Advancing the US–Africa Trade and Development Agenda: Aligning US Policy Tools to Address Core Competitiveness Constraints

Testimony before the House Committee on Ways and Means
Subcommittee on Trade

Ben Leo
Senior Fellow and Director, Rethinking US Development Policy Initiative
Center for Global Development

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Thank you, Chairman Nunes, Ranking Member Rangel, and other members of the Subcommittee. I appreciate the opportunity to appear before you today to discuss ways to advance the US-Africa trade agenda. This hearing, and the broader examination of the African Growth and Opportunity Act (AGOA) and other US policy tools, is very well placed and timed. Next week, Washington will host roughly 50 African heads of state, hundreds of cabinet-level ministers, and over a thousand American and African business leaders and investors. The African delegations are expected to deliver a unified message – they want to generate more trade and attract more US investment into their economies.

Within this broader strategic context, my testimony will focus on four interrelated points, followed by a number of policy recommendations at the end:[1]

(1) **African firm-level competitiveness is influenced primarily by business climate constraints, small market size, and collusive political economy dynamics.** Addressing these factors, even on the margins, will have a greater impact on US–Africa trade flows and private-sector-based development than expanding AGOA's preferential market access provisions.

(2) **Despite explicit criteria, AGOA country eligibility decisions by successive Administrations have not reflected whether African governments are establishing market-based economies and favorable business climates.** Congress should consider conditioning preferential access to the $17 trillion US economy on demonstrable business environment reforms.

(3) **Congress and the Obama Administration should bring greater focus, coordination, and scale to US trade capacity building programs in Sub-Saharan Africa.** This will require the

[1] This testimony draws upon Center for Global Development research, including: (1) Leo and Ramachandran (2014), *Getting Serious about Underperformance of the African Growth and Opportunity Act*; (2) Leo (2010), *Where Are the BITs? How US Bilateral Investment Treaties with Africa Can Promote Development*; and (3) Gelb, Meyer, and Ramachandran (2014), *Development as Diffusion: Manufacturing Productivity and Sub-Saharan Africa's Missing Middle*. Additional details can be found at http://www.cgdev.org/expert/ben-leo.

establishment of a centralized policy body, with appropriate budgetary authority, to focus US trade-related programs on core competitiveness constraints.

(4) **The US government should *stop* investing in ineffectual Trade and Investment Framework Agreements (TIFAs) and *start* investing in legally binding Bilateral Investment Treaties (BITs)**. Such action will promote greater investment to the continent while also positioning US investors on equal footing with European, Chinese, and other investors who benefit from BIT protections.

I. AFRICAN FIRM-LEVEL COMPETITIVENESS CONSTRAINTS

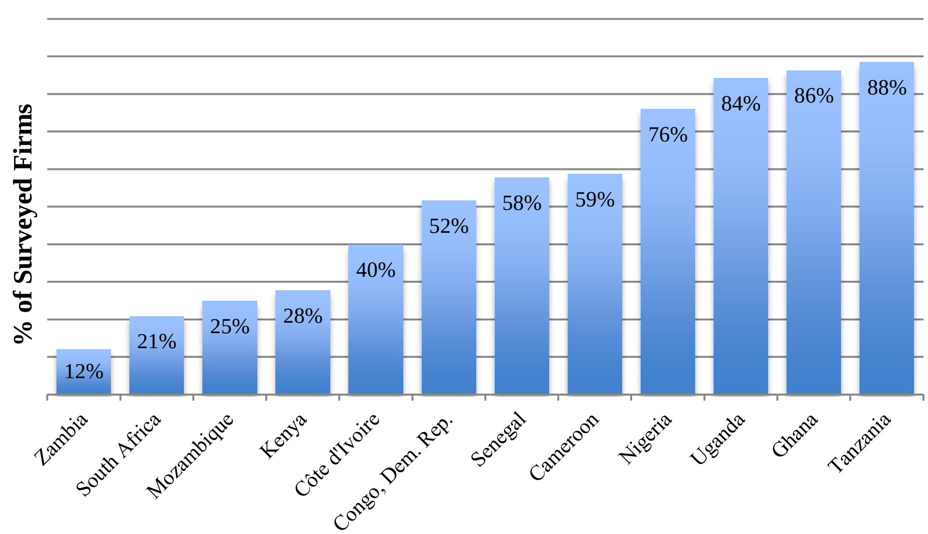
African trade competitiveness is influenced primarily by business climate constraints, small market size, and collusive political economy dynamics. Addressing these factors, even on the margins, will have a greater impact on US–Africa trade flows and private-sector-based development than expanding AGOA's preferential market access provisions. Nearly all of these issues must be addressed primarily by African governments. Therefore, the central policy question for the US government is determining how best to incentivize and support related reforms, which is addressed in the subsequent sections.

