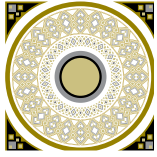

# Reflections on Kenya's Experience Under AGOA: Opportunities and Challenges

*Christopher Onyango and Moses Ikiara**

Kenya was among the first Sub-Saharan Africa countries to qualify for preferences under the Africa Growth and Opportunity Act. Undoubtedly, AGOA has played a positive role in Kenya's economic development. Apart from significantly increasing the country's exports, it has directly created more than 20,000 new jobs. Nonetheless, Kenya has not fully exploited the opportunities presented by the legislation. This paper reflects on Kenya's experience under AGOA thus far, examines the opportunities and challenges the legislation presents, and makes a number of recommendations for both Kenyan and U.S. policymakers to improve AGOA.

## Kenya's Experience

Kenya's bilateral trade with the United States increased fivefold between 2000 and 2010, from $163 million to $875 million. During this period, Kenya's exports to the U.S. expanded from a paltry $36 million to $284 million, with the highest growth from 2003 to 2005. More than 90 percent of the exports from Kenya to the U.S. have benefited from AGOA and the Generalized System of Preferences.

The bulk of Kenya's exports under AGOA are in the textile and apparel sector, comprising more than 94 percent of total exports in 2009. Among AGOA-eligible countries, Kenya is the second-largest exporter of these products to the U.S., and it has a market share of 23.2 percent. The sector has also been prominent in the economic life of Kenya's export-processing zones (EPZs). Although the sector constitutes only 25 percent of the enterprises located in the EPZs, it generates more than 90 percent of Kenya's apparel exports under AGOA and contributes 85 percent of the jobs created in the zones.

The declining trend of exports under AGOA in Kenya is replicated in other African AGOA beneficiary countries and has been mainly attributed to the end of the Multi Fibre Arrangement (MFA). Under the MFA, the U.S. and Europe restricted the volume of garment and textile imports from developing countries. As a result, AGOA gave a significant advantage to countries in Sub-Saharan Africa. With the expiration of the MFA, African exports have come under increasing pressure, and the region's share of U.S. textile imports fell by 21.9 percent and 18.9 percent in 2007 and 2008, respectively. Meanwhile, during the same period, Asia's share of these exports increased.

## Opportunities and Challenges

Although AGOA has given its beneficiary countries unprecedented access to the U.S. market, the opportunities presented by the legislation have not been utilized to their fullest potential, and likewise the challenges it poses have not been overcome. These opportunities and challenges include the development of value chains, diversification, high transportation costs to the U.S. market, the persis-

tence of nontariff barriers, the high cost of doing business, uncertainty about the future of AGOA, limited credit facilities, and the potential erosion of preferences. It is useful to outline each one.

*The development of value chains*. AGOA and existing regional integration structures (i.e., the East African Community and the Common Market for Eastern and Southern Africa) present the opportunity for the development of regional value chains of many products, including textiles and clothing. This is because AGOA's rules of origin allow a beneficiary country to source raw materials and inputs from other beneficiary countries. Production sharing among members of existing regional trading agreements provides opportunities for supporting both regional investments in trade as well supply to the U.S. market.

Although the textile rules of origin were ostensibly put in place to encourage vertical integration of the textile and clothing industry in Africa, little of this has taken place. For instance, while Kenya's textile firms have successfully used AGOA export window, this growth sharply contrasts with performance at lower levels of the value chain, where cotton production is barely 10 percent of demand. Further, there is limited or low regional trade in intermediate goods and components; hence, more than 90 percent of textile export products use non-originating raw materials.

*Diversification*. AGOA has also had a limited impact on Kenya's agricultural sector. Nonetheless, the share of its products under AGOA increased from 1.4 percent in 2007 to 4.6 percent in 2009. Yet the sector has immense potential to reduce poverty and create jobs in both Kenya and on the whole continent. Increased agricultural exports under AGOA could help to diversify Kenya's exports and boost production capacity in the sector.

*High transportation costs to the U.S. market*. The long physical distance between Kenya and the U.S. translates into high transportation costs and thus weak price competitiveness of products in the U.S. market. This problem is compounded by the absence of direct air freight services and limitations associated with sea transportation. The cost of air freight is high, while sea freight takes about 28 to 30 days to ship goods from Mombassa to the U.S. This time period is long, especially for perishable products.

*The persistence of nontariff barriers*. Under AGOA, the product approval process is long and cumbersome. Moreover, AGOA health and safety standards are very strict. Often, AGOA-eligible countries do not have mechanisms to adequately address these issues.

*The high cost of doing business*. A number of factors contribute to the high cost of doing business: poor physical infrastructure; high electricity tariffs; and expensive inputs like imported fertilizers, machinery and packaging materials, which are not readily available locally.

