case research study drawing on secondary data; the research will rely on existing data appropriate to the research question found in academic journals, articles, books, risk reports, democracy reports and newspaper articles. The data will be collected throughout the research process in order to allow adjustments along the way. The scope of the research is on the micro level, as it focuses only on the micro or industry-specific risks that are tied to the oil and gas industry, specifically looking at the case of Statoil in Angola. The use of a single case implies that the research study has a case study design; this design has been chosen because it allows for in-depth rather than wide-ranging study. A case study can be conceptualized as an empirical investigation that investigates a contemporary phenomenon within its real life context, and according yo Yin (1994) the purpose of a case study is not to obtain information about the problem area but to apply the data to a specific case (Yin, 1994). Furthermore, as noted by Burnham, Lutz, Grant and Layton-Henry (2008), a case study is most appropriate for a qualitative approach. Furthermore, a case study allows for a very complete account of a given phenomenon (Burnham et al., 2008: 66). The case of Angola has been chosen as it embodies several of the features that characterize emerging oil and gas markets today. The study is built on existing secondary data in order to analyze the causal relationship that the research question sets out to answer concerning the relationship between democracy and political risk for oil companies. The research study is explanatory, as it seeks to provide a better understanding of, and gain insight into, the topic. The study is also descriptive in that it seeks to describe the situation and events (Babbie & Mouton, 2005: 80). Furthermore, the research is causal, as it aims to establish a cause-and-effect relationship between the variables (Babbie & Mouton, 2005: 81; Newman, 2006: 33-35).

The theoretical framework of the study is based on problem-solving and decision-making theory, outlined in the second chapter. The third chapter, the descriptive section, will describe the current situation in Angola, as well as contextualizing the Angolan oil and gas industry. The qualitative data analysis of the information from the secondary literature will be

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structured in the form of a risk analysis. A political risk analysis entails the complete process from identifying the risks and assessing these in order to actually respond to the various risks (Lindeberg and Morndal, 2002: 2). The causal aspect of the study thus includes the application of the risk model to the case of political risk for Statoil in Angola, which will be applied in the fourth chapter.

1.6 Limitations and delimitation of the study

The intangible concept of political risk is difficult to define and conceptualize. The term political risk is not simply a reality standing on its own, as it does not refer to a specific object, state of mind, or a specific set of actions. Thus, one of the limitations of the research becomes the study of political risk in itself. If there is agreement on one thing in the literature, it is that there is no consensus on the definition of the term 'political risk' (Alon et al., 2006; Jakobsen, 2012; Alon & Herbert, 2009; Frynas & Mellahi, 2003; Brink, 2004). Furthermore the measurement and observation of political risk to a great extent depend on subjective individual judgment, which in some cases, according to Brink (2004), works as a handicap for political risk analysis (Brink, 2004: 2). Due to this limitation, in the political risk model for analysis it is essential to balance out the subjectivity of the user and provide a more objective estimation of risk that reflects the researched information. The role of the model of analysis is, according to Lax (1983), to refine the list and organize the variables, their relationship, flows and consequences into a useful analytical tool (Lax, 1983: 113-114). Thus, by applying a political risk model one aids this particular limitation to the study, as well as work as an objective framework of analysis for the researcher.

A second limitation that should be acknowledged is the single case research design in itself, as one cannot draw broad generalizations on the basis of this single research study. The context in which the oil and gas companies operate may not be translatable to other industries operating within Angola.

Undertaking field study in Angola as well as the collection of primary data would have been of benefit to this research study. However, as no financial resources were available, it was not possible to conduct a field study nor collect primary data. This limitation has been overcome by using up-to date-reports by Freedom House, descriptive literature on the state of democracy in Angola, as well as for the extractive industries. The literature used is adequately reliable and representative background for the purpose of conducting a political risk analysis.

The study will be limited in scope to focus on the research on the casual relationship between high levels of democracy in relation to the level of political risks, referring to lack of

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democracy as a political risk factor specifically for the oil and gas sector. The research will be further delimited in its historical span and incidents after June 2014 will not be included in the study, and as the study will deal only with the Angolan case.

1.7 Chapter outline

Chapter Two examines the theoretical framework, which serves as the foundation for this research study. Essential terms related to democracy and the theoretical framework related to the literature on democracy are conceptualized, as are the key political risk terms crucial for this research study.

Chapter Three will firstly contextualize the oil and gas industry, as well as the extractive industries in the Angolan case specifically. Moreover, the level of democracy in Angola will be examined and contextualized, especially by looking at the research of Freedom House.

In Chapter Four the political risk analysis model will be presented and applied by analyzing a set of factors and a subsequent risk report generated. The risk analysis presented will be used to test the research questions of this study.

Chapter Five will answer the research question and reflect upon the accomplishments of this research. Furthermore, possible improvements and avenues for further research are addressed. The goal is to make recommendations for companies seeking to invest, or who already have invested, in undemocratic countries.

1.8 Conclusion

This chapter serves as a general introduction to this research study. Furthermore, it provides a technical outline of the methodology, research design, limitations and delimitation, as well as a chapter guide. The objective of this study is to investigate links between high levels of democracy and low levels of political risk, the aim being to falsify or confirm this assumption when looking at the Angolan case. The next chapter provides the theoretical framework for this research study and will conceptualize the key terms within the field of political risk. The following chapter thus provides a foundation and framework for the remainder of the research study.

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Chapter Two: Theoretical Framework and Contextualization of Political Risk in the Oil and Gas Industry

2.1 Introduction

Multinational companies looking for new opportunities in uncharted territories and markets are often challenged with many unknown realities. Consequently, there is a need for companies to examine and identify these unknown conditions, which can translate into various risks. Risk is a constantly present factor in business decision-making processes, determining the appropriate ways to manage and mitigate such risks in order to achieve success in such business investments (Berlin et al., 2003: 1). This is especially important in the oil and gas industry, as there are high economic rewards at stake and as a result of the extensive time frame required for the contemplation of such investments. Still, while the oil and gas industry is susceptible to market price and commercial risks, it is also an industry that is highly exposed to political risks, given that the production pattern is directly related to the geopolitical location of oil reserves (Berlin et al., 2003: 2). Political risk management in the energy industry is of the utmost importance and should therefore play a key role in business strategies (Berlin et al., 2003: 2).

This chapter has three main components: firstly, it will review the political risk literature, which provides the theoretical framework that serves as the foundation for this research study; secondly, the key risk terms and concepts will be conceptualized; and thirdly, the concept of democracy is conceptualized and discussed in the final sections of the chapter.

2.2 Theoretical framework: Rational Choice Theory and Problem Solving Theory

The political risk literature that serves as the foundation of the theoretical framework of this study can be divided into two broad camps of scholars; the first group argues that the study of political risk has not yet been able to create a coherent theory of political risk, while the second group of scholars asserts the conceptualization and development of problem-solving and decision-making theory as the theoretical framework for understanding political risk. Political risk analysis is often criticized for failing to explicitly outline the causal relationship between variables of interest (Lax, 1983; Jakobsen, 2012; Brewer, 1993). The logical consequence of this shortcoming is arguably that any coherent theory of political risk has yet to evolve. As Lax (1983) argues, there are no general theories of political risk; analysts do not cover the area of study rigorously enough to allow for theory building (Lax, 1983). This issue is linked to the lack of a clearly defined dependent variable. The dependent variable may be

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an industry or company, or even project-specific, making it difficult to generalize to a broader theoretical framework. Most approaches identify the independent variables, although this is not always the case. There remains a major conceptual gap between identifying the field of study and the dependent and independent variables, on the one hand, and developing a theory of political risk, on the other (Lax, 1983: 110-111). Lax further argues that just as the gathering of facts does not produce understanding, the gathering of variables does not create a theory (1983: 111). As a conceptual tool for understanding, a theory organizes the variables, revealing how they interact and why. Here lies a serious shortcoming of nearly all approaches to political risk analysis: they are conceptually unable to explain why and how a given set of political risk variables affects the interests and goals of companies. (Lax, 1983: 111). In addition, Simon (1984) argues that there are three key reasons as to why a cohesive theory of political risk has not been developed. Firstly, the pressure for immediate results has been part of the reason for the lack of systematic analysis of political risk. Additional factors include a general skepticism among companies concerning the operationalization and quantification of non-economic variables, a preference for in-depth single-country analysis, and the lack of clearly defined boundaries for the discipline. Such skepticism is arguably rooted in a perception that political risk is too unstructured and subjective as a concept to be exposed to systematic quantitative analysis. The second factor obstructing the growth of a theory in political risk analysis is the problem of time pressure in companies that often favor sporadic individual country studies over a broader systematic cross-national analysis. A third obstacle is the nature of the study in itself. Simon here refers to the difficulty of economists, political scientists, business management scholars and legal experts communicating with each other, because their respective training and interests produce different ways of looking at the problem, which in turn precludes a collective growth in the discipline (Simon, 1984: 124).

More recently, Jakobsen (2012) describes theory building within the field as an "immense task given the assumption that political risk is a multidimensional phenomenon" (Jakobsen 2012: 39). The result of this, according to Jakobsen (2012), is rather unfortunate; the very firms that specialize in political risk assessment do so seemingly without basing their advice on any theoretical foundation (Jakobsen, 2012: 40). The lack of a coherent view on what constitutes the theoretical framework still remains a debated issue amongst scholars today, as illustrated by Jakobsen in his 2012 book, *Political Risk and the Multinational Company.*

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In contrast to this view, the second camp within the field has put forward problem-solving and decision-making theory as the theoretical foundation of political risk analysis, which will form the theoretical premise for this research study. Every aspect of business is ultimately a result of a decision made, a process of weighing and considering alternative possibilities in a given situation. Simon et al. (1987) contend that what steers the course of a society and its economic and governmental organizations is the process of decision-making and problem solving (Simon et al., 1987: 11). Problem solving includes the work of fixing agendas by selecting issues that are to be given attention, setting goals and creating an appropriate plan of action. Following this is the decision-making section, which includes the evaluation and finally choosing the decision to make (Simon et al., 1987: 11).

The theory of rational choice is one of the leading theories in the understanding of human behavior. This theoretical framework has been a dominant paradigm in economics, but in recent years it has become more widely used in other disciplines as well, such as the social sciences (Green, 2002: 2). Based on the same principles, decision-making theory and rational choice theory refer to the concept of rationality, meaning that a person acts upon balancing costs against benefits in order to arrive at a result that maximizes advantages. The starting point of such an analysis is the consideration of the choice of behavior of one or more individual decision-making units, which in basic economies are most often consumers or firms (Green, 2002: 2). According to this logic, the choice made by a company or an individual reflects the most preferred feasible alternative implied by the given preferences (Green, 2002: 46). Tversky and Khaneman (1986) ague that rational choice is logical rather than a psychological analysis of risk and value, and that normative analysis is used to forecast and explain actual behavior. Rational choice theory is regarded as a normative model of the archetype decision-maker, rather than an illustration of what real people do, as it tries to predict and explain why and how choices are made. People are generally seen as efficient in pursuing their goals, especially when there is an incentive to do so, and accordingly rational choice can be seen as a maximization process. Moreover, competition favors rational individuals and organizations, as optimal decisions increase the chances of survival in a competitive environment, and a minority of rational individuals can sometimes impose rationality on the whole market (Tversky and Khaneman, 1986: 251-252).

A political risk analysis adds value to the maximization process by laying out the potential costs against benefits, by outlining what is the best option of investment. Thus, when conducting a risk analysis, one draws the attention of the decision-maker to the different

problems that political risk might pose to the profitability of the investment. This creates an awareness of the problem, which means that management steps can be taken in order to avoid risks or gain profit from them (Brink, 2004: 30). According to Simon (1986), decision-making usually follows a six-step process, as outlined in the diagram below.

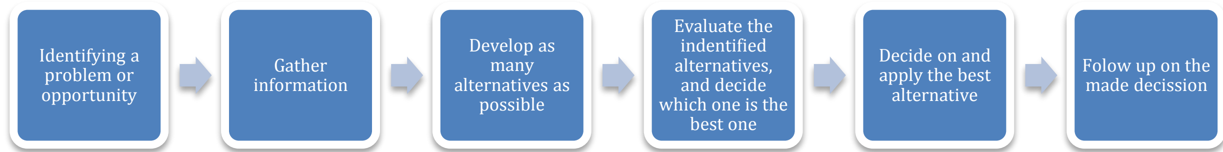

Figure 1. Decision-making process (Adapted from Simon, 1986: 11).

In order to identify, assess and manage a situation, political risk analysis evaluates both the external environment and the internal view of the business, in relation to the environment. Once a political risk analysis is conducted, it draws the attention to the political risks that can affect the profitability of the investment. Investments in countries that have high levels of corruption require both problem solving and decision-making among the people involved in the process. Political risk analysis assists in coming to a solution and helps rationalize the choice. As such, it becomes evident that solving the problem of where to invest or expand operations requires observations in order to find potential solutions; a political risk analysis requires observations in order to find potential solutions (Brink, 2004: 30-31).

Decision-making theory complements problem-solving theory, and it is generally assumed to be a theory underlying rational decision making in conditions of uncertainty. Uncertainty may derive from limited knowledge or from the objective random nature of the process occurring in or around the decision-making environment (Brink, 2004: 30). In problem solving potential solutions require a consecutive ordering of ideas that can be tested. It becomes clear that the solving of the problem of “where to invest” requires observations in order to find potential solutions. As the words “problem” and “solving” indicate, political risk analysis is concerned with situations in which one or more choices must be made, often under conditions of uncertainty (Beroggi 1999, in Brink 2004: 30). In both problem solving and decision-making management is required to make critical decisions on which strategy will be followed. Decisions may be strategic and often affect the long-term course of the company as a whole. Decision-making in smaller issues can be more tactical and operational, thus taken on a day-to-day basis within the company. Nevertheless, all decisions are important to the organization’s wellbeing (Simon, 1986). For the purposes of this study, it is argued that problem-solving and decision-making theory is the theoretical foundation of the field of

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political risk analysis, and it will accordingly also be used as the theoretical premise for this research study.

2.3 Conceptualizing key terminology

The objective in this section is to conceptualize the key political risk terms that are seen as essential to the study. The foundation that is built in the following sections is crucial, as it will provide the framework for presenting and analyzing the research data in the following chapters. First, the conceptualization of the term 'political risk' will be provided, followed by a discussion on micro-macro risks and industry-specific risks to the oil and gas industry. Secondly, the concept of democracy, and the link between political risk and democracy is examined.

2.3.1 Instability, risk and political risk

The intangible concept of political risk is not easily defined; the one aspect the literature does agree on is that a consensus has not yet been reached on a definition of political risk (Alon, 1996). A useful distinction to make when conceptualizing risk is the distinction between risk and instability. Instability is observable and can affect a company's property, equipment or licenses. Instability can take the form of a riot, or new government legislation and can cause harm to a company's assets. Risk, on the other hand, is not tangible, but rather a set of expectations concerning potential future instability that has market value and may regulate future revenue (Frynas and Mellahi, 2003: 545).

Risk is a subjective perception of how instability could affect a firm, and it is assessed to predict the probability of different types of instability (Frynas and Mellahi, 2003: 545). Risk is defined by Lax (1983) as the "chance of injury, damage, or subjective loss, compared to a previous standard", while the term 'political' refers to the class of decisions and events that concern the authoritative allocation of values and resources (Lax, 1983: 8). The term 'risk' is commonly associated with words such as hazard, peril, loss, threat, vulnerability, danger, misfortune, adversary, which are words commonly used in reference to uncertain situations (Boshoff, 2010: 22). Risk and uncertainty are both abstract concepts, which are difficult to measure. The distinction between the two concepts is described by Lindeberg and Mørndal as follows: "A decision is called risky when the probability that an event will occur in the future is precisely known, for example a roulette game. In contrast, a decision is called uncertain when the probability is not precisely known" (2002: 19). Both of these terms refer to future likelihoods, but risk implies the ability to calculate probabilities and therefore to protect against and manage future contingencies, whilst uncertainty does not (Lax, 1983: 8).

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Risk deals with measurable probabilities, while uncertainty deals with a subjective potential for a loss (Lax, 1983: 8) Brink (2004) argues that it is better to know what the risks are in order to manage them, rather than not knowing or being uncertain. Threats are recognized, Brink argues, as they are observed and measured, and as such one can plan ahead of them occurring, and predict or manage the threats (Brink, 2004: 3).

Political risk can be seen as a connected to risk, by being the analytical process that uses particular variables to forecast the possibility of events that may or may not affect an investment (Boshoff, 2010: 16). Political risk can assist in assessing how a business can be affected under different political scenarios (Moen, 2012: 17). As multinational companies work in a particular political environment, the phenomenon of risk must be assessed in a political setting. Political risk is a type of risk that investors, multinational companies, foreign-based organizations and governments face as a result of a politics-related situation, an unanticipated incident or environmental event. Political risk can be viewed as any political change that alters the expected outcome and value of a given economic action by changing the probability of achieving business goals (PWC, 2006).

Initially, the notion of political risk was narrowly based on the assumption of an inherently confrontational relationship between government and business (Alon & Herbert, 2009). The most common definition of political risk in the early generation of scholars concentrated on hostile governmental actions (Fitzpatrick, 1983: 249); it is most commonly understood in the terms of host government interference with business operations (Korbin, 1979: 67). Early political risk literature can generally be divided into two camps. The first group of scholars (Bunn and Mustafaoglu, 1978; Green, 1974; Thunell, 1977) defines political risk as the occurrence of any political events that might, directly or indirectly, affect foreign investors, such as expropriation, nationalization, tax increases and exchange controls. These incidents are normally "actions of governments" that directly obstruct the goals of multinational companies, which could result in the deterioration of the general investment climate of a country, and then causes losses for the firms (Jakobsen 2012: 30). The second group of scholars (Korbin, 1979, 1981, 1982; Poynter, 1982; Robock, 1971; Heenan, 1978) saw political events involving host-government interference with MNCs as the main direct cause of investor losses, that is, the chief form of political risk effects. Kobrin (1979) illustrates the view of the second group by stating that, "the emphasis on negative consequences of such government intervention entails an implicitly normative assumption that may not be universally valid" (Kobrin 1979: 69). Scholars in this second camp were

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critical of the strong focus on political instability in arguing that the events that usually are associated with such instability occurred rather infrequently, arguing that scholars were too preoccupied with events such as coups and revolutions. Incidents that were less eye-catching, though often equally detrimental and far more frequent, risked being overlooked and under-analyzed (Kobrin 1979, 1981; Lax 1983; Rummel and Heenan, 1978).

The contemporary view considers risk in a broader context grounded in and influenced by many environmental factors (Alon & Herbet, 2009). One of the most commonly used definitions of political risk is the definition by Stefan H. Robock, who draws the important distinction between political risk and instability, as well as the concepts of micro and macro political risk:

> Political risk in international business exists when discontinuities occur in the business environment, when they are difficult to anticipate, and when they result from political change. To constitute a "risk" these changes in business environment must have the potential for significantly affecting the profit or other goals of a particular enterprise (Robock, 1971: 7).

Lax (1983) and Simon (1982) follow along the lines of the earlier scholars, who conceptualized a broader environmental context in the definition of political risk. Lax (1983) defines political risk as "the probability that the goals of a project will be affected by changes in the political environment. It is the likelihood that political changes will prompt a change in the investment climate regulating a project" (Lax 1983: 8). Simon's (1982) conceptualization, which has become a widely accepted definition of political risk, states that "governmental or societal actions and policies, originating either within or outside the host country, and negatively affecting either a select group of, or the majority of, foreign business operations and investments" (Simon 1982: 68). His definition is further developed in Alon (1996) and Alon and Martin (1998) by adding an economic dimension to the definition – firstly, because the economic climate is understood as a central source in the political risk climate; secondly, because politics and economic, and thus the associated risks, are often are inseparable; and thirdly, because adding this dimension provides a more complete and precise conception of political risk (Alon et al. 2006). Frynas and Mellahi (2003) further expand the conceptualization, describing risk as a non-tangible concept, but rather a bundle of expectations concerning potential future instability that has a market value and determines future earnings. Furthermore, they see the distinction between risk and instability as a useful starting point when trying to define the concept of political risk. Frynas and Mellahi (2003) identify three types of uncertainty in the political risk literature: political risk such as war;

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government policy risk, which can involve expropriation measures; or social risk, which could manifest in the kidnapping of company staff. They further argue that the most common definitions of political risk exclude this third type of political risk, the social risk. A definition that excludes social risk is arguably too narrow to capture risk factors, which are often outside the sphere of the political process as, for example, in the case of Nigeria (Frynas & Mellahi, 2003: 547). Bremmer and Keat (2009) also operate with a broader definition of political risk: "the probability that any event will turn into a measurable loss". They further elaborate their definition by including risks such as global warming and demographic changes in their definition: "Political risk is the probability that a particular political action will produce changes in economic outcomes" (Bremmer and Keat, 2009: 4-10).

For the purpose of this research study a broader definition, which includes both a social and an economic dimension, is most appropriate, as a narrow definition would not be encompass the complex picture of the case in question. Thus, political risk is understood along the lines of the definitions presented in this section by Simon (1982), Frynas and Mellahi (2003), Alon et al. (2006) and Alon and Martin (2009). As their conceptualizations of political risk include multiple dimensions, they present a more holistic view of what political risk is and can be. Furthermore, as argued by Frynas and Mellahi (2003), risk should be interpreted as being primarily a company-specific or project-specific value assessment.

2.3.2 Country risk

Country risk is easily confused with political risk; nevertheless, the terms are intertwined and not easily separated. The term 'country risk' is often used to illustrate a variety of risk that can affect foreign investors. Country risk is usually taken to comprise all the many risks and uncertainties associated with conducting business across national borders, including those related to the economic, financial and political characteristics of a host nation (Jakobsen, 2012: 37). The term 'country risk' as opposed to 'political risk' has been gaining prominence because it has a broader meaning in that it can include any risk specific to a given country, whereas political risk restricts the risks to those that are exclusively political in nature (Bouchet, Clark, & Groslambert, 2003: 11).

