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Uganda: Responding to the US threat to remove AGOA preferences

In brief

- The second-hand clothing ban in the East African Community (EAC) is a policy aimed at spurring the development of the local EAC apparel industry. However, the US government has threatened to remove trade preferences that are provided to EAC countries if they do not reverse the tariff increases on second-hand clothing imports.
- Kenya decided to unilaterally revert to the pre-2016 tariffs which poses a challenge for the collective EAC position.
- This brief evaluates the options available to Uganda and the potential impacts of reverting to pre-2016 tariffs and not rescinding the ban on second-hand clothing.
- The researchers conclude that Uganda has little to gain but much potentially to lose by proceeding with their increased tariffs and eventual second-hand clothing import ban due to the strong incentives for apparel firms to relocate to Kenya.
- The researchers recommend that Uganda and other EAC countries follow the lead of Kenya in dealing with the US as this would allow time for member countries to agree a medium-term strategy for developing the apparel industry while maintaining preferential access to US markets.

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Background to the current situation

Uganda, Kenya, and Tanzania agreed on a joint Common External Tariff (CET) in 2005 in an important step towards the integration of the markets of the East African Community (EAC). Rwanda (and Burundi) joined the CET of the EAC in 2009. Typically, a common external tariff is part of a customs union, which allows for the free flow of goods between countries without restriction, and a further step towards full integration in a common market that allows for the free movement of labour and other services between countries.

Africa has been a beacon of cooperation in the recent geo-political landscape. While populist parties and leaders have led to the US' withdrawal from the Trans-Pacific Partnership, and the UK's announced withdrawal from the European Union, African countries have chosen to continue on the path towards the greater integration of the African market. This has been clear with negotiations of deeper integration within regional trade areas, including the EAC, as well as with the negotiation of the Tripartite Free Trade Area, and initial discussions on the Continental Free Trade Area.

Within the EAC, the countries have jointly negotiated the tariff levels for all goods entering the EAC region from outside of the region. The result has involved classification of all goods entering the EAC region into one of three tariff bands (0%, 10%, or 25%), or classification as Sensitive Items (SI), which are allowed to have much higher tariff rates. The application of these tariff levels has been uniformly consistent. In cases where countries have wished to be exempt, for a period, from the CET tariff levels, the EAC country has applied for, and received, special permission from the EAC Council of Ministers, before applying a tariff rate that differs from that of the CET.

One of the goods on the Sensitive Items (SI) list is second-hand clothing, discarded mainly from high-income countries. Recently, it was decided jointly by the EAC countries to ban second-hand clothing imports, beginning in 2019. This joint action was consistent with the, by necessity, joint nature of trade policy making by the member countries of the EAC.

This progress towards cooperation within the EAC took a step backwards in May, 2017 when Kenya, under threat of losing preferential access to the US market through African Growth and Opportunity Act (AGOA), unilaterally chose to revert to the tariff prevailing in 2015-16. This decision by Kenya has placed Uganda as well as Rwanda and Tanzania in a difficult situation, and the purpose of this paper is to put forward considerations that might shape the government's response in light of this situation.

EAC context: Collective decision-making

When one member country of a regional trade agreement unilaterally changes import tariffs (or bans) on goods coming into the country without the full consideration of the EAC Council of Ministers, it undermines collective decision-making in the EAC. Uganda and the other members might legitimately raise Kenya's unilateral policy toward the second-hand import ban at subsequent meetings of the Council of Ministers, and discuss ways to promote more effective collective positions towards external trading partners in the future.

Evaluating the credibility of the threat

Aside from the intra-EAC international political considerations mentioned above, Uganda and Rwanda need to determine how to respond to the current situation. The first step is to consider whether or not the US threat of removal of AGOA preferences is credible. Clearly, Kenya believes that the threat is credible. Otherwise, it would not have decided to reduce its tariffs.

To evaluate the credibility of the US threat, historical context on two dimensions is in order. First, what has led the US in the past to remove AGOA preferences? The following is a complete list of the instances in which African countries have been removed from the list of countries eligible for AGOA trade preferences.

In short, in all of the cases above where AGOA access has been removed by the US, the reason has been explicitly or implicitly related to lack of democracy and/or lack of human rights. In no case to date has the US removed AGOA access over a country's trade policy. Indeed, there appears to be a double standard in how AGOA eligibility is applied. The Southern African Customs Union (SACU) countries (South Africa, Namibia, Botswana, Lesotho, and Swaziland) require import licenses for second hand clothing, which are available only on humanitarian grounds. The SACU region thus imposes a near complete ban on the importation of second hand clothing, but this has never been considered reason for removing AGOA eligibility. What is even more surprising is that this is not a large US industry at stake—the US exports of second-hand clothing to the entire EAC was less than $30 million, which is a truly trivial number in the US context. The threat is, therefore, highly unusual.

