

5. The African Growth and Opportunity Act: The Impact of Its Rules of Origin

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1. Introduction

On 18 May 2000, “The African Growth and Opportunity Act (AGOA)” was signed into American law. Subsequently, President Clinton issued a proclamation on 2 October 2000 designating 34 countries in Sub-Saharan Africa as eligible for the trade benefits of AGOA. On 18 January 2001, Swaziland was designated as the 35th AGOA eligible country and on 16 May 2002 Côte d’Ivoire was designated as the 36th AGOA eligible country. The U.S. Government has moreover announced that it will work with eligible countries to sustain their efforts to institute policy reforms, and with the remaining 12 Sub-Saharan African countries to help them achieve eligibility. AGOA has become a major plank of United States’ initiatives toward the African continent.

2. Requirements for eligibility

The Act authorizes the US President to designate countries as eligible to receive the benefits of AGOA if they are determined to have established, or are making continual progress toward establishing among others market-based economies; the rule of law and political pluralism; elimination of barriers to U.S. trade and investment; protection of intellectual property; efforts to combat corruption; policies to reduce poverty, increasing availability of health care and educational opportunities; protection of human rights and worker rights; and elimination of certain child labor practices.

The US, like other developed countries, has been providing preferential access to African countries under the Generalized System of preferences (GSP). There are two provisions in AGOA viz. GSP provisions and apparel provisions (discussed below). The eligibility criteria for GSP and AGOA substantially overlap, and countries must be GSP eligible in order to receive AGOA’s trade benefits, including both expanded GSP and the apparel provisions. Although GSP eligibility does not imply AGOA eligibility, 45 of the 48 Sub-Saharan African countries are currently GSP eligible.

3. Objectives of AGOA

The Act aims broadly at improving economic policy-making in Africa, enabling countries to embrace globalization, and securing durable political and economic stability. As an incentive for Africa to adopt the necessary policy reform, AGOA offers increased preferential access for African exports to the United States. In simple terms this means that African exports to the US from eligible countries would be free of tariffs and quotas provided the exports meet some criteria (to be explained in detail in the section on rules of origin). The Act moreover envisages the possible conversion of AGOA—which is essentially a one-way preferential arrangement (meaning only eligible African country exports into US get preference and not the reverse)—into reciprocal free trade areas (FTAs) where feasible with interested African countries (indeed negotiations have begun with the countries in the Southern African Customs Union).

4. AGOA'S Main Provisions

Broadly, the provisions under AGOA can be classified into two categories:

- (i) Generalized System of preferences (GSP) provisions
- (ii) Apparel provisions

GSP provisions

One part of AGOA relates to extension of the earlier preference which African countries (along with other developing countries) have been receiving under the Generalized System of Preferences. Prior to AGOA, 45 sub-Saharan African countries were granted preferential access to the U.S. market—essentially paying a zero tariff subject to certain conditions—for a range of exports under the GSP. In 2000, the GSP covered about US\$4 billion out of Africa's total exports of US\$23 billion. The margin of preference—the advantage faced by African exporters compared with other most-favored nation (MFN) suppliers—was about 5 percent (the average MFN tariff rate)¹. AGOA represents two advances over the GSP scheme.

- First, the existing preferential access enjoyed by sub-Saharan African (SSA) countries under the GSP scheme has been extended in time (till 2008); The GSP scheme would probably have been extended even without the AGOA initiative. Nevertheless, the early assurance of its continuation under AGOA provides real benefits because it helps create a more predictable environment for traders and investors.
- Second, it increases the range of products for which preferential access is granted to include:
 - petroleum products;
 - a range of other agricultural and industrial products.

¹ The percentage is as a percentage of the price or unit value of the product.

Apparel provisions

The Act provides for duty-free and quota-free (apparel imports have been subject to quota limits under the MFA arrangement²) access to the U.S. market without limits for apparel made in eligible Sub-Saharan African countries from U.S. fabric, yarn, and thread. It also provides for substantial growth of duty-free and quota-free apparel imports made from fabric produced in beneficiary countries in Sub-Saharan Africa. Under AGOA I, apparel imports made with regional (African) fabric and yarn are subject to a cap of 1.5% of overall U.S. apparel imports, growing to 3.5% of overall imports over an 8 year period. AGOA II, which was ratified recently, doubles the applicable percentages of the cap.

