AGOA and its implications for SADC trade and integration

Leveraging Regional Integration for Sustainable Development in Southern Africa

Introduction

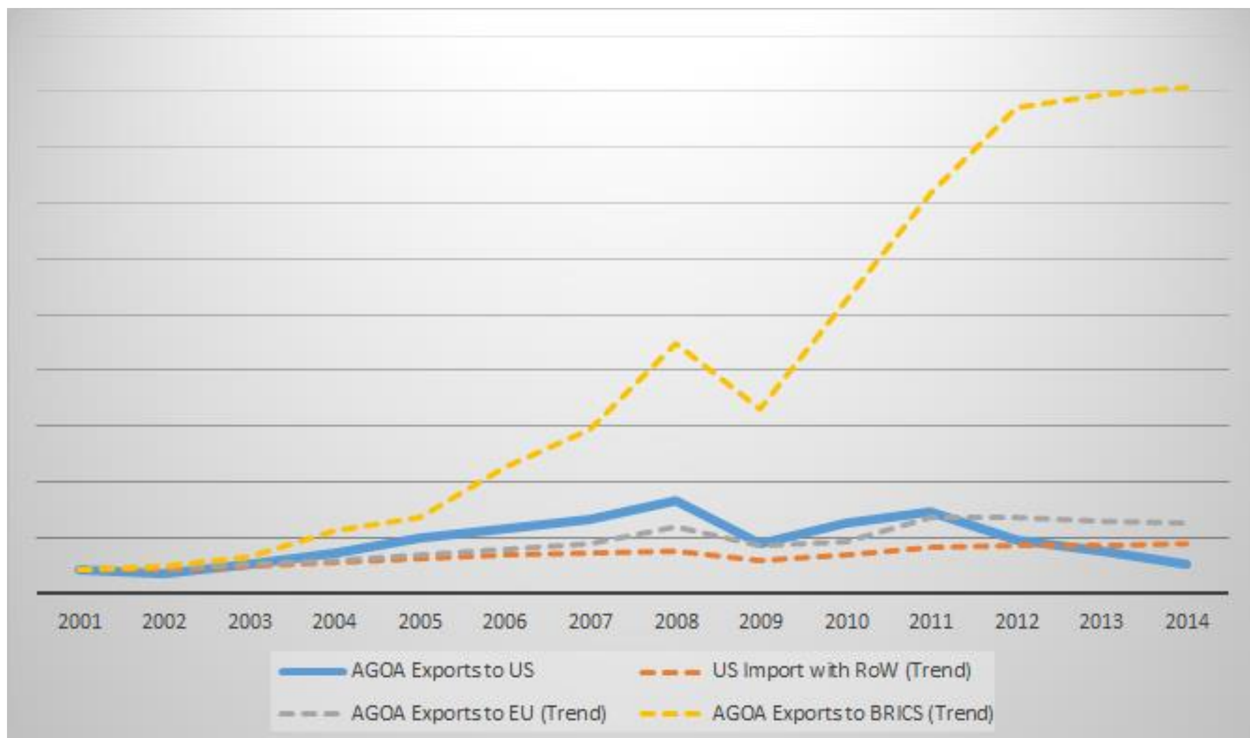
Serious questions remain on the capacity of preferential trade access to drive development in the face of deep structural constraints on productivity. Africans states have extensive access to some of the world's leading markets – through AGOA with the United States, EPAs and Everything but Arms with the European Union, and access for least developed countries with an increasing number of leading emerging markets. But the continent faces far more serious constraints to export growth than the formal barriers lowered by these agreements. High non-tariff barriers, infrastructure gaps, skill shortages, inadequate credit, uncompetitive domestic markets, and distortive subsidies in the developed world all contribute to keeping many African firms uncompetitive in global markets. With the renewal of the African Growth and Opportunity Act in June 2014, the central challenge for African countries is putting in place supporting policy that will allow firms to take advantage of the opportunity offered by AGOA.

