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# Export Profiles of Small Landlocked Countries

A Case Study Focusing on their Implications  
for Lesotho

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## Abstract

World Bank demographic and country characteristic statistics identify 16 small landlocked countries that are similar to Lesotho. Ng and Yeats attempt to determine what useful policy information can be derived from the recent trade performance of these “comparators.” Among questions they pose are whether the trade profiles of the comparators suggest potentially promising export ventures for Lesotho, do they indicate directions for a geographic diversification of trade, or do they suggest products in which Lesotho might acquire a comparative advantage. The authors also use U.S. partner country statistics to evaluate Lesotho’s export performance in this major market.

The U.S. data indicate Lesotho lost competitive export shares for about three-quarters of its major clothing products during the late 1990s. The data show these losses were primarily to the North America Free Trade Agreement (NAFTA) countries in the Caribbean. Lesotho was competing on basically equal terms and did not fare well. But it is generally held that the most efficient clothing exporters are in the Far East and not Latin America. Lesotho’s difficulties in competing with the latter have worrisome implications for its ability to compete with East Asian exporters when the Multifiber Arrangement is phased out.

The comparative advantage profiles of the landlocked comparator countries suggest Lesotho’s options for a greatly needed export diversification may be wider than is assumed. One or more of the comparator countries developed a comparative advantage in 110 four-digit SITC (non-clothing) manufactures which are generally labor-intensive in production. Many of these goods should also be suitable for production and export by Lesotho.

International production sharing often involves the importation and further assembly of components in developing countries. This activity can significantly broaden the range of new products in which a country can diversify. Statistics show many landlocked comparator countries have moved into component assembly operations, and it appears this activity could contribute to Lesotho’s export diversification and industrialization. But the quality problems associated with Lesotho’s trade statistics makes it impossible to determine the extent to which local production sharing is occurring. A special effort is needed to tabulate reliable statistics on Lesotho’s current involvement in this activity.

Finally, the authors attempt to determine how the commercial policy environment in Lesotho compares with that in other countries. Policymakers previously had difficulty in addressing this issue, but several recent efforts to compile comprehensive cross-country indices of the quality of governance and commercial policies now provide relevant information. These statistics suggest domestic commercial policies make Lesotho relatively less attractive to foreign investment than many other developing countries. Less than 20 percent of all Latin American countries have a domestic commercial environment judged to be inferior to that in Lesotho, while the corresponding share for East Asia is under 30 percent. Overall, almost 70 percent of all developing countries appear to pursue commercial policies that make them as, or more, attractive to foreign investment than Lesotho.

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## **EXPORT PROFILES OF SMALL LAND-LOCKED COUNTRIES**

*A Case Study Focusing On Their Implications for Lesotho*

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## I. INTRODUCTION

Economists recognize that a country's size, location, physical geography and natural resource endowments can have an important influence on prospects for industrialization and growth. For example, in the 1960s and 1970s several empirical analyses sought to determine whether there was a minimal size below which countries were not economically viable.<sup>1</sup> The reasoning here was that the limited size of domestic markets in many small countries appeared insufficient to support production operations for industries that experience economies of scale. As a result, many small developing countries, particularly those in Africa, made major efforts to negotiate regional trade arrangements (RTAs) that might help them circumvent some constraints associated with their small domestic markets. Country size has also been associated with other trade related problems. Countries with a small surface area often have a relatively limited natural resource endowment that may reduce their ability to export goods whose production is intensive in the use of these products.

Aside from country size, there is ample evidence that geographic factors such as distance to major international markets have an important influence on the composition and direction of trade. Numerous "gravity model" analyses of factors influencing the level of trade between countries shows distance has an important adverse effect. That is, *ceteris paribus*, countries geographically distant from each other generally are observed to have relatively less "intense" trade relations.<sup>2</sup> This has important policy implications since it suggests geographically remote countries, like those in central Asia or Southern Africa, may find it relatively difficult to access major European or North American markets. Another geographic factor generally held to negatively impact on trade is the lack of direct access to ocean transport, or to the sea via easily navigable rivers. This geographic problem is of particular importance for Sub-Saharan Africa which is the most land-locked region in the world (14 countries) rivaled only by central Asia. Land-locked countries are often at a major competitive disadvantage as exporters of the high bulk low value products that comprise many developing countries' commodity exports due to high

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<sup>1</sup> See Khalaf (1974) for an illustrative example. More recently, Ng and Yeats (2002) classified Sub-Saharan African countries into three groups (small, medium and large) based on their size and found a strong direct relation between size and the number of products exported.

<sup>2</sup> These models are based on the proposition that bilateral exports can be explained by a relatively few variables such as the gross national product of the exporting and importing countries and the distance between them. The relevance of these variables lies in the proposition that the quantity of exports a country can supply depends on its economic size or GDP, the absorptive capacity for imports is determined by the size of the country's market (that is, the GNP of the importing country), and the volume of trade will depend on transport costs which are assumed to correspond to distance. Expanded gravity flow models have included dummy variables to indicate factors such as whether countries share a common border or language, or whether they have exchanged special preferential trade arrangements. See Linnemann (1966) or Tinbergen (1962) for early applications of the approach.

freight and insurance costs incurred in the transit to the sea (see Livingston 1985 or Amjadi and Yeats 1995 for empirical evidence).<sup>3</sup>

The purpose of this study is to determine if an analysis of the recent export performance of selected small, geographically disadvantaged, developing countries can provide useful insights concerning new export options for a given "target" country (Lesotho) with similar physical characteristics. Lesotho was chosen as the "target" since it currently is the focus of major initiatives by several international organizations to provide technical and economic support to countries the United Nations classifies as being among the "least developed" of the developing countries. The analysis proceeds as follows. First, a comprehensive survey is undertaken to identify a "comparator group" of countries whose size and other physical characteristics correspond with those of Lesotho. Next, trade statistics for the comparators are tabulated and similarities, and dissimilarities, between the export profiles of individual countries are examined. The intention here is to identify products that the comparator group has been able to export successfully in spite of their geographic and physical constraints. This section also attempts to determine whether the comparator group's products generally have common characteristics, a point that could assist in the identification of new export ventures for Lesotho. Detailed analyses of the "revealed" comparative advantage (RCA) profiles of the comparator countries are conducted for this purpose. The paper closes with an assessment of available evidence on the commercial environment in Lesotho and its implications for the country's trade prospects. This assessment will attempt to determine if many of the general problems that plagued other African countries have a similar influence on Lesotho's trade prospects (see Box 1).

## II. COMPARATOR COUNTRIES FOR LESOTHO

### Key Observations

*World Bank demographic and country characteristic statistics help identify 16 small landlocked countries that are very similar to Lesotho. An important question is what useful policy information for Lesotho can be derived from analyses of the recent trade performance of these "comparator" countries. Among the types of questions to be addressed are whether the trade profiles of the comparators suggest potentially promising new export products for Lesotho, do they suggest directions for export diversification, or do they suggest product lines where Lesotho might attempt to acquire a comparative advantage.*

A first step in the process of compiling a list of comparator countries was the establishment of several specific parameters to ensure that the countries selected did not significantly differ from Lesotho

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<sup>3</sup> The United Nations Group of 77 (1997) noted that "lack of physical access to the sea, isolation and remoteness from world markets, prohibitive transit costs and high risks entail serious socio-economic consequences for landlocked developing countries. Therefore, it is no wonder that most of them have, on average, less than 400 dollars per capita GDP. Handicapped by their geographic location, the land-locked developing countries are in a particularly disadvantaged position with respect to the ongoing globalization process; the physical and non-physical barriers erode further their competitive edge and tend to marginalize them from the world trade liberalizing process." The report also notes "there are multiple other factors of both an objective and subjective nature that increase costs and limit the trading opportunities of these countries. These include risks of loss, theft, damage, the existence of cumbersome procedures both in crossing the land border and in transshipment at the ports. In many cases special security and customs arrangements for transit cargoes are needed that entail high insurance and administrative costs. That is why most land-locked developing countries incur significantly higher transport costs than their coastal neighbors."

### **Box 1. The General “Environment” for Sub-Saharan African Countries’ Exports**

Three recent studies commissioned by the World Bank’s Africa Region attempted to identify major problems and prospect for individual Sub-Saharan African countries exports. The initial investigations focused primarily on the identification of general production and supply constraints in Africa (Ng and Yeats 1997, 2000), while the third examined longer-term demand prospects for Sub-Saharan Africa’s traditional export products (Ng and Yeats 2002). The major conclusions, which may also have a direct bearing on Lesotho’s trade prospects were as follows.

#### **A. Africa’s Production and Supply Problems**

Sub-Saharan African countries continue to experience major supply constraints that limit their ability to capitalize on export opportunities in foreign markets. The importance of these production problems was reflected in the following observations.

- During the last three decades, global Sub-Saharan African exports either declined in absolute terms or expanded at a slower pace than world trade. Sub-Saharan Africa accounted for 3.1 percent of world exports in the late 1950s, yet by the mid-1990s this share fell to 1.2 percent. UN COMTRADE statistics show this reduction was largely due to the erosion of Africa’s competitive position in international markets. For the region’s 30 most important non-oil exports combined, Africa’s import market share declined by over 11 percentage points (from 20.8 to 9.7 percent), which implies annual trade losses of about \$11 billion. The value of these losses is about the same as OECD official development assistance (ODA) to Africa.

- No major expansion occurred in the diversity of products exported by most Sub-Saharan African countries, although there were a few exceptions like Madagascar and Kenya. Indeed the product composition of some African countries’ exports became more concentrated over the last decade. Africa continues to be heavily dependent on a relatively few commodities which have been the region’s traditional exports.

- An analysis of recent changes in Africa’s exports indicates no general increase occurred in the number of industries in which most countries have a “revealed” comparative advantage. This is consistent with statistics showing Africa generally failed to diversify its export base and, in several countries, trade became more concentrated. That is, a fewer number of products were being exported at the end of the last decade than at the beginning.

- There is little evidence that the relative importance of exports of processed domestically produced commodities increased, nor do the data indicate that intra-industry trade between Africa and other countries grew. Although other studies suggest that rapidly growing international trade in parts and components has been a major factor promoting interdependence and globalization little evidence was found that Africa was an important participant in this activity.

- Evidence was cited that strongly suggested the “lackluster” trade performance of African countries was largely due to an unfavorable internal environment. Cross-country indices of the quality of African governance, trade, fiscal, monetary and legal policies indicate major scope for improvement exists. The business climate in Africa appears to be distinctly inferior to that in many countries which compete with the region for foreign investment.

**Box 1. Continued****B. Long-Term Demand Prospects for Traditional Exports**

Former major commodity producing countries like Brazil, Thailand, Malaysia, China or Mauritius have made marked shifts over the last two or three decades in the composition of their exports, moving from primary commodities to manufactures. This raises the possibility that prospects for the remaining exporters of commodities, like those in Africa, may have improved. However, the World Bank's analysis of demand prospects for Africa's traditional (commodity) exports reveals the following;

- Over the last decade, global trade in Sub-Saharan Africa's traditional exports, which currently account for about three-quarters of the region's total exports, grew at a rate of 1.9 percent, or about one-third the corresponding rate for all goods. This is a continuation of trends observed for the 1980s. Furthermore, 1990-1999 trade growth rates for over 40 percent of Africa's traditional products were actually negative. The last half of the decade witnessed a major collapse in demand for many of these goods with 1995-99 global imports of several traditional products falling by more than ten percent annually. These developments contributed to the further erosion of Africa's global trade share which fell from 1.8 percent in 1990 to 1.3 percent in 1999.

- Over the last decade, world trade growth (5.7 percent) was roughly double that for income as measured by GDP. On average, income elasticity estimates for Africa's traditional exports are just over one-third (0.36). This implies that if world GDP expands at its recent rate of 2.5 percent, global trade in traditional products should grow by under one percent per year. As such continued reliance on traditional exports will significantly extend Africa's marginalization in world trade.

- The recent record provides no indication that the longer-term deterioration in traditional product prices has reversed. Over 1990-99, average real prices for all traditional products declined by about 24 percent. In a few cases, like coffee and lumber, where some modest improvement occurred, real prices still remain well below their 1980 levels. In addition, long-term price projections by the World Bank reinforce the basically negative outlook for traditional products and most commodities.

- African traditional product price instability is a major problem for exporters. Average annual price changes for these goods generally exceeded those for the all non-oil commodity price index, while one-half the traditional products experienced average price changes that were at least 50 percent greater. However, annual data clearly understate instability problems since traditional product prices often experience sizable consecutive year directional changes. Over a three-year period, consistent directional price shocks as high as 101 percent occurred, while changes of 150 percent were observed in four consecutive year data. These major price swings were generally associated with a "collapse" of traditional product prices as, over 80 percent of the time, they were in a downward direction.

- The policy message of these findings for Africa is simple and direct. Diversify away from traditional products or continue to experience serious negative trade effects including; (i) declining or relatively low growth in global demand for these goods, (ii) falling real prices for traditional products, (iii) very unstable prices and export earnings, (iv) a continued marginalization in world trade, and (v) diminished growth and industrialization prospects. However, there is no evidence that any general diversification is occurring.



in their physical and economic characteristics. Specifically, comparator countries were required to have the following attributes;

- *A relatively small population base.* This standard was established to ensure that major differences in the available work force were not the source of any significant variation in the volume and variety of goods exported. As such, comparator countries were limited to those with a population base of 10 million or less. The World Bank (2000) estimates the current population of Lesotho is just over 2 million.

- *Relatively small domestic market size.* Countries with relatively large domestic markets may be able to capitalize on economies of scale in local production that, in turn, could lead to the competitive export of these goods. As such, larger countries should, *ceteris paribus*, be expected to export a broader range of products than small ones. (Ng and Yeats 2002 provide supportive evidence on this point). Using GDP as a measure of market size, the comparator countries were limited to those with gross domestic products of \$5 billion or less (Lesotho's GDP is about \$1.2 billion).

- *Relatively limited natural resource endowments.* This factor may have several differential effects on the level and composition of exports. Sachs and Warner (1996) provide empirical evidence that developing countries with relatively large *exploited* endowments of valuable natural resources may experience "Dutch disease" effects that adversely influences the level and composition of exports. On the other hand, some natural resource endowments may provide opportunities for domestic processing for export not available to other countries. As such, countries with relatively large petroleum exports, or other extensive natural resources, were excluded from the comparators. The Heritage Foundation – Wall Street Journal (2000, p. 309) classifies Lesotho as a country with no significant natural resources except water.

- *Relatively remote location from major OECD markets.* Given the (previously cited) extensive evidence concerning the effects of distance on trade flows comparator countries were required to have a trade transit route to the nearest major OECD market of at least 1,000 miles.

- *Land-locked status.* Given the major trade and economic problems landlocked countries like Lesotho purportedly face (UN Group of 77, 1997) the group of countries selected as comparators were all land-locked.<sup>4</sup> Furthermore, the countries selected were all required to have no significant river access to the ocean, as does a developed landlocked country like Switzerland.

