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Making AGOA Work for Africa

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EXECUTIVE SUMMARY

The African Growth and Opportunity Act (AGOA) offers duty-free access to the largest market in the world, and has the potential to be a major driving force in African development. Thus far, however, it has failed to live up to its potential. AGOA has seen numerous success stories since its commencement in 2001 – such as the growth of automotive exports from South Africa to the US – but the broader picture has been disappointing. US imports from Africa continue to be dominated by energy commodities, which account for 88% of AGOA country (excluding South Africa) exports to the US. Of the top 10 African exports to the US, AGOA offers a major competitive boost in textiles, but little else. Even where the deal does grant a tariff advantage, African companies must still grapple with complex standards and rules of origin that often discourage otherwise competitive producers from exporting.

This weak performance should not raise questions about the importance of AGOA but rather serve to highlight how underutilised the preferences remain. The current legislation expires in October 2015 and, while renewal looks likely, this could be the last version of AGOA to offer non-reciprocal access. African countries and the US must seize the opportunity while it remains, maximising the untapped potential of AGOA preferences. A comprehensive strategy to do so should involve four pillars: core renewal of AGOA; assistance in overcoming non-tariff barriers to entering the US market; infrastructure development to boost competitiveness; and planning around a rapidly evolving global trading system.

RECOMMENDATIONS

- Speedily renew AGOA for a period of 10+ years, and include all currently eligible countries.
- Substantially expand the US Trade Hubs programme, and consider relaxed rules of origin for least-developed AGOA states.
- Support structural reform in African states by redoubling efforts such as Power Africa, contributing to capital market development on the continent, and considering tax breaks for repatriated non-commodity profits from Africa.
- Work towards simplifying EU and US standards under the Transatlantic Trade and Investment Partnership, and consider allowing cumulation from AGOA states in the Trans-Pacific Partnership.

RENEW AGOA

The first step needed is a full renewal of AGOA before it expires in October 2015. Renewal should take four factors into account. First, it must be completed timeously. While the Obama administration and the US Trade Representative have consistently thrown their weight behind a full renewal of AGOA, the bill must pass through a bitterly divided Congress. Progress has been stymied by the 2014 midterm elections and the subsequent lame-duck sessions in November and December. The 114th Congress convened in January 2015 and must act quickly on AGOA. The looming expiration date creates a great deal of uncertainty and stifles investment. In 2012, the Third Party Fabric amendment to AGOA, which facilitates the export of textile goods, was renewed with only days to spare. By that point, orders for African textile goods had already dropped by 35%. A similar situation must be avoided this time around.

Second, AGOA should be renewed for an extended period of at least 10 years, and ideally longer. If investors are to bear the start-up costs of entering African markets, they need to be assured they will benefit from market access for long enough to recoup their initial outlays. An extended renewal will bolster confidence and allow for long-term planning.

Third, larger African states, including South Africa, should be included in the deal. While it is true that AGOA was not initially envisioned as catering to a middle-income Africa, it is impossible to disconnect the future of these large states from the rest of the continent. Smaller and less developed African countries remain reliant on the industrial base of their larger neighbours in order to access the US market, and the subsequent regional value chains benefit all involved. These chains would be broken if the likes of South Africa or Nigeria were to be excluded from a new deal.

Last, the core AGOA bill should not be expanded to include the type of supplementary support discussed below. AGOA is likely to make it through Congress because it appeals to both parties – Democrats like its developmental stance, while Republicans like the fact that the bill is budget neutral and uses trade (rather than aid) to foster development. This dynamic changes if supplementary programmes requiring appropriations are added to the bill. An AGOA bill with large appropriations might be more effective, but would face a more uncertain passage through Congress. A clean, simple renewal – effected timeously and for a prolonged duration – would be the best approach for the core AGOA bill. Once this renewal is completed and uncertainty quelled, supplementary efforts can be debated.

ADDRESS NON-TARIFF BARRIERS TO TRADE

However, renewal itself is not enough. To make AGOA work, support and co-operation beyond tariffs is necessary for both the US and African states to fully benefit from the deal. The most direct path to improving trade linkages is to address non-tariff barriers to trade, of which two are particularly important.

