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FDI, AGOA And Manufactured Exports From A Land-Locked, Least-Developed African Economy: Lesotho

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Lesotho, a small, mountainous and resource poor country inside South Africa, has emerged as the largest and fastest growing exporter of apparel from Sub-Saharan Africa to the US. Its rapid manufacturing growth has been driven by inflows of export-oriented foreign direct investment. This paper explores this unusual experience against the setting of the dismal record of industrial growth and competitiveness in Sub-Saharan Africa. It traces the origins of apparel-based FDI in Lesotho and the critical role of trade preferences in stimulating its exports and notes the limited integration of foreign affiliates into the local economy. The recent export spurt reflects first mover advantages in apparel manufacture, but long-term prospects, after trade preferences, remain dubious unless there is a significant improvement in skills and productivity. The experience has important policy lessons for the Lesotho government, foreign investors and international community in terms of stimulating competitive industrial development in Africa.

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FDI, AGOA and manufactured exports from a land-locked, least-developed African economy: Lesotho

1. Introduction

Lesotho, a small, mountainous, resource poor and land-locked country inside South Africa, has emerged recently as the largest and fastest growing exporter of apparel from Sub-Saharan Africa (henceforth 'Africa') to the US. The rapid expansion of its manufacturing sector has been driven by inflows of export-oriented foreign direct investment. By these indicators, Lesotho stands out in the region as the only country (Mauritius apart) to emulate the 'new Tigers' of Southeast Asia. This paper explores this rather unusual economic experience, which goes against the rather dismal record of industrial growth and competitiveness in Sub-Saharan Africa (Lall and Pietrobelli, 2002).

Classified by the UN as a least developed country (LDC), Lesotho's per capita GDP in 2001 was $379, compared to $289 for all LDCs and $473 for Sub-Saharan Africa. Lesotho population was 2.1 million; it has no natural resources except for water, a significant part of which it has sold to South Africa on a long-term contract.[2] Its dominant activity, subsistence agriculture, has been declining over time, its share of GDP falling from 36 percent in 1970 to 18 percent in 1999 (World Bank, 2003). Much of its adult male population used to work in South African mines; with the downsizing and modernization of these mines, many have returned to Lesotho; remittances have consequently fallen, from 90 percent of GDP in the early 1980s to 23 percent in 2001. About 70 percent of its population now lives below the poverty line, a proportion that has not changed over the 1990s (ibid.); rural areas have considerable unemployment, which is now spreading to urban areas. In common with the rest of the region, Lesotho has a high incidence of HIV/AIDS.

Lesotho has nevertheless been growing at modest rates. Its GDP rose by 3.9 percent per annum between 1990 and 1995 and by 2.8 percent between 1995 and 2001, compared to 3.1 and 3.6 percent for Africa as a whole. The earlier driver of growth was worker remittances; as these fell, inflows in the 1990s for the Highlands Water Project compensated. The completion of the water project has led to a slowdown after 2000, with per capita GDP (in current terms) falling from $445 in 1998 to $379 in 2001. At the same time, as noted, manufacturing has grown rapidly, driven by a surge of inward FDI in export-oriented apparel manufacturing. Lesotho is now the leading African recipient of apparel FDI (Mauritius has a larger stock but its high wages are leading to outflows of apparel investments to neighbouring countries, led by Madagascar).

The recent spurt of FDI and exports has been stimulated by trade privileges offered by the US under the African Growth and Opportunity Act (AGOA).[3] The concessions, described below, apply to most of Africa (including South Africa and Mauritius), but there are two groups of beneficiaries. The 'Lesser Developed Beneficiary Countries' – defined here as countries with per capita incomes of less than $1,500 in 1998[4] – receive additional privileges over South

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

[3] According to Mattoo *et al.* (2003), AGOA "aims at broadly improving economic policymaking in Africa, enabling countries to embrace globalization, and securing durable political and economic stability. As an incentive for Africa to adopt these policy changes, AGOA offers increased preferential access for African exports to the United States" (p. 829).

[4] The AGOA definition is different from that of 'LDCs' used by the UN and covers many more countries. The AGOA definition includes as Lesser Developed Beneficiary Countries 42 countries (the whole of Africa apart from Botswana,

Africa, Mauritius, Equatorial Guinea, Gabon and Seychelles. AGOA has stimulated apparel exports from several countries, but Lesotho has been the largest beneficiary. Its apparel exports to the US are larger than Mauritius and South Africa, or than better located coastal countries and those with larger industrial sectors.[5]

The Lesotho case thus raises interesting issues. What, for instance, has led Lesotho, despite its location disadvantages, to become such an attractive site for foreign investors and a larger exporter than more industrialized countries? What benefits has FDI brought and what are its limitations, in terms of growth and diversification prospects? Will the current boom in FDI and exports, in other words, outlast the privileges under AGOA (currently due to end in 2008) and spread to other manufacturing activities? What can the government do to sustain the initial surge? Since apparel has been the main point of entry (resource processing aside) for many countries into export-oriented manufacturing, the Lesotho case also raises broader issues. Since the quota system under the MFA, which drove producers and buyers to countries outside East Asia, will end by 2005, how will the new entrants fare against East Asia, and in particular China, that are technically the most efficient producers? What does the Lesotho experience suggest about prospects for export-oriented manufacturing in an African LDC? Does the fact that a 'trade distortion' like AGOA stimulates the launch of industrial activity in a primitive economy have general policy implications for Africa and the international community?