Table 1 identifies the 16 land-locked comparator countries selected using these criteria, and also provides general empirical information on their trade and economic profiles. One important point concerns differences in the relative importance of manufactures in the exports of these countries. Among the land-locked comparator countries, manufactures share of total exports ranges from a high of 90

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<sup>4</sup> Our criteria does not distinguish between one potentially important factor, that is the length of the transit through neighboring countries to the nearest accessible seaport. For example, Lesotho faces a land transit of 720 kilometers through South Africa to Durban, while Chad has a land transit of 2,050 kilometers for goods exported through Lagos, Nigeria. In contrast, Mali has a transit of 640 kilometers to Dakar, Senegal while Upper Volta has a transit of about the same distance to Abidjan, Ivory Coast. See UNCTAD (1970, p. 8) for additional information. This point was not incorporated in the analysis given that other factors besides distance can have a major influence on the ease, or difficulty, of a land transit. See World Bank (1997) for information on this organization's efforts to facilitate Nepal's trade opportunities and reduce transit problems. Economic Commission for Africa (2002) discusses efforts by this organization to reduce transit problems encountered by several land-locked African countries.

percent for Bhutan down to about 4 percent for Chad and Rwanda. The table shows Lesotho falls among the countries that are more dependent on manufactured goods than average. Manufactures seemingly constitute about 80 percent of Lesotho's exports. This is over two and one half times the average share (34 percent) for the landlocked comparator country group. Two other points are apparent. First, Lesotho and the other comparator countries have an extremely narrow range of export products. Only 21 four-digit SITC products were exported by Lesotho (at this level over 1,100 individual products are identified) while Moldova exports the largest number (189) of products. Second, when measured on a per capita

**Table 1. Characteristics of Individual Countries Selected as Comparators for Lesotho, 1999**

Country	Population (million)	GDP (\$ million)	Exports Per Capita (\$)	Exports to GDP Ratio	No. of Products Exported <sup>1</sup>	Export Share (%) /b	
						Primary Goods <sup>2</sup>	Manufactures
Lesotho	2.1	957	81	.178	21	19.4	80.6
<b>Landlocked Countries</b>							
Armenia	3.8	1,845	30	.062	57	7.9	88.9
Bhutan	0.8	440	27	.049	29	9.4	90.0
Burkina Faso	11.0	2,580	16	.068	62	85.8	9.6
Burundi	6.7	714	10	.094	17	81.9	4.0
Central African Rep.	3.5	1,051	61	.203	40	25.6	74.0
Chad	7.5	1,564	14	.067	12	95.8	4.0
Kyrgyz Republic	4.9	1,250	46	.180	102	33.0	11.3
Lao PDR	5.1	1,451	46	.162	91	44.6	54.7
Malawi	10.8	1,810	45	.269	81	87.2	12.7
Mali	10.6	2,570	25	.103	80	88.1	11.1
Moldova	4.3	1,174	83	.304	189	33.3	66.3
Mongolia	2.4	916	135	.354	86	71.8	27.4
Niger	10.5	2,018	29	.151	57	55.7	42.8
Rwanda	8.3	1,935	6	.026	23	91.1	3.6
Tajikistan	6.2	1,084	25	.143	79	71.0	28.2
Zambia	9.9	3,104	61	.194	111	84.6	11.2
Average of Above	6.6	1,594	41	.170	70	60.4	33.7
<b>Memo Items:</b>							
Average GDP & Population)							
Low income countries <sup>3</sup>	22.5	9,044	95	.236	..	55.2	43.8
Middle income countries <sup>4</sup>	15.4	44,128	738	.258	..	43.4	70.0
High income countries	17.3	468,897	4,366	.161	..	15.5	81.4

Notes:

- <sup>1</sup> The number of SITC 4-digit export products (Revision 3) exceeding \$50,000 in 1999.
- <sup>2</sup> Primary goods are classified as SITC 0+1+2+3+4+68 and manufactures are SITC 5+6+7+8-68.
- <sup>3</sup> Based on country classification shown in World Bank GEP (2001), excluding India.
- <sup>4</sup> Based on country classification in World Bank GEP (2001), excluding China.

Source: Based on partners' import data drawn from UN COMTRADE Statistics.

basis the average level of exports from the land-locked countries (about \$40 per person) is quite low. This is less than half the per capita exports of all low income countries (\$95 - see the memo item), and about 5 percent of the corresponding level for the middle income countries.

### III. STATISTICAL CONSIDERATIONS

#### Key Observations

*Major discrepancies between trade statistics published by the Lesotho Central Bank and Bureau of Statistics are so great that this information cannot be used for empirical trade research or policy analyses. As such, empirical analyses of Lesotho's recent trade performance must be largely based on the one existing reliable source of available statistics, that is, partner country data as reported by the US International Trade Commission (USITC).*

Several important problems relating to trade statistics should be noted before proceeding with the analysis. First, some of the comparator countries (like Lesotho) also failed to regularly report data to UN COMTRADE, so partner country statistics were used for analyses of their trade performance. Two relevant points should be noted. Unlike the case of Lesotho, whose exports and imports are incorporated in an aggregate for SACU, UN COMTRADE partner country statistics always record imports and exports from the individual comparator countries. As such, combined statistics from the partner countries listed in the notes to Table 2 were used as the source of trade data for the comparators.<sup>5</sup> Since the "partners" listed in the table account for more than ninety percent of world trade their combined statistics should provide accurate information on the landlocked countries imports and exports. However, year 2000 trade data are not yet available for some of these partners so the analysis could not be extended into the current decade.

Unfortunately, the partner country approach will not work for Lesotho since, as noted, most countries UN COMTRADE records report combined imports from SACU and do not differentiate between individual member countries. The two national sources were also rejected as a potential source of statistical information on Lesotho's trade. As the report by Yeats (included in this annex) shows Central Bank and Bureau of Statistics data on the level, composition, and direction of Lesotho's trade are often so contradictory that they probably convey more misinformation than useful information.

The implications of this situation are that empirical analyses of Lesotho's trade performance must be largely based on the one existing reliable source of available statistics, that is, partner country data as reported by the US International Trade Commission (USITC). The major attractions of this approach are that roughly one-half of Lesotho's total exports appear to be directed to the US market so these data should be useful for assessing important general changes trade characteristics. Second, the US partner data are published at low levels of detail (that is, for five-digit SITC products), and the strict verification procedures, implemented in connection with GSP and AGOA preferences, work to ensure data quality.

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<sup>5</sup> For example, the combined imports of the countries listed in Table 2 were used to tabulate data on the exports of each of the comparator countries. An advantage of this approach is that import statistics are widely held to be more reliable than export data, given that the former are subject to tariffs and other forms of government imposed trade measures. However, imports are normally valued on a cost-insurance-freight (c.i.f.) basis (the United States, Canada, Australia and New Zealand are important exceptions) so this procedure will inflate somewhat the free-on-board value of exported goods. See Ng and Yeats (2000, 2002) for examples of empirical trade analyses base on partner country statistics.

On the negative side, the United States clearly appears to be a very minor supplier of Lesotho's imports so very little useful information on trade in this direction is available from the USITC statistics.<sup>6</sup>

### III. GENERAL TRADE CHARACTERISTICS

#### Key Observations

*Countries are often advised to avoid concentrating exports in a narrow range of similar goods that may be negatively affected by new, more efficient, competitors or by factors influencing the general level of demand. Statistics show that Lesotho's exports are far more concentrated than those of other similar landlocked countries. One four-digit SITC product, namely, men's trousers and overalls accounted for more than one-third of Lesotho's total exports to the United States, while the three largest products export share stood at 77 percent. This statistics accent the need for Lesotho to diversify into other types of products, particularly in view of the impending phase-out of the Multifiber Arrangement and its potential adverse impact on some exporters.*

Recent international developments show the geographic destinations of a country's exports can have important implications for its economic prospects. For example, countries whose exports were heavily directed toward Far Eastern markets saw their economic prospects weakened due to the region's financial crisis in the late 1990s. Similarly, countries whose exports are destined for markets where regional trade arrangements (RTAs) are in the process of forming or strengthening, as in the case of the European Union, NAFTA, or MERCOSUR, might expect some displacement of these shipments by RTA member countries. Export prospects can also be affected by the product composition of trade. If exports are concentrated in goods with low income elasticities of demand, this could cause a country's marginalization in world trade. Countries are often advised to avoid concentrating their exports in a narrow range of broadly similar goods that may be negatively affected by the emergence of new, more efficient, competitors or by factors influencing the general level of demand for these goods.<sup>7</sup> What does the available evidence concerning these points show for Lesotho and the comparator countries.

#### A. The Broad Profile of Exports

Table 2 provides summary statistics on the profile of Lesotho's exports to the United States by showing the total value of this exchange in 1995 and 1999, and the share accounted for by broad product

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<sup>6</sup> For example, in 1999 the US Census Bureau reported exports to Lesotho of approximately \$700,000. Conversion of this total to Maloti, at the average annual exchange rate reported by the IMF, implies US exports should be valued at about 4.3 million Maloti. This is less than one percent of the conflicting 1999 import totals reported by the Bureau of Statistics and Central Bank.

<sup>7</sup> As an example, in the 1970s the success of the so called "newly industrialized" Asian countries like Korea, Singapore and Hong Kong was largely based on the export of a relatively few labor intensive products including footwear, textiles and clothing. However, as incomes rose in these countries they, relatively quickly, lost their competitive edge to lower wage cost exporters like Malaysia, Thailand and the Philippines. Dramatic changes in international competitive conditions for textiles and clothing may occur over the next few years due to the phase-out of the Multifiber Arrangement (MFA) and many established exporters may see their exports severely eroded, or displaced entirely.

groups like foodstuffs, agricultural raw materials, ores and metals, or manufactures. Although the United States reported imports from Lesotho prior to 1995, these data are not shown since trade patterns for earlier periods may have been distorted by sanctions that were in place against the Republic of South Africa. For comparison, similar statistics are also shown in the table for the land-locked comparator countries as a group.

The major point clearly evident from Table 2 is that Lesotho's exports to the United States are almost exclusively confined to clothing products (SITC 84) as these goods accounted for more than 99 percent of all shipments in both 1995 and 1999. In contrast, the aggregate export profile of the landlocked comparator countries is considerably more diversified as textiles and clothing account for a combined 12 percent share. This observation accents the need for Lesotho to diversify into other types of products, particularly in view of the impending phase-out of the Multifiber Arrangement and its potential adverse impact all but the most cost efficient exporters. The table also shows Lesotho's exports almost doubled over 1995-99, while the total exports of the landlocked countries declined by about 10 percent. A massive erosion of Zambia's international market share for copper exports was a major factor contributing to this decline.

**Table 2. The Structure of Lesotho's and the Comparator Countries Exports in 1995 and 1999**

Product	Lesotho		Other Landlocked Countries	
	1995	1999	1995	1999
	<b>Export Value in \$ million</b>			
ALL GOODS (0 to 9)	62	111	4,124	3,705
	<b>Of which: Share of All Exports (%)</b>			
ALL GOODS	100.0	100.0	100.0	100.0
Food & Feeds (0+1+22+4)	0.0	0.0	20.1	20.5
Agricultural Material (2-22-27-28)	0.0	0.0	22.3	20.8
Ores & Metals (27+28+68)	0.0	0.0	31.2	18.8
Fuels (3)	0.0	0.0	1.5	4.7
Chemicals (5)	0.0	--	4.7	3.9
Machinery & Transport (7)	0.0	0.0	1.6	1.6
Other Manufactures (6+8-68)	99.7	99.8	14.8	24.6
Of which:				
Textiles (65)	0.0	0.0	1.9	2.7
Clothing (84)	99.6	99.7	4.3	9.1
Footwear (85)	0.0	0.0	0.1	0.3
Misc. Items (9)	0.3	0.2	3.8	5.1

Note: See the classification of landlocked countries in Table 1.

Source: Lesotho's export statistics are derived from United States partner country data. The comparator countries data were compiled from imports of the following countries as reported in UN COMTRADE; all original OECD countries, plus Algeria, Argentina, Burundi, Belize, Bolivia, Brazil, Barbados, Chile, China, Cote, d'Ivoire, Cameroon, Colombia, Comoros, Costa Rica, Cyprus, Czech Republic, Ecuador, Egypt, El Salvador, Estonia, Grenada, Greenland, Guatemala, Hong Kong (China), Honduras, Croatia, Hungary, India, Indonesia, Israel, Jamaica, Kazakhstan, Kenya, Korea, Kuwait, Lithuania, Latvia, Macao (China), Morocco, Madagascar, Maldives, Mexico, Macedonia FYR, Malta, Mauritius, Malaysia, Nicaragua, Oman, Pakistan, Panama, Peru, Philippines, Poland, Paraguay, Romania, Singapore, Slovak Republic, Slovenia, SACU, St. Lucia, Togo, Thailand, Trinidad & Tobago, Taiwan (China), Tunisia, Turkey, Uganda, Uruguay, Venezuela.

Table 3 provides a more focused view of Lesotho's exports by reporting the value the twelve largest four-digit SITC products in 1995 and 1999 along with each item's trade share. These statistics suggest Lesotho may be even more vulnerable to adverse international developments in markets for clothing than suggested in the previous table. Specifically, Lesotho's clothing exports are highly concentrated in a very narrow range of products. One four-digit SITC product, namely, men's trousers and overalls accounted for more than one-third of Lesotho's total exports, while the three largest products export share stood at 77 percent. In contrast, only two clothing products (men's trousers and pullovers) place in the other landlocked countries largest exports, and these items had a combined 1999 trade share of under 3 percent.

#### B. Are There "Dynamic" or "Declining" Exports?

Although they presently may not constitute a large share of current exports, there are reasons why one should identify "dynamic" or fast growing products. If their current above-average growth continues for an extended period, these items may eventually become an important source of a country's export earnings. Second, if the dynamic products have specific production characteristics, this could convey important information. For example, if they are highly labor- or resource-intensive, both the reasons for their growth and whether similar export opportunities exist in other related goods should be determined. Third, there is an obvious interest in identifying dynamic products to focus efforts on the removal of any important foreign trade barriers they may face. In contrast, there are reasons why one would also want to identify "declining" products whose exports are falling. If these reductions are due to a loss of market shares one would want to determine the reasons for the loss of competitiveness, and identify the countries responsible for the export displacement.

Table 4 reports 1995-99 growth rates for Lesotho's major five-digit SITC United States exports, it shows the 1999 value of trade and share of each item, also indicates each product's annual growth rate. The major impression conveyed by these statistics is one of very diverse trends in Lesotho's exports of individual items with one product (knit men's shirts) growing at an annual rate of 36 percent, with a second (articles of plastic apparel) declining at an annual rate almost two times higher. Second, while some of the products growth rates may, at first, appear impressive they are in all cases below the average 42 percent annual growth rate for all United States clothing imports. Lesotho's below average growth rates suggests its United States import market shares are being eroded by other competitors. See Box 2 which follows for further evidence on this point.

Table 3. Lesotho and the Landlocked Comparator Countries' Largest Exports, 1995 and 1999

Description	Share of All Exports (%)		Export Value (\$ 000)	
	1995	1999	1995	1999
<b>Lesotho:</b>				
Trousers and overalls	31.9	20.6	19,757	40,282
Jerseys and pullovers	20.0	36.0	12,388	23,004
Bib trousers and overalls	12.6	19.9	7,776	22,255
T shirts	5.8	8.9	3,561	9,943
Knit textile shirts	2.7	5.1	1,671	5,654
Suits and ensembles	3.9	3.9	2,410	4,316
Knit blouses and shirts	8.4	3.7	5,186	4,176
Baby garments	3.9	0.4	2,427	421
Garments, not elsewhere specified	2.1	0.3	1,321	300
Overcoats and anoraks	--	0.1	11	124
Skirts of woven textiles	3.1	0.1	1,933	111
Jackets and blouses	--	0.1	2	81
All above products	94.3	99.1	58,443	110,667
ALL GOODS	100.0	100.0	61,909	111,814
<b>Landlocked Countries:</b>				
Raw cotton excluding linters	13.6	14.8	560,174	547,678
Tobacco stripped or stemmed	6.0	8.2	245,923	305,536
Diamonds unset	3.2	6.5	131,491	239,422
Copper refined or unrefined	18.6	6.2	767,099	229,132
Copper ores/concentrates	3.1	4.3	126,167	159,072
Crude petroleum	0.5	4.1	19,890	153,154
Non-monetary gold	3.5	4.1	146,308	151,611
Coffee, not roasted	6.4	3.5	265,496	129,592
Radio-isotopes and compounds	3.6	3.2	147,329	117,301
Cobalt, titanium, or zircon	3.4	2.8	140,477	105,034
Jerseys and pullovers	0.6	1.6	23,453	59,200
Aluminum alloys	1.7	1.5	69,721	54,184
Tea	0.9	1.4	37,664	52,270
Men's trousers	0.6	1.3	24,315	49,341
Hot formed steel bars	0.3	1.3	12,671	48,031
Hot coil iron bars	1.0	1.2	42,689	45,370
Tobacco not stripped	0.9	1.2	36,077	44,482
Base metal ores	--	1.1	1,565	42,138
Hardwood rough	0.5	1.1	22,137	39,108
Non-ferrous metal waste	2.1	1.0	85,883	38,436
All above products	70.5	70.4	2,906,529	2,610,092
ALL GOODS	100.0	100.0	4,123,925	3,704,925

Sources: As reported in the notes to Table 10.

Table 4. Comparative Growth Rates for Lesotho's Major US Export Products; 1995-99

SITC	Product	1999 Exports		Export Growth Rate (%)
		Value (\$ 000)	Share (%)	
84371	Knit men's cotton shirts	5,654	5.1	35.6
84260	Women's bib and brace trousers	22,255	20.1	30.1
84540	T shirts and undershirts	9,943	9.0	29.3
84140	Men's bib and brace overalls	40,282	36.4	19.5
84425	Knit skirts and divided skirts	305	0.3	17.8
84530	Knit or crocheted jerseys and pullovers	23,004	20.8	16.8
84426	Knit women's trousers and overalls	3,281	3.0	9.9
84324	Knit men's trousers and overalls	81	0.1	2.9
84599	Garments knitted, nes	74	0.1	-3.6
84470	Women and girls knitted blouses	4,176	3.8	-5.3
84483	Women's nightdresses and pajamas	60	0.1	-8.5
84591	Track suits knitted	226	0.2	-34.8
84250	Skirts and divided textile skirts	110	0.1	-50.9
84821	Articles of plastic apparel	1	--	-66.6

Sources: As reported in the notes to Table 2.