First, African companies need expanded assistance in understanding and navigating the bureaucracy involved in exporting to the US. This can include assistance ranging from understanding paperwork and labelling requirements, to meeting difficult sanitary and phytosanitary rules. Support should be forthcoming from both the US and African countries. The US can best achieve this by an expansion of the US Trade Hubs programme, which provides one-stop shops for assistance in entering the US market but which is currently limited in scope geographically.[2] African countries, on the other hand, should marry assistance with their domestic export-promotion programmes, for example by providing information and training services in special economic zones and industrial development zones.

Second, rules of origin remain particularly restrictive under AGOA, as they are in most US free trade agreements. Rules of origin set minimum requirements on how much local value must be added to a product exported to the US. However, it is often difficult for goods from underdeveloped African countries with weak local manufacturing capacity and low labour costs (which artificially supress the nominal value add) to qualify for duty-free access to the US market. While more liberal rules of origin would be beneficial, they are also unlikely to be offered, as the US takes a universally strict approach in all its agreements. However, it is for this very reason that they could offer significant gains, giving AGOA countries a fair chance at competing with other nations with preferential market access, such as those involved in the Trans-Pacific Partnership (TPP). Since a blanket liberalisation of rules of origin in AGOA would be improbable politically, the focus should be on providing special exceptions for least developed countries. Similar preferences in the case of apparel, under the Third Party Fabric amendment, have been successful in boosting trade from the most vulnerable members of the AGOA group. This model should be pursued in a deeper and more focused way.

STRUCTURAL REFORM

AGOA preferences and a streamlined system of rules and regulations will assure good access to the US market, but in order to take advantage of this, African companies need a base level of structural competiveness. Arguably, the key factor holding back improved US–Africa trade is the lack of an environment conducive to the competitive production of those goods the US wants to buy. This competitive deficit has a wide range of causes, not all of which are easy to address. Regulatory problems, skills shortages and corruption issues do exist but are best dealt with organically at a domestic level. The greatest scope for co-operation is on financing for infrastructure development.

The US' current programmes towards African infrastructure development should be applauded, most notably the Power Africa initiative. Power Africa strategically targets perhaps the biggest barrier to the creation of a predictable productive environment in Africa: the energy deficit. But the US faces steep challenges in any effort to deepen co-operation. The Republican majority in the House is opposed to further domestic spending and would almost certainly reject large-scale appropriations for foreign assistance. While the US government has been relatively successful in connecting the country's private sector with investment opportunities in Africa, it is unclear how much additional value this creates, as the private sector would arguably find profitable opportunities regardless of government assistance (and barring information asymmetries).

The US cannot compete with the likes of China in flexing its financial muscle, and will have to be more strategic. First, the US should build a system of tax breaks for repatriated earnings from investments in Africa outside the commodities sector.[3] The current 35% tax on repatriated profits is a controversial issue in the US, with proponents arguing that it prevents the abuse of tax havens and supports the strained fiscus, and opponents arguing that the tax discourages the reinvestment of profits in the US economy. Tax breaks on repatriated profits from AGOA countries would steer the gap between these two sides: none of the qualifying countries has unusually low tax rates (Mauritius is the lowest at 15%) or generates substantial revenue (although the exact budget implications are unclear), but they can offer a route for profits from foreign direct investment to find their way back to the US. Perhaps more importantly (for Congress), such a tax break will encourage the US private sector to invest in the early phase of African development, helping overcome the short-termism of US investors, in which low current returns prevent investors from gaining a foothold in African boom markets before they become saturated and difficult to enter.

Second, following the work of the G-20, the US should commit to supporting the development of capital markets within Africa. Working capital markets, tied to the optimism of the 'Africa Rising' story, have proved effective in raising the necessary capital for large development projects, with vastly oversubscribed bond issues from countries such as Kenya and Rwanda. Efforts to develop capital markets will expand access to finance and help improve the structural compatibility of African economies with the US, where a large finance and service sector would favour capital investment opportunities rather than physical Greenfields investment on the continent. Efficient capital markets can fund African development and grant high returns to US companies, and are a clear area for mutually beneficial co-operation.