This paper addresses some of these issues. Section 2 describes its FDI performance and the economic background. Section 3 discusses some features of apparel FDI in Lesotho and Section 4 its ability to cope with international competition. Section 5 concludes with policy implications for the Lesotho government and the development community in general.

2. FDI in Lesotho: performance and economic background

According to data from the Bank of Lesotho, the country has done well in attracting FDI: inflows have risen (but with a dip in the mid-90s) from $3 million in 1982 to $243 million in 2001. However, these data include investments by the South African government in the Highlands Water Project, which is not private direct investment in the usual sense. If we exclude these inflows, the FDI figures are more modest and the trend is fairly static (though there are some increases in the pipeline, discussed later). On a per capita basis (and without the Highlands project), Lesotho is in the middle range for FDI in the region with $14.5 in 2000, not as high as more resource rich or industrialized countries like Botswana ($17.6), Namibia ($68.9), Zambia ($19.6), Mauritius ($27.7) or South Africa ($20.4), but better than Kenya ($2.0), Zimbabwe ($2.4), Malawi ($8.0), Mozambique ($7.7), Tanzania ($0.6) or Uganda ($11.4).

Lesotho's FDI seems more impressive if we take account of its lack of obvious attractions for foreign investors. It has a meagre resource base and a tiny domestic market. It is landlocked. It does not offer any special incentives to foreign investors. It has a tiny industrial base and does not have high value horticultural exports. It does have low wages (for literate but not technically trained labour) and attracts some assembly operations aimed at South Africa, but the prospects for a large 'maquiladora' sector (of the type on the Mexico-US border) are

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Equatorial Guinea, Gabon, Mauritius, Namibia, Seychelles and South Africa). The definition was later broadened to include Botswana and Namibia. See AGOA website at http://www.agoa.gov/eligibility/apparel_eligibility.html.

[5] Lesotho has other advantages over many African countries in attracting FDI. Its currency is tied to the South African rand, giving it an element of stability (at least in terms of linking it to a larger economy). It has a democratic government committed to private investment. It has a free trade agreement with its neighbours in SACU (South African Customs Union). It has a fairly 'business friendly' investment regime, with low entry barriers, little corruption, free repatriation and low tax rates (a uniform 15 percent on companies).

poor. South Africa suffers from massive unemployment and has 'homelands' with lower wages than Lesotho. Labour-intensive industries like clothing in South Africa find it difficult to face Asian competition and many are closing down.[6] Very few have chosen to relocate to lower wages neighbours like Lesotho as a competitive response.

Around 95 percent of FDI in Lesotho is in manufacturing, predominantly in export activities aimed at OECD markets; this is very unusual for a region where most FDI has gone into primary products, resource processing or import substitution and, more recently, into services (Lall, 2002). Within manufacturing, over 90 percent of FDI is in garments.[7] There are 38 clothing factories (of a total of 55 foreign factories,[8] accounting for the entire formal manufacturing sector), almost all owned by East Asians, led by Taiwanese. Their exports to the US – by far the main market – came to $111 million 1999, $140 million in 2000, $217 million in 2001 and $318 million in 2002, a compound growth rate of 30.4 percent.[9] Lesotho is now the largest apparel exporter to the US from Africa (under GSP, not just AGOA), accounting for 40 percent of imports of textile and apparel by the US from AGOA eligible countries in 2002. Its AGOA related apparel exports in 2002 were 2.6 larger than Kenya's, the next largest beneficiary in this industry. Even Mauritius and South Africa, much larger, more industrialized and better located exporters, only managed $107 m. and $88 m. of AGOA apparel exports in 2002. This surge has given Lesotho a relatively advanced export structure, with 70 percent of total exports consisting of manufactures, compared to 25 percent for Africa as a whole (excluding South Africa). In some ways, therefore, Lesotho resembles an East Asian 'Tiger'.

What attracted apparel FDI to Lesotho? The inflow started in the late 1980s, when (mainly Taiwanese owned) clothing firms based in South Africa started to shift to Lesotho. They had been initially attracted to South Africa by large incentives and, in Taiwan's case, by political factors (itself a political outcast, it was one of the few countries that maintained ties with the apartheid regime). When sanctions were imposed on South Africa, many Taiwanese firms (and some South African ones) moved to Lesotho. Lesotho had kept diplomatic relations with Taiwan; in addition, it offered quota free exports and, under the Lomé Convention, duty-free access to Europe (initially with no local content requirements). The presence of Taiwanese firms attracted new investors from Taiwan, all in apparel; by 1990 most of the firms present today were in operation in Lesotho. Most South African firms that had moved there earlier closed down or sold out to Taiwanese firms.

In the late 1980s, the EU started to apply 'cumulation' to ACP countries, meaning that at least two stages of production had to be carried out locally (the fabric used for apparel had to be local). Lesotho was able to get this requirement postponed ('derogated') for 8 years, attracting another wave of FDI till the late 1980s, when EU derogation ended. At this stage

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[6] Roberts and Thoburn (2003, 2004) provide a detailed analysis of the response of the South African textile and apparel industry to partial import liberalization. They find that employment in the textile segment declined by 45% and in the apparel segment by 20% between 1996 and 2001. There was considerable pressure on wages in the apparel industry, and several firms relocated within South Africa to rural areas. Several firms raised exports, but this was a defensive rather than offensive strategy, undertaken largely to utilise capacity. Only a few undertook productivity raising measures that would ensure their growth in open markets.

[7] The activity is essentially of the simplest 'cut-make-trim' (CMT) variety, using imported fabrics to make products to buyers' designs (Salm *et al.* 2002). The products are, according to interviews, in the lowest skill and quality segments.