### C. The Geographic Pattern of Lesotho's Trade

Where are the primary outlets for Lesotho's exports, and what factors in these markets might affect their level of import demand? Also, how does the direction of Lesotho's exports compare with that of the other landlocked countries? As Yeats reports in a companion study in this annex, the Lesotho Central Bank and Bureau of Statistics report conflicting statistics on the destinations of Lesotho's exports. As such, the best way to address this question is to show the possible *range* in export shares going to different markets. Although this approach is clearly less than optimal, the fact that both the CBL and BOS data identify South Africa and the United States as Lesotho's primary export outlets makes this information relevant.

Table 5 reports the total value of Lesotho's global exports in 1999 (BOS and CBL reported export totals are quite close for this year), and the range in estimated shares going to different destinations, i.e., all industrial countries (defined as all original members of the OECD with the exception of Turkey), industrial countries in Europe, North America, or Asia, and several other non-industrial regional groups. Again, for comparison, similar statistics are shown for the landlocked comparator countries.<sup>8</sup> The key question to be addressed in these comparisons is how significantly does the geographic destinations of Lesotho's exports differ from those of the comparator countries.

<sup>8</sup> The statistics in Table 5 are based on partner country data reported to the United Nations COMTRADE and this could bias downward the geographic trade shares for Sub-Saharan Africa. As a group, African countries have been most negligent in their commitment to report trade statistics to the United Nations. As a result, if data is missing any trade between a comparator country and the non-reporting African country will not be recorded. However, there is reason to believe the magnitude of this bias is small. Yeats (1998), for example, shows that the export and comparative advantage profiles of most African countries are very similar and this greatly reduces the potential for African intra-trade.



Table 5. Destination of Lesotho's and the Comparators Countries Exports, 1995 and 1999

Destination	Lesotho's 1999 Exports	Other Landlocked Countries	
		1995	1999
All Countries (\$ million)	171	4,124	3,705
Share of total exports destined for major markets (%)			
All Countries	100.0	100.0	100.0
Industrial Countries	45.9 to 49.7	57.8	60.1
Of which:			
North America	45.6 to 49.4	6.6	11.5
United States	45.6 to 49.4	5.9	10.2
European Union	0.2 to 0.3	40.0	43.5
France	-- to --	8.3	6.5
Germany	0.2 to --	8.8	10.8
United Kingdom	-- to --	2.4	2.4
Japan	-- to --	10.1	4.3
Australia & New Zealand	-- to 0.1	0.3	0.3
Developing Countries	50.3 to 54.1	42.2	39.9
Of which:			
Sub-Saharan Africa	50.2 to 54.0	4.4	5.4
South Africa	50.0 to 53.9	2.3	3.1
Middle East & N. Africa	-- to --	5.3	3.7
Latin America	-- to --	1.0	2.0
South Asia	-- to --	3.4	2.5
East Asia	0.1 to --	23.1	22.6
Others	-- to --	4.9	3.7

Source: Statistics for Lesotho from the Central Bank of Lesotho's *Annual Report for 2000*, (Maseru: March 2001) and the Bureau of Statistics, *1999 Foreign Trade Statistics*, (Maseru: 2001). Other data from partner countries' statistics.

As indicated in Table 5, the share of Lesotho's exports destined for South Africa (between 50 to 54 percent) is more than 15 times higher than that for other land-locked countries. In part, the geographic distance of Laos and the Central Asian landlocked comparators from South Africa contributes to the difference. As shown, an exceptionally high share of Lesotho's exports are also directed to the United States (the estimates range between 45 to 49 percent, roughly ten times higher than the comparators share).<sup>9</sup> Finally, Table 5 indicates that Lesotho has virtually no trade with other members of

<sup>9</sup> Recent developments within MERCOSUR (a Latin American regional trade arrangement consisting of Argentina, Brazil, Paraguay, and Uruguay) indicate the potential hazards of a high geographic concentration of exports. As a result of relatively high MERCOSUR tariffs against non-member countries, Argentina rapidly increased its share of total exports to MERCOSUR countries (mainly Brazil) from 10 percent to 30 percent during the mid-1980s to mid-1990s. At that point, severe monetary problems caused Brazil to significantly devalue its currency, a development that essentially made many Argentine exports uncompetitive. The resulting loss of export revenues was one factor accounting for the major financial crisis Argentina experienced over the last few years. Lesotho's almost sole dependence on two markets (South Africa and the United States) for its exports suggests it is exposed to a similar "geographic concentration" risk.

SADC aside from South Africa. This is probably due to the fact that Lesotho has almost no export capacity for machinery, capital equipment, natural resource based manufactures, and other types of goods that comprise the majority of SADC imports.

### III. THE INFLUENCE OF COMPETITION AND DEMAND ON EXPORTS

#### Key Observations

*While aggregate trade statistics report a significant total increase in Lesotho's exports to the United States, this is largely due to one four-digit SITC product, namely, trousers and overalls. Less aggregate trade data show Lesotho has been experiencing competitive market share losses in the United States for most of its major clothing product lines. This is largely due to major increases in clothing exports from Latin American countries that are the result of the extension of "NAFTA parity" to the region. Lesotho's apparent inability to compete, on equal terms, with several small Latin American countries has ominous implications for the post-MFA period when it will experience direct competition with the (purportedly) more efficient producers in East Asia.*

The previous analysis showed Lesotho's exports expanded at a fairly rapid pace over 1995-99. Factors relating to both supply and demand influenced this expansion, and an important question concerns the extent to which changes in international competitiveness contributed to this seemingly favorable trade performance. This question can be addressed by decomposing a country's export growth into three factors, two of which relate to changes in demand and competitive conditions. (A detailed description and early application of this procedure can be found in GATT (1966) or Kravis (1970)). The influence of demand for a specific good is measured by the change in the total all value of trade in the item. In calculating the influence of this factor, one first assumes that the exporting country maintained its trade share for the commodity over some specified period.<sup>10</sup> Specifically, if  $D_{0j}$  and  $D_{tj}$  represent world trade in product  $j$ , at time period  $o$  and  $t$  respectively, the change in exports attributed solely to demand  $\Delta E_{d,i}$  is,

$$\Delta E_{d,i} = \sum (s_{0j}) \times (D_{tj} - D_{0j})$$

where  $S_{0j}$  is the share of the country  $i$  in global exports of product  $j$  in the base period  $o$ , and the summation is over all goods exported. Therefore, this equation shows the change in country  $i$ 's exports that would have occurred if only changes in demand took place.

Second, the change in the competitive position of country  $i$  is measured by the difference between the exports that would have occurred in period  $t$  if the country's initial market share had not changed, and those exports that were in fact realized. This "competitive" factor ( $E_{c,i}$ ) is,

$$\Delta E_{c,i} = \sum (s_{tj} - s_{0j}) \times (D_{tj})$$

where  $s_{tj}$  is the share of the country in global exports of product  $j$  in period  $t$ , and the summation is over all goods exported. As a result, this equation shows how much exports changed, above or below the level

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<sup>10</sup> Normally, this procedure uses global import changes as a proxy for the demand factor while the competitive factor is based on changes in a given exporting country's global market shares. Given the nature of Lesotho's trade data problems, and the geographic concentration of Lesotho's exports, the demand and competitive factors are estimated for the United States market.

associated with pure demand changes, due to changes in a country's market shares. Any differences between changes in a country's total exports, and the sum of these "demand" and "competitive" changes are due to product diversification.<sup>11</sup>

#### A. Demand and Competitive Changes for Lesotho's Major Exports

Table 6 summarizes the results when the demand and competitive factor equations were applied to statistics on each of Lesotho's major clothing exports to the United States. The table shows the 1995 value of exports along with changes in the trade of each item due to the supply and demand factors. For example, Lesotho's 1995 exports of trousers and overalls totaled US\$ 19.8 million, and the 1995-99 market demand factor generated a increase in exports worth \$ 1.4 million. However, Lesotho's improved ability to compete, as reflected in its higher market share for this one item, resulted in a further export expansion of almost \$ 37 million.

Overall, Lesotho increased its 1999 exports by about \$4.9 million through competitive share changes, or 8 percent above their earlier level. While this is positive, an analysis of underlying product level statistics suggest developments are not been as favorable as they first appear. Lesotho, in fact, experienced competitive market share losses for 9 of the 13 clothing products that ranged upward to a high of \$11.3 million in the case of jerseys and pullovers. Analysis of the underlying US import statistics strongly suggests that NAFTA, and the extension of NAFTA parity to countries in the Caribbean, were the primary reasons for Lesotho's loss of competitiveness for some of its most important clothing products.

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<sup>11</sup> A simple illustrative example can help explain this analytical approach. Assume country *i* exports one product *j* and has a 20 percent share of the world market and exports of \$20 million in 1990, and a 25 percent share with exports of \$37.5 million in 1999. During this period, world demand for *i* rose from \$100 to \$150 million. The change in *i*'s exports attributable solely to changes in demand would be,

$$\Delta E_{d,i} = .20 \times (\$150 - \$100) = \$10 \text{ million}$$

while the change due to the competitive factor is,

$$\Delta E_{c,i} = (.25 - .20) \times \$150 = \$7.5 \text{ million}$$

The example assumes that the country experienced no diversification in exports.

**Table 6. The Influence of Competitive and Demand Factors on Lesotho's 1995-1999 US Exports**

Export Product	Exports to North America (\$ '000)*		
	1995 Value	Demand Factor	Competitive Factor
Trousers and overalls	19,757	1,353	36,934
Suits and ensembles	2,410	479	2,166
Knit textile shirts	1,671	865	1,228
Knit blouses and shirts	5,186	755	1,011
Fur clothing	77	109	-115
Plastic and rubberized clothing	87	30	-117
Bib trousers and overalls	7,776	11,128	-1,261
Skirts of woven textiles	1,933	242	-1,452
Garments, not elsewhere specified	1,321	-43	-2,084
Slips and petticoats	88	1,436	-3,309
Baby garments	2,427	2,512	-7,277
T Shirts	3,561	11,700	-9,533
Jerseys and pullovers	12,388	14,541	-11,294
All Above Items	58,682	45,107	4,897

\* The competitive factor shows the increase or decrease in exports attributable to the change in Lesotho's import market share. The demand factor indicates the potential increase or decrease in Lesotho's exports attributable to the overall change in United States imports.

As an illustration, Table 6 reports that Lesotho experienced 1995-1999 competitive market share losses of almost \$10 million for one of its most important clothing exports (T shirts). Over this same period, Mexico, Honduras, El Salvador and Canada increased their combined share of the United States market for this good by almost 25 percentage points (from 37.9 percent in 1995 to 61.2 percent in 1999). Although less dramatic, a 7 percentage point rise Mexico, Honduras, Guatemala and Canada's market shares for jerseys and pullovers was a major factor accounting for Lesotho's competitive share losses of about \$11.3 million for jerseys and pullovers.

The importance of these observations should be clearly recognized. As a result of NAFTA, and NAFTA parity for the Caribbean, Lesotho is competing on basically equal terms (due to its AGOA preferences) with the two groups of exporters in the Americas, and is not faring well (see Box 2). This has potentially serious implications for Lesotho with the impending MFA phase-out. It is generally held that the most efficient exporters of textiles and clothing are in East and South Asia. Lesotho's apparent

### Box 2. Implications of the Recent Export Performance of Several Small Latin American Countries

At any given point in time a country's supply curve for clothing exports is probably relatively elastic up to full production capacity, at which point curve probably becomes quite inelastic. However, evidence suggests major shifts may occur in the position of the curve in short time periods. Countries that are becoming increasingly competitive (cost efficient), or increasingly attractive for new investment, will see their supply curves shifting to the right as a result of new transnational corporation or local investments. Those that are becoming relatively less competitive will see their clothing export supply curves remaining stable, or even shifting to the left as new investments are directed to more favorable locations. When viewed in this context recent trends in US clothing imports suggest Lesotho is probably becoming relatively less competitive, or less desirable a location for new investment, than are some NAFTA or NAFTA parity countries whose supply capacity shifted upward at a remarkable pace.

SITC/Exporting Country	Exports to the United States (\$000)		
	1995	1999	Net Change
<b>Jerseys and Pullovers (8453)</b>			
Mexico	288,157	830,576	542,419
Honduras	126,751	337,136	210,385
Guatemala	30,546	239,292	208,746
El Salvador	68,627	150,380	81,753
Lesotho	12,388	23,004	10,616
<b>T Shirts (8454)</b>			
Mexico	289,715	978,666	688,951
Honduras	96,458	600,786	504,328
Guatemala	22,403	56,793	34,390
El Salvador	81,052	315,858	234,806
Lesotho	3,561	9,943	6,382
<b>Slips and Petticoats (8448)</b>			
Mexico	100,724	203,998	103,274
Honduras	66,401	117,192	50,791
Guatemala	4,857	30,890	26,033
El Salvador	46,013	119,090	73,077
Lesotho	88	60	-28
<b>Baby Garments (8451)</b>			
Mexico	26,456	85,104	58,648
Honduras	6,500	43,699	37,199
Guatemala	15,354	34,341	18,987
El Salvador	14,208	21,502	7,294
Lesotho	2,427	420	-2,007
<b>Above Four Products</b>			
Mexico	705,052	2,098,344	1,393,292
Honduras	296,110	1,098,813	802,703
Guatemala	73,160	361,316	288,156
El Salvador	209,900	606,830	396,930
Lesotho	18,404	33,427	14,963
<b>Memo Item</b>			
Lesotho - Total Exports	62,100	110,800	48,700

**Box 2. Continued.**

The statistics shown above illustrate this point for four of the products in which Lesotho experienced 1995-1999 competitive market share trade losses (see Table 14). During this short period, exports from such relatively small countries as El Salvador and Honduras rose by 200 to 300 percent, while Guatemalan exports of these products grew by just under 400 percent. Lesotho's exports grew, but a far lower pace. Evidence suggests that a relative loss of competitiveness, and a relatively less favorable commercial environment that makes Lesotho less attractive to new investment (see Section VI which follows), were responsible for this observed pattern.

While it might be suggested that Lesotho's recent export performance largely reflects supply constraints there are several indications that competitive problems are also a factor. As shown above, Lesotho's exports of two of the four products actually *declined* in absolute terms with 1999 exports of baby garments standing about \$2 million below their earlier levels. Similarly, of the 15 four-digit SITC clothing products Lesotho exported in 1995, the absolute value of 1999 exports of 9 of these items was actually lower than in the earlier year. Analysis of the underlying data strongly suggest these absolute trade losses were caused by the *displacement* of Lesotho's exports by more competitive NAFTA or NAFTA parity countries.

inability to compete effectively, on equal terms, with countries in the Americas is worrisome with regard to the likely outcome of direct future competition with Asian exporters. The results of the competitive "trial run" with NAFTA and the NAFTA parity countries strongly accents the need for Lesotho to implement needed measures to improve its international competitiveness (see Section VI which follows).

A second important point concerns the major expansion of United States clothing imports that occurred over 1995-1999. During this five year period, US imports of all clothing products grew by 42 percent, but import increases for some of Lesotho's major export products listed in Table 6 were far sharper. Imports of trousers and overalls, and bib trousers, grew by 74 and 90 percent, respectively, while imports of T shirts increased by 150 percent. These statistics raise an important question. Lesotho's recent export performance has been fueled by a major, largely unprecedented, expansion of US clothing imports. Lesotho's future performance will heavily depend on how long an import expansion of this magnitude can be maintained?

### B. Implications of the Concentration of Exports

Empirical evidence shows developing countries often need to diversify the products they export, and the geographic destinations and origins of their trade, since countries exporting a narrow range of products may be vulnerable to major adverse developments in international supply or demand. This problem may be particularly acute for many African countries that are heavily dependent on the exports of a relatively few primary commodities, which are often subject to highly unstable prices and unfavorable long-term demand prospects (Ng and Yeats 2002). The importance of this point is highlighted by a recent World Bank study showing countries with more diversified export structures generally achieved superior economic growth rates (De Ferranti et. al. 2001).

As noted, several trade concentration, or diversification, indices can provide useful insights concerning these issues as they relate to Lesotho's exports. One such measure is simply a "count" of the number of four-digit SITC products exported. This tabulation requires that some "cut-off" be used to

exclude items that are marginal in trade and which may not be exported on a regular basis. UNCTAD adopted an approach that seems sensible in that it excludes items where trade was below either \$100,000, or three-tenths of a percent of total exports. The higher the numeric value of this "product count" index, the greater the diversity of exports. A second index that has been used to measure concentration is the share of total exports accounted for by the largest, three largest, or five largest products. These "trade share" indices range upwards to 100 with higher values indicating more concentrated export structures.

