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FDI, AGOA and Manufactured Exports by a Landlocked, Least Developed African Economy: Lesotho

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Abstract

Lesotho, a resource-poor country located inside South Africa, is now Africa's largest exporter of apparel to the US. Its performance, very unusual for Africa, relies heavily on Asian investors and trade privileges. This article traces the origins of FDI in Lesotho and the determinants of its export competitiveness, showing that apparel production suffers from low productivity, poor skills and weak local links. Its prospects after AGOA (the African Growth and Opportunities Act) remain uncertain unless the government addresses these structural problems. Lesotho holds important lessons for industrial development in Africa, going beyond creating a good investment environment.

Notes

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†This paper was accepted for publication before Sanjaya Lall's untimely death in June 2005. In addition to his well-known contributions to development studies, Sanjaya was a valuable resource for The Journal of Development Studies as a conscientious and insightful referee. He will be sorely missed by friends and colleagues.

This article draws upon the author's contribution to a World Bank Integrated Framework Study and an Investment Policy Review of Lesotho by UNCTAD, both in 2002. The author wishes to thank these institutions, the members of their teams working on Lesotho and those in Lesotho who provided information, insights and comments. The author also thanks Andy Salm in particular for sharing his knowledge of apparel in the region, and is grateful to John Thoburn, University of East Anglia, and an anonymous referee for valuable comments. The author alone is responsible for the views expressed here.

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The water is piped directly to South Africa from a new dam in its highlands (Lesotho cannot access this pipeline even though Maseru, its capital, is facing growing water shortages). The Lesotho Highlands Water Project, financed by South Africa and now nearly complete, is the largest infrastructure project ever undertaken in the country. It accounted for about half of capital formation there for about a decade, and its completion has led to a large fall in total investment.

Calculated from data provided by the Lesotho Bureau of Statistics [[2004](#)]. The manufacturing production index on this website only goes back to 1997.

Its earlier growth was also due to trade privileges under the MFA and the Lomé Convention, described later. For a full analysis of AGOA provisions see AGOA [[2003](#)].

The AGOA definition is different from that of 'LDCs' in the UN and covers more countries. The AGOA definition includes as Lesser Developed Beneficiary Countries 42 countries (Africa apart from Botswana, Equatorial Guinea, Gabon, Mauritius, Namibia, Seychelles and South Africa). The definition was later broadened to include Botswana and Namibia. See the AGOA website at http://www.agoa.gov/eligibility/apparel_eligibility.html.

However, the US Congress is currently (May, 2004) considering the extension of AGOA from 2008 to 2015, and the extension of third country fabric sourcing (below) from 2004 to 2007 [[Ilungole, 2004](#)].

Garment manufacture is of the simplest variety, using imported fabrics to sew products to buyers' designs the lowest quality segments [[Salm et al. 2002](#)]. According to [US ITC \(2004\)](#), 'production consists almost entirely of basic trousers, particularly denim blue jeans, and knit tops such as T-shirts'. (K-13). In 2001, total capacity was estimated at 21 million pairs of trousers and 35 million knitted shirts.

Apart from the garment plants, there are three South African companies in footwear and four South African electrical/electronic firms, all assembling components aimed at their home market. There are four food-processing firms (two South African, one US and one Chinese). Finally, there is an assortment of six foreign owned plastic, umbrella and other manufacturing firms.

There are two main reasons why Lesotho cannot hope to establish a large 'maquila' sector. South Africa is suffering from massive unemployment and some 'homelands' offer lower wages than Lesotho. More importantly, labour-intensive industries in South Africa are finding it difficult to overcome Asian competition and many are closing down. Roberts and Thoburn [[2003](#), [2004](#)] find that between 1996 and 2001, employment in the textile segment declined by 45 per cent and in the apparel segment by 20 per cent. Several firms raised exports, but as a defensive rather than offensive measure, largely to utilise capacity. Only a few undertook productivity raising measures that would ensure sustained growth in open markets.