[8] Apart from the garment plants, there are three foreign companies in footwear, all South African owned and selling to the South African market. There are four electrical or electronic firms, again South African owned and oriented, of which two are large (one assembling Korean televisions, the other assembling simple electrical products). There are 4 food-processing firms, two South African, one US, and one Chinese. Finally, there is an assortment of some 6 plastic, umbrella and other manufacturing firms with foreign equity.

[9] In the first six months of 2003, apparel exports to the US were $170 million, 17.5% higher than in the comparable period in 2002. Data are from US Department of Commerce at http://reportweb.usitc.gov/africa/by_country.jsp.

several clothing factories closed down while others downsized and shifted to the US market (which had lower quality requirements), paying the import duty that applied to the whole developing world. There was no restriction on their sourcing of inputs, which continued to come from the cheapest source, East Asia. Their main advantage at this stage (in common with newcomers in South Asia and North Africa) MFA quotas.[10]

Apparel exporters in Lesotho, however, had another advantage: the strong 'East Asian connection'. The East Asian firms in Lesotho had tight links with 'full package' apparel suppliers from Hong Kong. These are the main exporters of apparel from Asia (they are emerging in Latin America, particularly in Mexico, but are not well established), with subcontractors throughout East, Southeast and South Asia (Gereffi, 1999). They are highly organised supply networks that act as intermediaries between buyers from the US, Europe and Japan and apparel manufacturers. They win orders and contract them to producers (with or without direct equity links) in Asia and other regions, ensuring quality, price and delivery. In managing the supply chain, they provide subcontractors with designs, specifications, inputs, technical assistance and help with staff recruitment and logistics. Most Lesotho firms belonged to groups with other operations in Asia and established links with full package firms: these information and trust relations are an important competitive advantage.

The launch of AGOA in 2000 gave fresh stimulus to Lesotho exporters[11] and to inward FDI. Note, however, that despite the stated intention of AGOA to stimulate US investment in beneficiary countries, none of the new FDI came from the US. The established network of Taiwanese firms perpetuated their hold on the industry.

As a 'lesser developed country', Lesotho could sell apparel in the US duty and quota free and, in the first phase (2000-2004), procure inputs freely anywhere in the world (a privilege not open to more developed beneficiaries like South Africa or Mauritius). However, in the second phase (2004-2008), the distinction between the two kinds of beneficiaries ends, and Lesotho, while it will have duty and quota privileges (the latter ceases to matter in 2005 when MFA ends), will have to procure inputs from other AGOA beneficiary African countries (including South Africa) or from the US.[12] Unlike the requirement under the Lomé Convention (replaced by the Cotonou Agreement) that two stages of production be local, AGOA stipulates that three stages (yarn, fabric and clothing) be local or sourced from the US (Mattoo et al, 2003). Thus, the second stage of AGOA is more stringent in terms of input sourcing than the Lomé Convention or the Cotonou Agreement.

East Asia remains the cheapest source of fabrics and yarn, offering the wide range required to meet changing fashion needs; it also has the lowest transport costs to Africa. African sources, including South Africa, have lower transport costs but the textile industry is not as developed,

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

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

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

cheap or diverse.[13] Moreover, as South African firms respond to intense Asian competition, they are moving away from the standard fabrics used in Lesotho (Roberts and Thoburn, 2004). Though some new facilities for fabric and yarn are planned for Lesotho and South Africa, their real economic viability relative to Asian counterparts is not clear. In particular, scale, capital and skill intensive operations like weaving and finishing may not be competitive. According to Salm et al. (2002), however, knitting operations may be efficient, since they can be operated efficiently at smaller scales.

US producers have the range to provide the inputs needed but are more expensive than Asia and face significantly higher transport costs to Africa.[14] Since the US textile industry is facing severe competitive pressures from Asia, particularly in the lower quality ranges needed in Lesotho, and is undergoing massive downsizing as a result, its ability to supply African exporters remains doubtful.

Lesotho's competitiveness in apparel after 2004 (the first phase of AGOA) and 2005 (after MFA) will depend on the balance between the higher cost of inputs, tariff advantage (currently 13%) and the relative efficiency of production with respect to competitors (particularly from Asia). In 2008, if AGOA ends as planned, Lesotho will also lose its tariff privilege (which may decline in value if US import duties in general fall). However, it will be able to again source inputs freely and can exploit its new backward linkages with local or African fabric and yarn producers. Its competitive position will then depend solely on its relative efficiency and costs, that is, on comparative wages, skills, technology, productivity, infrastructure, logistics and organizational efficiency, not just in apparel production but along the whole supply chain. We return to some of these factors below.

To sum up, the surge in apparel exports by Lesotho reflects the interaction of several factors. Lesotho moved ahead of other AGOA beneficiaries because of its existing base of apparel exporters. This first mover advantage reflects its historic links with South Africa and Taiwan, the MFA quota regime and its close ties with Asian full package suppliers. Even with the quota preferences offered by the trade regime, Lesotho's competitiveness so far has depended on the ability to source fabrics freely. When the first phase of AGOA ends in 2004, it is not clear if tariff advantages will be sufficient to offset higher input costs, but MFA quotas will provide a cushion. When MFA quotas end a year later, only the tariff advantage will exist, but only for three years till AGOA ends.