*Uncertainty about the future of AGOA*. Uncertainty regarding the future of AGOA—it is set to expire in 2015—makes it difficult to guarantee a secure market for trade and investment. Along the same lines, the potential removal of a country from its AGOA-beneficiary status can be a significant disincentive for a company considering moving its operations to Africa. Uncertainty about the extension of the Third-Country Fabric Provision, set to expire in 2012, presents a challenge for investors in Kenya.

*Limited credit facilities*. The lack of adequate export credit facilities for micro, small and medium-sized enterprises hinders these businesses from exploiting AGOA opportunities. Indeed, these enterprises require funds to cope with domestic supply or production constraints, to meet the cost of exporting to the U.S. and to conform to U.S. market requirements.

*The potential erosion of preferences*. There have been proposals for the U.S. to extend the trade benefits currently available to AGOA-beneficiary countries to developing countries outside Africa. This would erode the preference margins that

Kenya and many other African countries currently enjoy. Many of the countries that would receive these benefits, such as Bangladesh and Cambodia, have significantly higher levels of trade with the U.S. than do the majority of Sub-Saharan African countries.

## Policy Recommendations for the Kenyan Government

To enable Kenya to better take advantage of AGOA, while meeting the challenges and seizing the particular opportunities described above, we offer the following policy recommendations for the Kenyan government:

*Negotiate a bilateral agreement for air freight transportation.* Direct flights into the U.S. from Kenya would significantly reduce the transportation costs faced by exporters. The Kenyan government should work with the private sector to create the appropriate environment to encourage couriers to operate this route. This may also require offering incentives for air freight couriers to establish the route. Direct air freight routes between Kenya and Europe have helped to increase the volume of perishable goods exported from Kenya.

*Identification and prioritization of export products.* Kenya should consider setting up a task force to identify products for which the country has a comparative advantage in producing and to diversify its export base. South Africa has diversified its exports to include agricultural products, chemicals, minerals, machineries and energy-related products; Kenya may be able to learn from its experience. Targeted incentives could be considered to nudge exporters toward producing new products.

*Enhancing competitiveness.* A number of measures should be implemented to reduce transaction costs and increase productivity. Among the key issues are infrastructure development, better transportation systems, trade facilitation and worker training. Additionally, exporters require capacity building in the areas of market research, product development and supply chain management. U.S. development assistance should target these and similar constraints.

*Building domestic and regional supply chains.* Measures such as conditional incentives for exporters that procure raw materials and intermediate inputs from beneficiary countries in key regional economic communities should be considered. As a regional and continental leader, Kenya should aggressively pursue the growth of intraregional and intra-continental trade and the development of regional supply chains, as platforms for strengthening international export competitiveness.

*Addressing AGOA's uncertainty.* Kenya and other African governments should negotiate with the U.S. to make AGOA more long term, predictable and transparent. These outcomes are important for encouraging strategic and sustainable planning and investment.

## Policy Recommendations for the U.S. Government

To enable the United States to better implement and administer AGOA vis-à-vis Kenya, we offer the following policy recommendations for the U.S. government:

*Extend the third-party fabric arrangement and simplify product eligibility requirements.* The U.S. should simplify existing rules of origin and extend the third-party fabric requirement. Suspension of this rule could adversely affect the production and exportation of textiles and apparel.

There is a need to further simplify existing rules of origin and extend the third-party fabric requirement, taking into account the fact that the envisaged vertical integration of the cotton value chain has not taken root in Kenya. Suspension of the rule could adversely affect the production and exporting of textiles and apparel because exporters would relocate to other more competitive countries and regions. Furthermore, enforcement of stringent standard requirements—including residue levels of pesticides, sanitary and phytosanitary

standards, traceability, social accountability and environmental safety—discourage export diversification into other sectors, such as agroprocessing, where Kenya has a competitive advantage. This issue could be revisited to ease any requirements that do not threaten health and safety standards.

*Development assistance.* U.S. development assistance should target AGOA-related constraints, including infrastructure development, trade logistics and value chain development in order to promote production capacities, diversification and greater program utilization. In particular, the U.S. could provide technical assistance to strengthen and develop domestic and regional supply chains.

*Maintenance of preference margins.* The envisaged extension of preferences to non-AGOA beneficiaries would seriously undermine the gains already made by Kenya, especially in the textile and apparel sector. The U.S. should consider improving country-level support to ensure that such local industries are not adversely affected. Moreover, the rationale behind the initial limitation of AGOA to eligible African countries should not be forgotten as the program is being extended to other beneficiaries. Thus, giving extra preferences or support to the original targeted countries could be explored.
*Addressing uncertainties.* The benefits the Kenya has received under AGOA should be enhanced and sustained with a longer-term view. Depending on the industry, it can take years for a business to recoup its initial investment and start to make a profit. Therefore, it is important for AGOA to maintain a longer time frame that will allow investors to invest in Africa and begin to reap gains from those investments.

* *Kenya Institute for Public Policy Research & Analysis (KIPPRA-Kenya)*