Table 7 compares Lesotho's export concentration indices with those for the 16 other landlocked comparator countries. The point immediately evident from these statistics is that Lesotho's exports are very highly concentrated, even relative to the comparators. Lesotho exports only 21 different product line items which is about one-third the average number for the comparators. Five products account for about 95 percent of Lesotho's total exports, which is about 20 percentage points higher than average for the other countries. Unfortunately, there are reasons to believe that these comparisons almost certainly *understate* the importance of the product concentration problem. Lesotho's exports are concentrated in a narrow range of broadly similar clothing products and any important negative development, like a general slackening of demand, would likely cut across all items. In contrast, the exports of the individual

**Table 7. Measures of Export Concentration for Lesotho and the Landlocked Comparator Countries**

Country	Number of Products Exported*	Share of total exports (%)**		
		Largest Product	Three-Largest Products	Five-Largest Products
Lesotho	21	36.4	86.8	95.4
<b>Landlocked Countries</b>				
Armenia	57	68.7	75.2	78.7
Bhutan	29	39.7	69.9	75.1
Burkina Faso	62	66.4	74.3	79.4
Burundi	17	69.9	83.9	92.3
Central African Rep.	40	72.0	79.2	85.4
Chad	12	83.3	95.3	97.7
Kyrgyz Republic	102	55.7	65.0	74.1
Lao PDR	91	13.0	23.1	33.1
Malawi	81	60.0	67.7	75.4
Mali	80	84.1	86.5	88.9
Moldova	189	13.6	36.4	30.3
Mongolia	86	45.2	56.5	64.1
Niger	57	51.1	90.6	93.2
Rwanda	23	57.9	74.3	81.8
Tajikistan	79	32.9	64.0	74.3
Zambia	111	38.3	56.0	63.1
Average of Above	70	53.2	68.6	74.2

\* The higher the value of this index the lower the concentration of exports.

\*\* The higher the value of this index the higher the concentration of exports.

### Box 3. Implications of Statistics on Lesotho's Exports to South Africa

As previously discussed major discrepancies occur in Bureau of Statistics and Central Bank export statistics for Lesotho which were sufficient to preclude use of these data for most analytical purposes. Although the findings must be interpreted with a high degree of caution, this box attempts to determine if the available data imply a similar high level of product concentration in Lesotho's exports to South Africa, as did the United States import statistics.

The following table shows the twenty largest six-digit harmonized system (HS) products exported to South Africa in 1999, as reported by the Bureau of Statistics. The products are ranked in descending order of importance with each item's share of total exports shown. These data clearly imply a very high level of product concentration in exports to South Africa as only five six-digit HS products account for over 50 percent of total exports, and the 20 largest items account for almost 90 percent of this exchange. To put these numbers in some perspective, the harmonized system distinguishes between about 3,000 different items at this level of detail. In short, the available information suggests Lesotho's exports to South Africa are also highly concentrated in a relatively few product lines.

#### Lesotho's Largest Export Products to South Africa in 1999.

<u>HS Number</u>	<u>Description</u>	<u>Share</u>	<u>Cumulative Share</u>
220190	Waters not sweetened	15.01	15.01
852810	Color television receivers	12.32	27.33
640299	Footwear with rubber tops	9.76	37.09
640340	Other protective footwear	8.08	45.17
620349	Men and boys trousers, nes	7.80	52.97
640320	Footwear with leather soles	6.66	59.63
640359	Leather footwear, nes	4.75	64.38
640610	Parts of shoes	4.50	68.88
110510	Flour and meal	3.04	71.92
020890	Meat offals	2.89	74.81
520942	Denim	2.86	77.67
020710	Fresh poultry	1.53	79.20
611030	Sweaters of MMF	1.37	80.57
690490	Ceramic floor blocks	1.20	81.77
210500	Ice cream	1.20	82.97
640590	Footwear, nes	1.13	84.10
620640	Blouses of MMF	1.06	85.16
300339	Medicaments with hormones	0.91	86.07
660199	Umbrellas	0.87	86.94
621040	Other men and boys garments	0.84	87.78

Aside from television receivers, which probably reflects the assembly of components produced elsewhere, footwear clearly is of major importance among these 20 largest export items. The six footwear products listed above account for about 35 percent of Lesotho's exports to South Africa. The potential importance of this finding is that a local production base has been established for what could become a major export item in trade with OECD countries, although the United States import statistics give no indication of any trade in footwear products is now taking place.



landlocked comparator countries often are in more differentiated goods (see Appendix Table 1) which would minimize the potential for negative cross product effects. In short these comparisons strongly stress the need for Lesotho to diversify its export base in both the US and South Africa (see Box 3). The section that follows examines information relating to the potential direction for such a diversification.

#### IV. IMPLICATIONS OF REVEALED COMPARATIVE ADVANTAGE PROFILES

##### Key Observations

*An examination of the comparative advantage profiles of the landlocked comparator countries suggests Lesotho's options for export diversification may be far wider than is often assumed. Specifically, the comparator countries have developed a comparative advantage in a wide range of manufactures that are generally labor intensive in production and do not appear to have relatively high nominal transportation costs. The evidence suggests that many of these manufactures should also be suitable for production and export by Lesotho.*

Measures of 'revealed' comparative advantage (RCA) have been used to help assess a country's export prospects. One question they have been used to address is whether a country is in the process of extending the number of products in which it has a trade potential, as opposed to situations where the number of products that can be competitively exported is static or even declining (Ng and Yeats 2000). These indices have also been used to help identify situations where potentially beneficial bilateral trading opportunities exist. These are most likely in situations where two countries have different RCA profiles. Countries with similar RCA profiles, like many of those in Africa, are unlikely to have high intra-trade shares because they export similar types of goods. Finally, analysis of the revealed comparative advantage profiles of countries with broadly similar economic endowments can potentially help a specific country identify new products it might competitively export. The RCA profiles of the comparator countries will be used in this way to try and help determine how Lesotho might diversify its own, very narrow, export base (see Box 4 for a related approach to this question).

The revealed comparative of country *i* for product *j* is generally measured by the item's share in the country's exports relative to its share in world trade.<sup>12</sup> The index ( $RCA_{ij}$ ) has a simple interpretation. A value of less than unity (which indicates that the share of product *j* in *i*'s exports is less than the corresponding world trade share) implies that the country has a revealed comparative *disadvantage* in the product. Similarly, if the index exceeds unity, the country is said to have a revealed comparative *advantage* in the item. In a few cases, however, the net trade ratio has also been used as an indicator of

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<sup>12</sup> That is, if  $x_{ij}$  is the value of country *i*'s (global) exports of *j*, and  $X_{ij}$  is the country's total exports its revealed comparative advantage index is,

$$RCA_{ij} = (x_{ij}/X_{ij})/(X_{iw}/X_{tw})$$

where the *w* subscripts refer to world totals. RCA indices are sometimes computed only for processed goods or manufactures because trade in agricultural products is sometimes distorted by export incentives or trade barriers which may obscure whether a country has a comparative advantage or disadvantage in these goods.

comparative advantage.<sup>13</sup> Values for this index range between -100 to +100 with higher positive (negative) values indicating a comparative advantage (disadvantage).

Before proceeding, several points should be noted concerning the application of the revealed comparative advantage concept. First, the utility of the index is considerably reduced in cases where significant export subsidies or other related incentives are extended to specific products, or where high tariffs or other trade barriers exist. In such cases, the RCA index value may largely reflect the influence of the incentives, and not correctly indicate a true comparative advantage. As an example, during the last decade the European Community consistently ranked as one of the world's largest sugar exporters, yet it is generally conceded that Europe would be globally uncompetitive without the massive export subsidies that were paid to domestic sugar producers. In addition, guaranteed EU market quotas for some relatively inefficient developing country sugar producers (like Mauritius) almost certainly imparted significant biases in the RCA indices for these "quota receiving" countries.

#### A. "Large" Exports of the Comparator Countries

Efforts to compile statistics on the largest export products of the comparator countries can convey some useful information, although these data need not indicate that the country has a revealed comparative advantage in the item. From Lesotho's viewpoint a tabulation of the largest export products can identify specific goods for which the comparator countries have been able to establish a prominent production and trade base. However, to be most useful and relevant these tabulations should focus on manufactured goods that are normally *labor intensive* in their production.<sup>14</sup> The rationale here is that Lesotho does not possess an abundance of arable land and other natural resource endowments needed to produce, and competitively export, most agricultural materials and foodstuffs, nor does it possess extensive mineral deposits. Lack of a broad natural resource base should not constitute that much of a problem for most labor intensive manufactures, although it could be a production constraint for items such as wood or paper products.

Table 8 lists the largest manufactured export products of the landlocked comparator countries and shows their value and share of total exports. Clearly clothing dominates this list as these products account for over 50 percent of all manufactured exports classified in the SITC 6+8-68 product group. However, the comparators have been able to collectively establish a significant presence in the trade of

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<sup>13</sup> The net trade ratio of country k for product j is defined as,

$$N_{kj} = \left( \frac{x_{kj} - i_{kj}}{x_{kj} + i_{kj}} \right) \times 100$$

where x and i refer, respectively, to country k's exports and imports. This index will also be computed to compare results with the traditional RCA measure. It should be noted, however, that the net trade ratio can be seriously affected by a country's own trade barriers if they have an important impact on the level and structure of imports.

<sup>14</sup> Most empirical trade analyses define manufactured goods as all items classified in SITC product groups 5 through 8 less 68 (non-ferrous metals). However, the tabulations reported in Table 8 utilize a narrower definition of manufactures, namely, SITC groups 6 + 8 less 68 less uncut diamonds and gems. This excludes chemicals which often require some specific natural resource endowment for efficient production. It also excludes machinery and transport equipment which generally are capital intensive in production and not suitable for most developing countries. Finally, SITC groups 6 and 8 (less 68) are normally composed of manufactured goods that require labor intensive production inputs, a factor that should make them suitable for developing countries.

several products that might also be suitable for Lesotho's diversification efforts.<sup>15</sup> These items include handbags and luggage, leather, bed and table linen, and footwear. Available evidence indicates these types of items are normally manufactured by highly labor intensive techniques, and they generally have

**Table 8. The Largest Manufactured Export Products of the Land-Locked Comparator Countries**

SITC Code	Description	1999 Manufactured Exports		
		Product Value (\$000)	Product Share (%)	Cumulative Share (%)
8453	Jerseys and pullovers	59,200	10.0	10.0
8414	Men and boys trousers	49,341	8.4	18.4
6762	Hot formed steel bars	48,031	8.1	26.5
6761	Hot formed steel coils	45,370	7.7	34.2
6513	Cotton yarn	36,443	6.2	40.4
8415	Men and boys shirts	29,744	5.0	45.4
8411	Men and boys coats	27,866	4.7	50.1
6522	Woven cotton fabrics	27,112	4.6	54.7
8426	Women and girls trousers	24,528	4.2	58.9
8421	Women and girls coats	20,076	3.4	62.3
8454	T shirts	19,482	3.3	65.6
8437	Men and boys knit shirts	18,067	3.1	68.7
6584	Bed and table linen	14,705	2.5	71.2
8458	Garments not knit, nes	12,822	2.2	73.4
6715	Other ferro-alloys	12,550	2.1	75.5
6612	Portland cement	11,017	1.9	77.4
8452	Felt coated textiles	9,009	1.5	78.9
6726	Semi-finished iron	7,192	1.2	80.1
8427	Women and girls blouses	6,803	1.2	81.3
8312	Trunks and suitcases	6,700	1.1	82.4
8514	Footwear with leather uppers	6,626	1.1	83.5
8451	Baby's garments	6,361	1.1	84.6
6116	Goat leather	6,347	1.1	85.7
6115	Sheep leather	5,848	1.0	86.7
8412	Men and boys suits	5,600	0.9	87.6
6727	Semi-finished iron	5,509	0.9	88.5
8448	Women and girls nightwear	5,423	0.9	89.4
8442	Women and girls knit outerwear	5,270	0.9	90.3
8413	Men and boys jackets	4,660	0.8	91.1
8423	Women and girls jackets	4,658	0.8	91.9
8966	Antiques	4,461	0.8	92.7
8459	Garments not knit, nes	4,216	0.7	93.4
6552	Knit fabrics	3,594	0.6	94.0
8425	Women and girls woven skirts	3,526	0.5	94.5
	All Above Products	558,157	94.5	
	ALL SITC 6 + 8- 68-unset gems	590,380	100.0	100.0

<sup>15</sup> The inclusion of four ferrous metals products in Table 8 came as something of a surprise. Examination of the underlying country statistics shows that almost all of these exports originated in four Central Asian comparator countries, namely, Armenia, Kyrgyz Republic, Moldova and Tajikistan.

high value/bulk ratios in transport, so Lesotho could presumably be competitive in their production and export.

### B. RCA Profiles of the Land-Locked Comparator Countries

While Table 8 identifies the largest four-digit exports of the landlocked comparator countries, an important related question is whether these countries have a comparative advantage in these goods. If not, their longer-term trade prospects may not be favorable if the comparators exports are in danger of being eroded by more efficient producers. A "two-stage" application of the revealed comparative advantage index can provide information relevant to this point. This approach will first estimate RCA indices for the *combined* exports of the comparator countries in an effort to determine if there are items whose production characteristics generally make them suitable as exports from the group. However, combined export data could obscure potentially important information on the exports of individual countries. As such, in a second test, revealed comparative advantage indices are estimated for each individual landlocked comparator country in order to tabulate the frequency with which RCA indices for specific products exceed unity. (see Appendix Table 2 for country specific data).

Table 9 lists the individual four-digit products, exclusive of clothing, for which the land-locked comparator countries collectively had a 1999 comparative advantage, it reports the value of both the index and net trade ratio, and indicates the total value of the comparators exports. Clothing has been excluded since the intention is to identify products which Lesotho might select to diversify away from this sector.

**Table 9. Manufactures in which the Land-Locked Countries Collectively Have a Comparative Advantage**

SITC Number	Description	RCA Index	Net Trade Ratio (%)	Exports (\$ 000)
6762	Hot formed steel bars	11.8	62.7	48,031
6761	Hot rolled iron bars	12.1	84.6	45,370
6513	Cotton yarn	7.7	79.9	36,443
6562	Woven unbleached cotton fabrics	11.0	54.3	27,112
6584	Bed and table linen	3.5	49.8	16,070
6715	Other ferro-alloys	3.1	90.4	12,550
6612	Portland cement	3.8	-66.6	11,017
6726	Semi-finished iron and steel	1.6	79.3	7,192
8312	Trunks and suitcases	3.3	50.4	6,700
6116	Goat and kid leather	19.7	91.6	6,347
6115	Sheep leather without wool	8.3	98.9	5,848
6727	Semi-finished iron	6.6	65.1	5,509
8966	Antiques over 100 years	2.7	99.7	4,461
6618	Asbestos fiber cement	3.2	-48.8	2,489
6651	Glass containers	1.1	-54.6	2,030
6585	Curtains and drapery	1.4	-12.2	1,881
6735	Flat rolled steel	2.3	-20.6	1,760
6344	Plywood	1.9	-41.4	1,564
6921	Metal tanks and vats	2.0	-27.8	1,321
6117	Animal leather nes	2.4	69.5	1,076
6645	Cast or rolled glass sheets	2.6	16.1	517
8965	Coins and nature collections	1.1	98.4	371
6593	Hand woven rugs	1.9	-0.22	148
6545	Woven jute products	1.4	-57.6	125

Source: World Bank estimates

#### Box 4. Implications of Industry Level Labor Intensity Indices

The statistics examined in this report show that Lesotho has a extremely concentrated export structure and that a high priority should be assigned to diversification into new product lines. Considerations for product diversification should recognize two points. First, new export ventures should be highly intensive in the use of a factor Lesotho has in abundance, that is, low cost relatively unskilled labor. Second, given Lesotho's geographic disadvantage the products should have relatively high value/stowage factor ratios to help overcome transportation cost constraints.

In order to assist countries like Lesotho evaluate potential new exports, the World Bank (1993) initiated a study aimed at identifying goods that were normally produced using labor intensive manufacturing processes. Detailed surveys of industrial production statistics were undertaken and various measures of labor intensity were computed for over 600 individual industry sectors. A key statistic was the ratio of the value added per employee in the industry to the average value per employee in all United States manufacturing industries. Two specific points regarding this approach should be noted. First, use of US industrial census statistic was justified by detailed surveys by the National Bureau of Economic Research (NBER) that goods manufactured by *relatively labor intensive* processes were normally manufactured by similar methods in other countries, irrespective of their income average levels. Second, it should be noted that there is an inverse relation between the numeric value of the industry index. That is, the lower the numeric value of the index the higher is the labor intensity of the product. It also follows that products with very high index values (that is, well above 100) are capital intensive in their production.

A surprising result of the survey was that manufacturing processes in a relatively high number of industries were dependent on highly labor intensive production methods, and therefore, suitable for adoption in developing countries. While textile and clothing products were often identified as highly labor intensive, the following table lists a few of the other products that also utilize very high labor inputs.