Overview of AGOA

AGOA was first enacted in 2000, and grants eligible African states duty-free access to the US market on 1800 tariff lines. An AGOA-eligible, non-LDC country will therefore have duty-free access on 9000 of the United States' 10,500 tariff lines (with the remainder gained through the Generalised System of Preferences and zero-rated MFN tariffs).

Figure 1 compares the growth of AGOA country exports to the US against some broader trends in US and African trade, and seems to indicate that AGOA remains a marginal driving force in Africa-US trade, which notably lags behind the outstanding growth in African exports to the BRICS.

Figure 1: AGOA Group Exports to the US vs Trends



AGOA exports remain heavily concentrated in commodities, particularly oil, as can be seen in Figures 2 and 3. While the importance of oil has declined since 2011, this is mostly driven by the falling oil price and declining total oil imports by a US flush with shale gas, rather than growth in other sectors. The US maintains a small tariff on the import of crude oil, but it is unlikely that tariff changes would significantly influence oil imports, which are is driven by a combination of core fundamental demand and political considerations like the diversification of oil sources.

Figure 2: Composition of AGOA group exports to the US, by Commodity

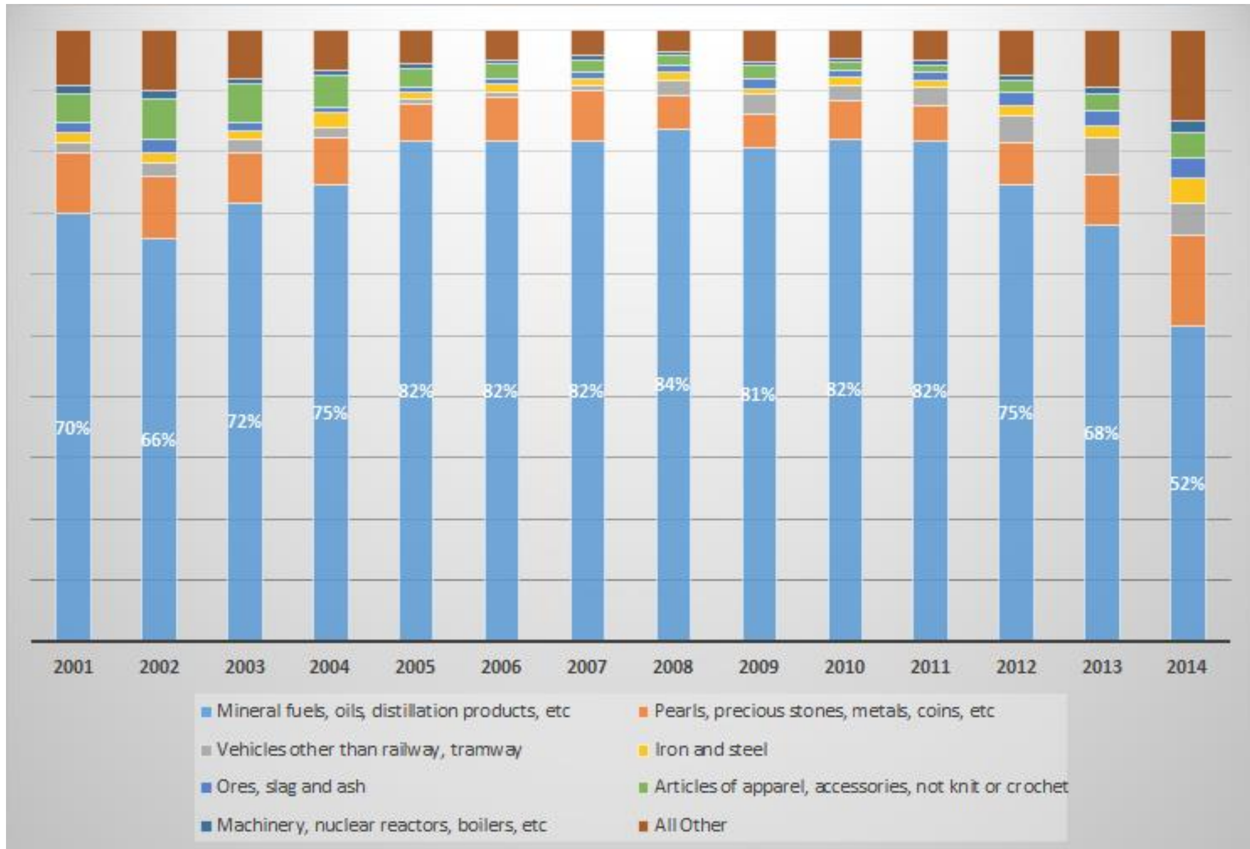
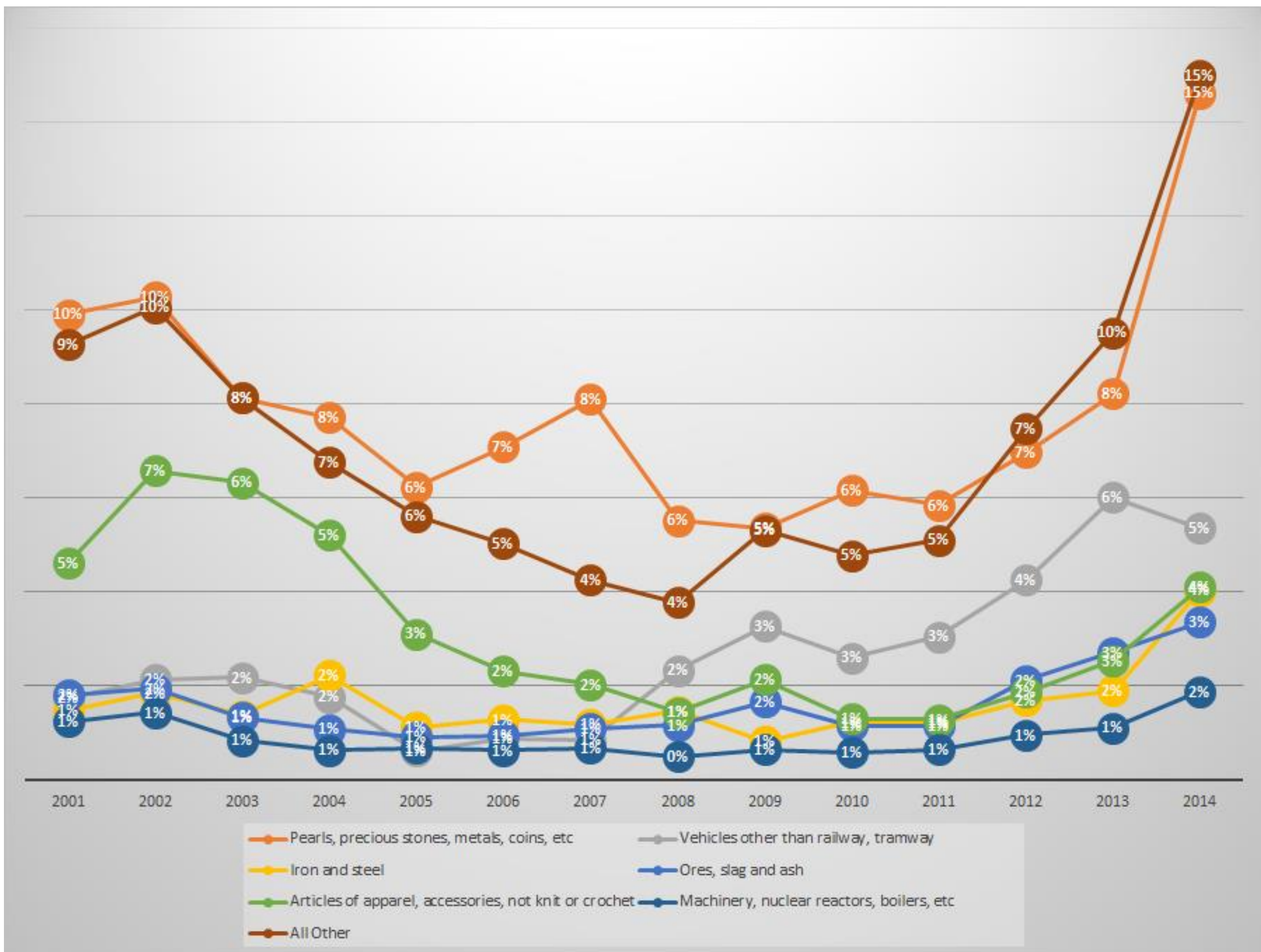