Under a special rule for Lesser Developed Beneficiary Countries (LDBC), those with a per capita GNP under \$1,500 in 1998 will enjoy duty-free access for apparel made from fabric originating anywhere in the world until 30 September 2004. The Presidential proclamation of 2 October 2000 designated 28 countries as eligible for the Special Rule, once they have met the additional requirements for the AGOA apparel provisions (these additional requirements are laid out in the section on rules of origin). Forty-two countries in sub-Saharan Africa fall below the specified GNP level and hence qualify as an LDBC under AGOA; another two countries—Botswana and Namibia—have recently been designated as LDBCs despite their high GNP levels under AGOA II. Thus, only the following four do not qualify for the special rule: Gabon, Mauritius, Seychelles, and South Africa.

5. Product Coverage under AGOA

Table 1 describes the coverage of the existing and future regimes for Africa and allows a disaggregated assessment of benefits. In terms of import coverage, whereas GSP covered about 17 percent of SSA's exports in 2000 (first unshaded panel in Table), AGOA would increase this fourfold to 72 percent. The really important *incremental* benefits (i.e. the products which did not receive preference under GSP but do receive preference under AGOA) provided by AGOA relate to the two non-petroleum categories in the lightly shaded panel in Table 1. The first comprises exports of apparel products and the second a whole range of non-apparel products, including footwear, agricultural products, watches etc.

² The Multi Fiber arrangement is a system under which countries including the US put a country specific quota on the amounts of apparel that can be imported. This quota could vary in time. It is important to note that in 2000, only 2 countries in SSA were formally subject to quotas: Mauritius and Kenya. And only Mauritius faced quotas (on about 25 percent of its exports) that could be considered binding.

Table 1

Category/ Import program	Number of tariff lines (8 digit HTS)	Average MFN ad-valorem rate ³	SSA Exports in 2000 (million US \$)	Main products
Current GSP: Extended Under AGOA				
Energy	10	1.5 %	3149	Energy and related products
Non-energy	2458 =A 1071 = A* 1630 = A+ Total = 5159 ⁴	5.0%	776	Agricultural products, machine tools, minerals, metals, yarns and fabric, and chemicals.
<i>Sub-Total GSP</i>	<i>6159 (48%)</i>		<i>3925 (17%)</i>	
AGOA: Incremental Coverage				
Energy	36	1.5%	15569	Energy and related products
Apparel	622	12.8% ⁵	816	Apparel products
Non-energy non-apparel	1780	9.4%	424	Agricultural products, minerals, plastics and metal products, articles of wood, watches and accessories, paper products, footwear
<i>Sub-Total AGOA</i>	<i>1783 (14%)</i>		<i>16809 (73%)</i>	
Exclusions from AGOA				
Duty between 0 and 5%	174	2.5%	14.5	Yarns, fabrics, agricultural products (tomatoes, mandarins, olives, grapefruit), watches, footwear, glass products
Duty greater than 5%	893	10.9%	25.4	Fibers, yarns, and other textile products
<i>Sub-total exclusions</i>	<i>893 (8%)</i>		<i>40 (0.2%)</i>	
Total	12750		23160	

³ Includes ad valorem tariffs or the ad valorem equivalent of specific tariffs wherever applicable.

⁴ A refers to GSP for all developing countries, A* to GSP for some countries and A+ to least developed countries.

⁵ This understates the true measure of protection because of the quotas on textile exporters under the MFA.

A number of items in the non-apparel category, are, however, subject to tariff rate quotas⁶, with out-of-quota tariffs (average and peak) being exceptionally high in many cases. Some of these items are of special export interest for Africa and include tobacco (350 percent), peanuts (164 percent), Brazilian nuts (132 percent), beef (26 percent) etc. It is difficult to estimate how binding the quotas are in reality i.e. whether they restrict exports to levels lower than the one that would be without the quota. The reason is that quotas might not be binding (i.e. exports are below the quota limit) for the simple reason that exporters would deliberately restrict their exports in order to not pay such high tariffs, which are imposed on the exports exceeding the quota⁷.