The interviews conducted by the author, covering most foreign investors in Lesotho, suggested that investors were generally satisfied with the legal and regulatory regime and with the low levels of corruption and bureaucratic obstruction. Their only complaints related to delays in getting visas and work permits for expatriates.

The 'Starting-a-Business' indicator has five components: number of procedures, time, cost in dollars, cost as percentage of per capita income and minimum capital requirements as a percentage of per capita income. Countries that do worse in terms of time taken include large FDI recipients like Brazil, Botswana, Indonesia, Spain and Venezuela [World Bank, [2004](#) b].

The four indices here are 'flexibility of hiring', 'conditions of employment', 'flexibility of firing', and 'employment laws'. Countries with worst scores in flexibility of hiring include Argentina, Brazil, Finland, France, Germany, Indonesia, Italy, Mexico, Pakistan, Portugal, Spain, Taiwan, Thailand and Venezuela.

UNCTAD [[2003](#)] commends Lesotho's labour policy and administration as a model for other countries.

Data from Central Bank of Lesotho [[2002](#)] converted at current exchange rates.

However, it is impossible to calculate Lesotho's share in AGOA textile and apparel imports by the US because the totals for the leading five African exporters add up to over 100 per cent of the totals shown in the US ITC data for 2001-2003 (reaching 254 per cent in 2001, 126 per cent in 2002 and 110 per cent in 2003). I therefore use total textile and apparel imports by the US in these years to derive export market shares.

Mexican and Caribbean firms had additional privileges in the US under NAFTA and the Caribbean Basin Initiative.

Mattoo et al. [[2003](#)] note that 48 African countries had preferential access to the US market before AGOA, paying zero tariff for specified products under the Generalised System of Preferences, GSP, giving them a 5 per cent average advantage over other regions. AGOA provided two additional benefits. First, it extended African GSP privileges over time. Second, it increased the coverage to include petroleum products, apparel (previously subject to MFA, with quotas and tariffs) and some other agricultural and industrial products. While GSP covered 17 per cent of African exports in 2000, AGOA increased the coverage to 72 per cent. Apparel was a much larger beneficiary than petroleum, which, while much larger in value, only faced a 1.5 per cent tariff earlier, compared to an average of 13 per cent on apparel. In fact, of the 2,632 tariff lines on which AGOA has given additional privileges to Africa, those with significant protection account for only 23 per cent of non-oil exports by value.

AGOA is intended to promote use of US inputs, expensive as they are. Apparel made with African fabric and yarn is subject to a cap of 1.5 per cent of US imports, growing to 3.5 per cent by 2008. A recent law has further raised the cap to 7 per cent, while apparel made with US yarn and fabric is not capped. The cap on African inputs is, however, unlikely to constrain exports, since the values below the cap are very large (\$4.2 billion with the 3.5 per cent cap and \$7 billion with the 7 per cent cap), compared to present exports (\$514 million in 2002). In 2001, China exported \$36 billion of clothing. According to Gherzi, a leading Swiss textile consultant, the share of China and India in clothing exports will rise from 22 per cent in 2001 to 33 per cent by 2006. See page 6 of Gherzi [[2003](#)].

Textile firms in South Africa are highly protected by common SACU tariffs and the extensive use of anti-dumping measures by the South African government [[Roberts and Thoburn, 2004](#) ; [World Bank, 2003](#)]. This may hold back the speed of its upgrading.

This is based on information provided by apparel producers in Lesotho and by Salm et al. [[2002](#)]. It is supported by Mattoo et al. [[2003](#)].

I am grateful to the journal referee for this valuable insight.

According to Salm et al. [[2002](#) : 41], 'Of the workers interviewed for this survey 66 per cent were either very negative or quite negative towards the company they work for, while only 18 per cent were positive or very positive. These perceptions are so bad as to be considered dangerous and a serious threat to the established industry and a constraint on its future development and growth'.

There was a riot in 1998 that caused considerable damage to Chinese property and some loss of life, leaving a legacy of insecurity in the Chinese community.