Figure 3: Composition of AGOA group exports to the US, by Commodity (excluding oil)



Figures 4 and 5 illustrate the countries with which the US trades most heavily under AGOA. With the collapse in the oil price, South Africa now ranks as the largest exporter to the US, although Nigeria and Angola have traditionally been the largest partners. Removing oil from the export data paints a radically different picture, in which South Africa dominates trades, followed by exporters of textiles and agriculture goods, like Kenya, Lesotho and Mauritius.

Figure 4: Composition of AGOA Exports to the US, by Country

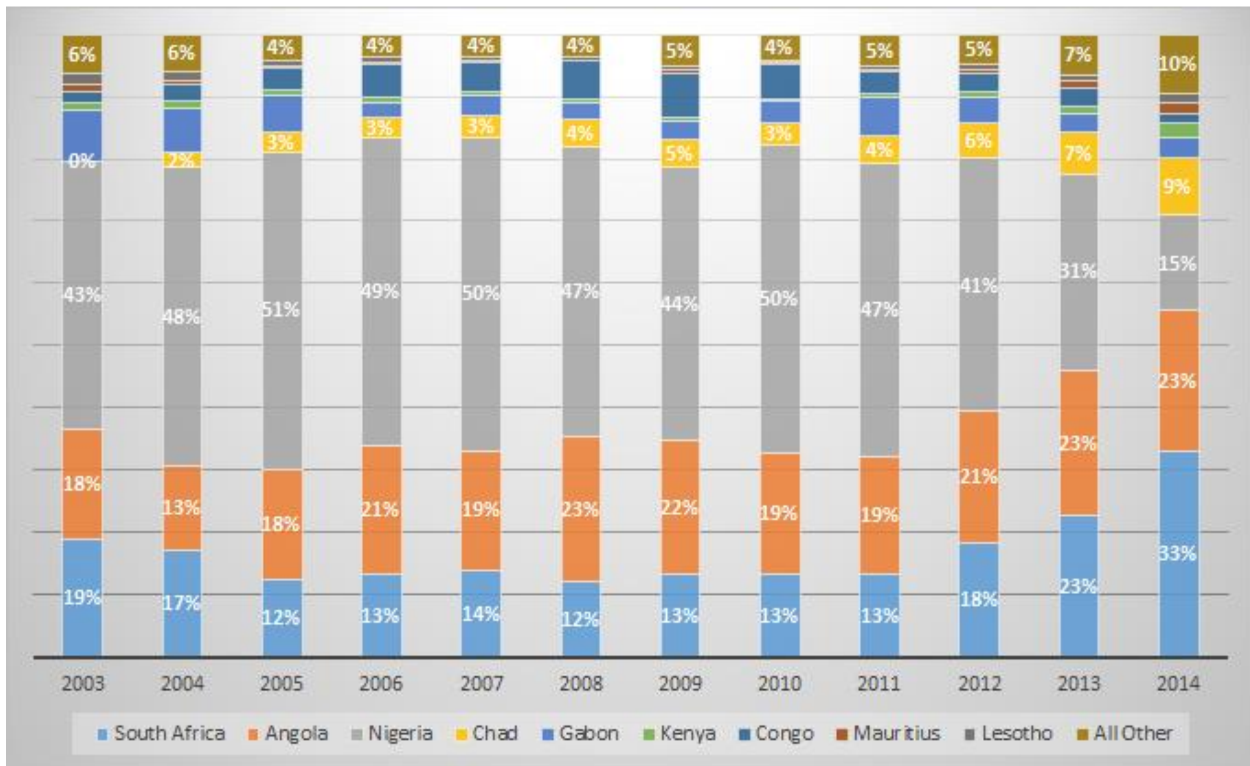
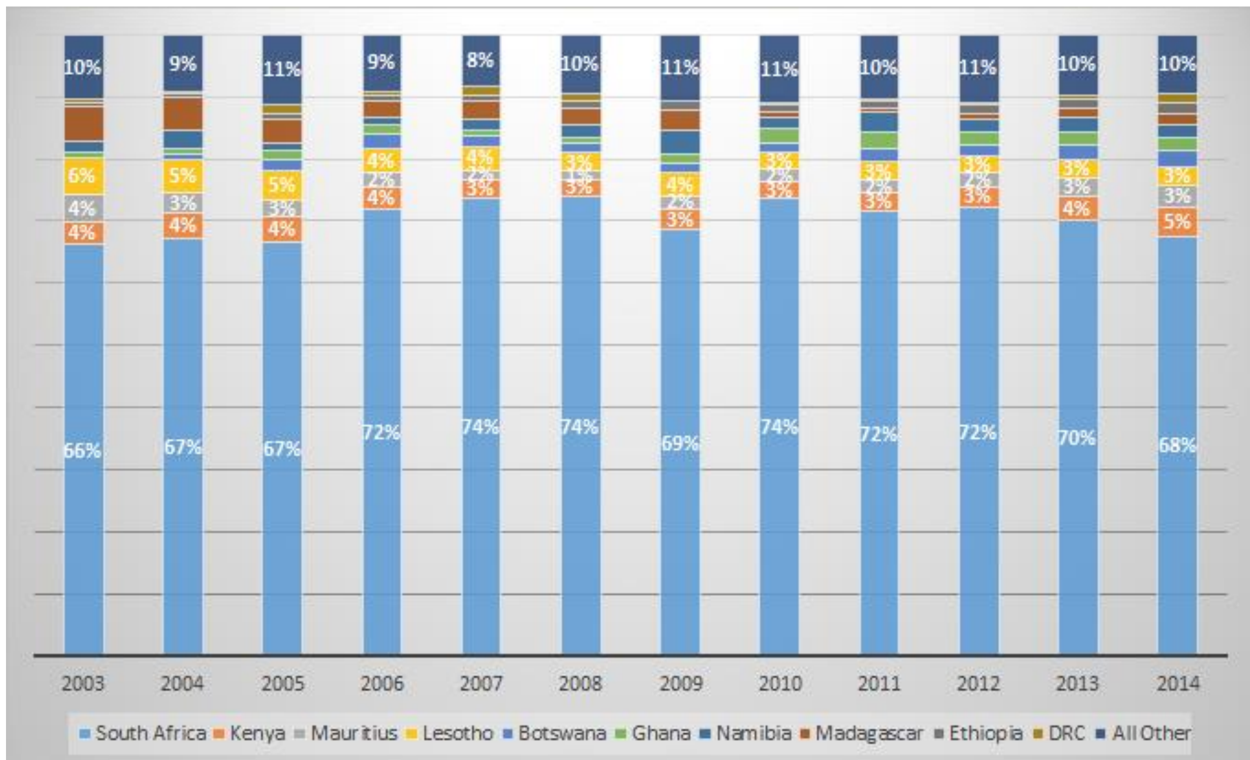


Figure 5: Composition of AGOA Exports to the US, by Country (excluding oil)