In both these apparel and non-petroleum non-apparel products, although current exports are low, *potential* benefits are large because average protection in the US is high: while the table shows that average tariffs on apparel are 13 percent, actual protection is considerably higher because of the quotas on exporters under the MFA⁸. If this protection were eliminated, exports could increase substantially. However, a key determinant of these benefits will be the rule of origin that African exporters will have to meet to qualify for the duty free treatment. The following sections examine in greater detail, how the rules of origin will affect the benefits flowing to African countries in the key apparel sector and how they qualify the generosity of AGOA.

Without doubt, apparel is the most talked about sector with respect to AGOA among policy makers and businesses alike. There are several reasons for this. Apparel traditionally is an industry where labour is the predominant input and labour in Africa as in most developing countries is the relatively cheap and abundant factor. (Mauritius and South Africa, with reasonably high wages, are notable exceptions in this regard). Second, some African countries like Mauritius and Madagascar already have a foothold in the US market and can begin to reap very quickly the fruits of preference.

6. The rules of origin under AGOA

The benefits of the incremental coverage under AGOA—the extension of access to apparel and other products—will hinge crucially on the rules of origin that African exporters will have to meet. These rules vary across these two categories of exports.

⁶ Products subject to tariff rate quotas are allowed duty free access to the US market as long as the total exports is less than a pre-specified quota limit. Exports beyond that limit face tariffs, which are usually exceptionally high.

⁷ In the estimates that we develop of the potential gains under AGOA, it has been assumed that they are not binding. Consequently our estimates are an overestimate of the benefits accruing to African nations owing to AGOA.

⁸ As in the literature we use the term protection for tariffs and/or quotas. The term protection is used to refer to the fact that tariffs, quotas and in general any trade barriers *protect* the domestic producers from competition from foreign producers.

Rules of origin for non-apparel exports

Under the GSP scheme, duty-free treatment is to be applied to any designated article that meets the requirements of the basic GSP origin and related rules. The key is a requirement of 35 percent value addition⁹ within the customs territory claiming preference. However, for non-apparel products eligible for duty-free access under AGOA, the 35 percent value added content can be met also by counting production or materials from other beneficiary countries or the United States. The rules of origin clauses are supplemented with implementation requirements. For example, an importer claiming duty-free treatment must make and maintain (for a period of five years from the date of entry) the records validating facts like proof of production, value addition, shipping papers etc.

Rules of origin for apparel exports

Before elaborating on the rules of origin, it is important to understand the stages in production of apparel. Broadly the production of apparel can be classified into three stages of transformation. In stage 1 yarn is converted into fibers (spinning), in stage 2, fiber is converted into a textile or a fabric (weaving) and then fabric is made into an apparel (assembly). Rules of origin relate to restrictions at different stages of production and the inputs used.

AGOA's provisions on rules of origin relating to apparel essentially require that apparel be assembled in eligible sub-Saharan African countries and that the yarn and fabric be made either in the United States or in African countries. It is important to note here that prior to the enactment of AGOA, African exporters predominantly imported yarn and fabric from outside Africa mainly from China and India. This reveals that the cheapest source of input were these countries. Hence, adhering to the AGOA rule of origin would make production costlier. Such stringent rules of origin do not apply to the least developed countries in Africa until 2004. The least developed countries in their grace period can obtain yarn and/or fabric from anywhere in the world but would need to do the assembly within the customs territory in order to receive preference. In addition a number of customs requirements need to be satisfied by both groups of countries. To receive the apparel and textile benefits of AGOA, a United States Trade Representative (USTR) chaired inter-agency committee must determine, inter alia, that countries have an effective visa system and enforcement procedures to prevent unlawful transshipment¹⁰ and the use of counterfeit documents.

⁹ Value addition roughly refers to the difference between the value of the final product and the raw materials used.

¹⁰ Transshipment refers to goods that are imported into a country and exported without any change to the final market, with the objective of this transaction being to benefit from advantageous tariff treatment.