#### Examples of Industrial Products Normally Using Labor Intensive Manufacturing Processes

Industry (Labor Intensity Index)	Industry (Labor Intensity Index)	Industry (Labor Intensity Index)
Poultry dressing plants (41.7)	Wood TV and radio cabinets (50.3)	Women's handbags (48.2)
Fresh and frozen fish (59.7)	Wood kitchen cabinets (67.5)	Leather gloves (43.0)
Curtains and draperies (42.5)	Wood office furniture (72.7)	Leather belts (60.5)
House furnishings (58.7)	Upholstered furniture (57.3)	Leather tanning (68.9)
Textile bags (50.5)	Bookbinding (53.2)	Luggage (62.7)
Canvas products (57.6)	Watches and clocks (66.7)	Earthenware food utensils (47.6)
Hardwood flooring (45.1)	Musical instruments (64.4)	Pottery (57.7)
Hardwood plywood (57.4)	Dolls (66.5)	Artificial flours (59.6)
Softwood plywood (55.2)	Costume jewelry (64.7)	Buttons (57.5)
Nailed wood boxes (49.9)	Fabricated rubber products (83.3)	Woven carpets (62.0)
Folding paper boxes (72.8)	Rubber & plastic footwear (47.4)	Cordage and twine (63.7)
Envelopes (81.1)	Boot and shoe stock (52.7)	Wood kitchen cabinets (67.5)
Wood containers (45.2)	House slippers (46.2)	Luggage (62.7)
Wood household furniture (50.1)	Men's footwear (54.9)	Sewing machines (71.1)
Brooms and brushes (71.1)	Women's footwear (53.0)	Residential light fixtures (73.5)

Note: The lower the level of the intensity index the higher the labor intensity of the product. An index value of 100 indicates the good employed average labor inputs for all sectors of the economy.

A final important point was that the Bank's analysis suggested the potential for developing countries in these types of activities was indeed promising. In global trade, many of these products had relatively high growth rates. In addition, while developing countries were increasing their international market shares for many of these products, there was clearly further scope for a major expansion.

For reasons previously indicated, these empirical tests have been confined to products classified in SITC groups 6 and 8 less 68. In interpreting this information, it should be noted that the RCA index is regarded as a dichotomous measure, that is, it indicates whether a country has, or does not have, a comparative advantage in a product with *relative* index values conveying little useful information.<sup>16</sup>

Collectively, the landlocked countries have a revealed comparative advantage in 24 non-clothing manufactured products, and several appear to be potential exports for Lesotho. Trunks and suitcases are generally manufactured using labor intensive techniques (as are similar goods like handbags – see Box 4). Hand woven rugs also utilize relatively high labor inputs, although it is surprising that the net trade ratio for this product is slightly negative. Three types of leathers appear on the “collective” comparator country RCA list, and these items (particularly sheep and goat leather) could be promising candidates for export diversification. One attraction of establishing a production and export base for leather is that this could make it easier to support forward linkages to the manufacture of several labor intensive manufactured products like footwear or travel goods (see Box 4)

If one turns to the analysis of individual comparator countries RCA profiles, the potential directions for Lesotho’s diversification appear to be far broader than initially suggested by Table 9. Specifically, one or more of the landlocked countries has acquired a comparative advantage in 110 four-digit SITC products (exclusive of ferrous metals and textiles) within the general SITC 6+8-68 grouping and, in cases, up to five of these countries has an advantage in a specific product. Table 10 lists 45 representative items drawn from the full list of 110 four-digit SITC products (see Appendix Table 2). It identifies the land locked comparator countries that have acquired a revealed comparative advantage in each item, and also shows the range in estimated RCA index values. As expected, products that the World Bank (1993) identified as labor intensive in production are prominent among these items identified as potential new exports for Lesotho.

An important question is how to identify the most promising of these potential candidates for Lesotho’s export diversification. Clearly, trade related technical assistance projects sponsored by the United Nations Conference on Trade and Development (UNCTAD) can help in this effort. In particular, specific features of UNCTAD’s Trade Point Program should be considered. This electronic trading opportunities system, maintained by the World Trade Point Federation, provides global information on specific products that individual companies are currently attempting to purchase. The Trade Point Program provides useful information on international demand prospects for specific products, and also identifies those companies that are active traders for both manufactures and other types of goods.

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<sup>16</sup> An example can help clarify this point. Assume products k and j comprise 100 percent of the total exports of countries a and b, and that the share of product k and j in world trade are 10 and 1 percent, respectively. Although both countries have a absolute comparative advantage in these products the maximum possible RCA index for product k is 10 while that for product j is 100.

**Table 10. Representative Manufactured Goods in which One or More Land Locked Comparator Country has a Comparative Advantage in Production and Export.**

SITC	Description	Comparator Countries with RCAs Above Unity	RCA Index Range*
6113	Bovine leather	Moldova	8.2
6115	Sheep leather without wool	Burkina Faso, Mali, Rwanda	2.4 to 126.1
6121	Industrial leather manufactures	Central African Republic	2.6
6122	Harness makers goods	Laos	1.5
6291	Pharmaceutical rubber products	Tajikistan	3.0
6351	Wooden boxes and drums	Rwanda	1.2
6354	Household wood articles	Burkina Faso, Laos, Malawi, Rwanda	1.3 to 3.3
6513	Cotton yarns	Tajikistan, Zambia	31.1 to 39.0
6522	Woven unbleached cotton fabrics	Kyrgyz Republic, Malawi, Moldova, Tajikistan	1.2 to 154.6
6565	Embroidery	Tajikistan	2.7
6574	Quilted textile products	Burkina Faso	1.9
6581	Textile sacks and bags	Kyrgyz Republic, Malawi, Tajikistan	2.1 to 2.7
6583	Blankets and travel rugs	Malawi, Mongolia, Tajikistan	1.1 to 3.0
6584	Bed and table linen	Malawi, Moldova, Tajikistan	1.8 to 19.7
6585	Curtains	Malawi, Mali	1.2 to 9.0
6589	Made-up textile articles	Bhutan	18.9
6591	Linoleum	Kyrgyz Republic, Niger	2.2 to 4.5
6592	Knotted carpets	Armenia, Bhutan, Mongolia	1.2 to 7.7
6593	Hand woven rugs	Armenia, Laos, Moldova, Tajikistan	1.2 to 13.4
6595	Woven carpets	Moldova	7.8
6638	Asbestos manufactures	Tajikistan	1.5
6643	Glass sheets	Armenia, Kyrgyz Republic	5.0 to 39.8
6651	Glass containers	Moldova	10.5
6921	Metal tanks and vats	Kyrgyz Republic, Moldova	9.1 to 14.8
6931	Wire ropes and cables	Bhutan	5.1
6951	Agricultural hand tools	Kyrgyz Republic	2.5
6957	Mixed hand tool sets	Laos	1.2
6978	Household appliances	Burkina Faso	1.4
8312	Trunks and suitcases	Moldova	34.9
8512	Sports footwear	Laos	1.7
8514	Footwear with leather uppers	Moldova	3.8
8515	Footwear with textile uppers	Laos, Moldova	1.2 to 1.6
8519	Parts of footwear	Moldova	4.7
8711	Binoculars and telescopes	Armenia	3.5
8731	Gas and electric meters	Armenia, Niger	1.7 to 1.8
8741	Navigation and survey equipment	Bhutan, Burkina Faso	2.4 to 6.1
8743	Fluid gauges and instruments	Niger	1.7
8812	Movie cameras and projectors	Burkina Faso	2.9
8843	Optical lenses and mirrors	Armenia	1.2
8919	Parts of firearms	Burkina Faso	4.4
8931	Plastic boxes and lids	Kyrgyz Republic	2.1
8973	Jewelry	Armenia	8.2
8982	Musical instruments	Burkina Faso, Mali	2.9 to 3.6
8991	Carvings and moldings	Bhutan, Laos	1.9 to 5.6
8997	Baskets and brushes	Burkina Faso	2.3

\* The figures shown below indicate the range in RCA indices that were above unity.

## V. GLOBALIZATION AND INDUSTRY TRADE TRENDS

### Key Observations

*International production sharing, which often involved the importation and further assembly of parts and components in developing countries, can significantly broaden the range of new products in which a country can successfully diversify. Statistics show that many of the landlocked comparator countries have moved strongly into component assembly operations, and it appears this activity could contribute to Lesotho's export diversification and industrialization. However, the quality problems associated with Lesotho's trade statistics makes it impossible to determine the extent to which production sharing is occurring.*

One major aspect of the move toward increased globalization is the expansion of production sharing between countries. Production sharing recognizes that the complete manufacturing process for a specific good may consist of several distinct sub-processes or operations, some of which may be relatively labor or capital intensive. Numerous benefits may result, and efficiencies achieved, by locating the labor intensive segments of the manufacturing process in a developing country, while segments that are capital intensive are completed in relatively richer countries. Several specific examples can help illustrate the nature of production sharing.

- *In the Far East*, electronic components, like micro-chips and transistors, are produced in Japan (this operation is capital intensive) and are then sent to relatively poorer countries like Thailand, the Philippines, or China for further assembly. The latter process may involve wiring the components into metal boards, or the final assembly of office equipment, computers, or electronic machines. These finished goods may then be re-exported to Japan or to third country markets. In 1996, the value of East Asian intra-trade in parts and components intended for further assembly totaled \$165 billion (Yeats 1999).

- *In the United States*, synthetic yarns and fabric are produced and exported to Caribbean countries like Jamaica and the Dominican Republic where they are sewn into semi-finished, or finished, clothing. This activity is encouraged by special provisions in the United States tariff schedules that apply duties only to the value added component of the product assembled abroad, and not on the actual value of the finished good. Estimates indicate the value of Caribbean exports of manufactures produced using imported components rose to approximately \$5 billion in the mid-1990s.

- *In the European Union*, metal parts and sheets are produced and exported to Eastern Europe for cutting, shaping and further assembly. EU tariffs also encourage these production sharing activities by applying duties only to the value added component of the foreign assembled good. The value of OECD intra-trade in parts and components has been estimated at over one-quarter trillion dollars in the mid-1990s.

- *Intra-developed and developing country production sharing* is of major global importance. In the automotive industry, for example, car parts are produced in Japan and Canada and then sent to Europe or the United States for final assembly. In recent years, shipments of electronic parts, and parts of clothing and furniture, from Singapore and Hong Kong to developing countries have grown rapidly. As a result, some recent estimates indicate production sharing now accounts for at least one-quarter of global trade in manufactured goods.



Analysts that have studied production sharing operations generally argue that this process has a number of very positive attractions and benefits for developing countries. Production sharing broadens choices for industrialization and development strategies. In the absence of production sharing, developing countries would have to master entire production processes in order to become viable competitors in world markets. Fragmentation and component specialization eliminate the need to gain competency in all aspects of production and allow emerging countries to enter into the network of global trade by focusing on just one aspect of production, or no more than a limited subset of all activities involved in making a final product. *As such, production sharing can significantly broaden the range of new products in which a country can successfully diversify.* It is also alleged that production sharing may involve important job creation and revenue enhancement effects in developing countries, as well as learning effects that can assist in the launch of other new export ventures.

While it was previously difficult to assess the magnitude and direction of production sharing, recent revisions to the Standard International Trade Classification (SITC) system have greatly expanded the level of information on traded parts and components. Specifically, the SITC Revision 2 classification system identifies over 60 different three and four-digit product groups that consist solely of components, while even more component products are identified in the Revision 3 classification system. This information makes it possible to measure the level of the comparator countries' involvement in production sharing and assess the implications for Lesotho.<sup>17</sup>

Table 11 provides summary information on the involvement of the landlocked comparator countries in production sharing. These statistics are consistent with those from other studies showing that poorer developing countries generally are only marginally involved with the production and export of components, but are far more involved in assembly operations employing these goods. On average, only about one-half of one percent of the comparator countries' exports consists of parts and components, and this share reaches a high of about 2 percent in the case of Bhutan.

However, on the import side a markedly different picture emerges. The share of components for further assembly exceeds 10 percent of total imports for 10 of the 16 comparators, and is over 15 percent in the case of Bhutan, Central African Republic, Laos, Malawi, Rwanda and Zambia. While some of this trade may involve the replacement of defective parts in existing equipment, or the further assembly of goods to be disposed of in local markets, studies show the assembly of foreign produced parts and components have provided a major stimulus to many developing countries' exports. As an example, in the mid-1990s about 50 percent or more (measured by value) of the total manufactured exports of such diverse countries as Haiti, Thailand, Dominican Republic, El Salvador, Malaysia, Jamaica, Honduras, Colombia, or Costa Rica to the US consisted of parts and components that were initially manufactured by *United States companies*. Production sharing of this sort is a major component of the globalization process and the integration of individual economies into the global economy.

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<sup>17</sup> Almost certainly these data will understate the actual importance of production sharing. The problem is that some traded products, like cotton thread, have few end uses in themselves and are almost exclusively used in the production of higher stage manufactures like textiles and clothing. The present analysis is confined to SITC products specifically labeled as "parts and components" in order to avoid speculation on the end use of numerous other goods.

Table 11. Recent Changes in the Comparator Countries Trade in Parts and Components

Trade Flow/Country	1999 Trade in Parts & Components (\$ '000)	Share of Parts and Components In Total Trade (%)	
		1995	1999
<b>EXPORTS</b>			
Armenia	357	0.44	0.32
Bhutan	483	0.52	2.32
Burkina Faso	415	0.50	0.24
Burundi	243	0.03	0.35
Central African Republic	854	0.19	0.39
Chad	1,043	0.46	0.97
Kyrgyz Republic	1,095	0.31	0.48
Lao PDR	366	0.10	0.16
Malawi	647	0.16	0.13
Mali	1,609	0.26	0.60
Moldova	1,718	0.47	0.49
Mongolia	316	0.04	0.10
Niger	4,913	0.26	1.63
Rwanda	156	0.31	0.30
Tajikistan	919	0.55	0.59
Zambia	829	0.10	0.14
<b>IMPORTS</b>			
Armenia	17,513	3.62	6.22
Bhutan	6,996	10.14	21.25
Burkina Faso	41,962	12.07	7.75
Burundi	9,534	11.81	12.49
Central African Republic	13,953	13.51	15.90
Chad	10,920	14.84	12.50
Kyrgyz Republic	33,150	4.73	9.40
Lao PDR	85,969	5.12	15.69
Malawi	61,487	11.89	15.09
Mali	76,153	13.23	10.79
Moldova	31,061	4.35	6.27
Mongolia	30,975	8.93	11.63
Niger	18,588	11.57	6.54
Rwanda	34,781	5.83	18.73
Tajikistan	6,323	11.03	4.69
Zambia	118,655	17.65	18.55

Source: Based on partners' data from UN COMTRADE Statistics.

International production sharing seemingly has the potential to play an important role in an export diversification strategy for Lesotho, but a major problem is that the unreliability of available trade statistics (see the report by Yeats in this annex) makes it impossible to determine the extent to which Lesotho is currently engaged in this activity, or for which types of manufactures (if any) production sharing is occurring. Lesotho, like the landlocked comparator countries, would seemingly have its greatest comparative advantage in the import and assembly of foreign produced components. However, given the extreme differences between the Central Bank and Bureau of Statistics import values little can now be said with any confidence on this issue.

While this report earlier stressed the need for a thorough quality assessment and reconciliation study for Lesotho's conflicting trade statistics, there is clearly an immediate pressing need for the compilation of information on Lesotho's current involvement in components trade. Production sharing potentially is a useful vehicle for promoting a much needed export diversification, but the data required for such an assessment are not now available.

## VI. IMPLICATIONS OF THE DOMESTIC ENVIRONMENT

### Key Observations

*Policy makers in specific countries previously had difficulty in determining how their domestic commercial environment compared to those implemented elsewhere. Several recent efforts to compile comprehensive cross-country indices of the quality of governance and commercial policies now provide relevant information. These statistics suggest domestic commercial policies make Lesotho relatively less attractive to foreign investment than many other developing countries. Less than 20 percent of all Latin American countries have a domestic commercial environment inferior to that in Lesotho, while the corresponding share for East Asia is under 30 percent (largely due to countries like North Korea, China, Burma and Vietnam). Overall, almost 70 percent of all developing countries appear to pursue commercial policies that make them as, or more, attractive to foreign investment.*

Admittedly Lesotho is disadvantaged by several of its physical characteristics, like remoteness from major markets, its small size, or its land-locked status that may reduce its internationally competitiveness or ability to attract foreign investment. While government policy makers have little control over these geographic variables, they clearly have the capacity to influence many key trade, monetary, fiscal, foreign investment, or tax regulations that have a major influence on the general internal commercial environment and a country's ability to attract foreign investment. In a recent (January 1998) address to the UN Economic Commission for Africa in Addis Ababa, World Bank President James Wolfenson graphically highlighted the general importance, and negative influence of these commercial and governance factors throughout Sub-Saharan Africa,

**“But what do we see when we look at Africa? We see that Africa is missing out. Of \$300 billion in total foreign private capital flows, Sub-Saharan Africa received about \$12 billion. And of that, only \$2.6 billion in direct investment – a trivial number in relation to the size and potential of the continent. But we also have to face facts. It is not just because the private sector is myopic that less than 1 percent of direct investment comes to Africa. Africa needs to set itself up to attract private investment and that means a clean regulatory environment, it means a judicial system that works, it means property rights, corporate law, predictability in taxes and, in relations to governments, it means**

*capacity building, health care, and the infra-structure to go along with it. And it means that corruption must be stamped out. Without these, private investors simply will not invest.”*

A practical problem relating to this point is that policy makers in a specific country previously had difficulty in determining how their own domestic commercial environment compared to those implemented elsewhere, or even if their economic and governance policies were relatively favorable or repressive. Specifically, Lesotho must compete with other countries for foreign investment and a key question is whether its own internal policies make it relatively attractive, or unattractive, to foreign finance.<sup>18</sup> If Lesotho is relatively unattractive, which specific policies are primarily responsible for the country's negative image. While it previously would have been difficult to address issues like these, several recent efforts to compile comprehensive cross-country indices of the quality of governance and commercial policies in over 160 countries can provide useful relevant information.