One firm was up by a local employee to subcontract sewing operations, but ran into serious difficulties; at the time of the survey it was about to close down.

These comparisons are at exchange rates ruling at the time (10 Maloti to the dollar). The South African Rand (to which the Maloti is tied) has risen by nearly 20 per cent since then (it is now at 11.8 per dollar). At this rate, wages in Lesotho are more or less on par with large Asian countries. Cost comparisons by Gherzi [[2003](#)] show that textile wages in China range from US\$ 0.44 per hour to \$0.76, with an average of \$0.57; for India the figures are \$0.28-0.60, with an average of \$0.50. In Lesotho the range is around \$0.38-0.50 for sewing machine operators. Note that the textile industry is more

capital and skill intensive than the apparel industry, so the data for China and India may overstate wages in the latter.

The US ITC [[2004](#): K-14] survey on Lesotho says, 'productivity [in the non-jeans segment] reportedly falls to about 50 per cent of Asian standards if pattern styles change'. As style changes are frequent in the knitwear segment, this confirms the figures given in interviews.

This is based on the author's interviews in Sri Lanka, Pakistan, Malaysia, Mauritius, Philippines and Thailand. On China see the report by China Textile University and HCTAR [[1999](#)].

There was some adverse publicity in the USA in 2002 regarding working conditions in Lesotho, leading to consumer movements protesting against apparel imports from there. While there may have been grounds for grievance earlier [[Salm et al., 2002](#)], conditions seem to have improved. Employers are increasingly subject to scrutiny by foreign buyers who inspect working conditions. The widespread use of locals as personnel managers has also improved relations with workers.

Salm et al. [[2002](#): 34].

In addition, there are differences between Lesotho and South Africa on customs clearance and valuation, technical standards regulations, sanitary and phytosanitary measures and intellectual property rights [[World Bank, 2003](#)]. These differences raise transaction, implementation and compliance costs to Lesotho exporters.

See Lall [[2002](#)], Loewendahl [[2001](#)], Spar [[1998](#)], UNCTAD [[2002](#)] and Wells and Wint [[1990](#)].

Mauritius, with a population less than half of Lesotho, had ten times as many people involved in export and FDI promotion, with a budget over 30 times larger. Singapore, with a somewhat larger population (3.5 million), is even more impressive: its Economic Development Board has 450 staff and in the late 1990s spent nearly \$35 million per annum.

Some analysts, like Mattoo et al. [[2003](#)], estimate the impact of AGOA by imputing supply responses to price changes arising from tariff and quota changes. This may be misleading in that it assumes smooth supply response curves; a more realistic scenario

is that with full liberalisation high cost producers will be completely removed from the export arena as foreign investor return to more efficient sites.

Policy issues pertaining to Lesotho specifically are dealt with in the World Bank [[2003](#)] and UNCTAD [[2003](#)]. On structural constraints to African industrialisation see Lall [[1995](#)].

According to UNIDO [forthcoming], the share of Africa (excluding South Africa) in global manufacturing value added declined from 3 per cent in 1985 to 1 per cent in 1998 and in manufactured exports from 1 per cent to 0.5 per cent (and nearly a third of these exports came from one country, Mauritius). With liberalisation, most manufacturing firms in African countries are also doing badly in domestic markets (for case studies of Kenya, Tanzania and Zimbabwe see Lall [[1999](#)]). There are exceptions: processing local resources and making 'heavy' products (like cement) where import competition is limited by transport costs, customised products (like school uniforms or windows) or niche products geared to local tastes. These exceptions have not, however, been enough to drive sustained industrial growth or to catalyse manufactured exports.

While high technology products like electronics now constitute the main manufactured export from developing countries, success in complex exports is highly concentrated in a few countries in East Asia and, to a lesser extent, in Latin America. Africa is effectively marginal in such exports, partly because of low domestic technological capabilities and partly because it has not been able to plug into hi-tech MNC production networks. See Lall [[2000](#)] and UNIDO [[2003](#)].

I am grateful again to the referee for this point.

Additional information

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