THE GLOBAL TRADING SYSTEM

An expanded AGOA must keep pace with the rapidly evolving global trading system. The US is currently negotiating free trade agreements with the EU through the Transatlantic Trade and Investment Partnership (TTIP) and with a block of Asia–Pacific countries in the TPP – both of which can erode the competitive advantage granted by AGOA preferences. African countries are undergoing their own changes, as the EU gains market access under the Economic Partnership Agreements (EPAs) and the continent works towards integration through the Tripartite Free Trade Agreement and the Continental Free Trade Area. Parties are further affected by the apparent collapse of the Doha Round, with even the very limited Bali package seemingly lost in the mire of WTO negotiations. These developments pose challenges for Africa, most notably the improved access offered to competitor economies in East Asia by the TPP, but they also offer opportunities.

First, the US and EU must work hard to build a common regulatory system for imports under the auspices of the TTIP. Meeting European and US standards remains a costly and difficult process for potential African exporters, but the relative benefit of this outlay is greatly increased if meeting standards for one allows access to the other. A common regulatory platform would make the case for upgrading to meet TTIP standards especially compelling, as well as encourage African firms to bear the costs, and governments and financiers to support such capacity-building efforts.

Second, and perhaps most difficult, AGOA must remain relevant in the world of the TPP – a world in which highly competitive producers such as Vietnam compete on an equal market access footing with countries such as Lesotho. The TPP looks bound to happen (eventually), and the best way for African states to embrace the deal will be by locking in place a route to enter the subsequent value chains that the deal will create and reinforce. As noted, rules of origin for US free trade agreements are famously restrictive, and are likely to remain so in the case of the TPP (as they are in AGOA). A key way to make AGOA work – and to increase the benefits of the TPP for all – would be to allow cumulation from AGOA states (or at least from least developed AGOA states). Cumulation would treat inputs sourced from AGOA countries as though they were sourced from within the TPP group, and would thus allow African intermediate good producers to sell their products to Asia–Pacific manufacturers with the potential benefit of better access to the US market.

Third, this latest iteration of AGOA will find itself at work in an EPA Africa. The EPAs marked the end of unilateral market access offered by the EU in favour of an asymmetric two-way deal that reflects emerging thinking of Africa as a future export market. The US is bound to follow suit eventually, and there is already discussion of a reciprocal EPA-style AGOA emerging come the next renewal deadline. This final unilateral AGOA must embrace this pending shift, and build preparedness on both sides. For African states, this means embracing the reforms detailed above. For the US, it means building the necessary political will now to negotiate an AGOA-EPA that will be in its own national interest. The EU's experience clearly highlights the strain such negotiations can put on a relationship, with the 10-year negotiations proving deeply acrimonious and damaging to the EU's broader (non-trade) interests in Africa. More US concessions now, when AGOA remains a development project, will mean smoother negotiations and a better deal when AGOA is transformed into a reciprocal agreement.

CONCLUSION

The US' commitment to supporting African development through trade must be applauded, but trade is about more than tariffs. A comprehensive AGOA, working beyond preferential market access, can help the bill live up to its potential. This would not be an act of charity. For all the talk of African underdevelopment, 15% of Americans, of whom 16.4 million are children, still live below the poverty line. Their future depends on the US' maintaining high growth in the face of ever fiercer competition from countries such as China. The story of US development is not over, but with saturated economic relations with most of the world, its next chapter will certainly be written in Africa. A comprehensive AGOA strategy could be key to cementing a strong partnership with the final frontier in trade, investment and American growth.

ENDNOTES

1 Christopher Wood is a researcher in the Economic Diplomacy Programme at SAIIA.

2 Schneidman W, Testimony before the United States International Trade Commission, 14 January 2014, http://www.saiia.org.za/doc_download/468-agoa-event-testimony-dr-schneidman-itc.

3 Kimenyi M & J Frank, 'Promoting private sector investments', in *Improving AGOA: Toward a New Framework for US–Africa Commercial Engagement*. Washington, DC: Brookings Africa Growth Initiative, 2011.

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