#### A. The Wall Street Journal – Heritage Foundation Index

One such initiative involved an effort by Transparency International to construct numeric indices of the extent of corruption in over 50 countries by using detailed interviews with government officials and local and foreign businessmen. The indices ranged, theoretically, from a value of zero for a country perceived to be totally corrupt to a value of 10 for a country perceived to be totally clean. More recently, the Wall Street Journal and Heritage Foundation (WSJ-Heritage 1997) compiled, and annually updated, an index that measures the general overall commercial policy environment in over 150 countries. This initiative produced similar indices on government policies relating to ten business factors, namely, the extent of trade controls, the level of taxation, the extent of government interventions in the economy, national monetary policy and its contribution to inflation, restrictions on capital flows and their impact on foreign investment, government controls on banking, the extent of government imposed wage and price controls, the security of property rights, the extent of government regulation of industry, and the size of the black market.<sup>19</sup>

The WSJ-Heritage Indices for each of these ten variables are assigned on the basis of objective criteria, and can take a value of one to five with *lower values* indicating an environment more conducive to economic growth. Since the index values are assigned on the basis of clearly specified empirical

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<sup>18</sup> In consultations with the World Trade Organization (1998, p. 8), the Government of Lesotho stated “It is recognized that the success of Lesotho in attracting investment is dependent upon the creation of an enabling environment. Efforts are being made to maintain political stability, good governance, accountability, transparency and macro-economic management.” These observations are clearly of major importance, but previously policy makers had little objective evidence as to how favorable, or unfavorable, was the commercial environment in Lesotho relative to most other developed or developing countries. The objective of this section is to examine evidence relating to this point.

<sup>19</sup> For example, in the construction of the taxation index five gradations of income tax levels were set. These ranged from no taxes on income, or a flat tax of 10 percent or less – a situation assigned a value of 1.0 – as opposed to an environment where a top rate of over 50 percent was applied along with a tax on average income between 20 and 25 percent. This latter “worst case” environment was assigned an index of 5. Similar gradations were made for intermediate corporate tax rates and index values assigned accordingly. The corporate and income tax indices were then averaged to arrive at an overall “tax environment” index for the country. For details on how the indices were constructed and information on the specific factors surveyed within each of the government policy sectors see Wall Street Journal and Heritage Foundation (1997).

standards the potentially corruptive influence of subjective judgments was greatly reduced.<sup>20</sup> Finally, an overall index of the quality of the national economic environment was derived for each country by averaging the ten WSJ-Heritage policy indices. This overall index is often viewed as one measure of the attractiveness of a country for foreign investment and its ability to sustain industrialization and economic growth.<sup>21</sup>

**Table 12. Values of the 2002 WSJ-Heritage Index of the Commercial Environment in Developed and Developing Countries**

WSJ-Heritage Index Range	Commercial Classification	Classified Countries*
2 or Under	Free	Hong Kong, Singapore, New Zealand, Estonia, Ireland, Luxembourg, Netherlands, United States, Australia, Chile, United Kingdom, Denmark, Switzerland, Finland, Bahrain, Canada
Over 2 and Under 3	Relatively Free	Bahamas, El Salvador, Sweden, Austria, Belgium, Germany, Cyprus, Iceland, UAE, Barbados, Portugal, Spain, Italy, Lithuania, Taiwan (China), Czech Republic, Hungary, Thailand, Japan, Norway, Trinidad & Tobago, Argentina, South Korea, Latvia, Uruguay, Cambodia, Costa Rica, Israel, Armenia, Belize, Bolivia, France, Jordan, Malta, Panama, Poland, Kuwait, Peru, Greece, Guatemala, Sri Lanka, Colombia, Tunisia, Botswana, Cote d'Ivoire, Jamaica, Mali, Mexico, Mongolia, Namibia, Oman, Slovak Republic, South Africa, Philippines, Qatar
3 to Under 4	Relatively Restricted	Dominican Republic, Mauritius, Saudi Arabia, Uganda, Central African Republic, Morocco, Mozambique, Algeria, Brazil, Djibouti, Gambia, Madagascar, Malaysia, Paraguay, Slovenia, Swaziland, Benin, Cape Verde, Honduras, Lebanon, Nicaragua, Burkina Faso, Guyana, Kenya, Senegal, Cameroon, Gabon, Macedonia, Zambia, Albania, Guinea, Mauritania, Pakistan, Indonesia, Moldova, Turkey, Bulgaria, Croatia, Fiji, Georgia, Ghana, <i>LESOTHO</i> , Nepal, Rwanda, Tanzania, Ecuador, Azerbaijan, Malawi, China, Egypt, Ethiopia, India, Chad, Kazakhstan, Nigeria, Togo, Venezuela, Bangladesh, Romania, Russia, Congo, Yemen, Haiti, Tajikistan, Ukraine, Vietnam, Bosnia-Herzegovina, Equatorial Guinea, Guinea-Bissau, Surinam
4 to 5	Restricted	Yugoslavia, Burma, Syria, Zimbabwe, Belarus, Uzbekistan, Turkmenistan, Iran, Laos, Cuba, Libya, Iraq, North Korea

\*Within each group countries are listed in terms of ascending indices of the commercial environment. For example, within the first (free) group Hong Kong has the lowest (most favorable) index and Canada has the highest (least favorable) commercial index.

<sup>20</sup> As an illustration, a trade policy index of 1 was assigned to a country with average tariffs of 4 percent or less, while an index of 2 was assigned to countries whose tariffs were in the 5 to 9 percent range. The worse rating (an index of 5) was assigned to countries with average tariffs exceeding 20 percent. WSJ-Heritage also examined various published studies by the IMF, WTO, World Bank and UNCTAD to determine the extent that nontariff protection was used to supplement that from tariffs. Where NTBs were extensively applied the tariff derived index was increased by one point.

<sup>21</sup> Ng and Yeats (1999) employ the WSJ-Heritage index to show conclusively that countries with relatively attractive commercial environments achieved significantly higher levels of GDP per capita, they experienced higher growth rates for exports, imports and GDP, and were more successful in integrating into the global economy. Regression results indicated the WSJ-Heritage commercial indices explain over 60 percent of some measures of economic performance, which implies that a country's own national policies are a major determinant of its rate of growth.

Table 12 provides a summary view of the current (2002) rankings of the business environment by grouping 155 countries into one of four commercial categories. Countries with a composite index of 2 or under are classified as having a very favorable (free) commercial environment, while those with indices in the range of 4 to 5 have the least favorable (restricted) environment. Within each of the groups countries are listed in terms of ascending (increasingly unfavorable) indices. For example, within the first ("free") group Hong Kong has the lowest (most favorable) commercial environment index while Canada's business climate is the least favorable.

According to the WSJ-Heritage indices, Lesotho is ranked 108<sup>th</sup> out of 155 countries, and its overall index of 3.40 places it quite high in the "relatively restricted" country group which indicates a generally unfavorable commercial environment. Lesotho's worst scores (4 or more) occur for the relative height of trade barriers, the fiscal burden of taxes, government regulation of industry, and the size of the black market. Its best score (2.5) relates to a relative lack of government intervention in the economy. Box 5 shows Lesotho's indices for each of the 10 commercial policy measures along with WSJ-Heritage observations as to why these scores were assigned.

**Box 5. Lesotho's 2002 Scores for Major Policies Influencing the Commercial Environment.**  
(Scores: 1 best possible, 5 worst possible)

**Trade Policy:** Score 4 (Recent change – worse: High level of protectionism)

Published Comment: Lesotho is a member of the Southern African Customs Union which has a common external tariff rate of 12 percent. Lesotho maintains non-tariff barriers through import controls on a number of agricultural products. Based on increased evidence of non-tariff barriers, Lesotho's trade policy score is 1 point worse this year.

**Fiscal Burden of Government:** Score 4.5 (Recent change – stable: Very high cost of government)

Published Comment: In 1999, government expenditures equaled 49 percent of gross national product.

**Government Intervention in the Economy:** Score 2.5 (Recent change – stable: Moderate level)

Published Comment: Government consumes about 19.4 percent of GDP. In 1998, Lesotho received 6.5 percent of its total revenues from state owned enterprises and from government ownership of property.

**Monetary Policy:** Score 3.0 (Stable: Moderate level of inflation)

Published Comment: From 1991 to 2000, Lesotho's weighted average annual rate of inflation was 6.99 percent.

**Capital Flows and Foreign Investment:** Score 3.0 (Stable: Moderate barriers)

Published Comment: Lesotho has no established investment code, but does offer a series of investment incentives. Equity investment faces few barriers, but debt investment requires prior government approval. The government also prefers the hiring of local employees and may refuse to issue visas to foreigners. Investment is also discouraged by Lesotho's political instability. As part of its International Monetary Fund program, Lesotho has identified investment promotion as a priority and says it plans to open all economic sectors to foreign investment; it remains to be seen what progress will occur.

**Banking and Finance:** Score 3.0 (Stable: Moderate level of restrictions)

While state involvement in the financial sector is considerable, the government has sought to privatize the

**Box 5. Continued.**

state-owned Lesotho Bank, and has closed another state-owned bank because it could not find a buyer. The government does affect the allocation of credit, however. The Economist Intelligence Unit reports that two state owned banks provide credit to the industrial sector, along with other banking services. Foreign banks are permitted, and a South African institution recently established a greater presence. The government plans further reforms. According to the Economist Intelligence Unit, "the government will attempt to improve banking regulation by developing a reporting format for offsite surveillance of commercial banks."

**Wages and Prices:** Score 3.0 (Improvement: Moderate level of intervention)

Published Comment: Although many prices have been liberalized in Lesotho, the government still influences them through the large state owned sector – particularly in utilities – through import and export controls. According to the Embassy of Lesotho, "the following agricultural commodities are still subject to import/ export controls: bread, fruits and vegetables, dairy products, livestock and meat, wool and mohair, hides and skins, and poultry meat." The government also sets most wages since it is the largest employer in the economy. However, on the basis of new information Lesotho's wage and price score would be [the most favorable possible] or 1.0.

**Security of Property Rights:** Score 3.0 (Moderate level of protection)

Published Comment: Private property is guaranteed, and expropriation is unlikely. According to the U.S. Department of State, "The Constitution provides for an independent judiciary; however, in the past magistrates appeared to be subject at times to government and chieftainship influence." Lesotho's legal system also is inefficient and is undermined by police abuse. The Department of State notes the existence of "credible reports that the police, at times, used excessive force against detainees ... There are long delays in trials.

**Government Regulation of Industry:** Score 4.0 (Stable: High level)

Published Comment: The government is Lesotho's largest employer, and its unwieldy bureaucracy impedes efficient regulatory rule. The government has pledged to address labor market inflexibility and the inefficient public sector as part of its IMF package, but results have yet to be forthcoming. The Economist Intelligence Unit reports that "that the government has already initiated a long-term and wide-ranging public sector reform and improvement project. ... However, past experience may cause some doubt as to whether the government has the resources to implement effectively all the initiatives to which it is committed. In the fall of 2000, the government identified fighting corruption as one of its major goals."

**Black Market:** Score 4 (Stable: High level of activity)

Published Comment: Lesotho has a substantial black market, particularly in consumer goods. Smuggling of firearms, automobiles, and dagga (a narcotic) between South Africa and Lesotho is a concern.

Source: Heritage Foundation-Wall Street Journal (2002)

Table 13 is intended to provide a somewhat different perspective on the question of how attractive is Lesotho for foreign investors relative to other countries. Here, Lesotho's overall commercial policy index is compared to those for other regional groups of developing countries – like those in Latin America or East Asia. The table shows the average and median index within each regional group and also indicates Lesotho's position relative to the other countries. For example, Lesotho's index (3.40) is slightly higher (worse) than the average for all other Sub-Saharan African countries, while the commercial environment appears to be more attractive in 70 percent of these other African countries.

These statistics suggest that domestic commercial policies make Lesotho relatively less attractive to foreign investment compared to many other developing countries. Less than 20 percent of all Latin American countries have a domestic commercial environment inferior to that in Lesotho, while the

**Table 13. The Relative Position of Lesotho's Commercial Environment Index as Compared to Indices for Other Major Developing Country Groups.**

Developing Country Group	Lesotho's Commercial Index	Country Group Index		Lesotho's Position in Group (% of Countries Above or Below)*	
		Average	Median	Above	Below
Sub-Saharan Africa	3.40	3.30	3.25	30.0	70.0
East Asia	3.40	2.97	2.95	28.6	71.4
South Asia	3.40	3.35	3.40	50.0	50.0
North Africa & Middle East	3.40	3.28	3.05	33.3	66.7
Central Asia	3.40	3.88	3.73	100.0	0.0
Eastern Europe	3.40	3.15	3.28	32.0	68.0
Latin America	3.40	2.87	2.95	19.0	81.0
ALL ABOVE COUNTRIES	3.40	3.15	3.13	30.6	69.4

\*The "above" column shows the percentage of countries in the group with a commercial environment inferior to that in Lesotho while the "below" column shows the percentage of countries with a superior commercial environment.

corresponding share for East Asia is under 30 percent (largely due to countries like North Korea, China, Burma and Vietnam). Overall, almost 70 percent of all developing countries appear to pursue commercial policies that make them, at least, or more attractive to foreign investment and business activity.

#### B. The Index of International Competitiveness

Another related national "commercial environment" index is contained in the World Economic Forum's (2001) **Africa Competitiveness Report 2000/2001** published by Oxford University for the World Economic Forum (Schwab *et. al.* 2000). Given that this source only makes comparisons among African countries its international scope is considerably narrower than that of WSJ-Heritage measure. The Competitiveness Report offers objective and subjective rankings of 24 African countries with an analysis of their competitive strengths and weaknesses. Each African country is given a four page profile that provides an analysis of the political, economic and social factors that affect each country's competitiveness. The countries are then ranked on numerous variables classified in six categories; openness, government, finance, infrastructure, labor, and institutions.

Although somewhat different criteria are used, the conclusions of the Competitiveness Report are fully consistent with those of WSJ-Heritage. Specifically, the Forum places Lesotho at about the mid-point of the 24 African countries whose international competitiveness is assessed. Lesotho receives relatively high scores regarding the operation of its courts and customs services, for the quality and operation of its local labor market, and the simplicity and transparency of its trade barriers. However, Lesotho ranks among the lowest 20 percent of the African countries in terms of the quality of its infrastructure (total railways, internet hosts and users, air transport quality), government (government expenditure and deficit, employee payroll tax, employer payroll tax, waiting time for permits), and finance (gross domestic savings and time to transfer money). In the area of civil service stability Lesotho's rating is last among the 24 African countries.



The clear message that emerges from these comparisons is that Lesotho must take the lead in implementing significant domestic policy changes that would significantly improve the local commercial environment. Lesotho's success or failure in future export and related commercial ventures will largely depend on what it does and not on what outsiders do for the country.

## VII. PRIORITY POLICY ISSUES

This report identified several priority policy problems that have a major bearing on Lesotho's trade. These problems relate to the pressing need for diversification of exports, and issues relating to Lesotho's international competitiveness, and the related influence of the domestic commercial environment.

### A. Export Concentration and the Need for Diversification

Statistics examined in this report clearly show Lesotho's exports are very highly concentrated, even relative to those of other landlocked countries. Lesotho exports only 21 differentiated products, which is about one-third the average number for the comparator countries. However, an analysis of the revealed comparative advantage profiles of the latter strongly suggested that Lesotho potentially has more outlets for diversifying exports than is generally recognized. The problem that needs to be addressed is how to choose between possible new export ventures.

Utilization of several trade related technical assistance support programs maintained by the United Nations Conference on Trade and Development (UNCTAD). UNCTAD's Trade Point System has extensive global information on firms who are buyers of specific products, which has been useful information for assessing prospects for items that are potential candidates for export diversification.<sup>22</sup> Lesotho should consider actively involving this international organization, possibly in cooperation with UNIDO, in the design and implementation of its own, much needed, export diversification strategy.