However, Brink (2004) defines country risk as sovereign, credit and transfer risk. Country risk differs from political risk in the sense that country risk can be explained as potential financial losses as a result of problems arising from macro events in a country (Brink 2004: 18-19). The difference between political risk and country risk is explained by Brink (2004) as follows: political risk refers to the unwillingness of a country to repay loans,

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while country risk is a country's inability to repay loans. Thus, a country can experience one without the other, meaning that the two do not necessarily go hand in hand. This distinction between deliberate unwillingness and inability is essential; however, this can be hard to differentiate (Brink, 2004: 23). Economic and political variables as interrelated; behind a political decision to interfere with affairs of multinational companies can lie more fundamental economic or financial causes, and vice versa. Politics largely determines economic outcomes, including those that concern foreign investors (Jakobsen, 2012: 37). Thus Brink (2004) argues that it is important that country risk factors should be incorporated into a political risk analysis. The emphasis on the political factor is weighted less as a factor in a country risk analysis than it does in a political risk analysis. Political risk can therefore be seen as a factor of country risk, whereas economic indicators form a part of a factor of analysis undertaken in political risk, which may include political and societal factors and their indicators (Boshoff, 2010: 18). The global economy affects different spheres of a country and as such has political implications. As the two concepts are clearly interrelated, both concepts should be incorporated into a risk analysis.

2.3.3 Micro and macro risks or industry-specific risk

Making a distinction between micro and macro risks or industry-specific risk and the general political risk is not a novel approach (Robock, 1972; Kobrin, 1981, 1982; Lax, 1983; Alon & Herbert 2009; Alon et al., 2006; Simon, 1982). The terms micro and macro risk were originally coined by Robock in his 1971 article "Political Risk: Identification and Assessment". According to Robock's conceptualization, macro risks refer to large-scale and often dramatic socio-political incidents such as revolutions, warfare and substantial changes in investment rules – which may affect all businesses in the host country. Micro risks, on the other hand, are events, actions or changes that "are intended to affect only selected fields of business activity or foreign enterprises with specific characteristics" (Robock 1971: 9-10). Korbin (1981) defines the concepts as follows: "Macro risks are environmental events, which affect all foreign firms in a country without regard to organizational characteristics, and micro risks … are industry, firm, and even project specific" (Kobrin 1981: 253). Lax (1983) defines micro level risks as risks that specifically target particular sectors of the economy, types of firms, or even individual companies (Lax 1983: 10).

The micro-risk literature points to the even narrower concept of industry-specific risk. Alon and Herbert (2009) describe academic research on micro-political risk as "still in its infancy". Most of the research to date has focused on macro-political risk, generating broadly

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based insights into specific countries or regions. The lack of research on micro-political risk is probably the result of the difficulty in generalizing about risk that is specific to one case (Alon & Herbert 2009: 129). According to Lax (1983), the extractive industries, particularly oil, have long been the most sensitive area of foreign involvement, particularly in the developing world. There are a number of reasons as to why this is: the visibility of petroleum operations, and the importance of oil wealth and income to host economies. The vital role afforded to petroleum policies as the key to development, and the legacy of Western economic involvement in the developing countries, mean that the oil industry has proved to be especially sensitive to the turns of political events. As a consequence, the absolute and relative importance of oil in world affairs makes changes in the international industry politically significant (Lax, 1983: 30). Arguably this is still the case today; the terrorist attack on the joint British Petroleum (BP) and Statoil gas field of Amenas in Algeria on 16 January 2013 illustrates how the oil and gas industry remains a key target for groups seeking to prove their point politically (Golob, 2013).

Alon and Herbet (2009) argue that industries of strategic importance, such as natural resources, banking, finance and insurance, are more likely to be regulated than are industries of minor strategic importance, and thus face greater political risk (Alon & Herbet 2009: 129). Hallmark and Whited (2001) list a number of variables that affect industries such as oil and natural gas, electrical utility, and power companies: risk of wars and external threats; taxation systems; terrorism; civil and labor unrest; corruption; governmental regulations; repatriation restrictions; political instability; energy vulnerability; and environmental activism. Despite the long list of risks that the oil and gas industry are especially sensitive to, companies are arguably still "able and willing to work in almost any country in the world" (Hallmark & Whited 2001: 22). Lax (1983) classifies the industry-specific political risks posed to the oil and gas industry according to the issues involved; risk can as such be classified as transfer, operational, administrative/statutory, ownership, or contractual (Lax, 1983: 10).

Alon, Gurumoorthy, Mitchell and Steen (2006) make a narrower distinction between the risk that affects all sectors and, more specifically, the energy sector. Political risk variables such as war, terrorism, labor unrest, political instability and corruption are macro risk variables that will affect almost all sectors to varying degrees. Meanwhile, for the energy sector, variables such as energy vulnerability, oil embargoes, environmental activism and restrictions on oil exports can be identified as micro or industry-specific variables that especially affect the energy sector. One example of a risk that particularly affected oil and gas

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companies is, for instance, the Iraq War, which has become a major political concern for companies looking to invest in the region. Another example is Russia, a nation that has established itself as an oil-producing nation, but the unfavorable tax-system poses substantial potential risks for investors. In Nigeria ethnic militant groups kidnapped staff of oil companies, demanding ransom or employment (Alon et al., 2006: 632). Alon et al. argue that it is essential that, even though companies in the oil and gas industry monitor the macro variables, they should pay special attention to the particular micro variables that may affect them to a larger extent than macro variables (Alon et al., 2006: 632).

Another distinction made in the literature is firm-specific risk, which refers to the notion of political risk as being specific to a given firm. Robock's definition of political risk implies that changes in the business environment must have a potential for significantly affecting the profit or goals of a particular enterprise. It thus also follows that what is political risk for one firm may not be political risk for a different one (Robock, 1971: 7-8). Political risk is a subjective perception of how instability may affect the firm, and it is assessed to predict the likelihood of different types of instability (Frynas & Mellahi, 2003: 545). According to this logic, the risks that Shell face in Nigeria may differ from those that are facing Statoil. Shell's history in Nigeria as well as their business strategy will affect what level and type of risk they are subjected to; thus the political risk other companies in the same area are subjected to may be completely different. The same logic can be applied to the case of Angola. How one industry or company is affected by the level of democracy in terms of political risk will differ, as each company's history in the country, ties to the government and so on will determine the level of political risk that they may face.

2.4 Qualitative versus quantitative risk analysis

Political risk analysis is a multidisciplinary field; the normative nature of political risk analysis does not allow for complete objectivity. The objective of political risk analysis is to identify potential actions and to select the best course of action for a specific foreign investment (Brink, 2004: 31). In order to achieve this, the analyst needs to gain in-depth understanding of the investment environment of the host country; the needs of the investor; the elements in the host country and reputational impacts; and the effect these might have on the foreign investment (Brink, 2004: 32).

Various political risk agencies only use qualitative methods of analysis and apply them to models, while many political risk analysts seeks to quantify what is traditionally seen subjective political, economic and social factors, and apply them to mathematical models

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(Jessen, 2012: 21). Both qualitative and quantitative methods can be used in a political risk analysis; but versions that merge the two methods have been constructed into political risk models. An example of such a hybrid model is the one developed by Brink (2004) in the book *Measuring Political Risk*. Brink (2004) argues that the qualitative and quantitative approaches can be used in conjunction with one another, by merging the qualitative nature of soft variables and the quantitative hard variables into comprehensive political, social and economic factors of political risk (Brink, 2004: 12).

Qualitative researchers conceptualize variables and refine concepts as a part of the process of measuring variables. In contrast, qualitative researchers form new concepts or refine concepts that are grounded in data (Neuman, 2006: 460). Qualitative research involves collecting information in depth from a small number of cases and lays emphasis on in-depth knowledge about them (Burnham et al., 2008: 40). Qualitative research is defined by Strauss and Carbin (1991: 11) as establishing "findings not arrived at by statistical procedures or other means of quantification". Qualitative case studies are by nature exposed to the subjectivity of the researcher, as the researcher's interpretation may be influenced by background, opinions and values (Lindeberg and Mørndal, 2002: 17). The advantage of the qualitative method in relation to political risk is that there are a large number of variables that interconnect and, by using the qualitative method, they are separated more easily. Some companies find that quantitative methods minimize the subjectivity bias inherent in using only qualitative methods (Lindeberg and Mørndal, 2002: 31). Tjin (1988: 145) defines quantitative research as follows: "any analytical procedure that is based on data that can theoretically lend themselves to statistical or mathematical operations". There is a range of different quantitative methods; the most common approach is to predict the probability of the occurrence of a certain event through the use of a number of measurable indicators.

A fundamental problem with quantitative analysis in social science is that social science is difficult to represent quantitatively. This is also true for political risk, as argued by Lindeberg and Mørndal (2002). Political risk is difficult to quantify and the evaluation of it is thus made in a more or less subjective manner (Lindeberg and Mørndal, 2002: 3). This is thus one of the main reasons why the majority of social sciences include qualitative research. Other issues are associated with statistical probability; according to Brink (2004), political risk is not an actuality that can be analyzed and calculated, but rather a metaphor for a wide array of other phenomenon. Even though political risk analysis uses mathematically similar words such as likelihood, chance and probability, political risk analysis is not mathematical in

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the pure sense of the term; it involves judgments and not mathematical calculations, according to Brink (2004: 117). The uncertainties surroundings the validity of political risk analysis is also related to the skepticism related to the field of political risk, referring to the multidimensionality of the field of political risk (Brink, 2004: 12). The objective of using a quantitative method is to come to a thorough and balanced forecast; it is not a means to predict the statistical probability of events (Boshoff, 2010: 30). The main difference between the qualitative and quantitative methods of political risk analysis is how the models are used. There are, however, common features, such as that both models include micro risks within a macro environment; they are generally industry specific; and they exclude risks that are not a relevant threat. Furthermore, the models accommodate the specific client and also include factors that add to the reliability and validity of the analysis, which again is indicated by the specific client's needs and demands (Jessen, 2012: 23).

For the purpose of this study a hybrid model is preferred; a hybrid model merges the qualitative and quantitative method, which is seen as beneficial as it aids the controlling the subjectivity of the researcher. Furthermore, the multidimensional nature of the field of political risk calls for research methods that can be adopted across the different fields of study, meaning that the research can easily be communicated to audiences in other fields of study; furthermore, the companies for whom the analysis is conducted often prefer a qualitative method of research. As this research study looks at the oil and gas industry, it is only natural to select a method that such companies generally utilize.[4]

2.5 Conceptualizing Democracy

*The basis of a democratic state is liberty (*Aristotle, *The Politics).*

In the following sections of this chapter the concept of democracy and the relationship between political risk and democracy will be further examined. Democracy has been a concept debated for more than two and half millennia. There is little consensus within the literature about how to conceptualize democracy, nor how democracy can or should be measured, through time and across countries (Coppedge et al., 2011: 247). During the twenty-five centuries that democracy has been supported, debated, attacked, ignored, established, practiced, destroyed and re-established, this process has seemingly created consensus on some of its key principles and questions, Robert Dahl argues (1998: 3). The fact that democracy has such a long history, Dahl notes, means that democracy has meant different things to different

[4] The Boshoff and Lambrechts (2011) model and methodology used in this research study is explained in detail in Chapter Four, sections 4.2 and 4.2.1.

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people, at different times and places (1998: 3). For instance, the US was classified as democratic during much of the 19th and the 20th century, while at the same time it excluded a large part of the electorate, as blacks and women were not allowed to vote (Coppedge et al., 2011: 248). In order to establish what constitutes a non-democratic state or low levels of democracy, which is essential for this research study, one needs to establish what in fact constitutes a democracy. The term 'democracy' in the most basic sense means, "Rule by the people". All usage of the term also presumes sovereignty; arguably a society must have some degree of self-governance in order for a democracy to be realized (Coppedge et al., 2011: 248). Another minimal definition describes democracy merely as a system in which rulers are selected by competitive elections (Schumpeter, 1942 in Przeworski, 2002: 12).

When conceptualizing democracy a distinction should be made between electoral and liberal democracies, or minimalistic and liberal definitions. Przeworski (2002: 16) argues that a minimal conceptualization, are insufficient, because democracies only endure under certain conditions; elections alone are not sufficient for a lasting democracy. In the end the quality of democracy is what is important (Przeworski, 2002: 16). By definition Larry Diamond contends that liberal democracies, meaning the broader conceptualization, provide good protection of human rights, while electoral democracy by definition does not, as there arguably is no inevitable reason that electoral democracy and liberty must go together. There are currently many illiberal democracies with human rights abuses and civil strife, which has rekindled scholarly interest in liberal autocracies as a better, safer and more stable form of government than transitional forms of government (Diamond, 2002: 30). In his celebrated 1978 book *Polyarchy: Participation Opposition* Robert Dahl presents a broader definition of democracy or polyarchy as he labels it, saying that it:

> denotes a system of government that meets three essential conditions: meaningful and extensive competition among individuals and organized groups (specially political parties) for all effective positions of government power, at regular intervals and excluding the use of force; a highly inclusive level of political participation in the selection of leaders and policies, at least through regular and fair elections, such as no major (adult) social group is excluded; and a level of civil and political liberties-freedom of expression, freedom of the press, freedom to form and join organizations-sufficient to ensure the integrity of political competition and participation (Robert Dahl, 1971: 3-20).

Dahl's definition of polyarchy encompasses not only the freedom to vote, and contesting of the office, but also the freedom of speech and publish dissenting views, freedom to form and join organizations, as well as alternative sources of information (Diamond, 2002: 32). Larry Diamond states that the liberal democracy requires, firstly, the absence of reserved domains

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of power for the military and other actors not accountable to the electorate. In addition to the vertical accountability of rulers to the ruled, Diamond argues, it requires the horizontal accountability of officeholders to one another; this constrains executive power, which aids in constraining the executive power as well as aiding the protection of constitutionalism. Furthermore, it protects civic and political pluralism, as well as individual and group freedom. Freedom and pluralism can in turn be secured only through the rule of law; under the rule of law all citizens have political and legal equality, meaning that the state and its agents are also subject to the law (Diamond, 2002: 35).

In order to compare and measure democracy, consensus about the definition is desirable but impossible, according to Coppedge et al. (2011: 248). For example, if one cannot agree upon what X is, one cannot measure X either. Thus one must be aware what the definition adopted encompasses; a too narrow definition of the concept of democracy allows for labeling a society such as the United States as democratic, through-out the twentieth century and much of the nineteenth century, while large sections of the electorate are in fact not allowed to vote. However, Coppedge et al. (2011) argues that a broad conceptualization of democracy can be criticized for including factors that arguably derive far from the fundamental meaning of the term, "rule by the people

The independent organization Freedom House is widely known for its annual "Freedom in the World" report and "Freedom Index".[5] Freedom House operates with a thicker conceptualization of democracy, measuring the level of civil liberties and political rights in a country in order to determine the level of freedom in a given country. Freedom House argues that by using a broader conceptualization of democracy they are able to measure the real-world rights and freedoms enjoyed by individuals within a nation (Freedom House 2014b). One of Freedom House's main objectives is to speak about threats against democracy. Freedom House describes freedom as being possible "only in democratic political environments where governments are accountable to their own people; the rule of law prevails; and freedoms of expression, association, and belief, as well as respect for the rights of minorities and women, are guaranteed". Their publications have been described as an "essential source" and "indispensable guide" to democracy's development (Freedom House 2014b). One of the fundamental problems with measuring and comparing the concept of democracy begins at the level of the definition. For the purpose of this research study, a thick

[5] The Freedom House index and methodology will be explained in detail in Chapter Three, sections 3.3 and 3.3.1.

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conceptualization of democracy is adopted. Furthermore, a thick conceptualization arguably ties in better with what is most commonly perceived as a democratic state, which arguably entails more than elections and a multiparty system. Hence Freedom House's index and annual reports provide the basic premise for what constitutes an actual democracy in this research study.

2.5.1 The link between democracy, autocracy, MNCs, FDI and political risk

> *Monarchy is the best type of government because the King is then the owner of the country. Like the owner of a house, when the wiring is wrong, he fixes it"* (Banfield, 1958: 26 in Olson, 1993: 567).

The literature is full of conflicting theories and incompatible empirical results advocating either a negative or a positive impact of the level of democracy on the level of political risk for multinational companies. In this section the two main positions related to this issue will be examined. A currently widely accepted notion is that investing in emerging markets requires that so-called "soft infrastructure" is in place (Dunning, 1998; Jensen, 2006; World Bank, 2002; Jakobsen, 2012). Societies where democracy, the rule of law and bureaucratic efficiency is well established minimize the transaction costs for economic actors and hence also the scope for rent-seeking opportunism (Levy and Spiller, 1994; Mudambi and Navarra, 2002; North 1990). On the other hand, when institutions are poorly developed, a society can easily become caught in a vicious circle of autocratic uncertainty, deprivation of of property rights, high transaction costs, low levels of investment, and low levels of growth and development (Heinz, 2000; Hicken et al., 2005; North, 1990).

In his 1993 article "Dictatorship, Democracy, and Development" Mancur Olson presents the concept of "the rational long-term autocratic leader". Olsen's theory is based on the logic that it is in the interest of a secure autocrat to provide peaceful order and public goods that increase productivity. An autocrat[6] with a long-term perspective on his position has an incentive to increase productivity and to extract the maximum possible surplus from the society and use it for his own purpose. But an autocrat who expects a brief period in power will find that it is in his interest to confiscate as many assets or levy as many taxes as possible (Olson, 1993: 567). According to Olson (1993), an economy will generate maximum income only if there is a high rate of investment, even though the returns of said investment are received long after the investment is made. This means in turn that an autocrat who takes a long-term view on his position will try to convince society or investors that their assets will

[6] The term autocrat refers to "a person who rules with unlimited authority, one who has undisputed influence on power" (Merriam-Webster Dictionary, 2014).

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be permanently protected from theft by others, but also from expropriation by the autocrat himself. If investors fear expropriation, they will invest less, and this means that in the long-term the income for the autocrat will be reduced (Olson, 1993: 571). Thus, according to the logic of Olson's argument, it is clearly in the interest of an autocratic leader to provide a secure investment climate. The rational autocrat will have an incentive, because of his interest in increasing the investment and trade of his subjects, to promise that he will never confiscate wealth or repudiate assets. However, as Olson (1993) argues, the promise of an autocrat is not enforceable by an independent judiciary or any other independent source of power, as autocratic power by definition implies that there cannot be any judges or other sources of power in the society that the autocrat cannot overrule. Any dictator could, because of his insecure hold on power, take a short-term view; thus the promises of an autocrat are arguably never completely credible (Olson, 1993: 571).

Democracies, on the other hand, Olson argues, have an independent judiciary and, furthermore, electoral challenges can help to guarantee property rights and the security of long-term investments. There is typically no reliable contract enforcement in an autocracy, unless there is an impartial court system that can call upon the coercive power of the state to require individuals to honor the contracts they have made. Individuals need property and contract rights protected from violation not only by other individuals but also by the entity that has the greatest power in the society, the government (Olson, 1993: 572). Investors favor such democratic regimes, because their assets are protected from destructive banditry by dictators. Following the logic of Olson's argument, one can presume that higher levels of democracy are associated with higher levels of FDI, because of lower levels of political risk. Nevertheless, democracies are not necessarily long-term oriented either; the terms, tenure and time horizons of democratic political leaders can arguably be even shorter than those of the typical autocrat, and democracies can lose a great deal of efficiency as a result. However, in a secure democracy with predictable succession of power under the rule of law, the decision and enforcement of individual rights is not short-sighted, which often is the case under the rule of the autocratic leader. Thus Olson (1993) argues that capital often flees from countries with ongoing or episodic dictatorships (even when these countries have relatively little capital) to the stable democracies, even though the latter are already relatively well supplied with capital and thus offer only modest rates of return (Olson, 1993: 572). Olson (1993) states that the fundamental obstacle for long-run progress in autocracies is the fact that individual rights, such as property right and contracts confidence, can never be truly secure, at least over

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the long run (Olson, 1993: 572). As an autocrat usually has completely unchecked power, and thus has the power to change policies, laws and contracts quickly.

Jakobsen (2012) argues that MNCs prefer to invest in democratic nations. This is primarily based on the notion that risk of ex-post government intervention and policy changes are lower in democratic societies than in autocratic ones, but also because the political process in democratic countries is likely to be dominated by labor, which benefits from FDI (Jakobsen, 2012: 99). Jensen (2003, 2006) also concludes that democratic governments attract higher levels of foreign investment. The presumed credibility-enhancing nature of democracies is to a large extent based on the fact that there is no unchecked ruler through the presence of veto players and executive constraints, such as opposition parties, an independent judiciary and a parliament, whereas in an autocratic regime rule is most likely completely unchecked (Heinz, 2000; Jensen, 2006; Leeds, 1999). Undemocratic societies often have a number of different characteristics that often make them politically riskier than democratic societies. Autocratic regimes, even when they seem stable, may hide an underlying instability that ultimately leads to sudden and unpredictable change (Bremmer, 2005; Gates et al., 2006). Furthermore, Jakobsen (2011, 2012) argues, autocratic regimes worsen the investment climate by increasing the likelihood of corruption through giving bureaucrats and local businessmen the ability to extract rents from administrative procedures, exploit political institutions often tarnished by cronyism, and constrain MNC operations. Another risk that MNCs run by investing in such regimes is reputation risks, by increasing the likelihood of NGO and shareholder activism, as well as the probability of lawsuits against the company (Jakobsen, 2012: 103). Reputational risks such as those described here can have a huge impact on companies' operations in a country; however, reputational risks will not be further examined in this research study, as the scope of this study limits itself to political risk.

