Hubs without spokes: Building a more inclusive AGOA - SAIIA

Policymakers in Pretoria, Nairobi and Maseru are holding their breath as the latest renewal of the African Growth and Opportunity Act (AGOA) makes its way through the partisan gridlock of the US congress. AGOA offers duty free access to the richest market on the planet on 1800 tariff lines, generates over 62,000 jobs in South Africa alone, and sustains apparel industries in countries such as Lesotho and Mauritius.

The current iteration expires on 30 September 2015, and will need to be renewed soon to quell the uncertainty of nervous investors.

In the budget sent to the US Congress earlier this month, the Obama Administration backed a full renewal of AGOA, calling for lawmakers to enact a 15-year extension. To renew AGOA, legislation must first be tabled in various committees in the US Senate and the House. Once they pass out of those committees, the legislation would move to consideration to the full membership of those respective chambers. To date, the length of the renewal still remains undecided and some observers indicate that this will likely be proportional to the amount of funding that will be made available.

And yet, for many African states, the loss of AGOA would mean little. Around half of AGOA-eligible countries export goods worth less than USD $1 million to the US, a negligible amount in global trade terms. The exports of the US's biggest trading partners on the continent – Nigeria and Angola – are overwhelmingly concentrated in oil, which faces low trade barriers that are unlikely to deter imports.

The lacklustre impact of a lapsed AGOA certainly does not mean it is not important. It just shows how underutilised the preferences remain. The nascent development potential of AGOA is yet to be tapped. A step in unleashing that potential is to make the deal more inclusive.

Bringing in the laggards

The combined exports of the 20 countries that utilise AGOA the least is roughly equal to what the United States imports from the Netherlands Antilles. For these left-behind countries, AGOA is a reality on paper but not in practise. They will need significant support to bring them into AGOA.

There are many suggestions of how this could be achieved. The US Government Accountability Office (GAO) recommends assisting national governments in drafting strategic plans for utilising AGOA, and numerous commentators have recommended the expansion of the US Trade Hubs programme, which provides technical assistance in overcoming the red tape associated with entering the US market.

While these are excellent suggestions for economies with rich export potential – like Kenya and Ethiopia – they are not likely to spark trade growth in countries with negligible export levels such as Malawi or Burundi. This group primarily consists of Least Developed Countries and their problems are deeply structural. Assistance can ameliorate constraints such as insufficient infrastructure, high political risk and weak access to finance; but it cannot fully overcome them.

The AGOA laggards will be extremely difficult to connect directly to the US market. Nevertheless, they can be connected to regional hub economies that do have export reach. South Africa is a useful example. The country is easily the largest exporter of manufactured goods, especially automotive exports, to the US amongst the AGOA group.

The presence of this export hub creates clear linkages between the US and South Africa's regional neighbours. For example, Botswana barely trades with the US, but South African automotive exports include Botswanan wiring harnesses, transmission shafts, and batteries.

South Africa is often cited as a gateway to Africa, but here it is a gateway to the US. Large regional economies – like Kenya and Nigeria – can play similar roles, provided work is done on integrating the hubs into their regions. To USAID's credit, their Trade Hubs programme prioritises regional integration above direct support to enter the US market. This is the right approach, but can be expanded.

Trade Hubs can assist in connecting firms that currently export to the US market with potential suppliers in other AGOA states, and these suppliers should be assisted by their local government in their efforts to enter the value chain. Supplier firms should also be provided assistance in upgrading their internal monitoring and accounting procedures in order to build the capacity to meet the paperwork requirements that are essential to proving compliance with rules of origin along the AGOA value chain.

At a regional level, efforts need to be made to assure that local trading rules align with AGOA rules. The automotive sector currently faces stricter rules of origin in the SADC Free Trade Area than they do in AGOA. Getting local rules right first can create the spark for overcoming barriers to reaching more distant American shores.

Promoting value addition in the Hubs

Supply chains work best for goods in which there is the potential for multiple stages of value addition. The supply chain for oil, for example, is relatively simple: extraction, processing, and distribution. There is certainly scope for these types of commodity chains to create spillover benefits – particularly through services like engineering, transportation and retail – but the scope to build substantial African integration on short chains like natural resource extraction is limited.

Some level of economic diversification in the hub economies is needed to give African states a productive centre around which they can collaborate. AGOA is particularly generous in offering access for manufactured goods to the US market. This generosity has paid off for diversified economies like South Africa, in which manufactured goods comprise more than half of the country's exports to the US.

The onus of diversification and industrialisation of course lies with African states; which must first work to build the necessary skills, infrastructure, and business environment that allows firms to take advantage of the AGOA opportunity. However, strategic cooperation with the United States can also offer benefits.

First, the United States' excellent Power Africa initiative should be maintained and ideally expanded. A stable power supply is crucial to doing business, and particularly for manufacturing firms operating in a world of just-in-time production. The current batch of countries benefiting from Power Africa include Nigeria, Kenya, Ethiopia and Ghana – all of which can act as regional trading hubs for access to the US market. Power Africa and AGOA are an excellent couple; the logic of each reinforces the other, and both must be maintained to maximise the impact of US policy on the continent.

Second, the US should support capital market development on the continent. Capital markets provide avenues for governments to fund development and for firms to manage shocks and fund expansions. Capital markets are also the preferred entry point for many American investors, who prefer liquid portfolio investment to risky greenfield investment. Building working capital markets, with active secondary markets, can give American firms an entry point into doing business on the continent, while also giving African firms and governments the potential to expand and diversify.

Finally, as was first suggested by Kimenyi & Frank, Congress should consider offering tax breaks on the repatriation of profits from investments in African manufacturing firms. These types of incentives have a proven track record of driving investment, and will do so at very little real revenue loss to the US government, since American investment in African manufacturing is so small. If the cost of such a tax-break is a major concern, then it could easily be time-limited, perhaps offered for a period of ten years for those firms investing in the two years following the renewal. Such an offer could act as a powerful incentive for kicking off value-added investment during this next stage of AGOA.

The limits of AGOA

AGOA has immense potential, but thus far has largely remained a case study in the developmental limits of trade access without deeper transformation. Trade barriers are not the only barriers to trade. Low tariffs do little for small firms struggling with weak infrastructure and difficult local business conditions. Domestic constraints do not just undermine the ability of Africans to benefit from AGOA – they undermine US policy on the continent. For US policy to win over African policymakers and citizens, it must be viewed as functional. When China builds a road, it is seen to be working for African development. When the US extends AGOA, it is only seen to work towards African development if it is accompanied by the practical capacity to take advantage of it. Connecting smaller economies to hubs, and helping these hubs diversify, will send a powerful message that the United States is ready to share in the Africa Rising story.