The apparel trade regime – the quota system – and its value chain organisation have been more crucial to AGOA's impact rather than tariff privileges or low wages. This is suggested by the fact that no other labour-intensive assembly activities (e.g. footwear, toys and sports goods) moved to Africa though AGOA gives them the same tariff privileges. Apparel differs from these other products in that it has quotas and is managed by full package suppliers rather than by MNC systems. The quota system seems to force the relocation of producers to higher cost sites more effectively than the grant of tariff concessions to them. The location of those sites is clearly affected by network relations with the agents that allocate contracts.

3. Aspects of apparel FDI performance in Lesotho

FDI has benefited Lesotho significantly in terms of employment and exports. The long experience of clothing manufacture has created new operating skills and work attitudes, a

[13] The textile industry in South Africa is also highly protected by common SACU tariffs and the extensive use of anti-dumping measures by the South African government (Roberts and Thoburn, 2004, World Bank, 2003). This may hold back the speed of its upgrading.

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

better trade infrastructure and some support services. Foreign affiliates account for less than 3% of the number of establishments covered by the Bureau of Statistics' 'Establishment Survey' but for over half of employment by these establishments. The apparel industry employed 21.6 thousand workers in 2000 and 33.3 thousand in 2001, over 80 percent of total employment by foreign firms. In addition, according to Salm et al. (2002), 12,600 new jobs are planned in the near future: 600 from expansions of two factories and the remainder from new entrants (all from Taiwan).

The phasing of AGOA is leading to a deepening of the industry in Lesotho from simple cut, make and trim operations to fabric production; a few firms have shown serious interest in setting up weaving and knitting plants. One firm is already building a denim factory for around $100 m. and others are planning knitting facilities. Thus, the initial fear that many firms would pull out form Lesotho in 2004 is receding; however, the product range does not show signs of upgrading. Within the region, fabric capacity is being expanded in South Africa. In fact, some Taiwanese investors in Lesotho are setting up or acquiring textile plants in South Africa and local firms are likely to become more closely integrated with South African counterparts.

The issue remains, however, of whether the more integrated textile and apparel industry in Lesotho can survive open world competition after 2008. Productivity in Lesotho's apparel manufacturing still lags well behind that in Asia (see below) and the production structure remains confined to the simplest commodity end of the product range. Unless productivity rises and the product range diversifies, it will be difficult to sustain garment exports from Lesotho, and so to retain a substantial part of its FDI stock.

While FDI has created employment and foreign exchange earnings for Lesotho, several factors offset these benefits. There is heavy reliance on expatriates in foreign affiliates. In 2001 there were 1,076 expatriates, mainly from Taiwan and China, in the clothing industry. As Salm et al. (2002) note, this went with very low entry by the native Basotho at the managerial and supervisory levels – the only exception was personnel relations where there was a strong Basotho presence. What is more important for productivity and capability building, however, is production operations, and here there are problems. Most line supervisors come from mainland China. They do not speak Basotho and are barely proficient in English. Apart from the significant differences in culture and work ethic, this exacerbates industrial relations problems.[15]

Skill creation by foreign investors is one of the main benefits expected of FDI, particularly in export-oriented activities with stringent requirements of cost, quality and delivery. Even simple, low-technology assembly activities can create valuable skills, not just in the manufacturing process but also in repairs and maintenance, quality management, supervision and management. Foreign investors in Lesotho have created new skills: all local employees are given some on-the-job training in handling sewing machines, cutting, pressing and the like. However, the training is limited to basic production requirements. While large MNCs tend to have well-developed training and technology transfer routines and try to maximize the employment of locals for cost reasons, foreign investors in Lesotho are not of this type. Taiwanese firms make little effort to impart more advanced skills, even within the confines of CMT operations. Most workers are taught to use only one machine; in Asia, they are taught to master two or more processes. Machine maintenance, layout, pattern making and other

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

skills are not taught. Most supervisory, technical and managerial jobs remain, as noted, with expatriates, even in firms that have been in Lesotho for a decade or more, with no systematic effort to create a local cadre with these skills. Only one company had in-house training program for supervisors.

Skill needs in Lesotho are rising apace. The deepening of the apparel industry into textiles, a more capital-intensive and complex activity, will soon call for more advanced skills. The loss of trade privileges in 2008 will accentuate this need. The relocation of labour-intensive activities from RSA will be sustainable only if skill levels rise. There is little use of industrial engineering (studies of task level productivity) in enterprises, without which it is very difficult to achieve sustained productivity increase. There are practically no industrial engineering skills available in the country. Management skills are weak and there is little or no local design or marketing capability. Yet all such skills are necessary if the industry is to narrow its productivity gap and build a genuine competitive edge as it diversifies its industrial base and moves up the technology and quality ladder.

Recruitment procedures also show lack of concern for skills. Very few firms recruit using formal tests of competence. "Testing for literacy, numeracy or dexterity is simply not done, no training records are kept and in most cases only very basic records are kept of employees. Unstructured recruitment leads to accusations of favouritism, the possibility of bribes, uniformed selection of potential supervisors and, ultimately, poor industrial relations" (Salm, et al, 2002, p.41).