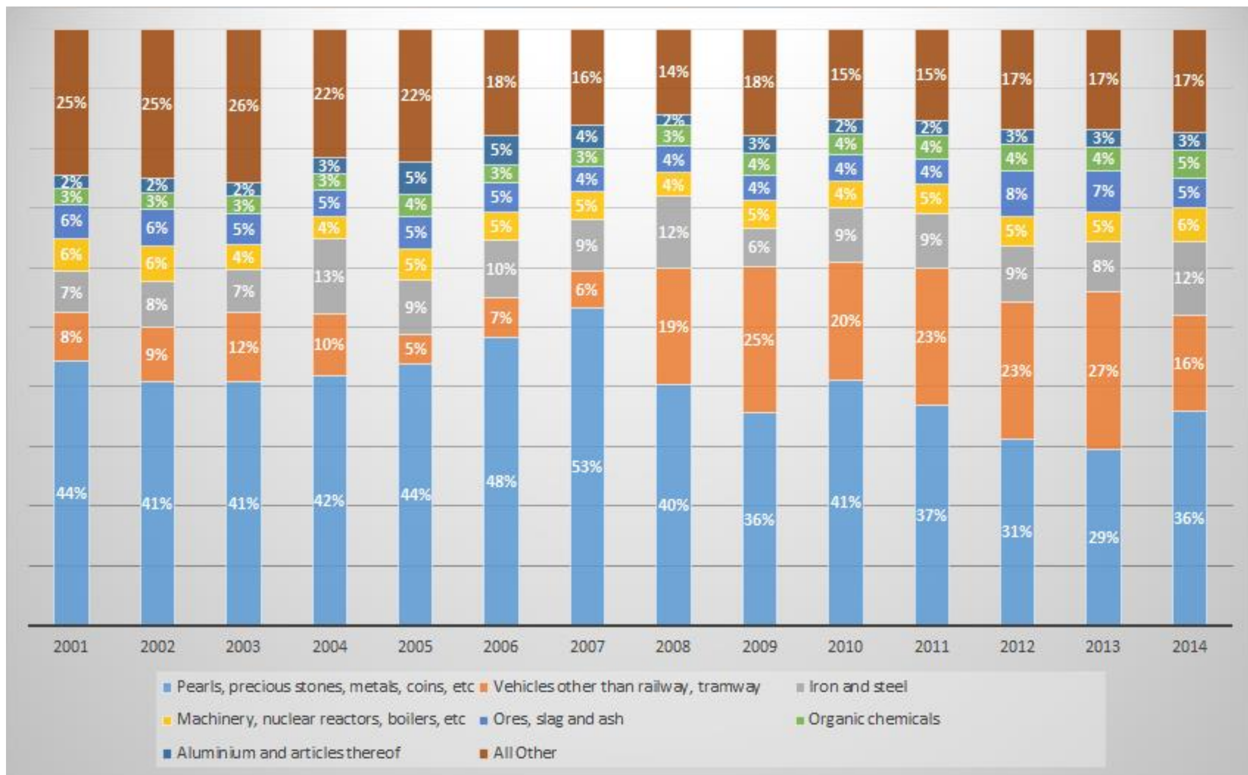


AGOA is accompanied by a number of other US-Africa economic cooperation initiatives, the core of which include USAID's Tradehub programme (aimed at trade facilitation), Power Africa (aimed at improving energy generation), and Feed the Future (an agriculture and food security programme).

The Potential of AGOA

Thus far AGOA has, at best, a mixed record. Preferential access to the richest market in the world could be a major driving force for development, but has thus far failed to drive significant export growth, nor inspire much diversification. A useful case study of the potential offered by AGOA can be found in South Africa. South Africa's exports to the United States tend to be far more diversified, and include the type of manufacturing exports that are coveted by many policymakers in the region. Figure 6 shows the bundle of goods comprising South African exports to the US.

Figure 6: Composition of South Africa exports to the United States, by Commodity



South Africa's utilisation of AGOA has primarily been facilitated by three factors.

First, is the relatively more diversified structure of the economy.While much of the continent remains reliant on commodities like oil, South Africa's largest sectors are finance and business services (at 19.4% of GDP), government services (15.1% of GDP), and the retail and entertainment sector (13.7% of GDP). Manufacturing lags far behind the standard of large industrial countries and emerging Asia, but at 13% of the economy is large relative to the rest of the continent. Diversification is important for a number of reasons - from job creation to productivity spillovers - but it also improves a country's responsiveness to trade access. Commodities generally face low trade barriers even under MFN rates, and are already driven by global demand, with limited capacity to easily increase output in the wake of trade access.

