ADDRESSING UNCERTAINTY TO SPUR INVESTMENT IN AFRICA

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The Africa Growth and Opportunity Act (AGOA) has facilitated a significant increase in trade between the United States and Africa. Exports from AGOA-eligible African countries to the U.S. increased from $23 billion in 2000 to $81 billion in 2008. While intended to spur growth in all export sectors, African exports to the U.S. continue to be dominated by oil and gas, which account for about 90 percent of all AGOA exports.

It is essential that AGOA preferences benefit all sectors of African economies in order to have the intended effect of promoting growth and development. However, a number of constraints continue to hamper non-oil AGOA exports, including: AGOA's short time horizon, potential competition from other developing countries, and difficulty in mobilizing private investment. It is important to recognize and address these constraints in order to help Africa fully capitalize on its potential under AGOA.

SHORT ON TIME

When the law establishing AGOA was enacted in 2000, the duty free provision was meant to last for only eight years but was later extended to 2015 in July 2004. Similarly, the apparel agreement was supposed to come to an end in 2007 but was also extended to 2012 in December 2006. The underlying assumption behind these timeframes was that AGOA-eligible commodities were already being produced in Africa and so the agreement would simply spur increased production and exporting. At the inception of AGOA, Africa's production capacity was quite low, however, and substantial time was necessary to establish the productive capacity and infrastructure to take advantage of the benefits of the preference scheme. Many countries required foreign investors to build capacity to produce AGOA-eligible products. The eight year time period in the first AGOA bill was much too short to attract investors and develop production capacity. Similarly, an expiration date of 2015 will severely limit current and future investment.

Although AGOA provides incentives for investors arising from the duty-free market access, the risk associated with the short and uncertain life of the law lowers the potential benefits substantially. Investors are concerned about making large investments, such as in efficient high-technology processing plants, as they may not recoup their capital before the expiry of AGOA. This is compounded by other barriers that investors already face in African countries, including infrastructural and institutional weaknesses. While some African governments have done their part in improving the business environment, the life and uncertainty of AGOA has undermined such investments.

INCREASING COMPETITION

The elimination of the Multi-fibre Arrangement (MFA) in January 2005 removed the quota system and opened up the apparel sector to competitive market forces. This exposed AGOA apparel-producing countries to competition from cheaper and larger producers from China, India and other East Asian countries. AGOA apparel exports progressively plummeted from $1.7 billion in 2004 to $0.9 billion in 2009.

External competition continues to be a major constraint for AGOA apparel producers. AGOA producers now face the risk that the U.S. government may extend similar benefits to other developing countries that are already far more competitive than African countries. While this has not happened yet, there have been proposals by Congress to extend AGOA-like benefits to countries such as Cambodia and Bangladesh. Such a preference scheme would lead to an erosion of the preferences granted to African countries under AGOA. In essence, extending benefits to more competitive developing countries that are already claiming a large share of the U.S. export market would greatly undermine the core objectives for which AGOA was enacted.

DIFFICULT INVESTMENT CLIMATE

Private investment, both domestic and foreign, is essential for developing a strong export base in Africa. Foreign direct investment (FDI) inflows to Africa have increased significantly from about $10 billion in 2000 to $88 billion in 2008. However, the majority of FDI inflows to Africa are concentrated in oil and other mineral resources. In order to develop a diversified base of exports from Africa, there is need for private investment in a diverse range of industries. These, however, have to be backed by market availability.

Investors have often cited poor infrastructure, corruption, bureaucracy and access to capital as some of the major constraints to doing business in Africa. Working together with African policymakers, AGOA should help to stimulate private investment for non-oil exports. This is critical to increasing Africa's trade capacity.

POLICY RECOMMENDATIONS

Much can be done to address these constraints and to help African countries take full advantage of AGOA. First, if the goal of AGOA is to promote lasting growth and development, then the AGOA time horizon should be extended for a more sizeable period. Recognizing that the U.S. Department of Agriculture rulemaking process for new agricultural products can take up to three years to process for goods that are "economically significant," it is important to extend the AGOA time horizon to allow new exporters the opportunity to take full advantage of AGOA. This will provide investors with the market certainty they need to make long-term investments in Africa.

Second, AGOA should be exclusive to Africa. Firms that have invested to exploit the opportunities accorded by AGOA would be adversely impacted by extending AGOA-like benefits to other developing countries. These firms need more time to engage in exporting and acquire the capacity to compete in international markets. The extension of AGOA-like benefits to other developing countries will only hamper or even reverse the progress that has been made to develop Africa's export sector.

The U.S. could adopt a more nuanced approach to extending trade preferences to developing countries in other regions by extending preferences to specific beleaguered sectors in those countries. Bangladesh exports more apparel to the United States than all of sub-Saharan Africa combined. Therefore, preferences should be extended to other sectors in Bangladesh that are less developed. This will have the impact of promoting development in less developed countries worldwide without putting African producers out of business.[1]

The U.S. can also help to stimulate private investment in Africa by offering tax incentives to U.S. companies that invest in select non-oil industries in Africa and export back to the

United States. U.S. policymakers should work with their African counterparts to identify key potential growth industries that would be eligible for these tax advantages. The focus should be on industries that have low production capacity at present but have the potential for stimulating growth.

In turn, African governments should continue to remove barriers that increase transaction costs in Africa by improving regional infrastructure, reducing corruption, enforcing property rights, improving governance and facilitating loans for businesses involved in export activities.

ENDNOTES

1. Thahane, Timothy. The 2010 AGOA Leaders Forum. April 26, 2010. Washington, DC.