Unreliable and costly electricity is a major competitiveness constraint for most African businesses.

- Half of African firms cite electricity as a major constraint on their competitiveness, profitability, and expansion potential. In some African economies, losses from power outages amount to more than 10 percent of sales.

- More than 80 percent of firms in Ghana, Tanzania, and Uganda cite concerns with power reliability and affordability.

Figure 1 – African Firms' Citing Electricity as Major Constraint, Select Countries



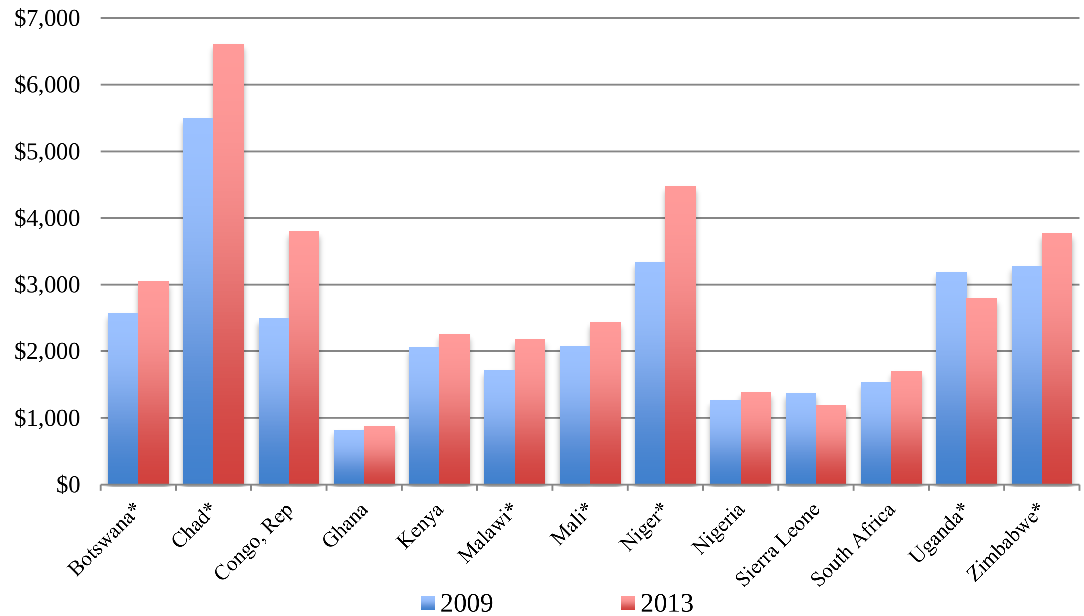
Source: World Bank Business Enterprise surveys

Despite some progress in transport and export-processing times, high costs remain a serious competitiveness burden.

- Across the region, nearly 30 percent of Sub-Saharan African firms cite transportation as a "major" or "severe" constraint.