Global production sharing, which involves the importation and further assembly of foreign produced parts and components, has been a major vehicle for promoting trade expansion and export diversification in many developing countries, particularly those in East Asia and the Caribbean. However, given the nature and magnitude of Lesotho's trade data problems it was not possible to determine if there was any significant local involvement in this activity, and (if so) in what specific types of operations was it occurring. Given the apparent potential for assembly operations in Lesotho, efforts should focus on the tabulation of accurate import and export statistics on parts and components to help determine what appropriate policy measures and incentives should be implemented *vis-à-vis* this activity.

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<sup>22</sup> In an effort to develop an export diversification strategy for Ghana, the World Bank utilized surveys of local domestic and foreign firms engaged in various export activities to identify specific types of non-traditional products Ghana might export successfully. Second, the Bank report extended the survey approach to determine what were the impediments facing these potential exports. These efforts appear to have produced much useful information concerning potential avenues for diversification and consideration should be given to initiation of a similar survey for Lesotho,

### B. Implications of the Commercial environment

Two important issues that are interconnected relate to Lesotho's capacity to compete in foreign markets, and the ability of the country to attract foreign direct investment. Evidence showed that, when competing on an equal footing in the US market, Lesotho generally had its import market shares for clothing products eroded by other producers in NAFTA and the Caribbean. With the impending phase-out of the Multifiber Arrangement, this observation has serious implications. It is often suggested that the most efficient exporters of clothing are in East and South Asia, and not in NAFTA or the Caribbean. Lesotho's apparent inability to compete effectively are worrisome as to the likely outcome of more intense future competition with Asian exporters. The "trial run" with NAFTA and the Caribbean countries strongly accents the need for Lesotho to further improve its international competitiveness.

Surveys of the domestic commercial environment suggest local policies make Lesotho relatively less attractive to foreign investment than most other developing countries. Less than 20 percent of all Latin American countries have a commercial environment inferior to Lesotho, while the corresponding share for East Asia is under 30 percent. Even within Africa, Lesotho's trade, governance are perceived to be average, or somewhat below average. Overall, almost 70 percent of all developing countries appear to pursue commercial policies that make them more attractive to foreign investment and business activity.

The clear message that emerges from these comparisons is that Lesotho must take the lead in implementing significant domestic policy changes that would significantly improve the local commercial environment. Lesotho's success or failure in future export and related commercial ventures will largely depend on what it does and not on what outsiders do for the country.

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Appendix Table 1. Major Exports of Other Landlocked Countries in 1999

Country /ITC	Product	Exports (\$ '000)	Export Share (%)	Country /SITC	Product	Exports (\$ '000)	Export Share (%)
<b>Ethiopia</b>				<b>Malawi</b>			
0 to 9	All goods	113158	100.0	0 to 9	All goods	489200	100.0
6672	Diamonds unset	77793	68.7	1212	Tobacco stripped	293482	60.0
8421	Women's woven coats	7337	6.5	1211	Tobacco not stripped	37905	7.7
6715	Other ferro-alloys	3913	3.5	0741	Tea	37588	7.7
9710	Gold non-monetary ex ore	3295	2.9	611	Raw sugars	18697	3.8
8411	Men's woven coats	2862	2.5	6584	Bed/table/toilet linen	11804	2.4
8973	Precious metal & jewelry	2348	2.1	8415	Men's woven shirts	10773	2.2
2878	Molybdenum & zircon ore	2160	1.9	8454	T-shirts knit	9925	2.0
2875	Zinc ores	1063	0.9	0711	Coffee, not roasted	9830	2.0
8455	Bras and corsets	872	0.8	8414	Men's woven trousers	9484	1.9
6891	Tungsten and titanium	862	0.8	1213	Tobacco refuse	5183	1.1
<b>Madagascar</b>				<b>Mali</b>			
0 to 9	All goods	20739	100.0	0 to 9	All goods	267538	100.0
5249	Inorganic chemicals	8228	39.7	2631	Raw cotton	225063	84.1
6715	Other ferro alloys	6263	30.2	7764	Electron integrated circuits	6352	2.4
6341	Veneer sheets under 6mm	1074	5.2	6672	Diamonds unset	4734	1.8
2475	Hardwood rough	453	2.2	8966	Antiques over 100 years	4152	1.6
6345	Fiberboard	423	2.0	2634	Cotton carded or combed	2107	0.8
6343	Plywood under 6mm thick	360	1.7	6116	Goat or kid leather	1822	0.7
6589	Made-up textile articles	278	1.3	6115	Sheep leather without wool	1601	0.6
2732	Gypsum	244	1.2	0548	Vegetables fresh or dried	1249	0.5
6742	Tin plated or coated steel	231	1.1	0579	Fruit fresh or dried	1181	0.4
2482	Softwood simply worked	176	0.8	0545	Vegetables fresh or chilled	1068	0.4
<b>Eritrea</b>				<b>Moldova</b>			
0 to 9	All goods	175813	100.0	0 to 9	All goods	353719	100.0
2631	Raw cotton	116815	66.4	6762	Hot-form steel bars	48031	13.6
0611	Raw sugars	13811	7.9	6761	Hot-rolled iron bars & rods	45334	12.8
2225	Sesame seeds	8904	5.1	2882	Non-ferrous metal waste	13749	3.9
9710	Gold non-monetary ex ore	7862	4.5	1121	Wine of fresh grapes	12547	3.5
0545	Vegetables fresh or chilled	5213	3.0	0577	Nuts edible fresh or dried	12230	3.5
6116	Goat or kid leather	4518	2.6	0599	Fruit juices	11902	3.4
6115	Sheep leather without wool	4221	2.4	8426	Women's trousers woven	10400	2.9
2223	Cotton seeds	2394	1.4	6522	Woven cotton fabric	9766	2.8
8928	Printed matter nes	1085	0.6	2224	Sunflower seeds	9047	2.6
2924	Pharmaceutical plants	637	0.4	0612	Cane or beet sugar	7521	2.1
<b>Ethiopia</b>				<b>Mongolia</b>			
0 to 9	All goods	68999	100.0	0 to 9	All goods	321055	100.0
0711	Coffee, not roasted	48249	69.9	2831	Copper ores/concentrates	145056	45.2
9710	Gold non-monetary ex ore	9632	14.0	2683	Fine animal hair uncombed	36391	11.3
0741	Tea	5807	8.4	8453	Jerseys/pullovers/etc	24318	7.6
6673	Precious stones unset	1575	2.3	2878	Molybdenum & zircon ore	10509	3.3
2878	Molybdenum & zircon ore	1349	2.0	8411	Men's coats woven	9344	2.9
7812	Passenger motor vehicles	414	0.6	8414	Men's woven trousers	8986	2.8

Appendix Table 1. Continued

Country /SITC	Description	Exports (\$ '000)	Export Share (%)	Country /SITC	Description	Exports (\$ '000)	Export Share (%)
<b>Burundi</b>				<b>Mongolia</b>			
0341	Fish fresh or chilled	233	0.3	2482	Softwood simply worked	6020	1.9
0361	Crustaceans, frozen	151	0.2	8415	Men's shirts woven	5984	1.9
8442	Women's knit outerwear	136	0.2	8452	Felt coated clothing	5835	1.8
7139	Parts of engines	112	0.2	8437	Men's knit shirts	5257	1.6
<b>Central African Rep.</b>				<b>Niger</b>			
0 to 9	All goods	216624	100.0	0 to 9	All goods	296947	100.0
6672	Diamonds unset	156048	72.0	3330	Crude petroleum	151880	51.1
2631	Raw cotton	15537	7.2	5251	Radio-isotopes/compounds	117168	39.5
2475	Hardwood rough	13324	6.2	3344	Fuel oils	7794	2.6
2484	Hardwood sawn under 6mm	10830	5.0	7929	Aircraft parts	3819	1.3
0711	Coffee, not roasted	8595	4.0	2631	Raw cotton	3230	1.1
1211	Tobacco not stripped	2507	1.2	0222	Milk & cream, concentrates	1266	0.4
1222	Cigarettes	1578	0.7	0548	Vegetables fresh or dried	633	0.2
7331	Metal presses	689	0.3	7764	Electronic integrated circuits	551	0.2
2922	Lacs, gums and resins	601	0.3	8743	Fluid gauges & instruments	479	0.2
4314	Animal & vegetable waxes	430	0.2	7649	Telecommunications parts	462	0.2
<b>Chad</b>				<b>Rwanda</b>			
0 to 9	All goods	107354	100.0	0 to 9	All goods	52479	100.0
2631	Raw cotton	89660	83.5	0711	Coffee, not roasted	30382	57.9
2922	Lacs, gums and resins	12835	12.0	0741	Tea	8615	16.4
7924	Aircraft over 15000kg	2543	2.4	2878	Molybdenum & zircon ore	3911	7.5
7929	Aircraft parts	765	0.7	9710	Gold non-monetary ex ore	2586	4.9
7169	Parts of motors or generators	212	0.2	2876	Tin ores/concentrates	1223	2.3
7923	Aircraft from 2001-15000kg	208	0.2	6842	Aluminum alloys worked	758	1.4
2633	Cotton waste	169	0.2	2929	Vegetable materials nes	541	1.0
2923	Vegetable plaiting materials	88	0.1	5629	Chemical fertilizers nes	462	0.9
5989	Chemical products nes	68	0.1	2927	Cut flowers or foliage	404	0.8
7482	Shaft bearings or housings	56	0.1	2111	Bovine hides raw	369	0.7
<b>Kyrgyz Rep.</b>				<b>Tajikistan</b>			
0 to 9	All goods	225792	100.0	0 to 9	All goods	155328	100.0
9710	Gold non-monetary	125729	55.7	6841	Aluminum alloys	51109	32.9
2631	Raw cotton	21012	9.3	2631	Raw cotton	48241	31.1
2882	Non-ferrous metal waste	20516	9.1	6522	Woven cotton fabrics	16045	10.3
3510	Electrical energy	8867	3.9	6513	Cotton yarn	6196	4.0
0611	Raw sugars	3108	1.4	8414	Men's trouser woven	4992	3.2
6732	Flat rolled steel	2926	1.3	1211	Tobacco, not stripped	2728	1.8
2614	Silk worm cocoons or waste	2893	1.3	0612	Cane or beet sugar	2401	1.5
6726	Semi-finished iron	2745	1.2	6524	Woven cotton	2189	1.4
2111	Bovine or equine hides	2302	1.0	6735	Flat rolled steel	1729	1.1
6841	Aluminum unwrought	2108	0.9	2614	Silk worm cocoons or waste	1402	0.9
<b>Lao PDR</b>				<b>Zambia</b>			
0 to 9	All goods	234670	100.0	0 to 9	All goods	591254	100.0
8453	Jerseys and pullovers	30455	13.0	6821	Copper refined or unrefined	226562	38.3

Appendix Table 1. Continued

Country		Exports	Export	Country		Exports	Export
ITC	Description	(\$ '000)	Share (%)	/SITC	Description	(\$ '000)	Share (%)
<b>ao PDR</b>				<b>Zambia</b>			
2475	Hardwood rough	23799	10.1	6898	Cobalt, titan or zircon	104873	17.7
0711	Coffee, not roasted	23507	10.0	2879	Base metal ore, nes	41685	7.1
2484	Hardwood sawn under 6mm	22508	9.6	6513	Cotton yarn, nes	30086	5.1
8414	Men's woven trousers	20636	8.8	2631	Raw cotton	23148	3.9
8415	Men's woven shirts	11970	5.1	2927	Cut flowers or foliage	18372	3.1
8437	Men's knit shirts	9446	4.0	2831	Copper ores/concentrates	14016	2.4
8426	Women's woven trousers	8054	3.4	6824	Copper wire	13904	2.4
8458	Garments, nes	7363	3.1	6673	Precious stones unset	12170	2.1
8454	T-shirts knit	6217	2.6	1212	Tobacco stripped/stemmed	10973	1.9

Appendix Table 2. The RCA Profiles of Individual Landlocked Comparator Countries in 1999

SITC-4	Product	Armenia	Bhutan	Burkina Faso	Burundi	Central African Rep.	Chad
6115	Sheep leather			126.1			
6116	Goat and kid leather			295.2			
6117	Animal leather nes						1.6
6121	Industrial leather articles					2.6	
6133	Whole fur skins assembled				14.3		
6259	Retreads and inner tubes			2.6			
6341	Veneer sheets etc <6mm		109.1				
6343	Plywood <6mm thick		15.7				
6345	Fiberboard		38.5				
6349	Wood simply shaped		17.3				
6354	Domestic wood articles.			2.7			
6412	Uncoated paperboard		1.3				
6519	Yarn-textile fibers		2.8				
6529	Woven cotton fabrics nes		2.2				
6574	Quilted textile products			1.9			
6589	Made-up textile arts nes		18.9				
6592	Carpets knotted	7.7	1.2				
6593	Hand woven rugs	4.9					
6612	Portland cement		1.2				
6623	Refractory bricks		6.4				
6645	Cast glass sheets	5.0					
6649	Glass n.e.s.	1.4					
6659	Glass articles nes	1.3					
6715	Other ferro-alloys	32.0	278.2				
6742	Tin plated/coated steel		20.2				
6931	Wire ropes and cable		5.1				
6978	Household appliances			1.4			
8711	Binoculars/telescopes	3.5					
8731	Gas and electric meters	1.8					
8732	Meters and counters nes		3.1				
8741	Survey equipment		6.1	2.4			
8812	Movie cameras & projectors			2.9			
8825	Photo film undeveloped	1.1		2.2			6.6
8843	Optical lens	1.2					
8919	Firearm parts			4.4			
8928	Printed matter			3.7			
8961	Paintings and drawings	1.4					
8963	Original sculpture			4.3			
8964	Stamps for collections	11.3	39.0				
8965	Coins and nature collections			5.8			
8966	Antiques over 100 years			1.3			
8973	Precious metal jewelry	8.2					
8982	Musical instruments			2.9			
8991	Carvings and moldings		5.6				
8997	Baskets and brushes			2.3			
8999	Manufactured goods nes						1.2



Appendix Table 2. Continued

SITC-4	Product	Kyrgyz Rep.	Laos PDR	Malawi	Mali	Moldova	Mongolia
6113	Bovine leather < 2.6 m2					8.2	
6114	Bovine leather nes					1.0	
6115	Sheep leather w/out wool				31.4		
6116	Goat andkid leather				78.3		
6117	Animal leather nes		22.2		1.5	2.9	
6121	Industrial leather articles						
6122	Harness-makers goods		1.5				
6133	Whole fur skins assembled					1.6	3.4
6253	Aircraft tires					2.3	
6332	Agglomerated cork					2.1	
6344	Plywood/laminates nes		22.3	2.1	2.3		
6345	Fiberboard				1.4		
6349	Wood simply shaped					7.7	
6353	Builders wood materials		7.6				
6354	Domestic wood articles.		2.2	1.3	3.3		
6359	Wood manufactures nes		2.8				
6414	Uncoated kraft paper					2.9	
6511	Wool yarn	4.2					1.8
6522	Woven cotton fabric	1.5		1.2		41.3	
6523	Woven cotton <200g					4.1	
6544	Woven flax fabrics					4.2	
6545	Woven jute etc fabrics	22.6					
6552	Knit fabric nes						6.6
6581	Textile sacks and bags	2.7		2.1			
6583	Blankets & travel rugs			1.1			1.9
6584	Bed & table linen			19.7		8.8	
6585	Curtains nes			9.0	1.2		
6591	Linoleum	2.2					
6592	Carpets knotted						2.8
6593	Hand woven rugs		1.2			13.4	
6595	Carpets, woven					7.8	
6596	Carpets nes	6.4					
6611	Hydrogenated lime	1.2					
6612	Portland cements	6.3				19.1	
6618	Asbestos fiber cement	38.4				7.3	
6635	Rock wool minerals	3.4					
6643	Drawn glass sheets	3.9					
6645	Cast or rolled glass sheets	39.8					
6651	Glass containers					10.5	
6659	Glass articles nes	3.7				1.8	
6726	Semi-finished iron & steel	9.7				7.5	2.9
6727	Semi-finished iron					69.5	
6731	Flat rolled steel-1	2.8					
6732	Flat rolled steel-2	4.7					
6755	Cold-rolled stainless steel					1.1	
6761	Hot-rolled iron bars					127.3	
6762	Hot-form steel bars					123.4	
6764	Iron & steel bars nes					3.5	
6781	Iron non-alloy wire					1.3	