These deficiencies reflect, to some extent, the nature of the foreign investors in the Lesotho apparel industry. Family owned and tightly controlled East Asian firms have a culture practices that does not conduce to local skill creation or participation at higher levels of management, technology and decision making. Business at these levels is conducted almost wholly in Chinese. The (natural) tendency to bring in experienced but not well-educated textile workers from China reduces skill transfers and promotion at the shop-floor level. In general, Chinese expatriates are not well integrated into local society, living in enclaves across the border in South Africa or on the factory premises. Some firms may have a 'footloose' attitude (i.e. that they are in Lesotho only for as long as trade preferences last) and so be less inclined to invest in local skills and creating local managers. In turn, suspicion and hostility on the part of the local population to the Chinese (this does not apparently apply to South Africans) prevents the creation of greater trust and social capital.[16]

Part of the problem, however, also lies with the institutional structure. There is no training centre for the garment industry; there was a Lesotho Garment Centre funded by the UK aid agency, but closed down in 2002. The local polytechnic provides generic management training and courses on design and bespoke tailoring and the Institute of Development Management and St Luke's Mission offer some management courses, but these are not geared to specific skill and technical needs of the garment industry. This failure to provide the public good of an training facility of a type common in most apparel producing countries may make it too costly and risky for private firms (in appropriating the returns to their effort if workers leave) to invest in worker training.

One important benefit of FDI in developing countries is the stimulation of local entrepreneurship and capabilities through knowledge spillovers or backward linkages (UNCTAD, 2001). This is practically absent in Lesotho. Even 15 years after the first garment factory was established, almost no local firms have emerged to compete with the foreign

[16] There was a riot in 1998 that caused considerable damage to Chinese property and some loss of life. It has left a legacy of insecurity in the Chinese community.

firms, subcontract from them, or supply them with inputs like packaging or accessories.[17] This is unusual in the CMT end of the garment industry, with its low entry barriers, simple technology and the possibility of subcontracting or approaching buyers directly. For instance, in Bangladesh, another country without strong entrepreneurial traditions, there was an efflorescence of local producers within a few years of foreign investors setting up garment operations (Rhee and Belot, 1990). Perhaps the difference lay in the fact that the lead foreign investor was a large Korean chaebol, which took workers to Korea and gave them intensive training. Bangladesh now exports over $3 billion of garments each year, a substantial proportion of this coming from local companies. Similar stories can be told of countries like Sri Lanka, Mauritius, Morocco and small economies in Central America.

It is not clear what accounts for Lesotho's poor record in this respect. Again, part of the explanation may lie in the reluctance of foreign firms to train local employees in high-level skills – after all, they have to serve in managerial and supervisory positions to learn the basics of the business before they can venture out on their own. Part may lie in the local culture and institutions that inhibit entrepreneurial activity. And part may lie in capital market deficiencies; there are no sources of risk capital available for prospective investors without a track record.

The impact of FDI on Lesotho is thus mixed. It has brought significant employment and export benefits, particularly valuable when other sources of both are declining. It has created a favourable image in the investor community, though this community seems to be largely comprised of East Asian firms. It has created some new skills, a nascent industrial culture and an infrastructure geared to export activity. However, it remains shallow and based on evanescent trade privileges. It has not created the capabilities and linkages that similar FDI has in export platforms in other regions. Local skills are weak and firms have not invested much in raising them, preferring to use expatriates. There is inadequate integration of expatriates into the local economy and culture: the resulting lack of social capital is harmful to the industry and the image of foreign investors. Poor labour relations feed into a spiral of low enterprise training and weak worker commitment. Supply linkages remain with the outside world rather than within the economy, with an absence of spillover benefits to Lesotho.

4. Competitiveness of Lesotho's apparel industry

The survival of the Lesotho apparel export industry after AGOA will depend on whether its process and organisational efficiency match those of competitors after adjusting for wage differences. Let us start with wages. Table 1 shows the minimum wages in force in Lesotho in 2002.

[17] One firm was up by a local employee to subcontract cut-make-trim operations but ran into serious difficulties; at the time of the survey it was about to close down.

Table 1: Statutory minimum monthly wages in Lesotho, 2001 (US$)

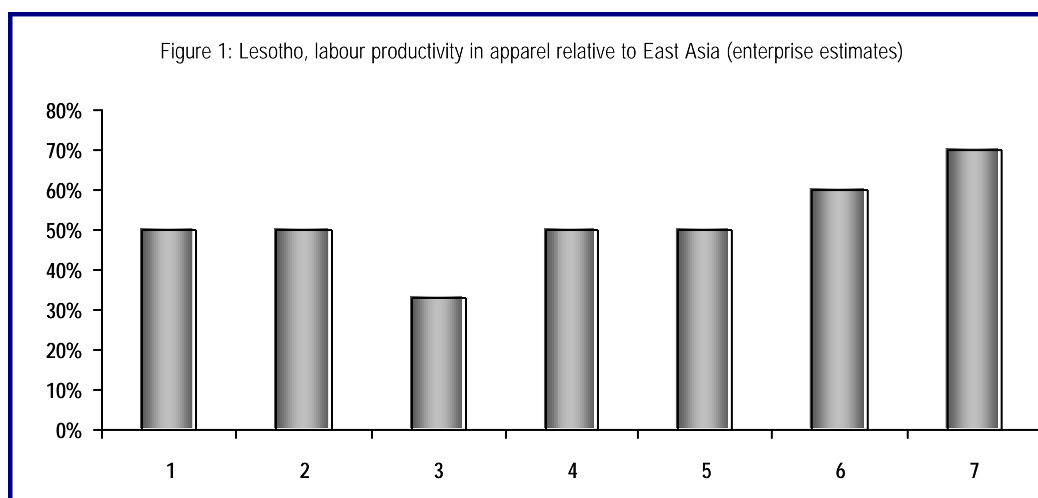
Sewing machine operator or weaver (six months training)	53.5
Sewing machine operator or weaver (trained)	56.0
Weaver (six months training)	53.5
Machine operator	73.2
Telephone operator	63.1
Unskilled labourer	53.5 to 58.9

Source: Government of Lesotho, Legal Notice no. 169 of 2001

Average wages including benefits are higher than minimum wages. Apparel firms pay shop-floor workers around $60-75 per month, with experienced workers receiving up to $250 per month.[18] These are about the same as in Malawi, Tanzania and Bangladesh, and perhaps marginally lower than India or China. However, as noted, workers in Lesotho have much lower capabilities than in Asia. Lesotho faces, according to enterprises interviewed, severe shortages of shop-floor, technical and managerial skills; they cope by using expatriates but also react by specialising in the simplest products and by not upgrading over time. Trade privileges have sheltered such skill inadequacies, but the deficiencies show up in productivity figures.