- Since 2009, the average cost of exporting a standardized shipping container increased in half of African countries. In fact, 13 countries witnessed higher costs while still reducing the transport and export processing times, such as Botswana, Lesotho, Malawi, Mali, and Nigeria. Monopolistic trucking cartels at least partly explain this dynamic in many countries.

Figure 2 – Cost Required to Export a Standardized Container, Select Countries[2]



Source: World Bank Doing Business surveys and authors' calculations

Access to finance remains another binding impediment to firm expansion potential.

- On average, nearly half of African firms cite access to finance as a major concern.

- This appears to be a particularly significant constraint in many resource-dependent economies, such as Cameroon, the Democratic Republic of Congo, Côte d'Ivoire, and Nigeria.

[2] Asterisk indicates that the country is landlocked.

II. FOCUSING AGOA ELIGIBILITY CRITERIA ON COMPETITIVENESS CONSTRAINTS AND CORE US POLICY OBJECTIVES

The African Growth and Opportunity Act of 2000 was designed as a compact with African governments that incentivizes and promotes private sector-based development models.

- AGOA country eligibility rules were designed to incentivize and reward African governments that demonstrate a clear commitment to sound economic policy, trade and investment policy, good governance, democratic pluralism, and respect for human and labor rights.

- The breadth of AGOA's eligibility rules produced a true bipartisan compromise that has stood the test of time.

- Several of the requirements closely relate to firm-level constraints, as detailed above, that are hindering African nations' global competitiveness.

While Congress created these eligibility criteria equally, successive Administrations have implemented them in highly unequal ways, choosing to maintain AGOA benefits despite the lack of improvement or sharp deterioration in many countries.

- By illustration, business freedoms and property rights declined significantly in Chad and the Republic of Congo since 2005, without affecting their eligibility for AGOA benefits.[3]

- Moreover, contract enforcement has worsened in a number of other African countries, such as Angola, Burundi, and Zambia – without any trade preference implications.[4]

Instead, the revocation of AGOA eligibility has been driven primarily as a response to military coups, other unlawful seizures of power, or gross human rights violations.

- Historically, this has been applied to: the Central African Republic (2004), the Democratic Republic of Congo (2011), Côte d'Ivoire (2005), Eritrea (2004), Guinea (2009), Guinea-Bissau (2012), Madagascar (2009), Mali (2012), Mauritania (2006), and Niger (2009).

- Put differently, AGOA has been used as a freedom agenda tool, yet economic freedoms have been basically ignored. This is a strange practice given that AGOA is focused on expanding economic opportunity through private sector activity.

[3] Source: Heritage Foundation, *Economic Freedom Index*, various years.
[4] By illustration, the time required to enforce a contract in Angola increased from 1,011 days in 2003 to nearly 1,300 days in 2013.

Going forward, Congress should consider utilizing all policy tools to incentivize business environment improvements, including conditioning preferential access to the $17 trillion US economy on demonstrable progress. Establishing an operational AGOA criterion based upon business environment factors must balance several important considerations.

- First, it must be perceived as real, with annual determinations being made transparently and on the merits (e.g., politically independent). The methodology should be made public and use publicly available third-party data.

- Second, the underlying indicators should be responsive to government reforms and related capital investments on a timely basis. Undue time lags between effort and observed impact will lead to policy, political, and communication challenges – particularly with African countries and the general public.

- Third, the ultimate methodology should not lead to excessive volatility in countries' eligibility status, which would create significant uncertainty for local businesses and foreign investors. However, some reasonable degree of eligibility responsiveness will be necessary.

- Fourth, there should be an initial transition period, such as three years, that would allow African governments to consider and implement targeted reforms and investments. After this period, the US government would begin including business environment progress as a core eligibility criterion.

III. FOCUSING US TRADE CAPACITY ASSISTANCE ON COMPETITIVENESS CONSTRAINTS AND US POLICY OBJECTIVES

Decentralized programming both across and within US agencies has produced a lack of strategic focus at the regional and country levels.