Second, is the presence of aggressive supporting policies, notably in the case of automotives. The industry is directly supported by the Motor Industry Development Programme (MIDP), which offers a range of investment incentives, the most valuable of which is a system of tariff rebate certificates, issued at equal value to every car exported. The MIDP is controversial, and has been criticised for its cost, questionable legality under WTO rules, and potentially distortive effects on the growth of

the motor industry in neighbouring countries. But it has driven remarkable growth in the South African auto industry. Since the programmes inceptions, exports of light automotives have grown by a factor of 25, and component exports by a factor of 12. On average, the United States accounts for 20% of South Africa's automotive exports. While the MIDP was not specifically targeted for AGOA, it demonstrates the ability of large support programmes to catalyse potential trade flows offered by preferential market access.

Third, is the existence of supporting trade infrastructure. South Africa ranks above all other Southern African countries, with the exception of the island states of Mauritius and Seychelles, in the "Trading Across Border" measure in the World Bank's Doing Business report. Hard infrastructure is complemented by the presence of a large service sector, which supports trade in vital tasks like marketing and navigating the legal red-tape involved in export. This hard and soft rade infrastructure is complemented by large two-way investment flows, which reinforce business relationships that can drive trade.

The Limits of AGOA

The South African case may highlight the opportunities on offer, but it also highlights three limits on the capacity of Southern African states to take advantage of AGOA.

Structural Transformation

The economic structure of many African economies limits their ability to take advantage of AGOA. The availability of preferential access is not necessarily going to create industries where no industrial base exists, since the initial investment costs are generally high enough to counteract the benefits of preferential access. The lack of industrial base is deepened by gaps in supporting infrastructure - from trade structures like ports and rail connections, to basic industrial infrastructure like power and water. The central competitiveness drag of these structural gaps often mean that AGOA access is inadequate to prepare exports to succeed in the brutally competitive US market.

Limited Timeline

Structural transformation is advancing across the continent, but the central challenge in the context of AGOA is the deal's limited timeline. A single large infrastructure project will easily take longer than the ten year lifetime of AGOA - and deep structural transformation will certainly take much long. While previous timelines have always generated uncertainty, the 2025 renewal date seems the most pressing. Policymakers in the United States have already expressed concerns over the unilateral nature of AGOA, and have begun calling for the deal to be transformed into a two-way agreement. This is partly inspired by the EU's shift from preferential access to Economic Partnership Agreements, and by the increasing desirability of the African consumer market. More developed African countries, most notably South Africa, seem very unlikely to continue to benefit from AGOA preferences beyond 2025, posing serious challenges for other Southern African Customs Union states.

Eroding Market Access

Even if AGOA is renewed, the benefits of the access will be increasingly eroded by the United State's efforts to develop major trade deals such as the Transatlantic Trade and Investment Partnership (TTIP) and the Trans Pacific Partnership (TPP). TPP is arguably the biggest challenge to AGOA, with highly competitive developing countries like Vietnam gaining an equal trade access footing to African countries. Any access gained under the likes of TPP will have the added benefit of stability, being free of the uncertainty that investors must confront in the face of short-term renewals of AGOA. While the specifics of both agreements are yet to be settled, it does seem that

firms wanting preferential access to the US market will have a growing set of countries in which they can invest.

Export Strategies

The central challenge facing African states wanting to utilise AGOA is therefore temporal. Growth and structural transformation is necessary to take advantage of AGOA access in a substantial way, but this will take a long time to achieve. AGOA benefits are limited to the next decade and will be eroded by rival market access long before that. Time is needed for a substantial policy response, but is not available.

Given these limitations, Southern African countries could arguably best utilise AGOA preferences by making use of short-term supporting strategies. This is a second-best approach, but with the limitations identified above, it is the best that can be done for now. There are many strategies that can considered, of which three are mentioned below.