O'Donnell (1978) presents an opposing view to Jakobsen's (2012), arguing that investors and autocrats often have a close relationship; as a result of the political leader's interests in the economic profits from FDI, the autocrat protects foreign capital from popular pressure for higher wages, stronger labor protection, or less capital-friendly taxation (O'Donnell 1978). The augment presented by O'Donnell illustrates that the investor-state conspiracy arguably favor foreign capital in highly autocratic societies. Haggard (1990) similarly argues that authoritarian regimes may be attractive to MNCs from countries where there are strong labor unions, or leftist economic traditions. An autocrat may in some contexts even protect property rights instead of practicing banditry, and furthermore, an authoritarian

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ruler may "give political elites autonomy from distribution pressures", allowing a broader range of economic policy options for the investor (Haggard, 1990: 258). Authoritarian regimes do have some policy discretion at their disposal, which enables them to make decisions and implement new policies relatively quickly (Leeds, 1999). Li and Resnick (2003) note that if an authoritarian leader uses his unchecked power to control wages, suppress popular criticism of foreign capital, suppress opposition parties, offer the MNCs lavish rates of return and provide reasonable macroeconomic policies, foreign investors can benefit from autocracy, at least in a short-term perspective (Li and Resnick, 2003: 203). Firms select investment sites based on how well their ownership-specific and internalization advantages mesh with location-specific benefits. Host government policies create location-specific conditions that affect how well a firm can exploit its advantages (Li & Resnick, 2003: 180).

Although the majority of the literature (Jakobsen, 2012; Jensen 2003, 2006; Heinz 2000; Bremmer, 2005; Gates et al., 2006; Leeds, 1999; Olson, 1993) concludes that democracies attract MNCs and FDI, because of the lower investment risks and a more secure investment climate, the notion of investing in an undemocratic country is not foreign to MNCs. Furthermore, many of the theoretical arguments presented in this section illustrate how creating a good investment climate in fact is in the best interest of the autocrat, and thus it is arguably not a farfetched notion that investing in a state under an autocratic regime in fact does not equal a high political risk level.

2.6 Conclusion

The first aim of this chapter was to provide the theoretical framework for the concept of political risk, as well as conceptualizing key political risk terms. The second objective was to conceptualize democracy, as well as the theoretical framework and debate on how the level of democracy affects political risk. This research study sets out to test whether high levels of democracy constitute low levels of risk, as the majority of the literature argues. Following this logic thus means that low levels or lack of democracy increases the political risks of investments. The theoretical and conceptual aspects of the research, which have been presented in this chapter, set the framework for the subsequent chapters of the study. The next chapter addresses the case of Angola; it will contextualize the oil and gas industry in general and in the Angolan context specifically, as well as further explore the issues related to the measurement of democracy.

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Chapter three: Angola and the Freedom House approach

3.1 Introduction

The first objective of this chapter is to contextualize the Angolan case with regards to democracy and the extractive industries. In addition, the national Norwegian oil company Statoil and its operations in Angola are contextualized. This is done in order to conduct a risk analysis of the political risks that face Statoil's operations within the Angolan context. The second objective is to implement the measurement of democracy using the Freedom House approach in order to determine the present level of democracy in Angola. This will answer one of the two sub-research questions of this study: "What is the level of democracy present in Angola?" In order to analyze whether high levels of democracy constitute low political risk, it is essential first to establish the current level of democracy in order to build on this analysis in Chapter Four.

Angola emerged from more than four decades of war to become Sub-Saharan Africa's second largest oil producer and third largest economy (Richmond, Yackovelev and Yang, 2013: 3). The Angolan case has been described as the perfect example of the duality of wealth and misery within a country, with an abundance of natural resources and a population living in extreme poverty (Le Billon, 2001: 57). The United Nations Human Development Index ranks Angola as number 148 out of 186 countries, which puts Angola in the lowest category of human development (UN Human Development Index, 2013). In 2002 the Angolan Ministry of Planning noted that as a result of the decades of civil war, the "destruction of the country's infrastructures, feeble health and education system, food insecurity, non-qualified human resources, disarticulated production, and misdistribution of revenues" have resulted in 58 percent illiteracy rate among adults, 75 percent lacking basic sanitation, and 65 percent having no health care (McMillan, 2005: 158). In the same year oil exports were $7 billion and diamond exports were $800 million, so the oil and the diamonds were bringing in about $700 per citizen. Meanwhile, 70 percent of Angolans were living on half that amount, less than a dollar a day (McMillan, 2005: 158). Although the major inequalities and high levels of corruption in Angola are not the focus of this study, it is still important to make a note of the context that oil companies are operating in. Is the pervasive corruption in fact is a symptom of the low level of democracy in Angola? This also ties in with some of the issues raised in Chapter One of this study regarding Western companies who choose to invest in countries entrenched in corruption, with authoritarian leaders and countless human rights violations. These are issues that should be kept in mind when examining the Angolan case, as one cannot

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detach issues such as inequality, corruption and poverty from the way a country is ruled and the risks that such issues can create for oil companies operating within this context.

3.2 Angola – the historical backdrop

Angola was ravaged by civil war for some three decades following independence from Portugal in 1975. However, the anti-colonial struggles begun years earlier, in 1961, with the start of the anti-colonial war. Angola settled into a low-intensity war, mainly fought in the peripheral areas of the country, which on the whole did not affect the large urban areas (de Oliveira, 2007: 596). The origins of the Angolan conflict had little to do with oil or other natural resources. The key causal factors were the nature of Portuguese colonial rule, particularly its failure to prepare for a stable transition to independence. As well as the development of three rival nationalist movements, each with a different ethno-regional core, competing external supporters, and leaderships set on achieving absolute power at the expense of their rivals (Hodges, 2001: 7). Hodges (2001) argues that, unlike the main colonial powers in Africa, France and Britain, which from the mid-1950s began to prepare their colonies for nationhood, the Salazarist[7] regime in Lisbon regarded its African provinces as an integral part of Portugal and thus did not prepare them for independence (Hodges, 2001: 8).

In Angola the nationalist camp was divided into three rival factions, the urban Movimento Popular de Libertação de Angola (MPLA), with a leftist orientation and self-proclaimed pan-Angolan discourse, attracting support from the country's second largest ethnic group, the Mbundu. The more ethnically based Frente Nacional de Libertação de Angola (FNLA) and União Nacional para a Independência Total de Angola (UNITA) both drew the majority of their support from the large ethnic groups the Bakongo and the Ovimbundu. These two factions, UNITA in particular, received outside support from the West (de Oliveira, 2007: 597; Hodges, 2001: 8). Despite military weaknesses, the nationalist challenge played a vital role in Angolan late colonial politics, pushing the Portuguese substantially to alter the nature of their presence and to make economic reforms (Clarence-Smith, 1985: 194). This meant opening up the previously protected economy, making major urban infrastructure investments, and the doubling of the European population. Consequently, the economy of the late colonial period was diversified and vibrant, with an annual real

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[7] Salazarism as an authoritarian political system in Portugal as well as in Africa, and thus there were no democratic traditions in the African colonies prior to the sudden disintegration of the empire in 1974-75. In the Portuguese colonies of, Mozambique, Guinea-Bissau, independence followed an armed liberation struggle (Hodges, 2001: 8).

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growth of 4.7 percent between 1961 and 1974, despite the ongoing war in isolated provinces (de Oliveira, 2007: 597).

The 1974 democratic revolution in Lisbon halted the ongoing development process, with the Portuguese deciding to end the fighting in Angola, which led to talks with the three nationalist factions and a commitment to decolonization. The 1975 Alvor peace agreement between the Portuguese and the three rival nationalist groups soon broke down, resulting in a three-way war for the control of the country. This lead to the invasion of Angolan territory by Cuban, Zairian and South African troops, each in support of one of the three competing nationalist factions (de Oliveira, 2007: 597). The MPLA and its Cuban allies triumphed in the capital of Luanda on the day of independence on 11 November 1975 and acquired control of the postcolonial state, after 14 years of armed struggle (Heimer, 1979 in de Oliveira, 2007: 597). Seizing power after defeating the Western-backed FNLA, the MPLA faced substantial problems in asserting its legitimacy and sovereignty (Le Billion, 2001: 58). While the FNLA had largely withdrawn into exile, resulting in its eclipse as a major nationalist force, UNITA continued to its fight against the MPLA's de facto government, which turned the transition into a long-term political and military deadlock (Le Billion, 2001: 58). In addition to the international support the MPLA received, the elite in Luanda and abroad prospered from growing oil revenues, while UNITA sustained its quest for power from diamond revenues and control of populations in the hinterland. A peace accord was finally signed in 1991 and UN-supervised elections were held the following year, leading to the victory of the ruling MPLA. In the presidential race sitting president José Eduardo Dos Santos did not secure enough votes for a first-round victory. A second round was never held, because within weeks the hope of peace was crushed as UNITA resumed the war after refusing to acknowledge its electoral defeat (McMillan, 2005: 157; Le Billion, 2001: 59).

In the divisive setting of the Cold War, a deep distrust between MPLA and UNITA leaders undermined two peace processes based more on consensus and accommodation than international constraints. The subsequent years of warfare led to more devastation than had occurred throughout three decades of the independence struggle and Cold War conflict, as the bush war turned into battles over the control of the cities (Le Billion, 2001: 59). Approximately 500 000 people were killed during the civil war, and between 2 to 4 million people were displaced. The Angolan civil war commenced as an uprising against the Portuguese colonial rule, but developed into a Cold War struggle between socialism and capitalism. By the 1990s ideology was no longer the driving force for the conflict, but it had

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arguably been transformed into a struggle for Angola's oil and diamonds (McMillan, 2005: 158). In February 2002 government forces killed UNITA leader Jonas Savimbi, and following his death came a renewed attempt at peace. On 4 April 2002 the government and then rebel forces of the opposition UNITA signed the Memorandum Complementary to the Lusaka Protocol, which put an end to some 30 years of armed conflicts (Roque, 2008: 139). The alliances created by the Angolan civil war still play a key role in contemporary Angolan politics. This is illustrated in the following sections, which further examine and contextualize democracy in Angola.

3.2.1 Contextualizing democracy in Angola

Following independence in 1975, the MPLA established a one-party state and the current president José Eduardo dos Santos has been in power since 1979. To date there have been three parliamentary elections in Angola and only one presidential election (in 1992). The first multiparty parliamentary and presidential elections in 1992 gave the MPLA a majority of 129 out of 220 seats (see Table 1).

Table 1. Legislative Election Results, 1992, 2008 and 2012

	1992 Legislative Elections		2008 Legislative Elections		2012 Legislative Elections	
Party	Votes	Seats	Votes	Seats	Votes	Seats
MPLA	1,976,940	129	5,266,112	191	4,135,503	175
UNITA	1,258,103	70	670,197	16	1,074,565	32
PRS	77,605	6	204,478	8	98,233	3
FNLA	84,110	5	71,600	3	65,163	2
Nova Democracia	0	0	77,405	2	13,337	0

Based on numbers from the National Electoral Commission (CNE, 2014).

As noted in section 3.2, the first round of presidential elections were not conclusive,

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but a run-off between sitting president José Eduardo dos Santos and his main competitor, the leader of UNITA Jonas Savimbi, were never held (Human Rights Watch, 2009: 6). These first multiparty elections in 1992 failed miserably. They were intended to consolidate the peace and democratization process, but civil war resumed. Another ten years of war followed (Amundsen, 2013: 5). The succeeding phases of governance in Angola have been closely interrelated with political, ideological and social evolution. The starting point, after independence, was the superimposition of a Stalinist political model on the already highly centralized and authoritarian political system inherited from Portuguese colonialism. The original aim was to establish a strong state, which could fend off and defeat external and internal enemies, achieve national unity, and promote social and economic development (Hodges, 2001: 43).

3.2.2 The 2008 legislative elections

It took sixteen years before the government felt sufficiently secure to arrange new elections. In addition, the government repeatedly delayed new elections, arguing that post-war reconstruction was a priority and a necessary pre-condition for holding elections (Human Rights Watch, 2009: 6). These second elections were held in September 2008. They were described as ‘credible and transparent’ but not ‘free and fair’ (Amundsen 2013: 5). As illustrated in Table 1, the ruling MPLA secured its position by winning 82 percent of the votes, taking 191 out of 220 of the seats in Parliament, almost wiping out the opposition. This also meant that the MPLA secured the necessary two-thirds majority needed in parliament in order to change the constitution without approval from the opposition (Amundsen, 2013: 5). In 2010 the government changed the Constitution by abolishing direct presidential elections, implementing the practice that the first person of the party list receiving the most votes in the parliamentary elections would become president (Amundsen, 2013: 5-6). Amundsen (2013) argues that the constitutional change sharpened the authoritarian character of the regime and strengthened presidential rule even further by weakening the basic democratic principle of division of powers. Roque (2013) argues that with the 2010 constitutional amendment and the de facto attempt to by-pass parliament’s ability to check and audit the executive, President dos Santos consolidated his grip on all sectors of society, the economy and emerging political forces. Roque (2013: 2) further argues that the constitutional alterations delayed democratic transformation by enforcing the president’s control over the state and the division of power.

3.2.3 The 2012 legislative elections

It was under the new Constitution of 2010 that the third multiparty general elections were

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held in August 2012. Once again the ruling party won by a large margin, with almost 72 percent of the votes and 175 of 220 Members of Parliament, as can be noted from Table 1. Although UNITA gained almost 20 per cent of the votes, the results were no surprise, and voter turnout very was low (Amundsen, 2013: 12). According to Amundsen's (2013) the best explanation for the outcome of the elections was the extensive oil and gas resources had given the patronage politics of the Angolan regime. Hopeful individuals flocked to the party, co-optations were frequent, and voters, especially in rural areas, understood it was better to vote for a party that could 'bring home the beef' in terms of government favors to the constituency, cash and infrastructure projects (Amundsen, 2013: 12). Roque (2013) describes the 2012 elections as a "procedural exercise in democracy aimed at imbuing the dos Santos government with legitimacy" (Roque, 2013: 6). She further argues that the elections in reality had none of the elements of a credible election, as the principles of equality, fairness, inclusion, freedom of choice, transparency and integrity were not present. Furthermore, the MPLA government, by attempting to engineer the results, confirmed its position as an authoritarian electoral regime. The ruling party arguably also distorted the electoral race by using its control over media and vast state resources to promote its own agenda (Roque, 2013: 6).

Another interesting issue is that the number of observer missions and the presence of international media were significantly reduced compared to the 2008 elections. Two of the observer missions that had pointed out irregularities and suggested improvements after the previous elections were not present, namely the European Union (EU) and the Pan-African Parliament (PAP), with the EU claiming the costs were too high. As a result, only three observer missions participated, SADC headed by the former Tanzanian Foreign Minister, Bernard Membe, the African Union (AU) led by the former president of Cape Verde, Pedro Pires, and the Community of Portuguese-speaking Countries (CPLP) (Roque, 2013: 6). Human Rights Watch has criticized the Election Commission of Angola (CMI)[8] for "failing to address major violations of electoral laws, including unequal access of parties to the public media and ruling party abuse of state resources and facilities" (Human Rights Watch, 2013).

[8] The CNE was created as a part of the process of democratization in Angola. However, its establishment and institutionalization was rather done implemented above by the president, government and ruling party in a process of establishing control of elections (and election results), rather than as a core demand of the opposition forces. The perceptions of CNE independence still vary. On the one hand, critical voices such as Human Rights Watch claim that the CNE, despite a more balanced composition than in 2008, "was not able or willing to fulfill its role as an impartial oversight body" (HRW, 2013).

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Furthermore, the CNE hindered independent observations through the massively delayed, restrictive and selective accreditation of domestic and international observers. The CNE also obstructed the accreditation of opposition officials at the polling stations. According to this report, the police failed to act impartially during the election campaign and on several occasions arbitrarily arrested opposition activists (Human Rights Watch, 2013). When comparing the 2012 and 2008 elections, the 2012 elections were more revealing of Angola's development over the preceding ten years than they were a reflection of rivalry in a flawed democratic procedure. While the 2008 elections were an example of autocratic hegemony, the 2012 polls were a 'competitive autocratic' race that the ruling party was no longer able to dominate fully. The 2008 elections demonstrated the power and popularity of the MPLA, but the 2012 elections exposed its weaknesses (Roque, 2013: 2). It will be interesting to see how dos Santos and the MPLA are able to adapt to the growing strength of the opposition in the coming years up until the 2016 elections. The following section examines the role of the media, civil society, and the judiciary and the division of powers in Angola, and how the Angolan regime is affecting other aspects of society.

3.1.4 The division of power and the judiciary

The Angolan constitution stipulates that Angola is a multiparty democracy, with a separation of power between the judiciary, the legislature and the executive. However, in reality this has manifested quite differently (Amundsen, 2014: 176). Amundsen (2014) describes Angola as a "hyper-presidential system", with almost non-existent separation of powers as the President of the Republic is Head of State, Head of Government, Commander in Chief of the Armed Forces and President of the ruling party. The president appoints and can remove the Vice President and the Council of Ministers, the Attorney General, the Governor of the Central Bank, generals and commanders in the armed forces, police and security vices, members of the judiciary including the Supreme and Military Courts. Furthermore, the president has the power to dissolve parliament; however, parliament does not have the power to do the same. According to Amundsen (2014), there is also an informal element to the Angolan system, which refers to a set of informal mechanisms of presidentialism in Angola. These are just as strong as the formal ones, as there is a lack of respect for parliamentary and judiciary decisions (Amundsen, 2014: 176). The Angolan judiciary, whose task it is to enforce these rights given to the Angolan people by the constitution, fails in its task. The judiciary has been described by the U.S. Department of State as "understaffed, inefficient, corrupt, and subject to executive and political influence" (U.S. Department of State, 2008). The Angolan constitution

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and laws provide the individual with legal protection on a wide range of political, economic and social rights. However, there is an extensive gap between the rights given to people and their actual enforcement (Amundsen 2014: 181). The current situation is to some extent a result of the lack of human and technical resources, but mainly a result of insufficient government prioritization and political will to maintain an efficient and independent court system as the judiciary, just like the parliament, is completely dependent on the presidency (Amundsen, 2014: 181).

3.1.5 Media and civil society

Another key element that needs to be examined when contextualizing democracy in Angola is the role of media and civil society. The government and the MPLA control all media with a nationwide reach. The only daily newspaper *Jornal de Angola* as well as the TV service are state-owned and are rarely critical of the government. Private radio stations operate in the main cities, but there is minimal independent media outside of the capital (Amundsen, 2014: 183). The Angolan constitution guarantees freedom of expression, but in reality, Amundsen (2014) argues, the state and the MPLA exercise firm, centralized control over both state media and private media outlets, made possible by the fact that most of the media outlets are owned by individuals or groups with ties to the government or the ruling party (Amundsen, 2014: 183). Furthermore, the independent media are often subject to harassment, and government media have "no real competitors and [are] intrinsically opposed to independent voices within the country" (Mendes and Smith, 2006: 26). Like the independent media, civil society organizations (CSOs) and non-governmental organizations (NGOs) also face incapacitating government restraints. The government has not been willing to acknowledge civil society as a political actor and has expressed its dislike for human rights and activism in support of open political association (Amundsen, 2014: 183; Amundsen and Abreu, 2006: 14). Angolan CSOs working on political issues such as transparency, public finance management and budgets are few and have few members. Amundsen and Abreu (2006) credit this to the hostile working environment for such organizations, in addition to the persistent possibility of reprisals from the government (Amundsen and Abreu, 2006: 42–48). However, in the last couple of years there have been reports of an upsurge in the number of spontaneous anti-government street protests. Arguably inspired by the Arab spring, people have openly challenged the authorities. The government's response has been to deploy armed police, open use of violence, arrests and detention without trial (Redvers, 2011). Angola is currently experiencing the growing strength of the opposition, civil society and the media. Angola's

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new phase of "competitive electoral autocracy" has led to interplay of reforming democratic forces, the survivalist regime, the citizenry and elements of the security apparatus (Roque, 2013: 10). However Alencastro, (2012) argues, the great spectacle of elections must not obscure the fact that the political arena of post-war Angola remains significantly underdeveloped. If nothing is done to change this, the Angolan elections can become a ritual of legitimation for the MPLA, where the opposition plays the role of figurants, the masses trade their political passion for subventions and the international community cheerleads (Alencastro, 2012: 60). Roque (2013) argues that Angola will reach the stage where only a negotiated revolution will be possible. This will come about when the rulers can no longer govern and the ruled will no longer accept being governed in the same manner. The catalyst will probably be an alignment of several factors: the economic inability to sustain the wide patronage network, continued widespread pressure and demonstrations, greater autonomy within MPLA groups, and the growing strength of the opposition, civil society and the media (Roque, 2013: 10). The growing opposition, in particular the new generation of young people, which indeed has shown itself to be a powerful mobilization tool, may be what sets in motion mechanisms that may change the current picture. These developments, coupled with the run-up to the 2016 elections, may prove to be a critical juncture in the current political situation.

3.3 Measuring democracy in Angola: The Freedom House approach

The following three sections of this chapter examine the measurement of democracy, in particular the Freedom House approach, which is the measurement model of choice for this research study. Every year the independent organization, Freedom House, publishes its annual report "Freedom in the World". It is a global report on political rights and civil liberties, composed of numerical ratings and descriptive texts for each country. The 2014 and 2013 editions, which is the reports this study is based on, covers developments in 195 countries and 14 territories (Freedom House, 2014a). The methodology of the "Freedom in the World" report is largely based on the Universal Declaration of Human Rights, and as such the report is founded on the premise that these standards apply to all nations and territories, regardless of geographical location, religious or ethnic composition, or the level of economic development. "Freedom in the World" operates on the assumption that freedom for all peoples is best achieved in liberal democratic societies (Freedom House, 2014b).

As discussed in Chapter 2 section 2.5, there is no scholarly consensus on how to define or measure democracy, which again makes the objective of measuring democracy elusive. The terms 'freedom' and 'democracy' are often used interchangeably, but the two are

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not synonymous. Democracy can be seen as a set of principles and practices that institutionalize and ultimately protect freedom. Though it has proved difficult to come up with a precise definition, most observers today would agree that at a minimum the fundamental features of a democracy include government based on majority rule and the consent of the governed, the existence free and fair elections, the protection of minority rights and respect for basic human rights. Democracy presupposes equality before the law, due process and political pluralism (Economist Intelligence Unit, 2012: 25). According to Coppedge (2005), there is a key difference between what he labels "thin", or minimalist and "thick", or broader concepts of democracy. The "thin" concepts correspond closely to an immensely influential approach in the academic literature, that of Robert Dahl's polyarchy.[9] The Freedom House measure of democracy, based on political rights and civil liberties, can be described as a "thicker" democracy measurement.