Still, despite this overall context, the current US administration under President Donald Trump is less predictable than previous administrations. For this reason alone, the threat should be seen as credible. Uganda should expect that the US will block AGOA access should the tariff increases remain in place. President Trump has made it clear that he is not interested in making explicit effort to advance the interests of other nations, including developing nations. President Trump has also made clear that he would like to be perceived as protecting "America's interests", even if those interests are a relatively tiny fraction of the US economy.

Country	AGOA removal period	Explicit or likely reason
Democratic Republic of the Congo (DRC)	Jan. 1, 2011 – present	Insufficient progress in the area of human rights[1]
Cote d'Ivoire	Jan 1, 2005 – Oct, 2011	Failure of a peace agreement, and the failure to hold elections
Mauritania	Jan. 1, 2006 – December 22, 2009	Military coup
Guinea	December 23, 2009 – October ,2011	Military coup
Madagascar	December 23, 2009 – October, 2011	Coup d'état[2]
Niger	December 23, 2009 – June 26, 2014	The dissolution of parliament and presidential refUSl to follow the orders of a constitutional court.
Mali	December 20, 2012 – Jan. 1, 2014	Military coup
Guinea-Bissau	December 20, 2012 – present	Military coup
Swaziland	January 1, 2015 – present	Problems with "protection of internationally recognised worker rights"[3]
The Gambia	January 1, 2015 – present	Human rights abuses and political instability[4]
South Sudan	January 1, 2015 – present	Human rights abuses and political instability [5]
Burundi	2015 -	Human rights abuses and political instability

1. See news article entitled "DR Congo opposed to removal from US AGOA list", 23 December 2010, downloaded on October 10, 2017 from https://agoa.info/news/article/4680-dr-congo-opposed-to-removal-from-us-agoa-list.html.
2. Reason for the AGOA removal listed at the USTR website, downloaded on October 8, 2017 from: https://ustr.gov/about-us/policy-offices/press-office/press-releases/2014/June/President-Obama-removes-Swaziland-reinstates-Madagascar-for-AGOA-Benefits
3. Reason for the AGOA removal listed at the USTR website, downloaded on October 8, 2017 from: https://ustr.gov/about-us/policy-offices/press-office/press-releases/2014/June/PresidentThe -Obama-removes-Swaziland-reinstates-Madagascar-for-AGOA-Benefits
4. Reason for the AGOA removal according to the International Centre for Trade and Sustainable Development (ICTSD), downloaded on October 8, 2017 from: https://www.ictsd.org/bridges-news/bridges-africa/news/united-states-removes-three-countries-from-agoa
5. Reason for the AGOA removal according to the International Centre for Trade and Sustainable Development (ICTSD), downloaded on October 8, 2017 from: https://www.ictsd.org/bridges-news/bridges-africa/news/united-states-removes-three-countries-from-agoa

Potential responses and likely outcomes

Therefore, the current choice facing Uganda (as well as Rwanda and Tanzania) is relatively clear. If they continue with the second-hand clothing ban, then they will lose AGOA access. If they do not reverse the tariff increases, they will lose AGOA access for this industry. Reversing the tariff increases is essentially a status quo option.
Whether Uganda and Rwanda make the same decision regarding the second-hand clothing tariff is not of material consequence for the outcome. If Uganda and Rwanda both rescind the tariff increase and announce they do not plan a ban, they will join Kenya in this reversal. Although Tanzania's final position is uncertain, it is understood it is likely to offer a tariff of 35% which is reverting to a key element of the pre-2016 tariffs (albeit not the 0.25c/kg amount) and this may be enough for the US administration.

In either case, what matters, as will be clear below, is that at least one country in the EAC, Kenya will have rescinded the ban.

Let us first analyse the option of reducing the tariffs, since the core analysis of it is simpler.

Case 1: Uganda reduces their tariffs to pre-2016 levels

This outcome comes closest to retaining the status quo for Uganda. In this case, Uganda maintains AGOA access to the US market. The overall importance of that is illustrated in Box 1. This shows that through duty-free market access, AGOA has facilitated considerable and growing exports for Uganda in a variety of emerging markets (both garments and other). It also shows that AGOA is contributing to an increasing share of exports to the US, amounting to $24 million in 2016.