AGOA Zones

Special Economic Zones have played a central role in the development of East Asia, and have proliferated widely across Southern Africa, but thus far have a mixed record of success. Nevertheless, AGOA-focused export processing zones offer a way to overcome the temporal problem identified above: they can be rolled out relatively quickly, and create concentrated spaces that mirror the type of structural transformation needed to compete.

SEZ policy differs across the region and includes a wide range of incentives - but the most important element of these AGOA-zones is the provision of industrial parks with good physical and trade infrastructure. Hard infrastructure could include a supply of subsidised electrical generators and storage facilities within the zone, while trade infrastructure could include a dedicated offices of the local customs authority and space for freight-forwarding experts and trade lawyers. Traditional incentives, particularly tax breaks and financing for initial capital investment, could help speed-up firm's investment decisions and reduce some of the uncertainty generated by the 2025 deadline.

City Strategies

The latest version of the legislation calls for the creation of AGOA export strategies, with USAID's Tradehub programme likely to be tasked to fund and assist with this process. Building export strategies seems a good idea, but it should be targeted at the right level. Trade policy tends to be handled at the national level, but in countries with pool of development amidst vast stretches of underdevelopment, city and other local government can arguably play a more important role. The larger urban centres in many Southern African states are the logically launching pad for export industries, and face far fewer structural problems than the country averages suggest. The local administrations governing these areas are also closer to the ground, with greater capacity to work with firms, and understand where they need assistance. AGOA strategies need to take heed of the unique economic geography of Southern Africa, and target their efforts accordingly.

Value Chain Entry

The trend towards Global Value Chains - the increasing fragmentation of production across countries - remains a phenomenon that is concentrated in regional productive hubs. Closely integrated regions such as East Asia and Europe are also the most integrated into global supply markets. This is partly because the presence of regional value chains allows for a more efficient distribution of labour amongst countries, and thus improves the competitiveness of exports from the broader region. This specialisation is particularly powerful in regions with large development

disparities - as is the case in Southern Africa - as less developed countries that might otherwise not be able to compete in global markets, can find an avenue to enter by supplying inputs to pre-existing exports from more developed regional neighbours. South Africa's automotive exports to the United States, for example, offer an avenue for component manufacturers in the rest of the region to reach the US market. Entry into value chains can often be achieved more quickly than the creation of an export industry in finished goods, and offers the added benefit of assuring a better distribution of the benefits of AGOA across the region.

Regional Integration

AGOA does not have a large regional role to play, but may have some regional spillover effects.

The best possible role AGOA could play is in driving diversification in Southern African countries. The primary driver of low regional trade levels is the fact that Southern African countries produce little that their neighbours want to buy. A commodity-dependent economy has little to sell to another economy that is dependent on the same commodity. This is most dramatically illustrated in the case of South Africa, where a more diversified economy bucks the trend of low regional trade, and accounts for between 29% and 51% of the total trade of its neighbouring countries. Trade ties with the rest of the world can create a market base that can drive diversification, and in so doing drive regional integration. Firms that develop the capacity to export textiles to the United States, for example, could possibly succeed in exporting to South Africa. Diversification will, however, only succeed if the temporal problem outlined above can be overcome with supporting policy.

As discussed above, AGOA could also drive development of regional value chains. The relationship between regional value chains and regional integration is characterised by a dual causality: value chains increase integration, but integration also encourages value chain development. Because of this, AGOA will only be a major driving force in developing regional value chains if it is accompanied by further progress in the many regional integration initiatives ongoing across SADC and the African continent.

Conclusion

It is often assumed that the private sector will do most of the heavy lifting in taking advantage of market access, inspired to invest by the presence of access to rich markets. In the case of AGOA, however, the private sector cannot go it alone. AGOA may be a supporting reason for investment amongst firms that already plan to enter the Southern African market, but it is unlikely to inspire new investment without supporting policy. Targeted interventions that help firms cope with structural constraints can help unleash the nascent potential on offer in the African Growth and Opportunity Act.