Promoting Private Sector Investment

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Ultimately, the success of the African Growth and Opportunity Act is dependent on the profitability of investment directed at harnessing the trade preferences afforded by the act. It was expected from the outset that AGOA would trigger higher levels of foreign direct investment as a result of the profit opportunities associated with the trade preferences. More specifically, it was expected that the trade preferences would be sufficient to make it attractive for U.S. investors. In turn, higher levels of FDI would expand job opportunities, incomes and result in poverty reduction. AGOA is credited with both job creation and increasing FDI.[1] Between 2001 and 2007, FDI increased by 52 percent to $13.8 billion.[2] Nevertheless, the U.S. commercial presence in Africa remains small, and its relative importance is being eroded rapidly with the aggressive investment stance taken by Brazil, Russia, India and China, known as the BRICs.[3] Whereas FDI from the U.S. is primarily focused on oil and mineral extraction, investment from the BRICs is increasingly diverse. While FDI from the BRICs declined across all continents during the recent economic downturn, FDI to Africa decreased the least, from $72 billion in 2008 to $59 billion in 2009.[4]

Notwithstanding the opportunities afforded by AGOA, many U.S. investors remain reluctant to enter African markets. In addition to the real and perceived high costs of doing business on the continent, specific aspects of tact lead investors to discount its potential benefits. To increase FDI flows from the United States to Africa, policymakers should consider a variety of options.

Creating a Predictable Environment

Although AGOA has been extended a number of times, from the perspective of an investor, the act is "short term." Initially, AGOA was set to last until 2008, but it has been extended and is now set to expire in 2015. Investors consider such time frames insufficient to make investments, many of which are associated with large sunk costs. Many years are needed to establish the infrastructure and market share required for foreign trade with the United States. Equally, many African countries do not already have industries for AGOA-eligible commodities and await new investment to develop potential businesses. Thus, the overall framework with regard to the duration of the act needs to be reconsidered to ensure that it has inbuilt investment incentives.

Of immediate concern are the implications of AGOA's expiration in 2015. Given that investors are unsure of whether an extension will be forthcoming, they are unlikely to undertake any substantial investments. One suggestion is to institute a "grandfather clause" that would allow companies to continue benefiting from AGOA on contracts negotiated before the 2015 deadline, regardless of whether the act is extended or not. Such grandfathering of contracts would allow companies to operate under the AGOA trade policy as it is at the time of signing for a predetermined period of years.

Grandfather clauses have been used in other trade policies such as the General Agreement on Tariffs and Trade as well as the North American Free Trade Agreement.[5] Under a grandfather clause, investors and business leaders would be able to negotiate contracts with certainty that no matter how U.S. legislation affects AGOA in the future, they would be able to operate under consistent trade guidelines.

Financing Investment

With the high perceived risk of investing in Africa, many financial institutions are reluctant to lend for such investments. Thus, unless there is an alternative facility for investment finance, American investments in Africa will remain low and the potential benefits under AGOA will remain unexploited. There is therefore an urgent need for creative approaches to ease access to investment finance. For example, the White House recently launched a program designed to facilitate investment in young companies called the Startup America Initiative, which provides a range of tools to help build young companies and offers a model for how the U.S. could also facilitate investment in Africa. This program supports investment financing by providing $2 billion in matching funds for high-growth companies.[6] To facilitate investment in Africa, the U.S. could provide similar matching funds to U.S. companies investing in Africa. Additionally, the program proposes an elimination of the capital gains tax on the sale of certain small business stocks. Likewise, the U.S. could assist in the financing of investment in Africa by offering a reduction or elimination of the capital gains tax on the sale of stocks of African companies. This measure would offer an added incentive for investing in African companies and also increase the profits of U.S. investors selling African stock. In ways like these, the U.S. government should engage the private sector with a view to identifying viable approaches to investment finance.

Tax Incentives on Repatriated Profits

Although the investment climate in Africa has improved a great deal, much remains to be done to make the continent a competitive destination for FDI. Ultimately, the African governments must shoulder the main responsibility of attracting investments.

To complement the actions of the African governments, the United States should consider a more aggressive approach to supporting firms that invest in Africa. Currently, there is a scramble to invest in Africa by companies based in the BRIC nations, and this scramble is also being heavily facilitated and supported by the BRIC governments.[7] Such support is allowing the BRICs to access vital natural resources and also dominate important sectors of the African economies. It is therefore in the interest of the United States to support firms not only to make AGOA more effective but also to maintain a competitive commercial presence in the African market.

Although the removal of taxes on profits made in Africa can increase FDI flows, such approaches may not be politically feasible. An alternative policy would be to reduce the tax on repatriated income rather than attempting to abolish taxes altogether. In addition, tax credits could be extended to firms based on the number of jobs they create both domestically and in Africa. Tying tax benefits to job creation in the U.S. and Africa would not only make AGOA a true partnership but would also help build support with American constituents.

High-Level Trade Missions to Africa

Although many policy initiatives can be designed and executed through AGOA, the U.S. also has the ability to spur trade in Africa simply by influencing how Africa is perceived. One strategy would be to organize a series of trade missions to the region consisting of a delegation of American trade officials accompanied by heads of U.S.-based investment groups and business leaders. By conducting these trade missions to the region, the U.S. could reduce the perception of investor risk while simultaneously attracting the attention of African companies looking for partnerships abroad. President

Barack Obama and Secretary of State Hillary Clinton could play a central role by taking the lead and being part of such missions.

Promoting greater levels of FDI from the U.S. to Africa through the African Growth and Opportunities Act is beneficial for both the U.S. and Africa. Although the U.S. continues to provide the region with various forms of assistance, increased levels of FDI hold the potential for leading to more sustainable economic growth and development. It is therefore critically important that promoting U.S. investments be prioritized in evaluations of the Africa-U.S. commercial relationship.

Endnotes

[1] United Nations Economic Commission for Africa and African Union, "Economic Report on Africa 2011: Governing Development in Africa—the Role of the State in Economic Transformation," United Nations Economic Commission for Africa, 2011.

[2] L. Páez, S. Karingi, M. Kimenyi, and P. Mekalia, "A Decade (2000–2010) of African-U.S. Trade under the African Growth Opportunities Act (AGOA): Challenges, Opportunities and a Framework for Post AGOA Engagement," African Development Bank, 2010.

[3] Ibid.

[4] Barney Jopson, "BRICs in Africa: Adding It Up," Beyond BRICs Blog, *Financial Times*, August 5, 2010, http://blogs.ft.com/beyond-brics/2010/08/05/76851/.

[5] In the General Agreement on Tariffs and Trade, a grandfather clause was used to allow leniency for particular legislative requirements in order to avoid delaying membership for those requiring specific legislative reforms. On the North American Free Trade Agreement, see Organization for Economic Cooperation and Development, *International Investment Law: Understanding Concepts and Tracking Innovations* (Paris: Organization for Economic Cooperation and Development, 2008); and G. Zodrow, "Grandfather Rules and the Theory of Optimal Tax Reform," *Journal of Public Economics* 49, no. 2 (1992): 163–90.

[6] White House, "Fact Sheet: White House Launches 'Startup America' Initiative," May 8, 2011, http://www.whitehouse.gov/startup-america-fact-sheet.

[7] Mwangi Kimenyi and Zenia Lewis, "The BRICs and the New Scramble for Africa," in *Foresight Africa: The Continent's Greatest Challenges and Opportunities for 2011* (Brookings, 2011).