The Economist Intelligence Unit's 2012 "Democracy Index", which also rates democracy in the world, notes that "at preset, the best known measure is produced by the US-based Freedom House organization" (Economist Intelligence Unit, 2012: 25). The "Democracy Index" report, however, opts for an even thicker measurement of democracy than Freedom House, arguing that a measurement that reflects the state of political freedoms and civil liberties is not thick enough (The Economist Intelligence Unit, 2012: 26). However this underpins the argument that freedom is an essential part of democracy, whether its sufficient or not when measuring levels of democracy depends on the conceptualization used by the specific organization conducting the ranking. Hence, following the logic of a thicker conceptualization, freedom is a necessary cornerstone in a democracy, and as such the measurement of freedom can arguably translate into the measurement of democracy. In this research study a thick understanding of the democracy concept is the premise for the research; accordingly Freedom House's "Freedom in the World" report was a natural choice in the measurement of democracy. The following sections examine the Freedom House measurement model of democracy, as applied to the case of Angola, the scores given, and the reasoning behind them.

3.3.1 Freedom House measurement of democracy

The "Freedom in the World" report uses a three-level rating system, which includes scores, ratings and finally a status of *Free, Partly Free* or *Not Free*. A score from 0 - 4 is given to a country or territory for each of the 10 Political Rights (PR) indicators and 15 Civil Liberties

[9] See section 2.5 in Chapter Two for Robert Dahl's definition and conceptualization of polyarchy.

(CL) indicators/questions in the analysis. The indicators are designed as questions; a score of 0 represents the lowest degree of freedom and 4 the highest degree of freedom. The 10 PR indicators are grouped into three subcategories: Electoral Process, Political Pluralism, Participation, and Functioning of Government. The CL indicators are grouped into four subcategories: Freedom of Expression and Belief, Associational and Organizational Rights, Rule of Law, and Personal Autonomy and Individual Rights. The highest total score that can be given for the PR category is 40, and the highest possible combined score in the CL category is 60. The scores from the preceding years are used as a benchmark for the year that is under review. A score is usually only changed if there has been a "real-world development" during the year that warrants a lowering or raising of the score (Freedom House, 2014b). The second level of the freedom House analysis is the rating for each of the two categories of PR and CL for a country or territory. The rating is given based on two separate scores from 1-7, one for each of the two main categories, and is based on the total score for the PR and CL questions. As seen in Table 2 and Table 3, each rating of 1-7, with 1 representing the highest level of freedom and 7 representing the lowest degree of freedom, corresponds to a specific range of total scores, this is presented in the following section (Freedom House, 2014b).

Table 2. Political Rights Rating

Political Rights	
Total Score	PR Rating
36-40	1
30-25	2
24-29	3
18-23	4
12-17	5
6-11	6
0-5	7

Table 3. Civil Liberties Rating

Civil Liberties	
Total Score	CL Rating
53-60	1
44-52	2
35-43	3
26-34	4
17-25	5
8-16	6
0-7	7

(Freedom House, 2014b).

Each rating in the two different categories corresponds to a different set of characteristics; for the PR category these characteristics are outlined and described in Table 4:

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Table 4. Political Rights Characteristics

1	Countries and territories with a rating of 1 enjoy a wide range of political rights, including free and fair elections. Candidates who are elected actually rule, political parties are competitive, the opposition plays an important role and enjoys real power, and the interests of minority groups are well represented in politics and government.
2	Countries and territories with a rating of 2 have slightly weaker political rights than those with a rating of 1 because of such factors as political corruption, limits on the functioning of political parties and opposition groups, and foreign or military influence on politics.
3, 4, 5	Countries and territories with a rating of 3, 4, or 5 either moderately protect almost all political rights or strongly protect some political rights while neglecting others. The same factors that undermine freedom in countries with a rating of 2 may also weaken political rights in those with a rating of 3, 4, or 5, but to a greater extent at each successive rating.
6	Countries and territories with a rating of 6 have very restricted political rights. They are ruled by one-party or military dictatorships, religious hierarchies, or autocrats. They may allow a few political rights, such as some representation or autonomy for minority groups, and a few are traditional monarchies that tolerate political discussion and accept public petitions.
7	Countries and territories with a rating of 7 have few or no political rights because of severe government oppression, sometimes in combination with civil war. They may also lack an authoritative and functioning central government and suffer from extreme violence or rule by regional warlords.

(Freedom House, 2014b).

For the CL category, the ratings corresponding to the different characteristics are described and outlined in Table 5:

Table 5. Civil Liberties Characteristics

1	Countries and territories with a rating of 1 enjoy a wide range of civil liberties, including freedoms of expression, assembly, association, education, and religion. They have an established and generally fair legal system that ensures the rule of law (including an independent judiciary), allow free economic activity, and tend to strive for equality of opportunity for everyone, including women and minority groups.
2	Countries and territories with a rating of 2 have slightly weaker civil liberties than those with a rating of 1 because of such factors as limits on media independence, restrictions on trade union activities, and discrimination against minority groups and women.
3, 4, 5	Countries and territories with a rating of 3, 4, or 5 either moderately protect almost all civil liberties or strongly protect some civil liberties while neglecting others. The same factors that undermine freedom in countries with a rating of 2 may also weaken civil liberties in those with a rating of 3, 4, or 5, but to a greater extent at each successive rating.
6	Countries and territories with a rating of 6 have very restricted civil liberties. They strongly limit the rights of expression and association and frequently hold political prisoners. They may allow a few civil liberties, such as some religious and social freedoms; some highly restricted private business activity, and some open and free private discussion.
7	Countries and territories with a rating of 7 have few or no civil liberties. They allow virtually no freedom of expression or association, do not protect the rights of detainees and prisoners, and often control or dominate most economic activity.

(Freedom House, 2014b).

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The final status corresponds to the final rating given based on the combined scores of the PR and CL categories; this produces the "Freedom Rating", which is the number that determines the status of *Free, Partly Free,* or *Not Free,* as seen in Table 6 (Freedom House, 2014b). In the next section the Freedom Status of *Not Free* will be further examined in relation to the case of Angola.

Table 6. Freedom Status

Freedom rating (Combined average of PR & CL rating)	Freedom Status
1.0 – 2.5	Free
3.0 – 5.0	Partly Free
5.5 – 7.0	Not Free

(Freedom House, 2014b)

3.3.2 The Angolan case

The following section looks at Angola and the level of democracy in the country according to the Freedom House rating, as well as Freedom House's evaluation of the current situation within the two categories of Political Right and Civil Liberties. For PR Angola is given a score of 6, and for CL a 5, which gives a combined score of 5.5 and the Freedom Status of *Not Free,* as seen in Table 6, in section 3.3.1. (Freedom House, 2014a: 18). The following section deals Freedom House's evaluation and description of the current situation in Angola.

In the category of PR, according to the Freedom House data and evaluation, Angola is not an electoral democracy. Freedom House states that the 2012 Angolan legislative elections were not free and fair. Furthermore, the National Assembly has little power and 90 percent of legislation originates from the executive branch, according to the 2013 "Freedom in the World" report. Furthermore, although five political parties make up the National Assembly, the ruling MPLA dominates Angola's party system.[10] In May 2012 Angola's Supreme Court blocked the appointment of the new National Electoral Commission (CNE) leader, Susana Ingles, as she was seen to be a close ally of President Jose Eduardo dos Santos. André da

[10] See Table 1 in section 3.2.2 for complete overview of party and seat distribution in the Angolan parliament.

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Silva Neto was appointed to the post in June 2012. In the following moth the CNE disallowed Angolans living abroad from voting in elections. With respect to the Angolan government, Freedom House describes corruption and patronage as pervasive, as well as bribery, which often underpins business activity in the country. President José Eduardo dos Santos has criticized MPLA members for misallocating significant portions of the country's oil revenues, while the president himself is claimed to be one of the country's wealthiest men (Freedom House, 2013). In December 2011 a report by the International Monetary Fund (IMF) stated that from 2007 to 2010 $32 billion in government funds, which could arguably be linked to the national oil company Sonangol, had disappeared and could not be accounted for. Angola was ranked 157 out of 174 countries surveyed in Transparency International's 2012 Corruption Perceptions Index. The situation that is described here is what finally makes up the final rating for PR in Angola, based on the scores in the four different sub-categories of Electoral Process, Political Pluralism, Participation and Functioning of Government (Freedom House, 2013).

For the CL category, Angola scores a 5. According to Freedom House, although the Angolan constitution guarantees freedom of expression, journalists are often pushed to self-censorship as a result of threats of dismissal, imprisonment and prosecution. The state owns the main television stations, the national radio station and the only daily newspaper, and private media are often denied access to official information and events. Furthermore, in the last couple of years, the government has tried to restrict electronic communication. Many of the anti-government demonstrations in recent years were organized via social media or SMS, which could be one of the reasons for such restrictions (Freedom House, 2013). The constitution does guarantee freedom of assembly and association, but these rights are not respected in practice. In 2012 authorities continued to violently disperse sporadic demonstrations by mostly young anti-government protesters, and to arrest and intimidate protest leaders, according to Freedom House. There are hundreds of non-governmental organizations (NGOs) operating in Angola, many of which advocate for political reform, government accountability and human rights protections. The government sporadically threatens to shut down these organizations. In 2011 authorities restricted the activities of a number of local and international NGOs relating to a Southern African Development Community summit. The right to strike and form unions is also secured in the constitution, but the MPLA dominates the labor movement and there are only a few independent unions. The judiciary is subject to extensive political influence, particularly from the executive

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branch, though courts occasionally rule against the government's wishes. The president appoints Supreme Court judges to life terms without legislative input; the May 2012 decision disapproving the government's candidate for CNE head was a unique sign of judicial independence. The courts in general are hindered by a lack of training and infrastructure, a large backlog of cases, corruption and conflicts of interest. While the government has sought to train more municipal magistrates, municipal courts are rarely operational, leading to the use of traditional or informal courts (Freedom House, 2013). The situation described above is what finally makes up the final rating for CL in Angola, based on the scores in the indicator sub-categories of Freedom of Expression and Belief, Associational and Organizational Rights, Rule of Law, and Personal Autonomy and Individual Rights.

The picture that is painted of the current Angolan situation through the Freedom House descriptions, the combined rating of 5.5, which gives a Freedom Status of *Not Free*, as well as the descriptions provided in section 3.2.1, all serve as evidence for the claim that Angola is undemocratic. The second sub-research question of this research study, as presented in section 1.3 in Chapter one asks: "What is the level of democracy present in Angola?" On the basis of the evidence provided in this chapter, the level of democracy in Angola is 5.5 on a scale of 1 – 7, which means not democratic or *Not Free*, according to the conceptualization of democracy adopted in this study. This finding thus serves as a premise for the remainder of the research study. The following three sections of this chapter examine and contextualize the Angolan oil and gas industry, with a particular emphasis on the government's role and the conditions that foreign oil companies operate in. Additionally Statoil's operations in Angola are examined.

3.4 Contextualizing the oil and gas industry

> *"The international companies don't run the business anymore. The rule-makers are now the national oil companies. They drive the business"* (J. Robinson West in Blum, 2005).

On a global scale petroleum accounts for 15 percent of trade in the world; oil and gas production serves to meet nearly 60 percent of the energy consumed globally. The demands for increased production are growing, as expanding economies such as India and China require more energy to continue their growth. In the coming 20 years 90 percent of the production is projected to come from the developing world (Transparency International, 2011). The multibillion-dollar oil and gas industry can be divided into three areas. Upstream, also labeled the exploration and production sector, involves finding and extracting oil (Downy, 2009: 62). The midstream sector involves the transportation of crude oil and finished

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products by ships, pipelines, trucks and so on. The third area, downstream, also referred to as the refining and marketing sector, also involves storage. Both the upstream and downstream sectors are rather diverse with hundreds of competing organizations (Downey 2009: 74). Within the oil industry, the upstream sector, the exploration for and the production of crude oil, is the most profitable; however, it is also the sector that is the most prone and exposed to political risk (Downey, 2009: 83).

The oil industry can be generally divided into two types of oil companies, national oil companies (NOCs) and international oil companies (IOCs). The traditional view of the oil industry places the IOCs as the lead in production; however, government-controlled NOCs are now challenging international firms such as Shell and Chevron in the global competition for oil reserves (Al-Kasim, Søreide & Williams, 2008: 18). NOCs and IOCs often join forces in joint ventures, as the NOCs in many cases lack the technology, skills and finance that is required to develop large-scale projects (Al-Kasim, Søreide & Williams, 2008: 18). The oil sector is changing quite rapidly, towards stronger host governments and stronger national oil companies.

3.3.1 Contextualizing the Angolan oil industry

> *"The role of the state should be to take that wealth and apply it in ways that will benefit the people of Angola ... The oil revenues go straight to the state budget, but the people see very little benefit"* (Pinto de Andrade in Polgreen, 2003).

The Angolan oil industry was established during the colonial period, and the Angolan oil company Companhia de Petroleos de Angola – Petrangol started production in the mid-1950s. By independence in 1975 Angola was already an established oil producer, and oil was already its most important commodity (Frynas and Wood, 2001: 589). Following independence, the MPLA government created the national oil cooperation – Sociedade Nacional de Combustiveis (Sonangol). This introduced vast reforms in the oil industry, choosing a pragmatic strategy in its dealing with Western oil companies, allowing them to continue with their operations but at the same time forcing these companies to form joint ventures and production-sharing agreements with Sonangol (Frynas and Wood, 2001: 590). The Angolan oil industry entered a new phase of its development in the 1990s, as developments in extraction technology opened for exploration in deep and ultra-deep waters for the first time, resulting in vast oil findings for Angola. Furthermore favorable petroleum taxation and low operating costs prompted much outside interest in Angola's oil, leading to a development of a growing investor diversification (de Oliveira, 2007: 603; Frynas and Wood, 2001: 591). Angola rapidly became a hotspot for companies from all over the world such as BP, Shell,

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ExxonMobil, Statoil, NorskHydro, Petrobras, as well as the Chinese companies CNOOC and Sinopec, all intentionally drawn into Angola by Sonangol (de Oliveira, 2007: 603). By the end of the 1990s government interference in the oil industry raised the issue of Angola's attractiveness to foreign investors,[11] and reduced returns for the oil companies (Frynas and Wood, 2001: 591).

Angola experienced an "oil boom" from 2002-2008. However, the 2008 financial crisis caused a drop in world oil prices, leading Angola to change its natural resource management. By 2009 Angola was challenged by growing macroeconomic instability in a climate of significantly declining oil price revenue (Richmond, Yackovelev and Yang, 2013: 4). Richmond, Yackovelev and Yang (2013) describe one of the great challenges for Angolan policymakers as turning the resource wealth into development advances. Given a long oil revenue horizon and the possibility of finding more reserves, the main challenge in Angola is to maintain macroeconomic stability and stable spending levels despite volatile oil revenues. Oil revenue is subject to volatility because of prices, production and the institutional setting. In addition to shifting oil prices and production quantity, Angola also has recurring problems of unpredictable transfers of oil revenues from Sonangol to the treasury. The risk is that what is transferred is only what is left after Sonangol's financial operations. In 2011 oil production in Angola comprised 47.5 percent of GDP and oil revenue surpassed 80 percent of Angola's total tax revenue (Richmond, Yackovelev and Yang, 2013: 4). Oil alone accounts for 95 percent of Angola's export revenue.[12] Angola is thus heavily dependent on oil, which affects the economy on multiple levels. In a 2013 report the World Bank highlights some of the main challenges related to Angola's political economy and the oil industry. First, oil exports generate inflows of foreign currency, causing the local currency, the kwanza, to appreciate; this weakens the competitiveness of the non-oil sector by effectively making Angolan goods more expensive for foreign consumers, while foreign goods become cheaper for domestic consumers. Secondly, the oil sector and related industries tend to offer the highest returns on both financial and human capital, and they consequently attract the major share of domestic credit and employ the best-educated and most experienced labor in the country. This further damages the competitiveness of the non-oil industries, which must cope with an environment of scarce and expensive investment capital and high labor costs for skilled workers. Finally,

[11] The government changed the buying terms of offshore development, making investors lease floating production, storage and offloading vessels for offshore oil fields, rather than buying them (Frynas and Wood, 2001: 591).

[12] Angola is the least export-diverse country in Africa, and rivals Iraq as least export-diverse worldwide (World Bank, 2013: 5).

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the revenue generated by the oil sector boosts domestic demand for non-tradable goods and services, such as electricity and construction, which increases production costs in the non-oil tradable sector (World Bank, 2013: 5).

In the Angolan oil industry the national oil company Sonangol plays a fundamental role in addition to the government. Angola's management of its oil resources and revenues has been and still is subject to criticisms by NGOs and other international organizations, such as the IMF and the World Bank. The next paragraph sheds light on the causes of what has led to criticism of the controversial national oil company and its ties to the government, and of the Angolan government.

According to de Oliveira (2007), Sonangol is, on the one hand, "at the service of the presidency and its rentier ambitions" as well as "a basic tool for elite empowerment" and, on the other hand, it has been "from the very start protected from the dominant both predatory and centrally planned logic of Angola's political economy" and is, therefore is an "island" of proficiency thriving simultaneously with the collapse of most other Angolan state institutions (de Oliveira, 2007: 595). Sonangol is a modern company, employing thousands of people and operating on four continents. In Angola the national oil company has multiple roles: it is an oil concessionaire, a regulator of the industry, a tax collector, and a national oil company operating both alone and in joint ventures with foreign companies (Amundsen, 2014: 177). Sonangol also carries out quasi-fiscal activities. For example, it supplies petroleum products to the domestic market at subsidized prices, manages and services public debt, and markets the government's share of crude oil. This has turned the company into a "state within the state" (de Oliveira, 2007: 595). In the 1980s Sonangol handled oil-backed loans, which were used to finance the company's development, for the purchase of arms and intelligence services, and strengthening the powers of the president. The secrecy of the arms deals and the opportunities for bribery kept these operations out of the budget system. Later the IMF and the World Bank, amongst others, pressured Angola to reform its practices and subsequently it accounting practices did improve (Amundsen, 2014: 177). Nevertheless, the expensive borrowing practices still go on, in particular with a six billion US$ oil-backed credit line to China, Sonangol still operates a parallel expenditure execution system (Corkin, 2007; Corkin, 2011: 15). This suggests that a significant share of government costs is not included in the formal budgetary system, and that Sonangol is still instrumental in more suspicious finance operations, which has been labeled the "missing billions scheme". This was noted in a 2011 IMF report, which revealed an unexplained US$ 32 billion inconsistency in the Angolan

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government's accounts from 2007 through 2010 (IMF, 2011). There are two different financial methods applied to the petroleum sector in Angola and Sonagol plays a key role in both. In the deep-water fields production-sharing agreements (PSA) are common, while concessionary systems, based on taxes and royalties, are applied to the older on-shore fields. With Sonangol as an intermediary, the Angolan government's taxation of the oil multinationals is high and increasingly advanced. The "government take" from the petroleum sector was at 85 percent by 2006, which has been described as "very tough" by the industry itself (World Bank, 2006). Hence, Sonangol is a competent and sophisticated national oil company, protected and separated from the dominant clientelist logic of Angolan politics. De Oliveira (2007) argues that "Sonangol ensures that domestic economic opportunities are firmly controlled by those in power, and that independent businesses that could nurture alternative poles of influence do not develop and that its "tools and professional expertise ... are put at the service not of broad-based prosperity but the enrichment of the few" (de Oliveira, 2007: 614) Amundsen (2014) argues that despite Sonangol's professionalism – or rather because of its political purpose – and despite the fact that most Western banks and oil companies speak well of Sonangol and report hassle-free interactions with the company, there is a low level of transparency. Furthermore, the only information that is available from Sonangol's catalogs, reviews and website are collective figures and washed numbers. Comprehensive information on Sonangol-managed social projects funded by "social bonuses" and "corporate social responsibility" funds is not available from any open sources, as the amounts are subjected to the same confidentiality clause[13] that restricts the private companies from revealing information (Amundsen, 2014: 177). One of the extraction methods used by the Angolan state elite has arguably been, as mentioned earlier, the "missing billions" from the various oil contracts and signature bonuses in particular. Signature bonuses[14] are cash

[13] In July 2002 the government passed a Law on State Secrecy, giving itself broad authority to jail anyone who released information it regarded as damaging and allowing it to censor international news stories that exposed corruption. The legislation also took aim at the publish-what-you-pay campaign, providing for the prosecution of the multinational oil companies if they released data on their transactions in Angola (McMillan, 2005: 164).

[14] Signature bonuses are not in themselves a sign of corruption, but an auction design. The problem is that signature bonuses often are subject to two kinds of abuses. Firstly, they can be too large relative to the royalty rate, and secondly, they can be difficult to trace. In the pursuit of the best price for an oil contract, a government can use two different mechanisms, the signature bonus and the royalty rate. In a bidding competition among oil companies, it is essential that the government sets the right mix of upfront and ongoing payments. According to the theory of auctions, royalties make the bidding more competitive and the total price higher by evening out differences in the bidder's perceptions of the likely value of a contract; so generally, the government should put more weight on the royalties and less on the signature bonuses. A higher royalty rate and lower signature bonuses, up to a point, bring a

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payments made upfront upon signing a contract. Angola has revived large sums from oil companies, and for offshore drilling rights in Angola the signature bonuses have typically been around US$ 100 – 400 million dollars per drilling contract (McMillan, 2005: 158). The problem with signature bonuses can be that if a government with a short time horizon in anticipation of an eventual removal wants the cash right away, it might negotiate a higher signature bonus and lower royalty rates, thus working to the benefit of the government but to the cost of the nation as a whole (McMillan, 2005: 159). McMillan (2005) asks whether Angola in fact set signature bonuses too high and royalties too low in order to secure up-front payments. In 2001 oil companies reported that following an auction for a deep-water block they paid about 400 million US$ up-front in signature bonuses, while the Angolan government reported to the IMF that it received US$ 285 million in signature bonuses, for the same block. This means that from this particular auction more than 100 million US$ were unaccounted for (Amundsen, 2014: 175; McMillian, 2005: 159). McMillan states that even though Angolan law requires that the oil revenues are supposed to be controlled by the Treasury and the central bank, this is in fact not the case; the revenues are actually controlled by Sonangol and the president's office. Hundreds of millions of dollars are suggested to be held in Sonangol accounts in various countries (McMillian, 2005: 159). Although Sonangol and the Angolan government have faced an immense amount of criticism, the 2013 World Bank report points to some positive developments. According to the World Bank, the Angolan authorities have made significant progress in terms of improving transparency and accountability of public financial management; however, challenges remain. The government has improved collection of and reporting on oil revenues and transfers. This is expected to enhance transparency and accountability in the oil sector. The 2013 national budget for the first time included quasi-fiscal operations undertaken by Sonangol, which will decrease the budgetary uncertainty associated with oil revenue flows. A recent KPMG report also notes that the state company has taken steps to increase transparency of its activities after being criticized in recent years for not publishing its financial accounts; concerns still remain as to the opaqueness of state finances relating to oil revenues (KPMG, 2013: 10).