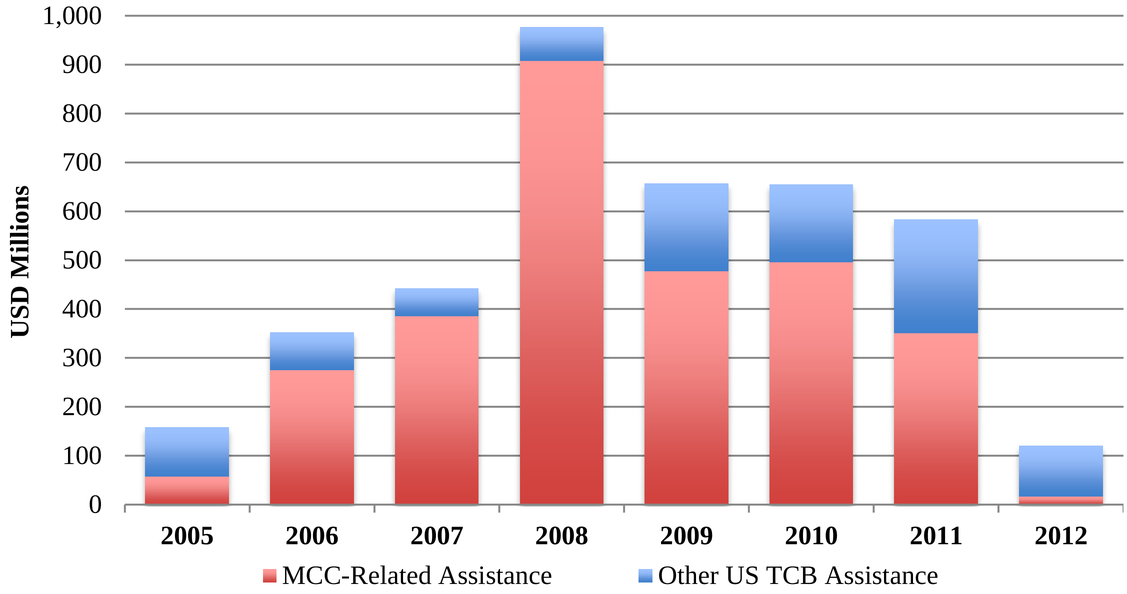
- US assistance efforts continue to lack a formal strategy and operational framework for determining trade capacity building (TCB) allocations across regions, countries, sectors, or themes.

Since 2005, the Millennium Challenge Corporation (MCC) has been the primary US trade capacity-building (TCB) vehicle.

- The MCC has provided nearly $3 billion in trade-related support to 12 African nations and has focused largely on port, transport, and power infrastructure. These compact programs have been well targeted at addressing African firms' most binding constraints.

- The MCC accounts for three-quarters of total US TCB assistance to Sub-Saharan Africa over the last eight years.

Figure 4 – US Trade Capacity-Building Assistance, 2005–2012



Source: US Agency for International Development (USAID) Trade Capacity Building database

USAID has provided a smaller share of US TCB assistance, with limited evaluations that rigorously examine program effectiveness.

- On average, USAID provided roughly $2 million per recipient country annually between 1999 and 2012.
- However, the duration of USAID's country-level activities has been mixed. In most countries, it was active only sporadically over time, which may have created uncertainty and instability in bilateral engagement and reform effectiveness.[5]
- Moreover, rigorous evaluation of USAID TCB assistance appears limited, or at least not available publicly. In comparison, MCC assistance is largely subject to evaluation, with results released to the public.

Beyond MCC and USAID funding, other US agency-level assistance has been sporadic and largely insignificant in absolute terms.

- On average, African countries or regional economic community (REC) secretariats have received support annually from two US government agencies totaling only $614,000 per agency.
- Individual US agencies often have provided funding to a respective country for only a single year. This sporadic engagement by non-core US agencies raises questions about the coordination of broader US TCB efforts.