7. Methodology for evaluating impact of AGOA on African exports

Mattoo, Roy, and Subramanian (2002) conducted a study to evaluate the potential impact of AGOA on the African exports, taking into account three things (i) the product coverage of AGOA illustrated in Table 1; (ii) margins of preference under AGOA; and (iii) rules of origin. The methodology in the study is based on obtaining the net margin of preference, which is obtained by subtracting the increase in cost of production owing to rules of origin from the tariff (or tariff equivalent of a quota¹¹), which constitutes the gross margin of preference.

The impact of preferences is essentially to increase the price received by exporters that are accorded preferential access. The extent of the increase in price is equal to the tariff that other, non-preferential exporters have to pay.

If there are strings attached to getting the preference such as restrictions on the inputs to be used, certain processes to be performed in the source country etc, then they too need to be accounted for as well. These restrictions i.e. the *rules of origin*, if effective, erode the margin of preference because in order to get duty-free entry exporters have to produce goods in a more expensive way. Hence the new price is not as high as it would be without the strings attached since a part of the higher price now goes toward meeting the higher costs. Combining the net margin of preference along with some estimate of how exporters would respond to the price increase that they enjoy (referred to as elasticity of export supply) yields estimates of the change in exports.

The study by Mattoo et al. (2002) places a lot of emphasis on the apparel sector as trade barriers are highest, and hence potential benefits the largest, in this sector. In quantifying the impact of the apparel provisions additional complications arise due to changes taking place in the external environment. Beginning 1 January 2005, WTO member countries, including the US, are required to eliminate all existing quotas on textile and apparel imports. There are only two African countries viz. Kenya and Mauritius where the quota actually bites in the sense that these countries have been restrained by quotas. In contrast, there are several efficient Asian suppliers to the US market most importantly China and India, which are severely quota constrained. This has helped the African suppliers who are relatively less efficient. First it has kept the price high in the US market and second it has let countries in Africa cater to the demand for apparel not satisfied by the Chinese and Indian (and others) suppliers owing to the quota.

Unless there is a major change in the efficiency of the African suppliers, the opening of the floodgates in 2005 will adversely affect the competitiveness

¹¹ Restriction of imports through either quota or a tariff raises the price in the US market. Hence one can find a tariff that would raise the price by the same amount as a given quota.

of the African apparel sector; in quantifying the economic impact of AGOA's apparel provisions this is an important consideration that has to be kept in mind.

One important breakpoint in the timing of benefits comes at the beginning of 2005 when under the WTO commitments, the United States is expected to fully withdraw the quotas imposed on the rest of the world producers of apparel. To the extent that countries like China and India which before 2005 would be quota constrained, this would be a big structural break in the flow of benefits. In the calculations listed below in section VI we indeed find that the impact of this change is likely to be substantial. In particular we estimate that with the rules of origin intact, removal of MFA quotas would wash even the marginal benefits which would otherwise accrue. In fact removal of MFA quotas on competitors of Africa would withdraw much more than AGOA possibly adds.

Given that the impact of removal of MFA quotas is likely to be substantial, African producers would be required to undertake some major changes in order to survive in the changed environment. Important changes that can be prescribed would be to reassess their comparative advantage within the apparel sector. This might require moving up the value added chain¹², producing high value luxury clothing, adoption of new technology (that compares unfavorably with countries like China) and in the long term if AGOA is extended to develop indigenous sources of yarn and fabric to cut costs¹³. Of course the underlying assumption in such a prescription is that overtime Africa can possibly develop some dynamic comparative advantages on the input side i.e. net of cost of transportation can produce inputs at costs comparable to the rest of the world.

8. Results from study

The important results from the Mattoo, Roy and Subramanian study are:

- AGOA will provide real opportunities to Africa. Even on conservative estimates about Africa's supply response, Africa's non-oil exports could be increased by about 8–11 percent. Most of this increase will be accounted for by the apparel sector, which is expected to grow by approximately 8.3%.
- AGOA's generosity has not been all encompassing for Africa: for about 1,067 tariff lines¹⁴ (1 percent of non-oil exports), preferential

¹² Mauritius is a good example in Africa which in order to overcome labor shortages (and hence rising labor costs) branched out into high value added apparel production in the EU market.