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larger ultimate payout. The signature bonus is received immediately, however, whereas royalties arrive years later (McMillan, 2005).

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Angola recently established a sovereign wealth fund,[15] which has the potential to do much to stabilize expenditure against oil price volatility or accumulate long-term savings in anticipation of the eventual decline of the oil sector (World Bank, 2013). It is evident that the Angolan government is making efforts to create a more transparent oil industry, but as illustrated throughout this section, and as noted by both scholars and the World Bank, they still have a long way to go before they reach this goal. The current system and institutions that are in place in Angola are not fulfilling their task of redistributing the massive Angolan oil revenues, and sadly the oil profits still to a large extent end up in the hands of a small elite with ties to the government and the MPLA.

3.3.2 Statoil in Angola

One of the main objectives of this study is to conduct a political risk analysis for the oil and gas industry in Angola, and more specifically for the Norwegian company Statoil. Statoil is an international energy company that operates in 36 countries. Statoil is a NOC, and the Norwegian state currently holds 67 percent ownership (Norwegian Ministry of Petroleum and Energy, 2013). Statoil has been operating in Angola's offshore oil and gas sector since 1991, and is currently producing more than 200 000 barrels of oil per day in Angola. Angola is Statoil's most important investment on the African continent, and is the largest contributor to Statoil's production outside of Norway, which makes Angola a key building block for Statoil's international production growth (Hanssen, 2013: 3). In 2011 Statoil was behind more than 10 percent of Angola's combined oil production. Statoil also received two new drilling licenses in 2011, with operatorship, which will mean an increased importance of Angola for Statoil in the years to come (Hanssen, 2013: 3).

Statoil generates income for Angola along three main avenues: indirect taxes, direct taxes and profits in oil kind.[16] The most significant contribution comes from delivering profit oil to Sonangol. The value of profit oil is more than three times higher than the taxes paid from the same production: approximately 18 billion US$, worth of profit oil in the period from 2007 – 2012, as compared to 4.9 billion US$ in paid taxes. The main source of the

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[15] Many resource-rich countries have created funds like the one Angola now has established, which invests broadly to hedge against fluctuating commodity prices, the biggest being oil-rich Norway's[15] government pension fund (Polgreen, 2012).

[16] Oil in kind is another method of commuting royalty. The landowner takes possession of the oil or gas produced for the landowner's share of the oil or gas production before the oil or gas is marketed by the production company. The landowner can insert a clause in the lease to take royalty either "in kind" or "in proceeds." This clause allows the landowner more flexibility and a higher royalty based on decisions of the market (Oil-gas-leases, 2006).

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Angolan government's take from Statoil's shares in production is profit oil. Table 7 gives a overview of Statoil's activities in Angola.

Table 7. Statoil's activities in Angola

Statoil's activities in Angola 2007 – 2012 (US$ million)					
Indirect taxes paid	Direct taxes paid	Profit oil in kind	Social Investments	Contractual social contributions	Signature bonuses
4	4 962	17 724	27	48	544

(Skedsmo, Bade, and Lunde, 2013: 20).

These figures do not enable one to calculate Statoil's actual profits in Angola. Statoil does not publicly publish such figures, nor does most other oil companies. This also has to do with the complexities of accounting and how investments made in one year may be devalued over several years. What can be derived from Table 7 is the level of income Statoil generates for the host country, in what form and the level of social investments and signature bonuses (Skedsmo, Bade, and Lunde, 2013: 20). Thus, it gives a fairly good picture of Statoil's financial contribution in Angola.

As an international company Statoil has operations all over the world, including in countries that can be considered as high-risk investment opportunities. This was seen in the 2013 Amenas terrorist attack in Algeria, which illustrates that no company is immune to political risks. The attack on the joint BP and Statoil gas field in Amenas also illustrates that the oil and gas industry remains a key target for groups seeking to push a particular political agenda (Golob, 2013). As a company operating within such contexts, it is essential to examine how Statoil conceptualizes such risks. As mentioned, Statoil may also face issues in a host country that can raise ethical questions with regard to corruption, human rights violations or authoritarian regimes. These are issues that can come into conflict with the company's own values, and as such examining Statoil's ethical values is important when evaluating their role within the Angolan context.

Statoil defines risk as "a deviation from a specified reference value and the uncertainty associated with it. A positive deviation is defined as an upside risk, while a negative deviation is a downside risk" (Statoil, 2011: 165). Statoil's risk management strategy aims "to ensure safe operations and to reach our corporate goals in compliance with our requirements". For Statoil, all risks are related to Statoil's value chain, which represents the value that is added in each step – from access, maturing, project and operation to market. In addition to the

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economic impact these risks could have on Statoil's cash flow, Statoil also try to avoid health, safety and environment (HSE) and integrity-related incidents such as accidents, fraud and corruption (Statoil, 2011: 165). According to Statoil's ethical code of conduct, the company is strongly committed to being known for their high level of ethical standards, referring to transparency in all of their actions, and they have a zero tolerance of corruption in their business. Statoil's ethical guidelines demand of the company and all working personnel to obey all laws and regulations, conduct themselves ethically and sustainably, and to be socially responsible. Statoil has a strong anti-corruption policy, as well as an anti-facilitation payments policy, and has launched an internal anti-corruption program to combat and hinder corruption (Statoil, 2013: 6-7).

However, Statoil has been frequently criticized in Norway for investing large sums in countries with regimes that have little or no respect for human rights or democracy, such as Angola, Egypt, Libya, Azerbaijan, Iran and Iraq. These regimes have no real revenue distribution policies, and small elite lives in wealth while the majority of the population lives in severe poverty (Windheim, 2013: 3-4). This stands in strong contrast to the values and principles that Norway stands for as an epitome of a democratic state. Is it right that Norwegian companies, in particular a nationally owned company such as Statoil, invest in countries where the majority of the people are not able to see the benefits of the oil revenues?

In an interview with the Norwegian newspaper *Aftenposten*, in January 2014 Knut Rostad, Statoil's media spokesperson, addresses the criticism in email:

> *Q: Should Statoil operate in undemocratic and corrupt countries?*
>
> A: "Whether we can be present in a country or not depends upon our ability to carry out our obligations and operations in accordance with national legislation, international standards and our ethical guidelines. If we can operate according to this, we have operations in the country".
>
> *Q: Many argue that Statoil's transfers underpin authoritarian regimes, such as in Algeria, Angola and Azerbaijan. What do you think about this?*
>
> A: "We report openly about all our payments to governments in countries where we operate. We have zero tolerance of corruption, with strict guidelines internally, clear procedures and good training of employees. We cannot control how the taxes we pay are used in some countries".
>
> *Q: Can you rule out that Statoil transfers end up in the pockets of a small elite?*

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> A: "It is not our job to comment on how a country distributes its own tax revenues. Our responsibility is to conduct a responsible business based on our values, national legislation and international rules. This applies particularly to transparency, zero tolerance of corruption and high standards of health, safety and environment" (Author's translation of *Aftenposten*, 2014).

Nevertheless, even though this criticism of Statoil's operations is significant and questions surrounding Statoil's operations in undemocratic and corrupt regimes should be raised, this criticism does not constitute political risk. It is rather reputational risks, for Statoil in Norway, or internationally, which is not the focus of this study, as this is criticism that hasn't been raised in the host country. However, issues such as corruption, regime changes in term of policy and violent protests are risks that could potentially affect Statoil's operations in Angola. As such, conducting a risk analysis of the industry-specific risks that face oil companies in Angola, as well as the company-specific risks that face Statoil, will as such establish what the level of these political risks are. This will be examined in more detail in the following chapter.

3.4 Conclusion

The first objective of this chapter was to contextualize two broad fields, namely the nature democracy and the oil industry in Angola. The second objective was to explore the measurement of democracy, particularly the Freedom House approach, and subsequently to establish the level of democracy in Angola. The findings in Chapter Three show that Angola has low levels of democracy; this conclusion is drawn on the basis of the literature presented, the Freedom House rating and the illustration of the Angolan case and context. Establishing the level of democracy in Angola serves as the basis of the discussion in Chapter Four. The overriding objective of this research study is to test whether low levels of democracy constitute high levels of risk; this premise will be explored in the next chapter by conduction a political risk analysis with reference to Angola.

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Chapter four: A political risk analysis of Statoil in Angola

4.1 Introduction

The three previous chapters of this research study examined the theoretical foundation, key concepts and the Angolan context. The objectives of this chapter are first to present the industry-specific risk model on which this study is based; secondly, to apply the industry-specific risk model to the case presented in Chapter Three; and thirdly, to present the risk report based on the analysis that has been conducted. By using an industry-specific model when analyzing the oil and gas industry in Angola, as well as the oil company Statoil, the analysis will be more precise and relevant, and as such the risk report will be more accurate for investors. This research study is based on a definition of political risk that sees political risk in relation to a particular industry, as different risks may impact in other ways in different sectors. As such, the oil and gas industry need to exhibit a detailed set of factors and indicators specific to it in order to analyze the political risk it faces. The risk model used in this study was developed by Boshoff and Lambrechts (2011), which was based on sources of political risk faced by the extraction industry as defined by control risks and variables relevant to the oil and gas industry, as suggested by Alon et al. (2006), Berlin (2003) and Lax (1983) The final findings and the answers to the main research question, however, will be addressed in Chapter Five. In the following sections the risk model and the methodology behind it are presented.

4.2 Developing an industry-specific model for the oil and gas industry

Political risk is usually not within the control of the investor and thus the level or degree of political risk must be determined before an investment takes place. Finally, the decision to invest or not is of one based on profit versus risk. It is also a decision that is affected by the market and numerous other variables. This section explores the development of an industry-specific risk model developed by Boshoff and Lambrechts (2011). The process of selecting risk factors for an industry-specific model for the extractive industries is a critical one; in this section the reasoning behind the indicators of choice for this specific model is presented.

In the development of an industry-specific risk model Lax (1983) argues that the role of the model is to refine the list and organize the variables – their relationship, flows and consequences – into a useful analytical tool (Lax, 1983: 112-113). Without the model, these variables only provide information. For an analysis to be successful, a framework is needed to organize this information and put it to work. However, Lax (1983) argues that there are

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simply too many variables to actually include them all in a risk model, and as such some must be grouped together and other disregarded, as is done in regards to this model.

Control Risks (2009) identifies four main sources of political risk that face the extraction industries in particular. Politics and governance (political instability, unclear legislation on security of tenure, corruption/poor governance, and changing royalty/tax regimes), security (civil unrest/ethnic conflict, kidnapping, insurgency and terrorism, labor unrest, and theft and pilferage), reputation and social issues (community opposition/social license to operate, artisanal miners, joint venture partner reputation, and human rights), and infrastructure and health (HIV/AIDS, disease, lack of transport, and communications infrastructure). The sources of political risk such as those described here are often inter-related, and as such are not easily separated (Control Risks, 2009). Berlin (2003) similarly highlights a number of factors that the extraction industry faces, such as current activities in the host country that affect the stability of the government (now or in future); the prospect of national government changes; past history of nationalization and expropriation; previous and present experience of other foreign companies; political activity and trends in the region; and the general economic condition of the country (Berlin, 2003: 10). Furthermore, Berlin (2003) argues that when looking at political stability, the focus should be on the legitimacy of the state authority, which is measured by the ability of that authority to impose and enforce decrees; the level of corruption that pervades the system of authority; and the degree of political fractionalization that is present. In terms of economic policy, the focus concerns indicators such as the degree of government participation in the economy, the government's external debt burden and the degree to which interests groups can successfully obstruct the decision-making process (Berlin, 2003: 10). Lax (1983) divides the key variables into three broad categories – host political risk, corporate political risk and external/international political risk (Lax, 1983: 112-113). The variables presented by Berlin (2003) and Lax (1983) were both taken into consideration in regards to the development of the Boshoff and Lambrechts (2011) risk model.

The model developed by Boshoff and Lambrechts (2011) is based on the principles and foundation of the model laid out in Alon et al. (2006). According to Alon et al. (2006), it is crucial for any company to conduct risk assessments, keeping in mind the unique industry-specific micro risks, while also considering general macro political risks. By assigning a weight to each critical indicator, a reflection of each company's specific industry, operational location, risk tolerance and general political-economic development is achieved (Alon et al.,

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2006: 639). Ultimately Boshoff (2010) argues that it is the conditions around the particular investment and the region and industry under investigation that will affect the importance of the weight assigned to the indicators in the model. When conducting a political risk analysis specific to the oil and gas industry the analyst either knows who the investor is or does not have knowledge of the investor. This changes the type of risk analysis undertaken significantly. The Boshoff and Lambrechts (2011) study conducts a risk analysis without knowledge of the investor, and as such conducted a phase-one political risk analysis. In this research study, however, there is knowledge of the investor and the type of investment, and accordingly an assessment of both phases one and two is undertaken. By also undertaking the phase two assessment, Boshoff (2010: 57) argues that the analysis can achieve a greater depth, having knowledge of the investor, the type of investment and the host country. This study thus differs from the analysis done by Boshoff and Lambrechts (2011), as it will use the complete model, using the case of Statoil in Angola. According to Boshoff (2010), by introducing phase two the analyst take onboard a considerable number of variables, which are absent in a phase-one political risk analysis and as such provides a more specific analysis, and then provides a more complete picture for the investor as the analysis is tailored to the specific needs of the investor. In this study the case of Statoil's operations in Angola is used to illustrate the industry-specific risk analysis for a specific company and phase two of the model. The following section presents the political risk model.

4.2.1 The risk model

The risk model incorporates three types of political risk – host country political risk, company political risk and international political risk. Each of the three risk types contains a set of factors and indicators, which are listed in the beginning of each sub-section.[17] In applying this model, each of the factors carries a percentage weight out of a total 100 percent across all the factors. The analyst weights certain factors higher/lower than others depending on the impact that factors have relative to the analysis and the other factors. Through this process the model attains a degree of adaptability, which is essential in order to create a successful political risk model. A rating score between 0 – 5 is given for each of the factor indicators, based on the following index: *0 – no risk, 1 – nominal risk, 2 – low risk, 3 –medium risk, 4 – high risk, 5 – extreme risk.* The sum of each factor's indicators is multiplied by the percentage weight assigned to that factor and divided by the sum of the highest possible rating score for all

[17] A simplified graphical presentation of the full model can be viewed in Appendix A.

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indicators of that factor, resulting in a weighted factor score. The next step is adding all the highest possible scores of the included indicators of a factor (Boshoff and Lambrechts, 2011: 4). The sum of the weighted factors scores provides an overall political risk rating score (OPRR) for the country or region under investigation. The OPRR determines the investment and the political risk indication of the country under assessment. The focus of this study is the OPRR and not separate ratings of the six factors, since the research will rely on an overall political risk rating. The OPRR is evaluated as follows: the higher the rating, the greater the political risk the investor and the investment faces, as described in Table 8 below.

Table 8. Scale for investment and political risk indication

Rating	Investment indication	Rating	Political risk indication
0-10	Highly advisable	0-20	Nominal
11-20	Advisable		
21-30	Very low risk	21-40	Low
31-40	Relatively low risk		
41-50	Low to moderate risk	41-60	Medium
51-60	Relatively moderate risk		
61-70	Moderate to high risk	61-80	High
71-80	Relatively high risk		
81-90	Inadvisable	81-100	Extreme
91-100	Highly inadvisable		

(Boshoff and Lambrecthts, 2011: 6).

4.2 Political risk analysis of the Angolan case

The following sub-sections examine the six factors: political, economic, societal, petroleum, company political risk and international political risk, as well as the subsequent indicators. The factors and the factor indicators that are measured will be outlined at the beginning of each of the following sub-sections. At the beginning of the description of each indicator the value awarded that specific indicator is identified, and the sub-section will conclude with a rating of that factor. However, each factor will not be assigned an individual risk factor rating, since the objective of this study is an overall risk rating. The following risk report will

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provide information that be used by an existing investor in the Angolan oil and gas industry. The results can also be used in the early stage in the decision making process for other investors, as the analysis also will provide useful insight about the extractive industry in Angola in general. What is presented in the sub-sections below is micro in its scope as in concerns a specific industry within a specific region and one company in particular.

4.2.1 Political (host country political risk)

In this sub-section the following indicators will be examined; regime/political stability, war and security, repatriation restrictions, corruption/poor governance, unclear legislation/security of tenure, and investment constraints.

Regime/Political Stability (4): Angola is ranked as *Not Free* by the annual Freedom House “Freedom in the World” report (Freedom House, 2014a). The Economist Intelligence Unit Democracy Index labels Angola undemocratic and ranks Angola within the category of *Authoritarian Regime*[18] (Economist Intelligence Unit, 2012: 7). Angola is a constitutional multiparty democracy; however, in reality this has translated very differently. Angola is described as a “hyper-presidential” system, with few to no checks and balances, and very limited separation of powers (Amundsen, 2014: 176). Since independence in 1975 there have been three parliamentary and one presidential election in Angola, none of which has been deemed free and fair. The majority of the media are either controlled or owned by the government or the MPLA, and independent media are very limited (Amundsen, 2014: 183). The media face a broad range of restrictions that hamper the right to free expression and encourage self-censorship. The state media and a number of private media owned by senior officials are ruling party mouthpieces in which censorship and self-censorship are common (HRW, 2013: 2). Angola is experiencing a strengthening of the opposition, which was somewhat mirrored in the 2012 elections. Arguably inspired by the Arab Spring, there has also been a clear upsurge in anti-governmental protests by Angolan youths. However, these protests by a small number of people have been met with violent repose by the regime, with arrests and following trails. The regime responded with a military blockade to new demonstrations in September 2011 demanding the release jailed of 18 youth leaders, while the police attacked journalists to stop media coverage of the situation (Morais and Moreira, 2011). Although Angola’s regime is classified as authoritarian, it is still a stable regime; however, its legitimacy is questionable. With the second longest sitting president on the African continent, who seemingly is not looking to step down in the immediate future, the

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regime is stable for the time being. An authoritarian leader with a long time horizon does not necessarily have a negative effect on the investment climate.[19] However, dos Santos's succession plans and the positioning of his deputy, Manual Vicente, are expected to raise tensions during the current presidential term. The planned 2016 elections will be the next opportunity for the opposition to challenge the presidency. A potential regime change has a great potential to affect the extractive industries, as this most likely would have an impact on how the extractive industry is managed. The opposition was seen as gaining ground during the 2012 elections; however, the likelihood of a regime change even with an election victory is not great. The main opposition party, UNITA, however, is still struggling to change its former guerilla image among the population, whose priority is to preserving peace. Near-term risk for political destabilization recently diminished with the relatively smooth passage of the August 2012 election, despite the violent run-up. Moreover, UNITA's renewed urban campaign might lead to an increase in street protests. In the long run the growing independence of civil society groups, progression in competitive politics, as demonstrated by the significant number of votes for a split-off opposition party, and President dos Santos's succession make it likely that the MPLA's hegemony will decline. The indicator is accordingly awarded a value of 4, *high risk*.

War and security (2): Emerging from nearly three decades of civil war, instability and conflict, after the peace in 2002 Angola has to a large extent been stable. In recent years, however, there have been a growing number of demonstrations,[20] particularly by young people calling for the resignation of President dos Santos. Political violence is not a substantial risk in most of Angola. However, there have been some incidents in the province of Cabinda, a small exclave of Angola separated from the rest of the country, which is calling for independence. Cabinda produces an estimated 500 000 barrels a day; this amounts to about a third of Angola's total oil exports. Separatist groups such as Front for the Liberation of the Enclave of Cabinda have been known to kidnap oil workers and use acts[21] of violence in order to draw attention to their cause; however, the likelihood of such acts is low. The Angolan government does have a heavy military presence in Cabinda, which is necessary to

[19] See section 2.5.1 Chapter Two for the "rational long-term autocratic leader" argument presented by Olson (1993).
[20] See sub-section 4.2.3 Societal for a more detailed description of these demonstrations.
[21] In 2010, when Angola was hosting the Africa Cup of Nations, separatist gunmen opened fire on a bus carrying Togo's soccer team, killing several people on board (VOA, 2012). In November 2010 a convoy carrying Chinese mine workers contracted by Sonangol was attacked and several miners were killed (BBC, 2010).

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suppress rebellion, according to the government (BBC, 2010; VOA 2012). However, such incidents are not frequent and as such do not pose any short- to mid-term risk; the indicator is thus given a value of 3, which indicates a *medium* risk level.

Repatriation Restrictions (3): A foreign investor in Angola has the right to transfer profits and dividends abroad, as well as amounts related to the investment made. The minimum amount for foreign investments is US$ 1,000,000 in order to benefit from taxation incentives and to be able to repatriate profits. In order to exercise this right the investor is required to have proof that the investment was made and that taxes due were paid, as well as obtaining a capital export license and complying with the conditions set out in this license given by the National Bank of Angola (MLGTS, 2012: 8). There are minimum periods, however, counting from the effective implementation of the investment, that the investor must comply with in order to repatriate profits and dividends, which depend on the amount invested on the location where the investment is to be carried out. Investments in the oil industries are governed by special regimes and require prior approval from the Angolan Central Bank and the Ministry of Petroleum and Sonangol (KPMG, 2012-2013). The rules regarding repatriation are complicated for a company unfamiliar with the process; however, evidence of oil companies not being able to repatriate earnings has not been found and as such the risk related to this is seen as 3 – *medium*.