Appendix Table 2. Continued

<u>SITC-4</u>	<u>Description</u>	<u>Kyrgyz Rep.</u>	<u>Laos PDR</u>	<u>Malawi</u>	<u>Mali</u>	<u>Moldova</u>	<u>Mongolia</u>
6782	Iron wire						
6791	Iron & steel tube seamless					1.2	
6921	Metal tanks and vats	9.1				14.8	
6951	Agricultural hand tools	2.5					
6957	Mixed hand tool sets		1.2				
6998	Articles of rare metals	1.4					
6999	Articles of rare metals nes	18.1					
8312	Trunks and suitcases					34.9	
8512	Sports footwear		1.7				
8514	Footwear leather uppers					3.8	
8515	Footwear textile uppers		1.2			1.6	
8517	Footwear nes					1.9	
8519	Footwear parts					4.7	
8825	Photo film undeveloped	12.9					
8931	Plastic boxes and lids	2.1					
8964	Stamps for philately		1.2				
8965	Coins & nature collections				3.4		
8966	Antiques over 100 years				34.8		
8982	Musical instruments				3.6		
8991	Carvings and moldings		1.9				

Appendix Table 2. Continued

ITC-4	Product	Niger	Rwanda	Tajikistan	Zambia
115	Sheep leather		2.4		
117	Animal leather nes				3.6
291	Pharmaceutical rubber items			3.0	
351	Wood boxes and pallets		1.2		
354	Domestic wood articles.		1.7		
359	Wood manufactures nes		2.9		
513	Cotton yarn nes			31.1	39.0
518	Yarn and fiber <5mm				3.9
522	Woven cotton fabrics			154.6	1.5
523	Woven cotton finish<200g			3.4	
524	Woven cotton finish>200g			13.2	
533	Woven synthetic fabric			7.1	
534	Woven synthetic blends			11.2	
535	Woven yarn and fabric			9.8	
551	Knit pile fabric		1.1		
565	Embroidery			2.7	
573	Coated fabric nes			2.0	
581	Textile sacks and bags			2.5	
583	Blankets & travel rugs			3.0	
584	Bed and table linen			1.8	
591	Linoleum	4.5			
593	Hand woven rugs			7.2	
611	Hydrogenated lime				1.2
612	Portland cement				9.8
638	Asbestos manufactures			1.5	
715	Other ferro-alloys				3.4
735	Flat rolled steel nes			53.3	
782	Iron and steel wire			1.1	
998	Articles rare metals				9.6
723	Mechanical-therapy equipment		1.7		
731	Gas and electric meters	1.7			
743	Fluid gauges & instruments	1.7			
749	Instruments nes	1.3			
825	Photo film undeveloped		2.1		
924	Printed cards		1.0		
965	Coins and nature collections				2.7

## ANNEX

### IMPLICATIONS OF THE EU-SOUTH AFRICA FTA

A common feature of free trade arrangements (FTAs) like Mercosur or the North American Free Trade Arrangement (NAFTA) is that most barriers to the intra-trade of member countries are removed, while existing tariffs and nontariff barriers facing nonmembers continue to be applied (see Box 1 for WTO regulations concerning free trade arrangements). This differential change in trade restrictions has a two-fold effect, the first of which involves *trade creation*. Due to the removal of trade barriers formerly facing FTA members' exports the landed costs of their products is lowered in the liberalizing markets. This allows FTA member exports to displace some goods previously supplied by domestic producers (trade creation). Second, there is an additional element. Since trade restrictions facing FTA members are reduced relative to those on other foreign suppliers, their improved competitive position should allow them to displace some non-member countries exports. This displacement of one group of foreign suppliers by another is known as trade diversion.

Several pre-existing institutional arrangements make the likely effects of the free trade arrangement between SACU and the European Union somewhat more complex than suggested by the above points. Specifically,

- Under the terms of the European Unions Generalized System of Preference (GSP) program most of Lesotho's exports to Europe already face zero preferential tariffs. While this situation seemingly is favorable, there are constraints that limit the benefits Lesotho experiences. Having a limited natural resource base Lesotho imports most of the raw materials used in manufacturing. This has led to difficulties in gaining access to European markets because of stringent rules of origin. As a result of this constraint, Lesotho manufactures are accorded derogation that limits the opportunities for exporters to expand their market share because of quantitative restrictions imposed by the derogation rules.<sup>23</sup> However, the key point is that the EU-SACU agreement will not significantly improve Lesotho's European market access conditions over and above what the country receives under existing institutional arrangements.

- Existing internal SACU regulations provide Lesotho with duty free access to South African markets. The EU-SACU free trade arrangement will give European Union countries similar preferential access to domestic South African markets. As such, existing trade barriers facing most EU products will fall to the same level (zero duties) as those Lesotho currently faces. This should allow the EU to displace (divert) some of Lesotho's exports to SACU. Two key questions are what products will be affected, and how large a diversion might be expected? Another related point is how Lesotho's competitive position in SACU might be affected by countries, like those in Eastern Europe, that appear likely to become EU members in the future.

#### A. Likely Effects on Merchandise Exports

Annex Table 1 provides information relevant to these questions by showing Lesotho's major six-digit HS export products that now encounter competition from the EU in South African markets. The table identifies each export product by name and HS code, and also reports the value of SACU's imports of the item from Lesotho in 1999. Altogether, these 34 products account for about 96 percent of

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<sup>23</sup> See World Trade Organization, Trade-related Technical Assistance Needs Assessment Presented by Lesotho: Integrated Responses by the IMF, ITC, UNCTAD, UNDP, World Bank, and WTO, (WT/COMTD/IF/21), (Geneva: World Trade Organization, 26 February 1998, p. 18).

Lesotho's exports to SACU. In addition, the table shows the value of imports from current EU members, as well as the level of MFN tariffs the European countries now face. Although it is a rough indicator, relatively high MFN tariffs might indicate products where the potential displacement of Lesotho's exports will be greatest after the EU-SACU FTA is fully implemented.

### **Box 1. World Trade Organization Rules Concerning Free Trade Arrangements**

The cornerstone of the World Trade Organization (WTO - formerly General Agreement on Tariffs and Trade) is the nondiscrimination, or most-favored-nation (MFN) principle, of WTO Article I. Trade concessions awarded to one member country are to be extended to all WTO members. FTAs conflict with this principle.

In spite of this conflict, WTO rules can accommodate the promotion of trade liberalization through "closer integration between the economies of countries party to such agreements." WTO Article XXIV permits departures from the MFN obligation provided that the FTA or customs union meets three conditions: (i) duties and other restrictive regulations are eliminated on "substantially all" trade between member countries; (ii) the general incidence of duties and regulations affecting third parties is no higher after, than it was before, the establishment of an agreement; and (iii) the agreement contains a plan and schedule for its complete formation within a reasonable length of time. Although the intent of these rules is sometimes interpreted as meaning that an FTA should be trade creating, there is no guarantee that this will be the case.

Since 1948, more than 60 FTAs and preferential trade agreements have been reviewed under Article XXIV provisions. Only four agreements including the South African-Rhodesian Customs Union (1948); the Nicaragua-El Salvador Agreement (1951); Nicaraguan participation in the Central American Free Trade Area (1958); and the Caribbean Community and Common Market (1973) were declared fully compatible with Article XXIV requirements. However, no agreement has been censured by a working group as being incompatible with GATT-WTO rules. As a result of these precedents, some feel that countries are perceived to be able to derogate from MFN obligations without regard to the effects on third countries.

This impression has been reinforced by the introduction of the 1979 "Decision on Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries (also known as the "Enabling Clause." As a result of this decision, regional arrangements involving only developing countries, like the Economic Community of West African States (ECOWAS), or the Preferential Trade Area (PTA) in Africa, are excluded from the requirement to meet the formal criteria of Article XXIV. Regional arrangements among these countries are permitted as long as they facilitate trade, do not create "undue difficulties" for the trade of other countries, and do not act as an impediment to the reduction or elimination of trade barriers on a most-favored-nation basis. Formal procedures have not been established to ensure that these conditions are met.

Several important points emerge from Annex Table 1. First, 22 or 65 percent of the major export products currently have zero applied MFN tariffs. As such, the potential for EU displacement of these goods, which account for 54 percent of Lesotho's exports to SACU, is minimal, or zero. Limited trade diversion might also be expected for an additional product (HS110220 - flour of maize) where a relatively low 5 percent SACU MFN tariff is applied. However, there are 11 products with SACU tariffs ranging from 12.5 to 40 percent where Lesotho's exports clearly are at risk. Of these, three products

(color television receivers, fresh poultry and ice cream) might be especially vulnerable to displacement given the relatively large

**Annex Table 1. Products For Which Lesotho Encounters Important Competition from EU Exports to South African Custom Union Markets.**

HS Code	Description	1999 SACU Imports (US\$ 000)		% of Lesotho's Exports	SACU MFN Tariff (%)
		Lesotho	EU (15)		
220190	Waters not sweetened	11,986	53	15.1	0
852810	Color television receivers	9,834	3,653	12.3	12.5
640299	Footwear with rubber tops	7,795	313	9.8	0
640340	Other protective footwear	6,453	78	8.1	30
620349	Men's trousers, nes	6,227	65	7.8	0
640320	Footwear with leather soles	5,317	27	6.7	30
640359	Leather footwear, nes	3,796	3,501	4.8	0
640610	Parts of shoes	3,595	881	4.5	35
110510	Flour and meal	2,427	126	3.0	20
020890	Meat offal	2,305	0	2.9	0
520942	Denim	2,282	411	2.9	0
020710	Fresh poultry	1,221	2,441	1.5	27
611030	Sweaters of man made fibers	1,090	12	1.4	0
690490	Ceramic flour blocks	962	50	1.2	0
210500	Ice cream	959	836	1.2	18.3
640590	Footwear, nes	898	76	1.1	20
620640	Blouses of man made fibers	847	214	1.1	0
300339	Medicaments with hormones	724	73	0.9	0
660199	Umbrellas	698	2	0.9	30
621040	Other men and boys garments	673	124	0.8	0
690410	Building bricks	650	2	0.8	0
610910	T shirts of cotton	603	525	0.8	0
100510	Seed corn	577	28	0.7	0
010290	Live bovine animals	573	0	0.7	0
110220	Flour of maize	571	17	0.7	5
710229	Other industrial diamonds	421	55	0.5	0
420100	Saddles and harness	387	104	0.5	30
510119	Wool greasy	366	2	0.5	0
620453	Skirts of synthetic fibers	353	158	0.4	0
610990	Other T shirts	345	307	0.4	0
020220	Other meat cuts with bone in	326	9	0.4	40
230240	Bran and sharps	325	0	0.4	0
100190	Wheat and meslin	312	2	0.4	0
250590	Other silica sands	311	65	0.4	0
	All Above Products	76,209	14,210	95.6	

trade base the EU has been able to establish in the presence of the existing high MFN tariffs.<sup>24</sup>

<sup>24</sup> UNCTAD and the World Bank jointly developed a trade projection model, named SMART (for Software for Market Analysis and Restrictions on Trade), that allows countries to estimate the effects of tariff changes on their imports and exports (see UNCTAD-World Bank, *A User's Manual for SMART*, Washington: World Bank and UNCTAD, 1989 for a description of this model). SMART projections suggest Lesotho should experience export losses in the range of \$2.5 to \$4 million for the 12 products listed in Annex Table 1 for which the European Union now faces non-zero MFN tariffs. Export losses of over 80 percent are projected for fresh poultry (HS 020710) due to the relatively high SACU MFN tariff (27 percent) and the relatively large established EU export base.

Annex Table 2 addresses the question of how this situation might change should the European Union expand to include potential new members, namely, Belarus, Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Liechtenstein, Lithuania, Malta, Moldova, Poland, Romania, Slovakia, Slovenia, Switzerland, Turkey and the Ukraine. The table shows the value of SACU imports from these potential EU countries matched with the previous tariff and Lesotho

**Annex Table 2. Products For Which Lesotho Encounters Important Competition from Potential EU Countries' Exports to South African Custom Union Markets.**

HS Code	Description	1999 SACU Imports (US\$ 000)		% of Lesotho's Exports	SACU MFN Tariff (%)
		Lesotho	Potential EU Members*		
220190	Waters not sweetened	11,986	0	15.1	0
852810	Color television receivers	9,834	97	12.3	12.5
640299	Footwear with rubber tops	7,795	23	9.8	0
640340	Other protective footwear	6,453	0	8.1	30
620349	Men's trousers, nes	6,227	6	7.8	0
640320	Footwear with leather soles	5,317	0	6.7	30
640359	Leather footwear, nes	3,796	66	4.8	0
640610	Parts of shoes	3,595	15	4.5	35
110510	Flour and meal	2,427	0	3.0	20
020890	Meat offal	2,305	0	2.9	0
520942	Denim	2,282	352	2.9	0
020710	Fresh poultry	1,221	0	1.5	27
611030	Sweaters of man made fibers	1,090	12	1.4	0
690490	Ceramic floor blocks	962	0	1.2	0
210500	Ice cream	959	1	1.2	18.3
640590	Footwear, nes	898	0	1.1	20
620640	Blouses of man made fibers	847	36	1.1	0
300339	Medicaments with hormones	724	0	0.9	0
660199	Umbrellas	698	4	0.9	30
621040	Other men and boys garments	673	10	0.8	0
690410	Building bricks	650	0	0.8	0
610910	T shirts of cotton	603	43	0.8	0
100510	Seed corn	577	0	0.7	0
010290	Live bovine animals	573	0	0.7	0
110220	Flour of maize	571	0	0.7	5
710229	Other industrial diamonds	421	0	0.5	0
420100	Saddles and harness	387	64	0.5	30
510119	Wool greasy	366	0	0.5	0
620453	Skirts of synthetic fibers	353	24	0.4	0
610990	Other T shirts	345	105	0.4	0
020220	Other meat cuts with bone in	326	0	0.4	40
230240	Bran and sharps	325	0	0.4	0
100190	Wheat and meslin	312	2	0.4	0
250590	Other silica sands	311	0	0.4	0
	All Above Products	76,209	860	95.6	

\*The potential European Union members are Belarus, Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Liechtenstein, Lithuania, Malta, Moldova, Poland, Romania, Slovakia, Slovenia, Switzerland, Turkey and the Ukraine.

trade data. The general impression is that potential EU members currently pose a very limited threat to Lesotho's exports to SACU. Without exception the potential EU members have yet to establish any but a minimal trade base for the high MFN tariff products where the potential for diversion of Lesotho's exports is greatest.

## B. Revenue Consequences of the EU-SACU FTA.

An important concern of many countries preparing to join a free trade arrangement relates to the potential loss of government revenues due to the removal of tariffs on member countries' exports. These potential revenues losses appear to be of major importance for developing countries like Lesotho, Botswana and Namibia where trade taxes generate between 20 to 50 percent of total government revenues. Customs duties produce about 50 percent of all government revenues in Lesotho. Since approximately 40 percent of all South African Custom Union imports originate in the European Union implementation of the free trade arrangement will clearly have a major negative impact on the size of the SACU common customs revenue pool. However, the problem of estimating revenue loss effects is more complicated than it may initially appear since a number of secondary effects, like higher induced import volumes or the influence of induced higher levels of economic activity under the FTA, must be taken into account. These associated effects can only be estimated using some form of general equilibrium model.

Several recent empirical analyses employed available CGE models, like GTAP, to estimate the likely magnitude of the EU-SACU FTA induced revenue losses. These projections show the revenue losses will be of major importance. For example, one joint study by the Botswana Institute for Development Policy Analysis and the UK Institute for Development Studies (BIDP-IDS) estimated that total SACU tariff revenue collections would decline by about one-third after the implementation of the agreement.<sup>25</sup> This analysis assumed that products currently excluded from the liberalization process (the status of these items is to be reviewed not later than five years after the agreement's entry into force), would continue to face tariffs indefinitely. If import duties on these items are also eliminated the decline in SACU customs revenues is projected to be about 50 percent below current levels.

According to the BIDP-IDS study, the revenue losses will have particularly severe effects on the budget deficit situations in Lesotho and Namibia.<sup>26</sup> Only in Botswana does the necessary fiscal adjustments appear manageable, since some scope exists for increasing personal and corporate taxation. Given the current rates applied, Lesotho, Namibia and Swaziland have little scope for increasing personal or corporate tax rates. This is a consequence of the mobility of investment and people within SACU, and the ease with which some relatively "footloose" industries, like textiles and clothing, can simply move elsewhere. As a result, the governments of Lesotho, Botswana, Namibia and Swaziland must either find alternative sources of tax revenue, reduce and reform government expenditure, or re-organize the tax administration in such a way that taxes are collected more efficiently.

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<sup>25</sup> See Institute for Development Studies and Botswana Institute for Development Policy Analysis, **Study to Assess the Economic Impact of the Proposed European Union – South Africa Free Trade Area on Botswana, Lesotho, Namibia, and Swaziland**, Final Report, December 1998.

<sup>26</sup> See "The EU – South Africa Trade, Development, and Co-operation Agreement: An Analysis of its Implications in South Africa" which can be found at the internet cite ([www.oneworld.org/erostep/eusouth](http://www.oneworld.org/erostep/eusouth)) for a useful and comprehensive account of the negotiations between South Africa and the European Union and an analysis of the economic effects of the arrangement on SACU member countries.







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