Productivity: It did not prove possible to get data to calculate total factor productivity, but we obtained estimates of shop-floor labour productivity in Lesotho compared to similar operations in East Asia. The results are impressionistic but revealing, given that they are by experienced managers and adjusted for the task and product. The equipment used is very similar across countries (CMT operations need simple power sewing machines) so capital-intensity and technology should not make much of a difference. Since the layout and work organisation are managed by East Asian firms, they it should also be fairly similar to East Asia. Figure 1 shows relative productivity as reported by seven Taiwanese firms in Lesotho.

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



Productivity in Lesotho apparel firms ranges from 30 to 70 percent of that in East Asia, with most estimates around 50 percent. While the figures are rough, there is clearly a significant productivity gap with East Asia.[19] This is the more worrying because it is not due to Lesotho being a new entrant (and so low on the learning curve). Most firms have been in Lesotho for a decade or more and have presumably exhausted available learning economies (which in any case are likely to be small in these simple operations). Since wages are fairly similar to major producers of similar apparel in East Asia, there are bound to be severe competitive problems for Lesotho once trade preferences go. In addition, Lesotho faces a location handicap – it has higher costs of transport than competitors located near or by coastal areas, however efficient the facilities are over South African territory.

If there is significant inward FDI in textile and yarn production in the second phase of AGOA, Lesotho's competitiveness will also depend on the productivity and efficiency of these operations. As these activities are far more capital and skill intensive than CMT apparel assembly, there will have to be major improvements in local worker capabilities if they are to match competitors in Asia. It is impossible to predict the outcome at this stage, but the apparel experience gives grounds for concern on their viability – more complex activities are likely to suffer from larger productivity gaps.

What accounts for the productivity gap in apparel? We have already noted one important set of explanations: low worker skills, inadequate training facilities, poor communication with management and the lack of productivity raising efforts. There are others.

The wage payment system seems to be a disincentive to workers to raise productivity. The Lesotho Labour Code forbids piece-rate (as opposed to time-based) payments, as does the organised labour movement. Piece rates are widely used in the export-oriented apparel industry in most developing countries (including China) and, combined with stringent quality management, are regarded as essential for high productivity.[20] Many firms in Lesotho complained about having to pay the same wages to workers with very different number of garments sewed per day, but are anxious to appease the labour movement.[21]

[19] The impression of low productivity in Lesotho is confirmed by technical experts in Salm *et al.* (2002).

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

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

Some mention was also made of the growing incidence of HIV/Aids. The high infection rate (around 30 percent in the total population, 42 percent in Maseru) is just staring to affect the industry, and over time threatens the entire industrial workforce. However, the productivity comparisons noted above are for the stable workforce and denote other problems.

Finally, some firms mentioned work attitudes and social norms, but the effects of these are difficult to distinguish from the economic variables like training and incentives.

Productivity will be only one (if perhaps the major) determinant of competitiveness once trade preferences vanish. Lesotho faces other competitive handicaps. One is the physical infrastructure. Given the distance from South African ports (Port Elizabeth and Durban), overland transport facilities are critically important to cost and delivery. The railhead in Maseru is the key node in the import of fabrics and other inputs and the export of apparel; however, it suffers from inadequate and outdated handling and storage facilities. The facilities are owned and operated by a private South African company, but the firm has no lease or tenure on the (government owned) site. This deters it from investing in improving the facilities, but the Government of Lesotho is not prepared to operate the site itself. "The result is a completely inadequate facility operated under dangerous and unsecured conditions."[22] Unsuitable storage means that containers have to be kept waiting in South Africa, at extra cost to the companies. Inputs are brought in by rail and outputs are sent by road; thus, empty containers are sent back by rail and empty road transport containers are brought into Lesotho. The movement of goods is also hampered by delays in customs and excise because of the use of manual procedures (and some minor corruption).[23]

There are other infrastructure problems in Lesotho. There is a shortage of industrial land and factory shells for foreign investors, hampering the setting up of new facilities to meet the growing demand in response to AGOA. Under Lesotho laws, foreigners could not own land (though there are proposals made by the Land Policy Review Commission to change these laws under considerations); they can only lease from a local institution. The Lesotho National Development Corporation (LNDC) fulfils this function, building factory shells and subleasing them for the long term to foreign investors. However, it faces financial constraints that hold back its ability to meet demand and it is not clear why a development institution should be engaged in providing basic infrastructure facilities. In most developing countries such facilities are now operated by the private sector.

There is another problem looming: the growing shortage of water in urban areas, including industrial estates in Maseru. This will particularly affect textile operations planned in the second phase of AGOA. If they use water from the river than runs by Maseru, they will worsen shortages to residents. The pipeline from the highlands to South Africa cannot be tapped, not just because of the contractual arrangement but also because of geography: the pipeline runs north from the highlands while Maseru and most other industrial sites lie on the west.