Corruption/Poor Governance (4): Angola has emerged from almost 30 years of civil war and instability, but the country still continues to struggle with major challenges of weak governance and widespread corruption. Angola ranks as number 153 of 177 countries on Transparency International's global transparency scale (Transparency International, 2013). This rating indicates that Angola is significantly corrupt and in fact among the most corrupt countries in the world. There are varying forms of corruption in Angola; petty bribery is widespread and public servants regularly ask for bribes. According to the U4 Anti-Corruption Resource Center, inefficient government structures and an obscure regulatory system combined with low civil-service salaries offer many opportunities for rent seeking. Grand corruption scandals in Angola often involve MNCs and top-level local and foreign officials (U4, 2010). There are some strong anti-corruption laws, but the institutions to enforce these laws are weak. Without institutions to enforce the laws and, more importantly, break the political hold that the presidency and Sonangol have over the country, increased transparency and real democracy will not be possible (Ramos, 2012: 16). One of the main issues in terms of transparency is linked to public management of Angolan oil wealth. In the Angolan

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economy, where oil export revenues accounts for around 86 percent of public revenues, the government keeps oil accounts, revenues, expenditures and contracting procedures hidden to a large extent. Furthermore, the relationship between the authorities and Sonangol is both secretive and complex. The majority of the Angola oil revenues flow through Sonangol; these revenues feed what Ramos (2012) describes as a vast patronage system. This patronage system, run by President dos Santos, has kept the ruling MPLA party and the government in check by rewarding elite public officials, family members and the military (Ramos, 2012, 14). Sonangol does publish audited annual financial statements on its website, but while there is increasingly more information available, this has not necessarily led to increased transparency as arguably the information released by Sonangol, and the Ministries of Petroleum and Finance is not consistent, comprehensive, reliable or independently verified (Ramos, 2012: 14). Furthermore, there have been incidents where what is reported by Sonangol is not consistent with the numbers reported by the oil company, as in the 2010 incident with the "missing millions"[22] (HRW, 2012). Corruption is widespread in Angola, and with most of the foreign companies in the country being involved in the extractive industries, where the corruption arguably is the most pervasive, oil companies are the most at risk of being involved in corruption. The major corruption scandals are often tied to "lost" sums of money, related to signature bonuses and so on, which is directly linked to the payments of foreign oil companies, and as such this is clearly an area where more transparency from the oil companies, Sonangol and the Angolan authorities is needed. The risk of corruption is as such ranked as 4 – *high*.

Unclear Legislation/Security of Tenure (4): There are contractual risks involved for MNCs investing in Angola. On the World Banks's Doing Business 2014 survey, Angola ranks 187 out of 189 economies in the survey on the variable of the "ease of enforcing contracts" (Doing Business, 2014). According to the Doing Business report, contract enforcement in Angola takes 1296 days, costs 44,4 percent of the value of the claim and requires 46 procedures. Angola's ranking is as such very low compared to the regional average for Sub-Saharan Africa, which would be a ranking of 123 (Doing Business, 2014: 82). As such, companies seeking to establish themselves in Angola should familiarize themselves with the difficulties related to contract enforcement. One of the key issues is that, even though laws are in place,

[22] In December 2011 the IMF issued a report that highlighted an unexplained US$ 32 billion discrepancy in the Angolan government's 2007- 2010 fiscal accounts linked to Sonangol's quasi-fiscal activities. This figure amounts to a quarter of Angola's gross domestic product (HRW, 2012).

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the legislation is complex and not properly enforced as the judiciary lacks independence and the mandate to actually enforce the laws. Hence there is a considerable amount of risk tied to this indicator, as the rule of law is particularly weak. A rating of 4 is thus awarded.

Investment Constraints (4): Angola is generally known as a difficult country to invest in, also when compared to the rest of the sub-Saharan region. In the World Banks's annual Doing Business 2014 survey, Angola ranks as 179 out of 189 in terms of overall ease of doing business. In May 2011 a new private investment law altered the benefits and incentives available for investors. The minimum size requirement to qualify for incentives was increased from US$ 100,000 to US$1 million. Furthermore, investors must enter into an investment contract with the Angolan state, represented by the National Agency for Private Investment (ANIP), which will establish the conditions for the investments as well as the incentives granted. Angola's private investment law expressly prohibits private investment in the areas of defense, internal public order and state security; in banking activities relating to the operations of the Central Bank and the Treasury; in the administration of ports and airports; and in other areas where the law gives the state exclusive responsibility. Investment in the petroleum, diamond and financial sectors is governed by sector-specific legislation (U.S. Department of State, 2013). The World Bank Doing Business report identifies Angola as one of the most time-consuming countries surveyed for starting a business. Launching a business typically requires 184 days, compared with a regional average of 80 days. In 2003 the government established the "Guichê Único" or one-stop shop, under the Ministry of Justice, bringing together representatives of various ministries in one place in an effort to simplify and speed up company registration time. However, the Ministry of Justice lacks authority over the other government ministries and the process remains slow. There is no formal discrimination against foreign investment, but Angolan or companies familiar with the bureaucratic and legal complexities of the business environment hold an advantage. The Promotion of Angolan Private Entrepreneurs Law gives Angolan-owned companies preferential treatment in tendering for government contracts for goods, services and public works. Furthermore, only firms with a majority Angolan stake can benefit from the loan guarantees, generous terms, and subsidized interest rates of the newly implemented US$ 1.6 billion fund to support micro, small and medium-sized businesses (U.S. Department of State, 2013). The aspect of time, as well as general ease of doing business, alters the risk of investment constraints for MNCs without an Angolan partner. "The business environment remains one of the most difficult in the world. Investors must factor in pervasive corruption, an underdeveloped financial system,

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poor infrastructure and extremely high on-the-ground costs" (U.S. Department of State, 2013). As a result investment constraints will be ranked as a 4 – *high risk*.

Final political factor score: 17,5 out of a 25 percent weighed factor score of the overall risk model.

4.2.2. Economic (host country political risk)

In this sub-section the factor of economy is examined, the following indicators is investigated; economic performance, balance of payments, creditworthiness, currency convertibility, energy vulnerability, public/private sector mix, and the current account deficit.

Economic performance (2): As a resource-rich developing country, Angola's fiscal policies are vital for growth. The Angolan authorities have taken steps to improve the heavy resilience on oil revenues in the economy since the start of the global financial crisis; however, according to the World Bank, there remains considerable room to strengthen the fiscal policy. Angola's level of public investment is very low compared to other countries in the region (World Bank 2014c). Angola's strong public debt profile and the revenue boost provided by the recovery of the oil sector offer a valuable opportunity to expand development spending and attract greater private sector investment in the non-oil economy (World Bank 2014c). Angola's economic growth as measured by gross domestic product (GDP) slowed down in 2013. Real GDP growth was at 4.1 percent in 2013, a decrease from 5.2 in 2012 (World Bank, 2014c). The current GDP per capita is 5,668 US$, and according to the forecasts by the World Bank, Angola will experience growth[23] in the years to come, a growth that is higher relative to the growth predicted for the Sub-Saharan region in general (World Bank, 2014a). Angola has experienced a steady decline in inflation levels in recent years; it is currently at 8.8 percent, which is high, however, it is improving (World Bank, 2014). Furthermore steps are being taken to diversify the economy and minimize the heavy reliance on oil. Coupled with the expected growth in GDP, the overall short- to mid-midterm Angolan economy is looking promising, and a rating of 2 is given.

Currency (3): The Angolan National Bank (BNA) has focused on stabilizing the nominal exchange rate. With the downward trend in inflation over the last few years – however, it is still high – the monetary policy has focused on stabilizing the kwanza. To maintain stability of the exchange rate, the BNA increased their interventions in the foreign exchange market. The increased foreign currency inflows through 2010-2011 as a result of the recovery in oil

[23] Expected GDP forecast for Angola is estimated at 5.2 percent for 2014; 6.5 percent for 2015; 6.8 for 2016 (World Bank, 2014a).

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export earnings saw increased pressure on the exchange rate. In response, BNA increased their open-market sales of kwanza, boosting international reserves (World Bank, 2013: 5). KPMG's Angola report evaluates the currency risk in Angola as stable, as it is stable against the US dollar, underpinned by the strength of the current account position. However, the outlook would change in the event of a sharp dip in oil prices (KPMG, 2012-2013: 16). In the short to medium term this is not a risk, but it can potentially become a risk, hence a rating of 3 is given.

Balance of payments (2): Following the global economic crisis and the decrease in oil production and prices in 2008-2009, the rising production volumes and recovering oil prices have now pushed the trade surplus to above the levels prior to the economic crisis. Angola relies heavily on imports of processed fuels and imported food. Strong growth in domestic consumption and construction activity has increased the demands for imports, narrowing the current account surplus (World Bank, 2013: 5). Angola's current account (2012) was estimated to have a surplus of US$7.5 billion, which is 6.7 of percent of GDP, which is decline from 2011, when the surplus was US$11.3 billion. The narrowing current account surplus is mainly explained by developments in the trade balance. Angola's fiscal balance is strongly correlated with the current account balance. With oil revenues accounting for over 80 percent of all government revenues, fluctuations in the current account are driven by changes in domestic savings. This was particularly true in 2008-2009, when Angola's savings rate plunged from about 27 percent of GDP to just 6 percent. Savings have recovered since then, but at 20 percent of GDP in 2012 they remain below their pre-crisis level. However, the recovery in overall savings has been primarily the result of an increase in public savings as the government returned the budget to surplus (World Bank, 2013: 16). In addition to this, the Angolan government established a sovereign wealth fund in 2012. The newly created sovereign wealth fund is assessed to act as a buffer and reduce the country's vulnerability to oil price falls (PWC, 2012: 25; EKN, 2013: 3). This can be regarded as a positive development, but the real effects of this remain to be seen. A rating of 2 is awarded the indicator.

Creditworthiness (3): Angola's creditworthiness is evaluated as BB- by the credit rating agency S&P. This rating indicates that Angola is "less vulnerable in the near-term but faces major ongoing uncertainties to adverse business, financial and economic conditions" (S&P, 2014). The credit rating company Fitch also gives Angola a BB rating, which labels Angola as "speculative"; this indicates the following about Angola's creditworthiness: "ratings

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indicate an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time; however, business or financial flexibility exists which supports the servicing of financial commitments" (Fitch, 2014). As described by KPMG, "Corruption, mismanagement, opacity in the use of public resources and political uncertainty – resulting mainly from the presidential succession issue – pose risks to sovereign creditworthiness" (KPMG, 2012-2013: 16). The risks related to this are evaluated as stable for the time being and the indicator rating is 3 – *medium risk*.

Currency convertibility (3): A Monetary Policy Committee (MPC) was established in August 2011 to oversee Angola's overarching monetary policy. This committee is responsible for monetary policy operations, including the key task of setting the interest rate on overnight loans in the domestic money market. The establishment of the MPC was accompanied by an expansion in monetary policy instruments; in particular, the BNA is now able to augment the management of the domestic money supply with instruments including reserve requirements, currency exchanges and an expanded array of open market operations (World Bank, 2013: 5). Short- to medium-term risk is evaluated as 3 – *medium*, because of the government's more recent efforts in controlling the development of this indicator.

Energy vulnerability (4): The oil sector remains the driving force of the Angolan economy, and the rising oil production coupled with high oil prices led to a recovery of growth in 2012. Oil currently accounts for 46 percent of Angola's GDP and 96 percent of its exports (World Bank, 2013: 1). Angola's strong reliance on oil affects the economy in numerous ways. First, oil exports generate inflows of foreign currency, causing the kwanza to appreciate; this undermines the competitiveness of the non-oil sector by effectively making Angolan goods more expensive for foreign consumers, while foreign goods become cheaper for domestic consumers (World Bank, 2013: 5). Non-oil GDP is increasing as a result of developments in the electricity sector and the recovery of the agriculture sector following the drought experienced in recent years, which heavily affected agriculture output. GDP growth is expected to accelerate in 2014 as oil production recovers from the global economic crisis. The 2014 budget is expansionary, with capital expenditures expected to increase by about 3 percentage points of GDP to about 13% of GDP. It outlines expenditures of US$ 55.4 billion (41.9% of GDP), with the broad aim of helping to diversify the heavily oil-dependent economy and boost job creation (World Bank, 2014c). The extractive industries are by and large the most important in Angola. Given the reliance on the export earnings from the dominant oil industry, most of the economic activity in Angola is related to this sector. Oil

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exports will remain the country's dominant source of foreign income in the coming years; however, the Angolan government is pursing plans to diversify the economy in other sectors through public investment programs in industries such as mining, construction and mineral extraction diversification (PWC, 2012: 27). Angola is highly dependent on oil revenues, which makes the country very vulnerable to changes in the oil price, and this makes Angola energy vulnerable and the risks related to this are rated as 4 – *high*.

Public/private sector mix (3): There are many challenges that face the private sector in Angola; some have been mentioned earlier under economic performance indicator. In addition to this, Angola's poorly developed financial sector, the banking sector, has grown rapidly in recent years, yet access to financial services remains very limited (Jover, Pinto and Mechand, 2012: 18). Another key constraint on private sector participation in the economy is labor market inflexibilities, shortage of skilled labor and the difficulties to hiring expats, and a weak and fragmented legal system. The law offers basic protection for bureaucratic and administrative disputes, but is a costly and complex process. Firms have a relatively low confidence in the courts, which are perceived as partial, corrupt and lacking in enforcement capacity. According Jover, Pinto and Mechand (2012), the constraints described obstruct entry, while competition in the local economy encourages informality and feed rent-seeking practices. Because bureaucratic and political barriers remain significant for the private sector, Angolan companies familiar with the bureaucratic and legal complexities of the business environment hold an advantage over foreign companies. Foreign companies seeking to do business in Angola are often recommended to find a local partner. However, finding the right local partner is not easy, as the element of corruption plays a role here as well (Jover, Pinto and Mechand, 2012: 19). But while Angola is a difficult environment in which to do business for a private investor, this should be weighed against the significant investment opportunities. The complexity of the investment climate does not in itself pose a risk, but companies need to be aware of this in order to avoid this becoming one. The risk is rated as a 3.

Current account deficit (2): Angola's vast oil exports have created a surplus in the current account balance. However, the high pace of growth and investment in the country require major imports as very little production takes place within Angola. This will lead to the current account surplus shrinking and eventually turning into a deficit. However, the current account deficit is estimated to remain modest, as Angola will continue to be a major oil exporter (EKN, 2013: 3). As such there is little to no current risk related to this indicator – 2.

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Final economic factor score: 25,5 out of a 20 percent weighed factor score of the overall risk model.

4.2.3 Societal (host country political risk)

In this sub-section the following social indicators are explored; internal violence, civil and labor unrest, homogeneity, ethno-linguistic/racial/national, ethnic conflict, community opposition/social license to operate, standard of living, and environmental activism.

Internal violence (4): In recent years there has been an upsurge in the number of demonstrations as well as episodes of violence in the capital and other major cities. Youth and civil society movements inspired by the Arab spring but without any political affiliation repeatedly call for freedom of expression and remedies for social injustice, and expressed growing disillusionment with the MPLA's failure to use the oil wealth to benefit its citizens instead of sustaining patronage. In May 2012 a group of former Angolan soldiers from all former armed movements staged new demonstrations, protesting unpaid pensions and benefits (HRW, 2013: 3). The key issue with regard to these demonstrations has been the authorities' response, even to small-scale peaceful protests, as the government has not hesitated to use excessive force, arbitrary arrests, unjust trials, and intimidation of journalists and other observers. In addition to this, the authorities created distress among the Angolan population by alleging that the protests could result in civil war and must thus be stopped. According to Human Rights Watch, the key perpetrators in regards to this have been groups of armed individuals, which act with complete impunity and appear to be civilians dressed as security agents. In the months leading up to the elections in 2012, attacks, threats, abductions, and forced disappearances, against the opposition activists and youth protestors leaders by these civilian dresses security agents increased in what appeared to be a systematic matter (HRW, 2013: 3). As there in general has been an increase of internal violence, in a country where speaking out against the government publicly has not been common, particularly in reference to the 2012 elections, the risk of there being an increase of such episodes in relation to the next elections is high, which gives a indicator score of 4 - high.

Civil and labor unrest (3): Angola's labor laws provide substantial protection and benefits to workers, including the right to strike (KMPG, 2012-2013: 32). Yet with reference to the indicator of labor unrest, the authorities' reaction to demonstrations on 27 May 2012 by former presidential guards who were claiming unpaid salaries clearly illustrates the authorities' views on labor demands. Violent attacks by law enforcement, and the abduction of two demonstration organizers whose whereabouts are still unknown, was the result. The

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police have rejected their families' requests to investigate the case, nor have the police followed up other complaints filed by protesters against their violent aggressors (HRW, 2013: 4). Again as noted in the two previous sub-sections, laws are in place, but the enforcement of them judicially as well as by law enforcement agencies is clearly questionable. The risk is accordingly rated as 3 – *medium risk*.

Homogeneity (2): The Angolan population is composed of different ethnic groups,[24] but this is not the root of any particular issues as will be seen in the next indicator section. In terms of religious beliefs, the majority of the population practices indigenous beliefs or some form of Christianity (CIA World Fact Book, 2014). However, the Angolan Muslim minority has recently accused the authorities of banning Islam after shutting down most of the mosques in the country, and there have been reports of violence against women wearing the veil. The Islamic Community of Angola (ICA) claims that eight mosques have been destroyed during the past two years, and anyone who practices Islam risks being found guilty of disobeying Angola's penal code (Cabeshe and Smith, 2013). Under Angolan law a religious group needs more than 100,000 members and to be present in 12 of the 18 provinces to gain legal status. There are only an estimated 90,000 Muslims in Angola's population. Rafael Marques de Morais, an Angolan journalist and political activist, claims that "I've seen an order that says Muslims must destroy the mosques themselves and clear away the debris, or they will be charged for the cost of the destruction". He suggested the government was seeking a convenient diversion from growing public hostility towards Chinese and Portuguese workers in Angola: "The government needs to deflect attention. They are trying to find a scapegoat for economic pressures and saying Islam is not common to Angolan values and culture" (de Morais in Cabeshe and Smith, 2013). The Angolan government denies any attempt to ban Islam: "There is no war in Angola against Islam or any other religion", says Manuel Fernando, director of religious affairs at the culture ministry (Manuel Fernando in Cabeshe and Smith, 2013). The key issue is again, although the facts related to these allegations are disputed, the way that the authorities have chosen to handle the situation, resulting in the use of violence against a minority group. The risk related to this indicator is rated as 2 – *low*, as these incidents can be seen as isolated events, and tot an overall trend.

Ethnic conflict (1): Ethnic divisions played a role during the Angolan Civil War, as different ethnic groups sought to ally themselves with distinctive liberation groups. Ethnicity has as

[24] Ovimbundu 37%, Mbundu 25%, Bakongo 13%, Mestiços (mixed European and native African) 2%, European 1%, and 'Other' ethnic groups 22% (CIA World Factbook, 2014).

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such played a role in Angolan politics and society during the years of the civil war; however, this has not translated into ethnic conflict in the post-civil war era. There is little to no empirical data suggesting any signs of an ongoing ethic conflict in Angola. The risk is hence rated as 1– *nominal*.

Community opposition/social license to operate (4): The constitution of 2010 guarantees the right to freedom of assembly and peaceful demonstration. The Angolan law explicitly states that public demonstrations without government authorization are allowed. Nevertheless, according to reports by Human Rights Watch, the government has banned a number of anti-government demonstrations in recent years and the police have obstructed the majority of peaceful demonstrations (Human Rights Watch, 2013). Again, the norm in Angola seems to be that the laws are in place, but the enforcement of the laws is weak, and as such not protecting Angolan citizens' rights as intended. Risk is evaluated as 4 – *high*.

Standard of living (4): Despite remarkable oil riches, the majority of Angola's population continues to live in extreme poverty and life expectancy is below the African average. Angola's development indicators remain low, with high property levels and limited access to social services, and most Angolans find themselves living in great poverty. The UN Human Development Index ranks Angola as number 148 out of 186 countries, which puts Angola in the lowest category and as a country with "Low Human Development" (UN Human Development Index 2013). The Angolan authorities struggle to meet the basic needs of large sections of the population; furthermore, the Angolan population struggles with lack of economic opportunity, rapid urbanization and large numbers of youths without work or education, which again contributes to instability (KMPG, 2012-2013: 4). The root of this current situation is again linked to weak governance, as it is defecits in governance which limit economic opportunities and access to services for the Angolan people. There are long-term risks related to this, as a grievance arguably has the potential to lead to violent conflict, hence the 4 – *high-risk* rating.

Environmental activism (1): There is no notable environmental activism currently observed in Angola. However, according to the organization the Environmental Justice Atlas, there are a number of environmental issues experienced because of the extractive industry. The people living along the cost of Soyo and Cabinda are dependent on small-scale farming and fishing, but according to the Environmental Justice Atlas, their livelihoods are undermined by the extractive industry. The extractive industry's technology pollutes, and events such as spills have dramatically decreased ecological productivity in the region. However, few people

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understand scientifically how extractive activities impact on their health and the health of local ecosystems. According to the Environmental Justice Atlas, since there is little understanding of the risks or how to mitigate them, most resistance efforts focus on local people gaining compensation for losses or receiving a larger share in the distribution of benefits from resource extraction (Environmental Justice Atlas, 2014). With little awareness, there is also currently 1 – *nominal* risk of environmental activism.

Final societal factor score: 9,22 out of a 17 percent weighed factor score of the overall risk model.

4.2.4 Petroleum (host country political risk)

In this section the petroleum factor is examined, which also relates to the host country political risk, as in the three preceding sub-sections. The following indicators are examined: ownership, domestic reserves/production, host's relative market position, level and destination of exports, strength of national oil company (NOC), role of the foreign company in the national oil industry, oil and gas prices, domestic ability to operate the industry, and ownership/contractual relationship between the firm and the host country.

Ownership (3): The state-owned oil company Sonangol controls the Angolan oil sector. Sonangol is at the moment a shareholder in most of the oil and gas exploration and production blocks in Angola. Sonangol owns 17 companies that operate throughout the extractive industries preforming tasks such as production and marketing of crude oil, exploration, storage and marketing of petroleum derivatives (EIA, 2014: 2). Sonangol is described as a professional international oil company; however, Sonangol's ties to President dos Santos raises questions about transparency and corruption, which again poses 3 – *medium* risks to investors.

