AGOA AND REGIONAL INTEGRATION IN AFRICA

A MISSED OPPORTUNITY BEYOND 2015

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True to its name, the Africa Growth and Opportunity Act has created a number of opportunities for Africa that would not otherwise exist, but it is in danger of missing a critical opportunity. AGOA can do more to support the meaningful integration of Africa's economies. Without effective regional integration Africa simply cannot compete in the global market for manufactures, traded services—such as tourism and IT-based services—and high value added agriculture. The region's ability to create high paying jobs and sustain growth depends on these industries. Integrating locally to compete globally is fundamental to Africa's long-term economic success.

WHY IS REGIONAL INTEGRATION SO IMPORTANT FOR AFRICA?

The continent's economies are small, both in population and economic size. Moreover, 40 percent of Africans live in countries without effective access to the sea, compared with 4 percent of the world's population. Many countries' ability to trade depends significantly on relationships and agreements with neighboring countries whose roads and ports are necessary for trade. Today, transport and power links between countries are limited, and poorly performing institutions—such as regulation of commerce and customs—raise the cost of trade logistics. Transportation costs in Africa can be as high as 77 percent of a product's export value.

Despite the overwhelming economic logic and the political rhetoric in favor of tighter regional ties, Africa has had relatively little success in forming effective regional groupings. Take the case of the Common Market for Eastern and Southern Africa (COMESA), a regional economic grouping that spans from Cairo to the Cape, encompassing 19 member states with a population of 430 million. This is a potential regional market of significant size and diversity, but COMESA is a "common market" in name only. In fact, it has not achieved free trade among its members, movements of people across its borders remain problematic, and it is a long way from integrating its financial markets. With a few exceptions, notably the East African Common Market and the Southern African Development Community (SADC), Africa's other regional economic groups have similar problems.

HOW CAN AGOA HELP?

Mainly by encouraging the development of regional value chains. One of the reasons why regional integration initiatives in Africa have shown so little dynamism is that the business community sees few opportunities in cross-border trade with neighbors. Unlike Asia where regional value chains have grown to serve global markets, in Africa there is little "production sharing" among countries. Trade among African countries in intermediate goods and components is low and therefore there is little pressure from the private sector for effective infrastructure and institutions to support regional trade.

In some ways, AGOA is well structured to support the development of regional value chains. Its rules of origin allow beneficiary countries to qualify for the minimum local input/processing requirements of using inputs from other AGOA beneficiaries. Intermediate inputs and components purchased from Uganda for example can "count" as part of the local inputs of a Kenyan firm exporting to the United States. In textiles and clothing, the third-party fabric allowances have made it easier for AGOA countries to procure low-cost inputs from one another.

But AGOA's eligibility criteria work in the opposite direction. Eligibility is determined on a country by country basis and the U.S. president conducts annual reviews to determine whether or not a country meets the eligibility criteria. Countries can be eligible one year and not eligible the next. This process has resulted in nine countries being added to AGOA and seven removed since 2002.

Under the current system, the removal of a country from AGOA has ripple effects on trading partner countries, as their inputs are no longer AGOA eligible. AGOA has no mechanism to offset trading partner losses or otherwise lessen the shock when an AGOA country is removed. This has the unintended consequence of discouraging regional supply chains in favor of one that is wholly sourced in a single country. Investors are likely to be apprehensive about creating regional supply chains if it is unclear whether certain inputs will disqualify their product from one year to the next.

The case of Madagascar is illustrative. Madagascar's budding apparel sector uses denim fabric from Lesotho, zippers from Swaziland, and cotton yarn from Zambia, Mauritius and South Africa. Despite significant protest from the private sector, Madagascar was removed from AGOA in January 2010 due to an undemocratic change of government. While the response to Madagascar's coup may have been appropriate, removing Madagascar from AGOA not only punishes Madagascar, but it also punishes the country's five regional trading partners, who are all AGOA beneficiaries.

It is possible to restrict eligibility for AGOA to countries that follow principles of good governance and AGOA's rules while at the same time reducing the uncertainty faced by investors interested in developing regional value chains. To do so, the AGOA rules of origin will need to be modified to ensure that AGOA eligible countries that are part of regional trading blocs are not punished for the behavior of their non-compliant regional trading partners. One option is to allow a non-compliant country to continue to provide eligible inputs to the AGOA eligible countries within the regional group, but restrict direct exports from the non-compliant country to the U.S. Another, as in the case of Madagascar, is to allow a country declared ineligible to continue to export goods that contain a specified amount of inputs from AGOA eligible countries in the regional group under a transitional arrangement. If the country continues to violate AGOA eligibility rules, preferences would be gradually removed but at a clear and predictable rate for investors.

AGOA could provide a further boost to regional integration by establishing clear eligibility criteria for qualified regional trading blocs, based on progress in trade and financial integration and including them as negotiating partners. In the case of Madagascar, for example, negotiations with the Southern Africa Development Community (to which all six countries belong) on a phase out of preferences for goods with substantial regional content, could have helped to minimize the losses to the five remaining AGOA beneficiary countries from the removal of Madagascar. In addition to reducing regional losses, such negotiations would also strengthen the role and relevance of the SADC Secretariat.