Finally, Lesotho faces a competitive handicap in the promotion and attraction of FDI. Foreign investors have come to Lesotho till now because of political circumstances, the East Asian connection and trade privileges, not in response to promotion. However, as competition for FDI, particularly export-oriented FDI, intensifies, effective promotion becomes vital. FDI regimes in most countries are converging on a common set of rules. Given the underlying

[22] Salm *et al.* (2002), p. 34.

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

economic conditions, MNCs respond positively to well-grounded promotion that provides them with relevant information on investment conditions, changes a negative image where one exists and, most important, promises to work towards making the host economy an efficient place to operate. The best examples of effective FDI promotion that transformed national competitive prospects are Ireland, Singapore and Costa Rica; investment promotion agencies are now a standard tool of in the competitiveness armoury of all developed and newly industrializing countries.[24] Large economies like China and India have not yet mounted strong promotion efforts, but are gearing up to do so.

For a small, remote and resource-poor economy like Lesotho, FDI promotion is of greater importance than to countries like China that would attract significant investor interest whatever they do. Such promotion is currently weak in Lesotho. The investment promotion agency for manufacturing consists of a small centre in LNDC (there is a separate unit for tourism FDI in the Ministry for Tourism, dispersing the meagre promotion effort). The centre has not been very active in promoting Lesotho's image or attractions overseas, though it provides very useful support to firms that have invested there. It lacks the financial and human resources, official stature and bureaucratic independence to conduct an effective campaign. It has a tiny staff (the director, a promotion manager, two investment officers, one research manager and one public relations officer). Its annual budget (including salaries, travel and advertising) is around $100 thousand, well below the minimum critical mass needed to reach foreign investors. [25]

To conclude on Lesotho's competitive prospects, the 'bottom line' is the wage/productivity nexus: its wages are comparable to major Asian competitors but productivity is much lower (and transport costs higher). If past experience is a guide, the deepening of the industry will probably exacerbate the gap. There is little sign that measures are being adopted to reduce the gap. On the contrary, while Asian producers are investing in new equipment, skills, quality, designs and marketing, Lesotho is continuing with the same product range and equipment and (low levels of) skills and training. There appears to be no concern in the government or industry with the productivity gap; most discussion focuses on the future of AGOA and negotiations for its extension.

If AGOA is not extended or relaxed in terms of local content requirements, the industry may simply disappear once its high cost, low quality base is exposed to the full force of Asian competition.[26] Even if it is extended, it will not mitigate the underlying competitive problem unless the structural issues are addressed; there is little possibility that the passage of time will by itself cure productivity deficiencies. There are also other competitive problems (infrastructure, transaction costs and FDI promotion) facing Lesotho, but these are relatively minor. AGOA may well be extended – in fact, we suggest that it should be – but this is only economically worthwhile if a coherent strategy is adopted, locally and by the international community, to raise local capabilities.

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

[25] Mauritius, with a population less than half of Lesotho, had 10 times as many people involved in export and FDI promotion, with a budget over 30 times larger. Singapore, with a somewhat larger population (3.5 million), is even more impressive: its Economic Development Board has 450 staff and in the late 1990s spent nearly $35 million per annum.

[26] Some analysts, like Mattoo *et al* (2003), estimate the impact of AGOA by imputing supply responses to price changes arising from tariff and quota changes. This may be misleading in that it assumes smooth supply response curves; a more realistic scenario is that with full liberalization high cost producers will be completely removed from the export arena as foreign investor return to more efficient sites.

5. Some implications, questions and policy issues

Lesotho's experience raises important issues concerning competitiveness and industrial development, not just in Lesotho but in Africa more generally.[27] Apparel is the main example of Africa's new industrial competitiveness (unlike traditional primary resource processing), valuable because the region has till now done so poorly in global competition.[28] Apparel (in this case, simple cut-make-trim assembly) is the archetypal entry-level manufactured export in less-developed economies. It has low technological, capital, skill and scale requirements and easy access to international markets because of the international buyers and full package suppliers seeking cheap or quota-free suppliers (Gereffi, 1999). If unindustrialized countries cannot establish a competitive base here, it is difficult to see them making headway in complex activities where 'best practice' technical, skill, organisational and marketing needs are far more demanding.[29] Lesotho is a particularly good case to analyse industrial competitiveness because it does not suffer from most of the extraneous (to manufacturing) problems that afflict much of Africa: political instability, wars and conflicts, macro mismanagement and crippling debt burdens, corruption, poor governance and policies inimical to the private sector. Lesotho, by contrast, has liberal trade and FDI policies, reasonably good infrastructure, low taxes and reasonably efficient, honest administration. Its experience thus allows us to focus on the capability building process more narrowly.

African apparel exports grew in response to MFA quotas rather than to local capabilities. In effect, the MFA provided infant industry protection to low wage entrants without significant skills or industrial capabilities, while the nature of the technology allowed them to reach acceptable levels of cost and quality in simple products fairly quickly. AGOA extended and amplified the protection offered, though limiting it in its second phase by imposing input conditions. While it has stimulated exports, it is not clear that the infants will reach maturity by the time it ends. The case for industrial policy, particularly through trade interventions, remains controversial, though it has been extensively used and has been very effective in some cases (Lall, 2003). In the apparel industry, it seems from the author's interviews with producers in South Asia that countries like Bangladesh and Sri Lanka have matured to some extent – they have developed sufficient technical, managerial and entrepreneurial capabilities to survive open competition after MFA. In Lesotho, and perhaps the rest of less-industrialized Africa, the learning process has not gone this far.