Domestic Reserves/Production (2): According to the World Bank, known crude oil reserves will allow for at least another 21 years of exploitation in Angola (World Bank, 2013). Angola has about 9.1 billion barrels of proven crude oil reserves. The majority of the proven reserves are located in the offshore parts of the Lower Congo and Kwanza basins. In the past couple of years Angola's oil production has averaged around 1.8 million barrels a day, 1.7 of which are of crude oil. Angola's production has been stagnant as a result of persistent technical issues, which has caused disruptions to supply in some fields. Rapid reservoir depletion has also resulted in steeply declining production rates at some oil fields. Angola has several oil projects planned to start production within the next five years and aims at increasing its production to 2.0 billion barrels a day by 2017 (EIA, 2014: 4). Because production continues

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to grow, and there are vast amounts of proven reserves, there is a 2 – *low* risk of a stop in domestic production or the development of new fields.

Host's Relative Market Position (3): Sonangol administers and regulates the oil industry, and inhabits functions that traditionally would be under the purview of the Ministry of Finance, or the Central Bank, which can create a conflict of interest, according to Ramos (2012). Sonangol also has a monitoring role bypassing the Angolan Ministry of Petroleum and Environment. Sonangol's organizational structure is described as porous, which according to Ramos (2012), increases the risk of corruption and dubious financial transactions. Sonangol inhabits an array of different roles; it is the concessionaire, equity partner and the operator in the industry. These three separate roles that Sonangol plays necessitates three budget transactions with the national Angolan budget: assets that Sonangol generates from equities in oil concession shares are largely reinvested in Sonangol and its subsidiaries; secondly, as a concessionaire, Sonangol signs the contracts and receives a share of the profits from the oil, which are transferred to the treasury; thirdly, Sonangol is commissioned with an array of quasi-fiscal activities that are funded from oil profits. As such Sonangol and consequently the president completely control the market, with little interference from other institutions such as the Ministry of Petroleum, Finance or any other institutions. The risk is evaluated as 3 – *medium* risk.

Level and Destination of Exports (2): Angola has become the second-largest supplier of crude oil to China since 2005, behind Saudi Arabia. Other major destinations of Angolan oil include the US, the European Union and India. Nearly all of Angola's oil production is exported, as Angola's domestic refining capacity is limited. US imports of Angolan oil have, however, declined recently (EIA, 2014). The global demand for energy supplies is growing, and as such there is little risk tied to either lack of demand or an overall downturn in nations seeking to buy Angolan oil; hence the 2 – *low* risk related to this indicator.

Strength of National Oil Company (4): The national oil company Sonangol is at the center of the Angolan oil industry. Second to the presidency, Sonangol is the most economically and politically important institution in Angola (Ramos, 2012: 23). By law MNCs that seek to do business in Angola must associate with Sonangol in the form of a Production Sharing Agreement (PSA) or a joint venture. In order to attain a contract, an MNC needs to pay signature bonuses, which can run up to billions of US dollars. Angolan law also obligates MNCs to contract Angolan companies for oil services, according to Ramos (2012), evidence points to the beneficial ownership and shareholdings in Angolan companies that have been

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awarded contracts by Angola public officials, violating both international and Angolan law (Ramos, 2012: 1). Arguably the national oil company is too dominant, which has led to a low level of control given the company's interaction and close relationship with the president and the MPLA; this is again related to the corruption indicator in section 4.2.1. The company's dominance becomes both its strength and its biggest weakness at the same time. Risk is measured as 4 – *high*.

Role of the Foreign Company in the National Oil Industry (3): The main contractual agreements used by Sonangol in its association with foreign companies are joint ventures and Production Sharing Agreements (PSA). Oil production in Angola is increasingly taking place in deep or ultra-deep water, which involves complex technology and particularly high development costs and risks. This means that small companies cannot participate without linking up with large MNCs,[25] which again makes the MNCs indispensable to the Angolan oil industry, and again Sonangol is dependent on these companies. Ramos (2012) argues that this gives MNCs leverage and ability to influence government policies. Furthermore, the MNCs have market power and that technical capacity that potentially has the power to promote development (Ramos, 2012: 25). However, historically this has not been the case in the Angola oil industry, as multinational oil companies generally don't address governance or transparency issues in Angola. There are some exceptions; BP and Statoil[26] in particular have made efforts in terms of seeking a greater degree of transparency. Risk is assessed as 3 – *medium*.

Oil and Gas Prices (4): As seen described in the previous three sub-sections, Angola is extremely dependent on the revenues from its oil exports, as they accounts for more than 46 percent of Angola's GDP and 96 percent of its exports (World Bank, 2013: 1). Thus international oil prices matter deeply in Angola. This is in large part a consequence of the lack of diversification in the Angolan economy. As seen in relation to the 2008 global financial crisis, Angola's oil revenues and GDP dropped dramatically as a result of a decline in global oil prices and a slowdown in domestic oil production. This also strongly impacted on the

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[25] International oil companies currently operating in Angola: Chevron (US), ExxonMobil (US), BP (UK), Total (France), Petrobras (Brazil), Cobalt (US), Tullow (UK), Vaalco (US), Pluspetrol (Argentina), Maersk Oil (Denmark), Eni (Italy); and those awarded licenses to operate in the most recent pre-salt and deep-sea concessions: Statoil (Norway) and Repsol (Spain). Beyond these, a number of other foreign oil companies are partners in oil blocks, including Galp (Portugal), SSi (China), Marathon (US), Falcon Oil (US), Prodoil (Norway), Ajoco (Japan), Svenksa (Sweden), Tenenge (Brazil) and Partex Oil & Gas (Portugal).

[26] See section 4.2.5. Company Political Risk for a more in-depth examination of Statoil's transparency efforts.

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Angolan economy as a whole, through weakened consumption, cuts in public spending and the increase of substantial arrears to domestic firms (World Bank, 2013: 1). The government has made efforts to diversify the economy, as well as establishing a sovereign wealth fund in order to prevent a drop in prices hitting the economy as hard as it has in the past; however, Angola is still heavily dependent on oil prices and would be adversely effected in the case of a dramatic drop in price level. Risk is evaluated as 4 – *high*.

Domestic Ability to Operate the Industry (3): As noted under the Role of the Foreign Company indicator, Angola and Sonangol are dependent on joint ventures and PSA agreements with multinational oil companies in order to secure proper technology and funds to develop and manage the deep and ultra-deep oil fields. In relation to no-technical issues, Angola's ability to operate the extractive industries is constantly questioned. The poor quality of Angola's institutions of redistribution is arguably the main source for the oil boom being describes by many as a "curse", as these institutions are designed to be "grabber friendly" (Amundsen, 2014: 173). Furthermore, extraction methods arguably used by Angolan state elites have led to "missing billions" from oil contracts and signature bonuses, or reports by the authorities to the IMF that large inconsistencies and millions unaccounted for are the norm, clearly puts Angola's ability to handle or operate the industry into question. But Sonangol is also praised by most Western banks, as well as most oil companies. Sonangol has become a sophisticated and modern oil company. MNCs speak well of Sonangol, reporting "hassle-free interactions with the company"; from this perspective Sonangol fills the requirements of competence, predictability and a measure of mutual trust (de Oliveira, 2007: 605). Angola's ability to operate the industry is twofold; in some aspects they are perfectly capable, while in regards to others Sonangol completely misses the mark, hence a rating of 3.

Ownership/Contractual relationship between the Firm and the Host Country (2): According to KPMG's Angola report, there is little risk of the Angolan government directly expropriating the assets of foreign investors. In terms of the contractual relationship between the authorities and the multinational oil companies, these are either in the form of a PSA agreement or a joint venture. As noted in section 4.2.2 under Unclear Legislation/Security of Tenure enforcing contracts, if there is a dispute, the matter can become challenging. Risk is 2 – *low*.

Final rating petroleum factor score: 9 out of a 15 percent weighed factor score of the overall risk model.

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4.2.5 Company Political Risk (Company political risk)

This sub-section examines the political risk tied to the company, which in this case is the Norwegian oil company Statoil. The following indicators are examined: nationality of the company, world industry positioning, special bargaining advantage, and host government relations.

Nationality of the Company (1): Statoil is the Norwegian national oil company, and as such classified as a NOC. Statoil is positioning itself internationally along the lines of a new growing trend, as described by Al-Kasim, Søreide and Williams (2008), where NOCs now are challenging the traditional IOCs in the global competition for oil reserves (2008: 18). Statoil is strongly based on the Norwegian heritage, its ethics, as well as playing a leading role in promoting increased transparency in the oil industry. Statoil's commitment to transparency is displayed in Transparency International's 2012 business ranking on transparency, which measured the 105 biggest public companies. This report ranked Statoil as number one transparent company with a score of 8.3. Transparency International describes Statoil as a company that "discloses significant information about its anti-corruption programs, subsidiaries, taxes and profits across its 36 countries of operations" (Transparency International 2012). Neither the nationality of the company nor the company itself poses any risk and as such the risk is rated as 1 – *nominal*.

World Industry Positioning (2): Statoil has gown immensely since it was founded in 1972 when Norway discovered its oil, and now has operations in 36 countries worldwide. Statoil expects its production and development internationally to account for a large share of its total production in the future (Statoil, 2013: 25). Angola is the company's most important investment on the African continent and the biggest contributor to Statoil's production outside Norway (Statoil, 2013). Statoil's main development projects are in Angola, Canada, Azerbaijan, the UK and the US, Statoil's petroleum production outside Norway amounted to an average of 470,000 barrels of oil equivalent (boe) per day of entitlement production and 669 000 boe per day of equity production (Statoil, 2012). Statoil's total proved oil and gas reserves were estimated to be 5 600 mmboe at year-end 2013, compared to 5 422 mmboe at the end of 2012 (Statoil, 2013). Statoil is increasingly becoming a key player internationally, and as an international company Statoil experienced on 16 January 2013 what risks this can entail. Statoil, BP and Sonatrach were hit by a terrorist attack in the Amenas production facility in Algeria, causing the death of 40 workers, five of which were Statoil employees. The terrorist attack clearly illustrates how no company is immune to political risk. The

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incident cannot be seen as a direct consequence of Statoil's position or solely as an attack on Statoil itself, as there were many underlying causes leading up to the attack, which will not be discussed here. Risk is assessed as 2 – *low*.

Special Bargaining Advantage (3): Most of the Angolan oil resources are located in deep or ultra-deep waters, which is one of Statoil's strongest fields of expertise. Furthermore, Statoil's technology is key for Angola, both in the pre-salt field where Statoil is now operator, as well as in the deep and ultra-deep oil fields. Statoil has also spent large sums on different CSR and development projects in Angola. In 2013 Statoil invested 121 billion Norwegian Kroner (NOK) in contractual social investments, which is required by partners in a PSA agreement. Statoil however spent 5 billion NOK in voluntary social investments, including a program that promotes higher education in petroleum sciences (Statoil, 2013: 20). Such initiatives make Statoil a strategic partner for the Angolan government, as the numbers in their annual report show that Statoil invests more in non-oil related development than what is required of them. As an operator at blocks 38 and 39, Statoil is clearly heavily invested in Angola, with a high level of sunken assets. This can play both in favor of and against Statoil, as a big investor has leverage, but if there were any big changes in the Angolan government's policies as a result of a change in government, risks might increase. As such short- to mid-term risks are low, though this has the potential to change, putting Statoil's investment at risk long-term. Risk is rated as 3 – *medium*.

Host Government Relations (3): Statoil's production in Angola exceeds more than 200 000 barrels a day, which is more than any other of Statoil's production outside Norway. Statoil's portfolio in Angola currently consists of seven offshore blocks.[27] Among the major oil companies Statoil has a lead in promoting transparency. Statoil uses the disclosure exemption provision in its PSA with Sonangol, whereby Sonangol will authorize foreign operators to publish such information if mandated by home country laws (Ramos, 2012: 25). By publishing the amount of signature bonuses paid, Statoil to some extent pushes the Angolan authorities to a greater degree of transparency in their dealings. According to numbers published by Statoil in 2013, the company paid 1.4 billion NOK in signature bonuses[28] to the Angolan authorities (Statoil, 2013: 20). Statoil is currently in a disagreement with the

[27] Block 17-23, 33%, Block 15-13, 33%, Block 31-13, 33%, and Block 4/5-20%. Statoil operated pre-salt assets: Block 38 – 55%, Block 39 – 55%. Statoil PSA agreements with 20%: Blocks 22, 25 and 40.

[28] Angolan petroleum law requires that a part of the signature bonus paid to the Angolan state be earmarked for social purposes; however, there is little information of how the funds are used and Sonangol has the final say in how the funds are spent (Ramos, 2012: 26).

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Angolan Ministry of Finance, which has calculated additional profit oil and taxes for Statoil on the basis of activities that currently include the years 2002 up to 2010. However, Statoil disputes the calculations and is pursuing these matters in accordance with the relevant Angolan legal and administrative procedures. On the basis of the assessments and continued activity on the four blocks up to and including 2013, the exposure for Statoil at year end 2013 is estimated at US$ 0.9 billion (NOK 5.5 billion), the most significant part of which relates to profit oil elements. Overall the relationship is good, with no particular short- to mid-term risks related to it, hence a rating of 3 is given.

Final rating for the company factor score: 3.6 out of an 8 percent weighed factor score of the overall risk model.

4.2.6 International Political Risk (International political risk)

In this sub-section international political risk is examined through the following indicators: host government international integration, host/home government relations, world petroleum market, world economic condition, the demonstration effect.

Host Government International Integration (3): In the years after independence, Angola had close relations to the Soviet Union. However, Angola has been determined to avoid repeating its Cold War proxy past. Consequently, the government skillfully maintains diversified diplomatic and financial partners. Despite China's massive loans for Angola's post-war reconstruction, the government has also arranged important oil-backed credit lines with Portugal, Brazil, Germany and the US. Moreover, Angola restored relations with the IMF during the 2009 crisis, enabling a Stand-by Agreement loan facility (SBA), while avoiding overreliance on Chinese financing and opening the door for improvements in the detrimental business climate. In the coming years Angola's key foreign policy aims will be to diversify access to international finance, to expand the county's regional and international influence, and to consolidate relations with key strategic partners – in particular, China, Brazil and Portugal (KPMG, 2012-2013:37). Relations with the DRC will remain tense, owing to expulsions of illegal immigrants by both countries and a quarrel over the delineation of the maritime border in oil-rich waters. However, the risk of an escalation is small, as the DRC will be careful to avoid an escalation into an armed conflict, given Angola's superior military strength. Angola's relationship with China, which is based on oil-backed Chinese loans and credit lines, continues to deepen. Warm relations with Portugal will continue, with that country's financially strapped government keen to attract Angolan investment (KPMG, 2012-2013:37). Angola is well integrated internationally and no particular risks are identified in

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relation to this indicator, hence a rating of 3 is awarded.

Host-Home Government Relations (2): Angola is the most important Africa country to Norway, in large part due to Norway's national oil company Statoil's substantial investments in the country. Furthermore, numerous other Norwegian companies are tied to Statoil's oil operations in Angola as well to the Angolan oil industry in general. In the March 2014 edition of the *Sonangol Universo* magazine the relationship between Angola and Norway is described as follows: "Angola-Norway a perfect partnership" (*Sonangol-Universo*, 2014: 7). Norway celebrates 37 years of diplomatic relationship with Angola in 2014, and oil is by far Norway's largest area of cooperation with Angola. According to Sonangol, Statoil has much closer links with Sonangol than most other oil companies, largely because of Statoil's contributions to developing Sonangol's operational company, Sonangol P&P. Outside the petroleum industry, two of the biggest NGOs present in Angola are Norwegian: Norwegian People's Aid and Norwegian Church Aid; both NGOs are doing important work such as clearing land mines, building organizational capacity in local and civil society, and providing water and sanitation to less urbanized areas. However, Norwegian aid to Angola has historically been very low (*Sonangol-Universo*, 2014: 13). Norway and Angola's relationship is extending far beyond oil, but this is and will probably continue to be the cornerstone of this mutually beneficial relationship. Statoil and consequently Norway are deeply invested in Angola, economically but also politically, by seeking to promote a larger degree of transparency in relation to oil revenues and signature bonuses. However, Statoil and consequently Norway are not using their leverage to promote good governance in Angola, nor seeking to make demands related to political issues a part of their business. Statoil merely sets out to follow the laws of the country it operates in. A rating of 2 – *low* is given.

World Petroleum Market (3): The oil market prices hit an extreme low during the global financial crisis in 2008-2009. In more recent years West Texas Intermediate (WTI) crude oil prices have been closer to 100 dollars per barrel[29] (EIA, 2014b). In the case of Angola, a country heavily dependent on oil prices, the fluctuation in oil prices greatly affects the economy. EIA estimates that non-OPEC liquids production grew by 1.4 million bbl/d in 2013, averaging 54.1 million bbl/d for the year. EIA expects non-OPEC liquids production to grow by 1.7 million bbl/d in 2014 and 1.0 million bbl/d in 2015. EIA estimates that OPEC crude oil production averaged 29.9 million bbl/d in 2013, a decline of 1.0 million bbl/d from the

[29] WTI Crude oil prices per barrel; 2012-94.12 $, 2013-97.91 $, 2014-100.98 $, and the prospect for 2015 is 95.17 $ (EIA, 2014b).

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previous year, primarily reflecting increased outages in Libya, Nigeria and Iraq, along with strong non-OPEC supply growth. EIA expects OPEC crude oil production to fall by 0.3 million bbl/d in 2014 and by an additional 0.1 million bbl/d in 2015 to accommodate growing production in non-OPEC countries. According to this EIA *Report* the inclusion of detailed 2015 oil demand forecasts, with total global oil deliveries for the year predicted as rising by 1.4 mb/d (or 1.5%) on the year to 94.1 mb/d. Newly industrialized and emerging market economies are once again forecast to lead the gains, rising by approximately 1.5 mb/d to 48.2 mb/d, while OECD demand is forecast to decline by around 0.1 mb/d, to 45.9 mb/d. (EIA, 2014c). EIA expects global consumption to grow by 1.1 million bbl/d in 2014 and 1.5 million bbl/d in 2015. Non-OECD countries account for nearly all of the expected consumption growth in 2014 and 2015. Predictions show an overall steady growth, and as such the risk is assessed as 3 – *medium* in the short-term.

World Economic Condition (3): According to the IMF World Economic Outlook report, global economic activity has broadly strengthened and is expected to improve further in 2014-2015, with much of the push coming from advanced economies (IMF, 2014). The IMF outlines three main concerns: emerging market risks have increased; there are risks to activities from lower-than-expected inflation in advanced economies; and geopolitical risks have resurfaced. Generally, the balance of risks, while improved, remains a weakness. The renewed increase in financial volatility in late January of this year highlights the challenges for emerging market economies posed by the changing external environment (IMF, 2014). The proximate cause seems to have been renewed market concern about emerging market fundamentals. In advanced economies growth is expected to increase to about 21⁄4 percent in 2014–15, an improvement of about 1 percentage point compared with 2013 (IMF, 2014: XV). In terms of current and projected growth in energy consumption, EIA expects global consumption to grow by 1.1 million bbl/d in 2014 and 1.5 million bbl/d in 2015, and in 2014 EIA projects that world energy consumption will increase by 56 percent (EIA, 2013). The key overall trend is continued growth; as such risk is assed as 3 – *medium*.

The Demonstration Effect (2): One of the key trends in the oil and gas industry is the NOCs gaining power over the international oil market. NOCs are now a great competitor to the traditional IOCs, and this is changing the playing field. According to a 2013 Deloitte report, the global expansion of NOCs and implications to their IOC peers are more nuanced than the overriding notion that NOCs are taking larger risks by buying underdeveloped acreage and fields, and initiating large purchases in emerging markets. This illustrates that NOCs are

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taking a long view and globally expanding for local resource development and technical capacity building (Deloitte, 2013: 18). NOCs' global procurement and expansion has primarily focused on oil over gas because of higher demand for oil and its premium price advantage. In terms of demand, NOCs' immediate priority is to secure oil supplies, as their economies are heavily oil-dependent for both exports and imports (Deloitte, 2013: 18). The global expansion of NOCs is not a new phenomenon, but the fact that expansion strategies differ between oil and gas is a recent and important development. NOCs have evolved from players focused on production in domestic oil resources to become interested in more complex and unconventional oil extraction. The NOCs from energy-hungry, developing countries, such as China and Brazil, are also transitioning from being passive partners of IOCs seeking supply security, and are becoming technical leaders in riskier plays (Deloitte, 2013: 18). Sonangol is also playing its part in this trend, as the company's reach internationally is growing. Sonangol maintains Sonangol Limited (for UK markets), Sonangol USA Company (for US markets), and China Sonangol. Sonangol has operations, exploration ventures and equity in oil projects in Cape Verde, Congo-Brazzaville, São Tomé and Príncipe, Brazil, Cuba, Venezuela and the Gulf of Mexico. However, the company withdrew from Iraq last December and recently announced withdrawal from Iran because of international sanctions (Ramos, 2012: 24). This also demonstrates how non-Western oil companies, and the NOCs from emerging markets in particular are seeking the mutual benefits of cooperation, and are increasingly becoming more dominant within the extractive industry. Angola and Sonangol are as illustrated here, clearly a part of this growing trend. The indicator is rated 2 – *low risk.*

Final rating for the international political risk factor score: 7.8 out of a 15 percent weighed factor score of the overall risk model.