¹³ This is true since our calculations show that rules of origin are a substantial erosion of margin of preference which becomes even more critical post 2004.

¹⁴ Every item that gets imported is accorded a digit classification (known as a tariff line). The higher the number of digits, the more disaggregated the product is. A product like shirt for example would be accorded two digits while a shirt made with cotton three digits, and a shirt made with cotton with fibers less than 10 microns in diameter four digits and so on. The analysis by Mattoo et. al. is done at the eight-digit level.

access was not extended. For 893 of these lines preferential access could have been meaningful because of the high level of MFN tariffs.

- While AGOA has increased the scope for preferential access for African exports, this increase is important only for categories of products which have significant protection. These currently account for 5 percent of total exports and 23 percent of non-oil exports.
- Even for these categories, the real medium-term benefits depends upon the impact of the rules of origin requirements as described above; particularly in the apparel sector.
- The medium-term gains could have been much greater if AGOA had not imposed certain conditions and not excluded certain items from its coverage. The most important condition is the stringent rule-of-origin, i.e., the requirement that exporters source certain inputs from within Africa or the United States¹⁵. The estimates suggest that the absence of these conditions would have magnified the impact nearly five-fold, resulting in an overall increase in non-oil exports of US\$0.54 billion compared with the US\$100-US\$140 million increase that is expected in the presence of these restrictions.
- These restrictions, particularly on apparel, will come at a particularly inopportune time (for the least developed beneficiaries in particular), as Africa will be exposed to competition from other developing countries when the quotas maintained on the latter's exports under the Multi-Fiber Arrangement (MFA) are eliminated in 2005. Africa's apparel exports will be lower by over 30 percent with the dismantling of the MFA; if, on the other hand, AGOA had provided unrestricted access, the negative impact of the dismantling could be nearly fully offset. In case of a representative general beneficiary (like Mauritius) and a least developed beneficiary like Madagascar, our estimates suggest that in the most optimistic scenario, the growth in their exports would remain positive (18 percent and 6 percent respectively) only without the rules of origin. With rules of origin the impact on the exports in case of both set of countries would be to unambiguously reduce them. The most pessimistic scenario based on our calculations is that exports of the representative country like Mauritius would fall by as much as 65% while in case of a LDC beneficiary such as Madagascar by around 40%.

¹⁵ In the analysis calculations have been made under two different assumptions about the cheapest source for importing inputs in order to meet the rule of origin. In the first, the cheapest source was assumed to be South Africa because the data since 2000 indicated that this was the overwhelming choice by Mauritian and South African exporters facing rules of origin. Second, calculations were also made on the assumption that the United States was the cheapest source. However, the results were broadly similar under the two scenarios because the relative efficiency of the United States in producing inputs was offset by the larger transport costs of sourcing from the United States relative to South Africa.

9. Conclusions

As stated in the results above, AGOA will raise the level of non-oil exports by between 8 and 11 percent, depending on the restrictiveness of rules of origin in the non-apparel sector. This expected change can be compared to a notional benchmark—fully unrestricted access—which is the level that Africa's trade would have attained had the U.S. (i) not excluded any product from the scope of AGOA and (ii) not imposed stringent rules of origin requirements to qualify for the benefits under it. The estimates are that non-oil exports would have been higher by about 43 percent if unrestricted access had been provided. This means that AGOA as it is now will yield only 19-26 percent of the benefits that could have been provided if access had been unconditional. Nearly eighty percent of this shortfall is accounted for by the rules of origin requirements in the apparel sector, which will significantly reduce exports below SSA's full potential.

Looking at the projected estimates of the gains, there is the broader question of whether the magnitude of gains is significant. The increase in exports indeed represents a small fraction of these countries' GDP, but this is a direct consequence of the fact that SSA is marginalized from global trade in the first place. However, even though in aggregate the gains are small, the experience of individual countries such as Mauritius and Madagascar show that the trading opportunities provided by preferential access can be harnessed in a way that promotes long-run growth.