Despite a decade and a half or experience in CMT operations, productivity in Lesotho is below that of major competitors. Since wages are comparable, its competitiveness cannot outlast trade privileges unless productivity improves sufficiently to match competitors (and overcome higher transport costs). We noted several possible reasons for low productivity: low skill levels, inadequate in-firm and external training, the wage system, heavy reliance on expatriates and poor relations between employers and workers. There may be other factors

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

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

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

that are more difficult to assess, like a deficient 'work culture'. To the extent that this is distinct from the effect of low skills, incentives and the like (i.e. workers are less productive even with similar training and incentives), it has disturbing implications for competitive industrialisation in Africa. It is not, however, possible to assess this without detailed research involving industrial engineering, and until then we must assume that the problem lies in economic factors to which there are policy remedies.

The remedies lie mainly with the Lesotho government and enterprises. On the human capital front, these involve better education, facilities to provide the specialized skills needed by apparel (and, soon, textile) manufacturers, incentives to employers to provide more training, better employee relations, modern recruitment and promotion practices and the like. On the technology front, they involve help with product upgrading, technical assistance where needed for textile and yarn manufacturing, better quality and standards procedures and so on. If local SMEs appear, a vital function would be to support their learning processes. On the infrastructure front, they involve improving the railhead facilities. On the institutional front, they would involve introducing a piece wage system with appropriate safeguards for labour standards. And so on.

However, some remedies also lie outside Lesotho. South Africa, with its advanced capabilities and well-developed textile industry, can help Lesotho's competitiveness by locating some production facilities there, developing local institutions and providing specialized training and information. The way it restructures its own textile industry (Roberts and Thoburn, 2003) will also affect crucially the future of Lesotho's firms. However, the most vital external decisions affecting Lesotho's export future will come from the US, on trade preferences and local content rules under AGOA. It is possible that AGOA will be extended, both overall and in its rules of origin. This will provide a longer infant industry period and probably induce more FDI in Lesotho and other less developed beneficiaries. Whether this is desirable or not depends on how effectively the period is used to raise productivity and deepen and diversify capabilities.

We noted that at this time there is no strategy on the part of the Lesotho government or apparel industry to address these structural issues (i.e. to benchmark capabilities, analyse shortcomings and devise means of remedying them). The donor community, led by the US government, should make this a necessary condition of extending AGOA privileges or granting other such privileges. It should also help with capability building directly, funding training within Lesotho and abroad, providing industrial engineering expertise, setting up technology support institutions and improving the infrastructure. As with any industrial policy, protection by itself may help the development of new capabilities, but it is unlikely to be sufficient if there are factor market and institutional failure.

One of the most intriguing effects of AGOA – or rather the lack thereof – is that other export-oriented, labour-intensive activities apart from apparel have not moved to Africa to take advantage of its low wages and tariff privileges. If African industrialization is to proceed and take root, it is vital to understand why and take measures to diversify the FDI and export base. It may reflect a perception or information gap on the part of the MNCs concerned, or a feeling that the 8 year period is not long enough to develop viable operations, or that Africa simply cannot compete with Asia in terms of productivity and reliable delivery. Each of these calls for specific policy measures.

Coming now to FDI, the Lesotho experience with apparel highlights both the benefits and handicaps of this mode of industrialisation and resource transfer. The benefits are evident enough – employment, exports, industrial experience and some skill and institutional development – and they have been of great value to an economy with Lesotho's structural

problems. The handicaps have been low local value added and zero local linkages, insufficient local participation at high levels of technology and management, inadequate training and productivity improvement, and poor integration with the local population. There is thus a real risk that the investments have not taken root and will vanish in the longer term.

Some of these deficiencies in FDI reflect rational reactions by investors to local conditions. For instance, local linkages may not have developed because there has been practically no entrepreneurial response to the presence of foreign firms. Similarly, reliance on expatriates may reflect weak local technical and managerial skills. At the same time, there does seem to be a singular lack of commitment on the part of Taiwanese investors to local capability development, in particular their reluctance to train local staff more rigorously and to promote them to higher level technical or managerial positions. There seems to be a feeling of impermanence in the enterprises that also permeates their social relations with the host community. It is not clear whether this reflects an acknowledgment of the inherent lack of competitiveness of their operations, their origins as investors from newly-industrializing economies (i.e. they do not yet have the global long-term outlook of large MNCs from the developed countries), or a lack of appreciation of local customs and culture (South African firms claim to train and promote locals much more). Some Taiwanese investors seem to be striking deeper roots in Lesotho and wish to stay on for the long term, but these are a small minority.

Policy issues with respect to FDI, apart from those on productivity, deepening and diversification, have to do with integrating the foreign community into Lesotho, creating trust and social capital and launching more effective and targeted FDI promotion. Capturing the beneficial externalities of foreign presence essentially requires entrepreneurial development, and this has proved an extremely difficult task in much of Africa, at least as far as modern manufacturing is concerned.

To conclude, Lesotho may or may not be the torch bearer of a new era in African manufacturing growth and competitiveness. Much depends on how effectively the government mounts industrial policy to upgrade local capabilities and tap FDI potential. There is a strong case for extending trade preferences on infant industry grounds to it and similar economies, but only if this is accompanied by a coherent and systematic strategy of industrial development. Otherwise Africa will not overcome its structural constraints to industrial development (Lall, 1995).

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