[5] USAID-funded programs have been active for 3 years or less (out of 14 total) in 42 percent of examined countries, while 40 percent of the countries received USAID trade-related assistance for at least half of the 14 years included in the USAID Trade Capacity Building database.

US assistance for regional economic community (REC) secretariats has been modest, despite their central role in facilitating regional integration.

- RECs play an important facilitative role for harmonizing policies and regulations, reducing non-tariff barriers, liberalizing trade, and developing transport corridors.

- While USAID support for the East African Community (EAC) has been more robust, it has provided only token assistance to other RECs.

New US initiatives, such as Power Africa and Trade Africa, could represent a major step forward for targeting African firms' most binding constraints.

- Through Power Africa, the US government will partner with private companies, investors, and African governments to improve power generation and reliability for commercial and industrial consumers in six target countries.

- Through the little-known Trade Africa initiative, the US government aims to help: increase trade within East Africa and with the United States as well as reduce border crossing times and costs.

- Future MCC compacts will also likely deliver sizable electricity and transport investments in a limited set of countries.

Going forward, the Obama Administration should establish a centralized policy body, with appropriate budgetary authority, to focus and streamline US trade capacity building programs.

- This policymaking body should: (i) establish a guiding framework for determining region- and country-level TCB assistance allocations; and (ii) oversee budgetary submissions for final signoff with the Office of Management and Budget.

- Importantly, allocation decisions should be based upon a clearly delineated methodology that incorporates factors such as: competitiveness constraints analysis, market size, trade and investment potential, political will to implement reforms, and sector diversification opportunities.

- To improve country-level coordination, the US ambassador should approve all TCB-related activities *in the field*; particularly those conducted by non-core US agencies.

IV. UTILIZING BILATERAL INVESTMENT TREATIES AS A LOW-COST POLICY TOOL

Bilateral investment treaties (BITs) have long been low-cost policy tools for promoting investment, both amongst developed and developing countries.

- From a development perspective, BITs can encourage investment by providing foreign investors with core protections against political risk and uncertain business environments, such as expropriation, discriminatory treatment, or weak and partial legal systems.

- According to UNCTAD, there are now over 3200 investment agreements globally, including almost 300 involving African nations.

- Many African governments are negotiating BITs with their neighbors, such as Mauritius, which has signed or ratified agreements with 17 African countries since 2000.

The US has only six ratified BITs with Sub-Saharan African countries, covering a mere 7 percent of regional GDP.

- Existing agreements include: Cameroon, the Democratic Republic of Congo, Republic of Congo, Mozambique, Rwanda, and Senegal.

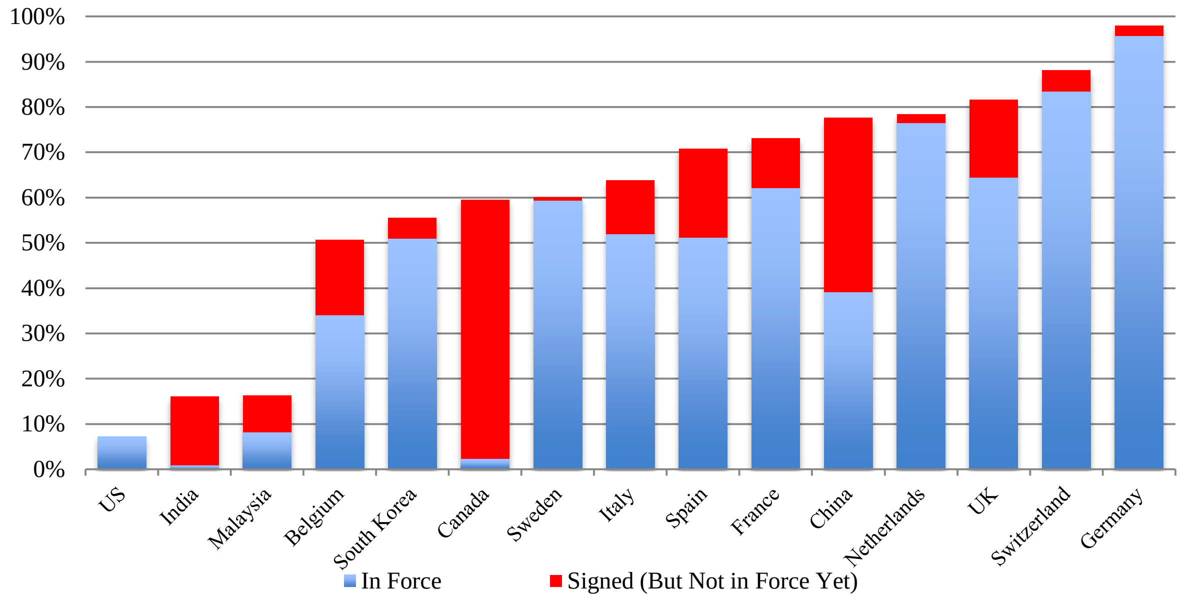
- Even including hoped for agreements with Mauritius and the East African Community, which the US has been negotiating for several years, regional coverage rates will remain extremely low at 16 percent.