However, second-hand clothing continues to be imported. The domestic apparel sector is not accorded the assumed special protection that it would receive with the banning of second-hand clothing imports. If one of the other EAC countries (e.g. Tanzania) continues with the higher-tariffs on second-hand clothing, there may be concern that second-hand clothing would in future be smuggled from Uganda/Rwanda to Tanzania, but that would be of greater concern for Tanzania. At the same time, Tanzania could not fault Uganda or other EAC members for reversing their policies, since this policy shift was clearly instigated by Kenya.

Case 2: Uganda does not rescind the second-hand clothing ban

In principle, if all of the EAC countries were jointly implementing a tariff increase and eventual ban, the trade-off would be between maintaining AGOA access on the one hand and the protection of the apparel sector on the other hand. However, with Kenya's decision to revert to pre-2016 tariff levels, the aforementioned trade-off has now vanished. The first part of the trade-off holds: Uganda will lose AGOA access. Unfortunately, the second part of the trade-off does not apply, as this action cannot be expected to benefit the domestic apparel industry.

The reason is as follows. Under the Case 2 scenario, firms that choose to locate in Kenya will continue to be able to service the US market through AGOA preferences. These Kenyan-based firms will also be able to service the EAC market through Kenya's membership in the EAC. As a result, there is very little incentive for new firms to set up in Uganda (or Rwanda for that matter), and there may well be sufficient incentive for firms to leave Uganda for Kenya to take advantage of the continued AGOA access in Kenya. With the AGOA access "tilting the playing field" in Kenya's favour, it would be a challenge to avoid smuggling of second-hand clothes coming into Uganda (and Rwanda) from Kenya. Indeed, the recent increase in Uganda's tariffs has already strongly increased the incidence of smuggled goods, with a discovery of 80 tonnes smuggled into the country between March and May 2017 alone.6 Hence, any potential protection offered by the second-hand clothing ban to the Ugandan apparel industry is strongly undermined by Kenya's decision to rescind the ban.

Therefore, in the Case 2 scenario, we cannot expect the growth and development of the Ugandan apparel industry. It might happen, but it is quite unlikely. However, what is virtually certain is the consequence of the removal of AGOA preferences. Current and future AGOA exports in all sectors where they currently occur would be lost. AGOA has had a considerable impact on exports from Africa (Frazer and Van Biesebroeck, 2010). Uganda (and Rwanda) would very likely lose their current exports, as in most cases the AGOA preferences have been central to the African export expansion.

While the second-hand clothing ban aims to develop the domestic apparel sector, and while there is some evidence that such a ban might have been effective in this goal during the period 1981-2000 (Frazer, 2008), this logic does not apply when Kenya is allowed to service that same market while maintaining AGOA preferences. Moreover, the final goal of development is not to serve the domestic market, but to serve the export market. Each of the newly industrialised countries that have risen up the rungs of

6. See the New Times, May 30 2017 "Authorities seize 80 tonnes of smuggled second-hand clothes" http://www.newtimes.co.rw/section/read/213375/

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the manufacturing ladder in the process of their development (Korea, Taiwan, China) have achieved this through apparel exports, not solely through apparel production for the domestic market. Therefore, exports are definitely the long-term goal, even if this goal might be facilitated by temporary protection of the domestic apparel sector for the purpose of birthing a domestic industry. However, even if that logic of domestic production were to apply in this case (and Kenya's decision ensures that it does not apply), it does not make sense to cut Uganda (or Rwanda) off from the massive potential of the US export market, when the long-term goal is, in fact, access to that market (and other industrialised country markets). Box 2 illustrates the extent to which Uganda's export opportunities are tailored to the US, which provides by far the biggest potential in terms of textiles. Similarly, Box 2 shows that the overall potential of exports to the US far exceed any type of opportunities within the EAC (both with and without Kenya).

Conclusions

Under the circumstances, it seems the best policy option for Uganda and other EAC countries would be to follow the lead of Kenya in its dealings with the US, and agree to revert back to the pre-2016 tariff levels agreed between the Office of the US Trade Representative (USTR) and Kenya. This would allow time for the EAC members to discuss fully a medium term strategy to developing the industry while maintaining preferential access to the US apparel market. Such a discussion could be based on careful analytical underpinnings that would weigh any consequences -- for job creation, investments and exports -- of protecting the domestic apparel market compared with losses of preferential access to the US market.

References

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