AGOA has not been in place for a long time but it is worth examining post-AGOA trade to see if any inferences can be drawn about its impact (See Table 2 below). Based on the notification of eligibility, AGOA provisions are now up to twelve months old for some sub-Saharan African countries. Knowledge about the implementation of AGOA has been publicly available since the beginning of 2000. The early trends could provide some indication of the changes in sub-Saharan Africa-U.S. trade owing to AGOA. There are a few striking features especially in the data on the apparel sector.

Apparel exports have recorded a substantial increase following AGOA: both in terms of values and quantities, exports in 2001 were about 27 percent higher than in 2000. What is striking however is that the most impressive gains have been recorded by the least developed beneficiary countries: as the table shows, Madagascar, Kenya, Swaziland, and Lesotho have recorded gains varying from 47 percent to 83 percent. In contrast, South Africa and especially Mauritius, have posted more modest growth. These results are consistent with the hypothesis that rules of origin are a restrictive clause in AGOA.

This differential performance could be due to a variety of factors. It is plausible that South Africa and especially Mauritius are running run up against capacity constraints especially with rising wage levels, whereas the least

developed countries are exploiting their cheap labor costs and attracting large amounts of new investment. A second reason could be that AGOA, for the period 2001–2004, changed the relative attractiveness of sourcing supply in the least developed countries compared with Mauritius and South Africa by imposing rules of origin requirements on the latter. A striking feature of the data is that a very small portion of total exports (9–14 percent) from South Africa and Mauritius have benefited from the tariff preference, whereas for the least developed countries not subject to the rule of origin requirement (till 2004) the corresponding share is close to 50 percent, highlighting the restrictive impact of the rules of-origin. Given the fact that the LBDCs will be subject to the same rules of origin in 2004, the above serves as a cautionary reminder about the likely effects for the poorer countries after 2004; in other words, export growth may be considerably muted for the LBDCs after 2004 as the rules of origin kick in.

It is interesting to compare the performance of SSA countries with those in the Caribbean, which have received preferential access similar to AGOA. Data for 2001 indicates that about 55 percent of the apparel exports of Caribbean countries benefited from preferential access compared with 9–14 percent for Mauritius and South Africa. One reason that Caribbean countries found it profitable to import yarn from the United States and avail themselves of the preferential access, a course that Mauritius and South Africa evidently found not to be profitable, appears to be the lower transport costs.

Although rules of origin have restrictive effects, mention should be made of their less unfavorable consequences. If there were literally no rule of origin, Africa could become a staging post for transshipping goods made abroad. In this case, there would be no value addition in, or economic engagement on the part of, the African beneficiaries. On the other hand, an onerous rule of origin that requires “too much” value addition in Africa could nullify completely the benefit of AGOA by making any such value addition unprofitable. It is quite possible that given time and a guaranteed market, weaving and spinning industries can be profitably established in Africa, but the question remains whether rules-of-origin are the right way of creating the incentives to do so.

The design of AGOA, with less onerous conditions for the least developed countries for a transitional period, also highlights an equity objective that the rule of origin aims to achieve. The design—tilting the incentives in favor of the poorer countries—seeks to ensure that within Africa the benefits of preferential access are not appropriated entirely by Mauritius and South Africa.

Table 2. Apparel Trade Under AGOA, 2000 and 2001

	Lesser Developed Beneficiary				Other		All
	Swaziland	Lesotho	Madagascar	Kenya	Mauritius	South Africa	
Exports (in US\$ million)							
2000	31.9	140.2	109.6	44	245	163.3	776
2001	48.0	214.8	178	64.5	238.3	194.9	975
Growth (in %)	50	53	62	47	-3	19	26
Of 2001 exports:							
Granted preference	8.2	129.2	92	51.6	38.8	30.4	350.4
(in % of total 2001 exports)	17	60	52	80	16	16	36
of which (in % of total granted preference):							
sourced from regional fabric	0	0	0	0	85	97	18
sourced from U.S. fabric	0	0	0	0	5	1	1
sourced from other foreign fabric	100	84	79	100	0	0	82

Source: OTEXA and authors' calculations