Other capital-exporting countries, such as China and Canada, demonstrate that African governments are ready and willing to sign investment promotion agreements.

- China has signed investment treaties with 24 African countries, including 15 out of the largest 20 regional economies. Once all of these agreements are ratified, China will have legally binding agreements covering almost 80 percent of regional GDP.

- Canada has signed BITs with eight African countries in the last few years, including Nigeria. In addition, it has several more negotiations underway, such as with Ghana and Kenya.

Figure 5 – % of Regional GDP Covered by Investment Treaty, Select Countries



Source: UNCTAD, IMF WEO database

The new Model BIT might be too complex for many countries, despite its greater flexibility to accommodate public policy concerns.

- The new 42-page template now affords more government discretion than in the past. For example, it exempts governments' actions (except "in rare circumstances") to protect health, labor, and consumer safety from investors' protections against expropriation. This is one reason the text is now so complex.

- The US should consider ways to address these complexity challenges, perhaps through technical assistance.

Going forward, the US government should *stop* investing in ineffectual Trade and Investment Framework Agreements (TIFAs) and *start* investing in its BIT negotiating capacity.

- USTR's focus on TIFAs has distracted limited US government attention from pursuing real negotiations. While China, Canada, and other nations were signing legally binding treaties, the US has been signing non-binding TIFAs.

- It's time to stop allocating scarce resources to these inconsequential talk shops and move toward pursuing real agreements that catalyze much needed (and wanted) investment flows.

V. CONCLUSION AND RECOMMENDATIONS

Congress and the Obama Administration should utilize the AGOA reauthorization process to consider a number of policy and programmatic reforms to better incentivize, and support, improvements in African economies' business environment. Ultimately, all of these measures should target the most binding competitiveness constraints.

(1) Congress and the Obama Administration should consider utilizing all policy tools to incentivize business environment improvements, including conditioning preferential access to the $17 trillion US economy on demonstrable progress.

(2) Congress and the Obama Administration should establish a centralized policy body, with appropriate budgetary authority, to focus and streamline US trade capacity building programs.

(3) USTR should *stop* investing in ineffectual Trade and Investment Framework Agreements (TIFAs) and *start* investing in its Bilateral Investment Treaty (BIT) negotiating capacity.

(4) The US government, including USAID, should increase support for regional economic communities that are pursuing concerted efforts to support integration and harmonized policies.

(5) The US Congress should protect funding for the MCC, which has been the US government's leading trade capacity building assistance vehicle since its establishment.

(6) The US government should increase support – through the Overseas Private Investment Corporation, MCC, and multilateral development banks – for electricity and transport infrastructure investments.