4.3 Risk report and key tends

The result from the political risk analysis as shown in Table 9 establishes that the overall score for the analysis is 57,97. As illustrated in Table 8, a rating between 51-60 indicates *medium – relatively moderate risk.*

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Factor	Indicators	Rating	Score
Political (25%)	Regime/political stability	4	17,5
	War and security issues	2	
	Repatriation restrictions	3	
	Corruption/poor governance	4	
	Unclear legislation/security of tenure	4	
	Investment constraints	4	
Economic (20%)	Economic performance	2	10,85
	Balance of payments	2	
	Creditworthiness	3	
	Currency convertibility	3	
	Energy vulnerability	4	
	Public/private sector mix	3	
	Current account deficit	2	
Societal (17%)	Internal violence	4	9,22
	Civil and labor unrest	3	
	Homogeneity	2	
	Ethnic conflict	1	
	Community opposition/social license to operate	4	
	Standard of living	4	
	Environmental activism	1	
Petroleum (15 %)	Ownership	3	9,0
	Domestic reserves/production	2	
	Host´s relative market position	3	
	Level and destination of exports	4	
	Strength of national oil company	2	
	Role of foreign Company in the national oil industry	4	
	Oil and gas prices	4	
	Domestic ability to operate the industry	3	
	Ownership/contractual relationship between firm and host country	2	
Company (8%)	Nationality of the company	1	3,6
	World industry positioning	2	
	Special bargaining advantage	3	
	Host government relations	3	
International (15%)	Host government international integration	3	7,8
	Host/home government relations	2	
	World petroleum market	3	
	World economic condition	3	
	The demonstration effect	2	
Total			57,97

Table 9. Risk Report

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This risk analysis has made the following key findings. The indicators with the highest risk ratings indicate the areas in Angola that investors in general should be aware of. In relation to the *political* indicators, elections and a possible change in presidency are the two that stand out. These are again linked with the social factor and the currently simmering social tensions. A distinction should be made between short- to mid-term risks and potential long-term risks, particularly in terms of the *social* and *political* factors. In the short term Angola seems to be, and will continue to be, stable politically, economically and socially as well as in relation to petroleum. However, in the run-up to the 2016 elections, or in relation to the succession plans of President dos Santos and the positioning of his deputy Manual Vicente, tension are likely to rise during this current presidential term. The fact that Angolan youths as well as civil society in general are starting to speak out against the regime to a much higher degree than ever before, demanding change, as the inequality in the country grows and the oil elite get richer, will at some point probably turn into a high level of conflict. Social conflict is a risk factor that could pose huge risks to international oil companies, such as in the 2013 Amenas terrorist attacks mentioned above. As a major player in Angola, the oil industry is a prime target. The recent threat of political derailment has diminished, yet challenges will emerge from presidential succession plans and increased empowerment of civil society and opposition groups, and companies should take note of potential long-term risks in relation to this situation. In terms of the *economic* and *petroleum* factors, Angola's extreme dependency on the oil export revenues and its vulnerability to changing international oil prices still pose a high level of risk. Angola's growth outlook, though optimistic, still has the potential of being affected by oil price fluctuations and as well as the risk of prolonged global economic downturn. Prognoses for world economic growth are, however, positive at this point in time. The medium-term scenario projects record highs in terms of growth supported by oil prices, which are likely to remain high in the coming years, while being increasingly pushed by large public investments in non-oil sectors. The poor infrastructure and difficult business climate will limit the development of both the private and non-oil sector. Nevertheless, thanks to solid oil revenues, Angola's external accounts are solid with strong financial fundamentals, a stable liquidity position and a surplus, though declining, on the current account. The main short-term risk in Angola's outlook results from the uncertain global environment, given Angola's fiscal strength, and despite the positive developments in fiscal management, Angola is still vulnerable to any sustained negative oil price shock.

Pervasive corruption and a lack of transparency in relation to oil revenues continue

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despite Statoil's effort to publish and report all their dealings with Angola. Statoil has a strict zero tolerance when it comes to corruption, but any company operating in a high-risk corruption environment is ultimately exposed to such risks.

There are no particular company-specific risks facing Statoil's operations in Angola. Statoil has a good relationship with Sonangol as well as the authorities. Statoil and Norway are deeply invested in multiple areas of the Angolan oil industry and society, and all parties are reaping the benefits of what clearly is a mutually beneficial relationship. Though Statoil is promoting a higher degree of transparency, it is not using its arguable leverage in order to question the lack of democracy, human rights violations, or the way the authorities are spending the infamous signature bonuses. In terms of long-term risks, Statoil has a high level of sunken costs in the country, as oil companies do, and if the political or social situation related to social unrest changes, the company's high level of tied up investments could potentially be at risk. It is important to note that this risk analysis is done based on an already existing investor, Statoil. The risks for a new, smaller investor that does not have the close ties to the extractive industries in the country, or the resources, may be very different than those facing Statoil's operations in Angola.

4.4 Conclusion

The objectives of this chapter were firstly to present the industry specific risk model; and secondly, to apply the industry-specific risk model to the case of Angola through the evaluation of six factors and the 38 subsequent indicators. Each indicator was assigned an individual score, based on the data presented, resulting in an overall factor score. By adding all the factor scores together a final OPRR score was arrived at that indicates the current overall company-specific political risk that faces Statoil in Angola. In the next chapter the research questions will be answered and the final finding of this study will be presented.

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Chapter five: Main findings and analysis

5.1 Introduction

Emerging markets are increasingly driving the world's economic growth, and a growing part of the world's energy supply comes from politically unstable or undemocratic countries with less developed institutions and inadequate rule of law. In order to keep up with international and domestic demand, and maintain profit levels, there has been and will continue to be a search for new sources of petroleum reserves. This has pushed the extractive industries to invest in new territories, some of which pose potential risks for new investments. These trends are changing where and how oil and gas companies are going about their business, as many of the political risks that face the extractive industries stem from the political, institutional and structural framework of the host country. Globalization is a key driving force behind the increasing number of investments in unstable, undemocratic and corrupt countries.

The main research question of this study, examines whether high levels of democracy constitute low levels of political risk. The aim of the research has been to answer this question by conducting a political risk analysis of Statoil in Angola using an industry-specific political risk model developed by Boshoff and Lambrachts (2011). By establishing the level of democracy, and subsequently conducting a risk analysis of a company operating within that given context, the extent to which the level of democracy will affect the overall political risk that the particular company is faced with is gauged. This is what was measured through the political risk analysis. The second sub-question directly pursues this further by examining the level of political risk that Statoil faces as a company operating in the oil and gas industry in Angola. The first sub-question concerned the current level of democracy in Angola, using the Freedom House approach, which was assessed in Chapter Three.

The following sections aim to answer the research questions, present the key findings of the research, as well as address the debate around the assumption that high levels of democracy constitute low levels of political risk, and subsequently that low levels of democracy are associated with high risk. Recommendations for further research will also be made.

5.2 Progress of the study

Chapter one laid out the premises of this study. A brief preliminary literature review was provided. The research question was presented together with two sub-questions that were

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identified as crucial to conduct the research study. The rationale of the research also addressed the relevance and validation of the study. The research design and methodology were outlined, followed by the limitations and delimitations of the study.

Chapter Two had three main objectives. The political risk literature was reviewed, key political risk terms were conceptualized, establishing the theoretical framework that served as the foundation for the research, and the concept of democracy examined, as well as the relationship between FDI, democracies and democratic institutions.

Chapter Three addressed three main elements related to the contextualization of the case. Firstly, the situation in Angola was contextualized, both in relation to democracy and the extractive industry. Secondly, the Norwegian oil company Statoil and its operations in Angola were examined. Thirdly, the chapter examined issues related to the measurement of democracy, looking especially at the Freedom House approach. This was done in order to determine the present level of democracy in Angola, subsequently answering the first of the two sub-research questions of the study.

In Chapter Four the risk model, as well as the pertaining methodology was presented. Secondly, an assessment and presentation of the risk factors and indicators was conducted in order to arrive at the overall political risk rating. This produced the findings that will be presented in the subsequent sub-sections of this chapter.

5.3 Discussing and answering the research questions

The main research question of the study was: Do high levels of democracy constitute low levels of political risk for oil and gas companies? The reasoning behind examining this question is the changing investment climate facing companies operating in extractive industries as a result of the search for new petroleum reserves. In emerging markets, which are not necessarily democratic, as in the case of Angola, companies face different conditions than those in a democracy. Arguably as a result of this, they face different types of political risks to those they would face in traditional democracies. The assumption that high levels of democracy constitute low levels of political risk implies, conversely, that low levels of democracy constitute high levels of political risk. The debate around this assumption is the core of this research study, and the political risk analysis done in this study sets out to test this proposition.

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There is a widely accepted perception among scholars that democratic institutions attract FDI, and that investing in emerging markets requires "soft infrastructure".[30] Democracies attract MNCs and FDI because of lower investment risks and a more secure investment climate, it is claimed. However, the empirical data and trends described in this study illustrate that MNCs and oil companies are to a greater extent choosing to invest in undemocratic nations, despite assumed levels of increased risks. Arguably the time has come to challenge the above assumptions, as our globalized economy is pushing MNCs, oil companies in particular, to invest in new territories, despite increased risk levels.

Olson's (1993) "rational long-term autocratic leader"[31] argument is useful when analyzing the Angolan case. President dos Santos's regime arguably follows the logic of Olson's argument. The Angolan economy will only generate the maximum income if there is a high rate of investment; the returns, however, are divided in two: signature bonuses paid before said investment is made, while the majority of the revenues are received a long time after the investment is made. According to this logic, it is in the best interest of President dos Santos to provide a secure investment climate in order to maximize Angola's – and as such his own – returns. As established in Chapter Four, the political risk is not as high as one would assume according to the assumption that low levels of democracy constitute high levels of risk. As indicated in Chapter Two, autocratic regimes that are seemingly stable may hide underlying instability that ultimately causes sudden and unpredictable change. This argument coincides with one of the key findings of the political risk analysis, namely that short- to mid-term risks are assessed as low; however, there are trends particularly related to political and social factors that hold a great potential of long-term political risks. Yet it is in the interest of the authorities in an undemocratic country to secure a stable and good investment climate, as seen in Angola. When examining the underlying motives for such efforts, it seems that they can vary greatly from those of a fully-fledged democracy, or autocracies implementing some democratic principles are simply seeking the highest possible profits. The findings of this research illustrate support for the argument that an undemocratic country does not always constitute high levels of political risk, as assumed in the literature. Though, as this research study suggests, there are simply are too many global factors that one has to take into consideration; thus based on the findings of this study one cannot make the assumption that democracy equals low levels of political risk or vice versa. It is rather the interplay between a

[30] See section 2.4.1, in Chapter Two for the debate on the relationship and link between democracy, autocracy, MNCs, FDI and political risk.
[31] Olson's "rational long-term autocratic leader" argument is presented in section 2.4.1, Chapter Two.

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number of factors and indicators. The world is constantly changing and as such our old perception of 'democracy good, autocracy bad' may be in the process of becoming dated, as far as investment is concerned.

The first sub-question examined the current level of democracy present in Angola. This was addressed in Chapter Three, which concluded that Angola has the rating of *Not free*. This implies that Angola is undemocratic, according to the conceptualization of electoral democracy that was adopted in this study, which is a thicker understanding of the concept. Hence democracy is more than a constitutional democracy with elections and a multiparty system. True freedom has to be achieved through democratic institutions in order for a country to be classified as a democracy; this has not yet been achieved in Angola.

The second sub-question was: What is the level of political risk that Statoil faces operating in the oil and gas industry in Angola? The aim was to answer this question by conducting a political risk analysis of Angola, using an industry-specific risk model. By testing for risk in an undemocratic country measures the level of risk a company faces. The political risk analysis shows that the political risks that face Statoil in the undemocratic nation of Angola are in fact not high. The analysis concludes with a result of 57.97, which indicates that investment in Angola poses a medium level of political risk. This speaks in support of challenging the above assumption, as the political risks are not necessarily higher in an undemocratic country. As noted in Chapter One, one can assume that the results found for Statoil in Angola can be translated into a general risk assessment for the oil and gas industry in Angola, as there are no particularities that would suggest that Statoil's operations in themselves would entail a higher degree of company risk than the general mainstream oil company.

5.3 Evaluation and key findings

The main finding of this research study relates to the main and the second sub-research question, and as described in the previous section, the overall political risk that faces Statoil and arguably the industry in general is medium – hence not high as one would have assumed based on the theoretical framework presented in Chapter Two. The key political risks that have been identified show how interconnected political risks in fact are, and one cannot isolate a single factor or indicator. This is also the reasoning behind doing an overall political risk rating of the Angolan case and not doing a single factor rating. The key findings of this research illustrate this interplay between the factors, particularly when looking at the *political* and *social* factors. As concluded in Chapter Four section 4.3, tensions are likely to rise during

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this current presidential term. This, coupled with the growing social tensions, has the potential of turning into a violent conflict, which is accordingly seen as a long-term risk factor for oil companies operating within this context. The study also found a strong interplay between the *economic, petroleum* and *international* factors. Angola's extreme economic dependency on the oil export revenues, and its vulnerability to changing international oil prices, still pose a high-level long-term political risk. Another potential risk that has been identified, which arguably runs through all of the six factors, is the element of pervasive corruption; as institutionalized as corruption still is in Angola, it becomes aspect of any of the six factors. As such any company operating in a high-risk corruption environment is ultimately exposed to such risks.

Another key finding is that one needs differentiate between long-term and short- to medium-term risk when conduction a political risk analysis of the Angolan case. Some indicators, particularly the *political* and *social*, have a great potential for being long-term political risks. Furthermore, the interplay between the economic, petroleum and international variables, where Angola's strong dependency of oil export revenues and consequently international oil prices, pose long-term risks, but this is not necessarily the case when assessing short- to mid-term risks.

A growing trend described in this study is that NOCs are increasingly taking control of the market and becoming more powerful players within the extractive industries. The relationship between Statoil and Sonangol is testimony to this very fact, illustrating the successful collaboration of two NOCs. However, an issue that has arisen as a consequence of this is the moral dilemma for Statoil, as the company is frequently criticized in its home country of Norway for investing large sums in countries with regimes that have little or no respect for human rights or democracy. As an NOC Statoil represents Norway, an epitome of a democratic state, in its transactions globally and as a consequence this dilemma arises when Statoil invests in undemocratic and corrupt countries. Arguably as a consequence of a globalized world, and the constant competition for new sources of oil and gas, these things are no longer as clear cut. As seen in the Angolan case, a relatively good investment climate can be provided with an authoritarian leader, hence the challenge to Western notions of democracy being the only feasible regime option for investment. Many factors come into play in such a debate, particularly in the Angolan case. On the one hand, there are massive oil riches and a small elite that is rapidly becoming richer, and on the other hand, there are one of the world's lowest human development ratings and highest corruption rates. Thus the issues

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concerning an oil company's moral obligations should as such still be raised, but can one demand more of a company than that they follow the international and host and home country laws?

5.4 Critique and suggestions for further research

This study builds upon the research study conducted by Boshoff (2010) and Boshoff and Lambrechts (2011). It has tested the model developed by conducting a risk analysis by using their complete model, with knowledge of the investor. Thus both the full potential of the model has been tested, as well as the reliability and validity of the original model and research.

With further research in mind, conducting a comparative study, a political risk analysis using the complete model, in a most similar or most different design, would provide additional insight into the validity and reliability of the model, and expand on the findings of this study. Using a similar case in future research, such as Nigeria or Uganda, with many similar traits as the Angolan case, would be advantageous in terms of further testing of the assumption about democracy and risk. A most different design could include research on South Africa, where the level of democracy is assumed to be higher. Such a study could contribute towards confirming the findings of this research study. In conducting research using the same political risk model, the researcher must be aware of the vast amount of data collection necessary, when using both phase one and two of the model. It is almost impossible to gather all the relevant information when undertaking a political risk analysis, or to get to know all the unknowns. For future research, finding a company that has yet to invest but is still planning to could potentially enhance the value of the study, as one is able to actually aid a company in its investment decision. Finding a company that has not invested yet but contemplating doing so would be beneficial, as there is no existing relationship with the host country. In this study the chosen company was already present and operating in Angola. This allows the researcher to examine the current and past relationship of the investor and host country, which can give useful insight into potential company risks.

The information that was used to analyze the indicators in the case of Angola was all retrieved from secondary sources. The study could have benefited from primary data from both the political risk industry itself as well as the extraction industry could have enhanced the knowledge regarding real-world development and the application of political risk models. Such first-hand information could be obtained by conducting interviews or by conducting

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longer-term field research. Furthermore, access to existing measurement tools of political risk that face oil and gas companies today could allow for valuable insight into and comparison of the indicators. Deeper understanding of the relationship these industries have with one another and the benefits that political risk analysis brings to the oil and gas industry, and the greater extraction industry.

5.5 Conclusion

In this research study the assumption that democracy constitutes low levels of political risk has been tested through conducting an industry- and company-specific political risk analysis of Statoil's operations in Angola. The core of the study has been the debate on the assumption that high levels of democracy equal low levels of political risk, and consequently that low levels of democracy equals high risk. The findings of this study, however, question these assumptions, suggesting that in the case of Angola specifically low levels of democracy do not translate into high levels of political risk.

This study can be seen as a contribution to the field of political risk as it is an industry- and company-specific political risk analysis, and as such contributes to a segment of the field which is still in its infancy. Political risk can be understood as the connection between business and politics; hence knowledge of this connection assists in understanding the political risks involved in making business decisions. Consequently, an industry-specific political risk analysis adds value to the study of political risk in general.

With constant and unforeseen changes in an ever more tightly interconnected world, the field of political risk has never mattered more.

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Appendix A

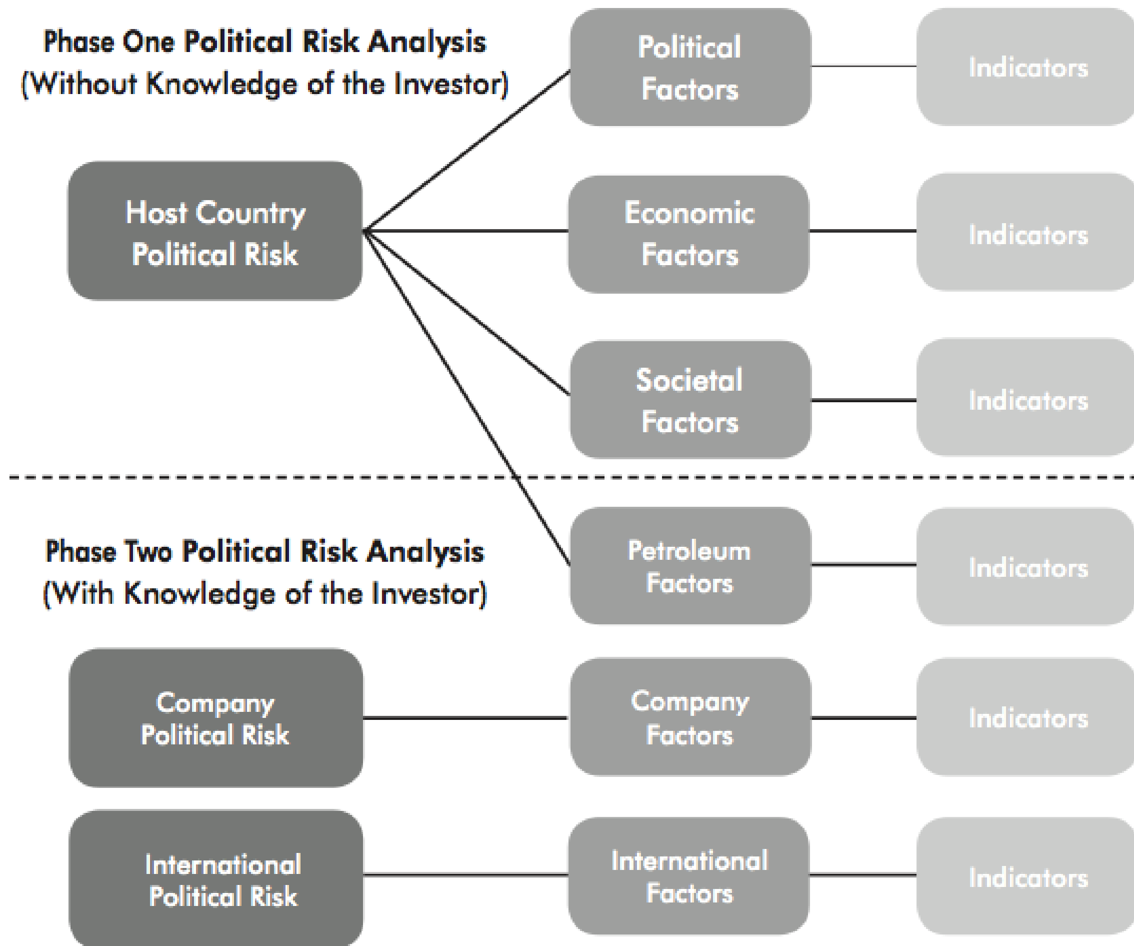

Figure 2. Complete political risk model (Boshoff and Lambrechts, 2011: 4).

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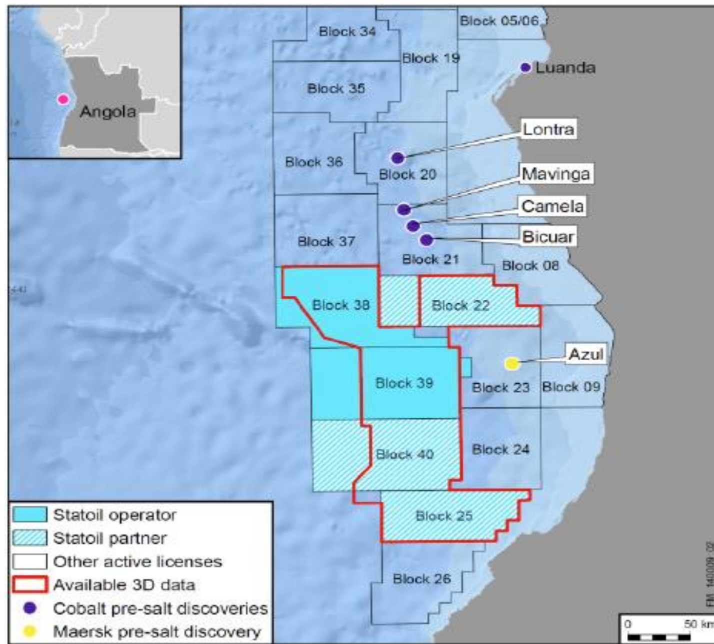
Appendix B



Map 1. Statoil´s current operations in Angola (Statoil, 2014).