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A STRATEGIC REVIEW OF THE INDUSTRIAL SECTOR OF LESOTHO WITH PARTICULAR REFERENCE TO THE TEXTILE AND CLOTHING SUBSECTORS IN THE LIGHT OF DEVELOPMENTS IN THE REPUBLIC OF SOUTH AFRICA

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CONTENTS

EXPLANATORY NOTES

References to dollars ($) are to United States dollars, unless otherwise stated.

Dates divided by a slash (1993/94) indicate a fiscal year or a crop year. Dates divided by a hyphen (1993-1994) indicate the full period, including the beginning and the end years.

In tables total may not add precisely because of rounding.

The following abbreviations are used in this document:

ACP	Africa-Caribbean Pacific (LDC members of Lomé Convention)
ATC	Agreement on Textiles and Clothing - in Uruguay Round of GATT.
BAPS	Basotho Advisory and Promotion Service
BEDCO	Basotho Enterprise Development Corporation
BSLN	Botswana, Swaziland, Lesotho and Namibia
CET	Common External Tariff (of SACU)
CMA	Common Monetary Area (rand)
CMT	Cut-Make-Trim (in garment-making)
EU	European Union - member-states of the European Communities
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GEIS	General Export Incentive Scheme (RSA)
GNU	Government of National Unity (RSA)
GoL	Government of Lesotho
GSP	Generalized System of Preferences
IPC	Investment Promotion Centre (in the LNDC)
JGIGC	Joint Government/Industry Garment Council (proposed)
LDC	Least Developed Country
LHWP	Lesotho Highlands Water Project
LNDC	Lesotho National Development Corporation
M	Maloti
MEDIA	Mauritius Export Development and Investment Agency
MFA	Multifibre Arrangement
MTI	Ministry of Trade and Industry
MTNs	Multi-National Trade Negotiations (Uruguay Round of the GATT)
MVA	Manufacturing Value Added
NCF	National Clothing Federation (RSA)
NIC	Newly Industrializing Country
R	Rand
RIDP	Regional Industrial Development Programme (RSA)
RSA	Republic of South Africa
SACU	Southern African Customs Union
SAP	Structural Adjustment Programme (RSA)
SMEs	Small/Medium-scale Enterprises (Lesotho)
SAP	Structural Adjustment Programme - S. African textiles and clothing industries
TECU	Textile Export Certification Unit - Lesotho (proposed title)
UK	United Kingdom of Great Britain and Northern Ireland
UNDP	United Nations Development Programme
UNIDO	United Nations Industrial Development Organization
Uruguay Round	The latest round of MTNs under the GATT
USA	United States of America
WET	Water-Electricity-Telephones (Public utilities)

PREFACE

This Study has been prepared by the Industrial Development Review Unit of UNIDO in cooperation with the Country Strategy and Programme Development Division (CSPD) under TSS-1 funding facility as a UNIDO input to the Strategic Options Report prepared by international organizations for the Government of Lesotho (GoL). This Study was initiated by the Ministry of Trade and Industry, Government of Lesotho. The Study reviews the structure and performance of the Lesotho manufacturing sector, taking into account of developments in the Republic of South Africa (RSA) in general and their implications for the textile and clothing subsectors in particular. The Study also attempts to assess the impact of government policy, with a view to recommending changes in general strategy and the adoption of specific measures considered likely to promote the diversification and expansion of the manufacturing sector.

For analytical convenience, this Study is divided into three parts which together encompass 10 Chapters. Part One comprises three Chapters and presents an overview of the industrial sector. Chapter 1 analyses the macroeconomic context, including an assessment of the impact of developments in RSA and its implications for Lesotho. Chapter 2 elucidates the industrial policy and investment environment, while Chapter 3 examines the structure and performance of the manufacturing sector.

Part Two reviews the performance of and prospects for textile products and garments in Chapters 4-7. Chapter 4 analyses the role of the main textile and garment subsectors including the supply of wool and mohair fibre, export-oriented garment-making and small-scale textile and garment producers. Chapter 5 depicts the perceptions of the Lesotho investment environment with reference to its strength and weakness as a location for serving world markets and an appraisal of government policy and its impact on the industrial sector. Chapter 6 reviews the country's exports of textile and garments by main categories and destinations. Chapter 7 presents details pertaining to garment production in the Republic of South Africa and their implications for Lesotho.

Part Three of the Study presents the principal findings and recommendations relating to industrial policy in general terms and specific measures with a view to promoting an enabling environment for fostering the pace of industrial expansion in Lesotho. Chapter 8 spells out the principal tenets of an enabling policy environment for the manufacturing sector in general terms, while Chapter 9 focuses specially on an appropriate policy environment for developing the country's textile and garment industries. Specific project proposals for technical cooperation initiatives are presented in Chapter 10.

The Study is based on an extensive review of published statistics and other material and field-research carried out in the course of a UNIDO mission. The UNIDO project team was led by Mr. Vinanchiarachi J., Industrial Development Officer, Industrial Development Review Unit, assisted by Mr. P.J.B. Steele, development economist and textile trade specialist, acting as international consultant, and Mr. T. Tsolo, development economist, acting as national consultant. Substantial assistance was also rendered by Ms. Mantlibi Pokane, Senior Programme Officer, CSPD. Overall guidance was provided by Mr. Torben M. Roepstorff, Chief, Industrial Development Review Unit. UNIDO acknowledges the invaluable cooperation of the UNDP mission in Maseru, and of the Ministry of Trade and Industry, Government of Lesotho.

This Report is based on information available at UNIDO headquarters and national sources as of April 1995.

EXECUTIVE SUMMARY

1. BACKGROUND

A. INTRODUCTION

The contribution of the Lesotho manufacturing sector to GDP has increased remarkably since Lesotho was granted its independence from the UK in 1966. In recent years it has been the most dynamic element in the economy other than construction and has also become the major source of merchandise exports. The textile and garment industry, in particular the latter, has played a major part in this overall achievement, thus helping to address a major weakness in the economy. However, the inherent economic circumstances of the country and changes in the external factors which had exercised a major influence on the development of manufacturing activity means the continuation of past growth rates must now be in some doubt and that even the maintenance of present levels of production is open to question.

It is concluded that there are prospects for the further development of the manufacturing sector and it is important for the future of the country as an independent economic entity that these opportunities are seized upon. The matter is made particularly urgent by the changes that have taken place in the Republic of South Africa (RSA) and the implications of these for Lesotho - in particular the likely reduction in foreign exchange income from Basotho miners' remittances and the curtailing of the country's share of the Southern African Customs Union (SACU) customs revenues.

If the growth prospects of the manufacturing sector are to be realized it is vital that the Government of Lesotho (GoL) adheres in general terms to the logic of the industrial strategy it formally adopted in 1991 - and had acknowledged in practice for some time before that. It is in the context of that overall strategy that the present study identifies a number of specific policy measures relating to the manufacturing sector as a whole and to the textile and garment industry in particular.

B. THE MANUFACTURING SECTOR IN GENERAL TERMS

a. Introduction

The manufacturing sector can be usefully divided into three distinct segments:

- The state-owned sector consisting of projects identified by the state planning apparatus of the day, largely financed by public investment and, in important instances, still managed by parastatal holding companies;

- The private sector consisting of projects financed almost entirely by foreign capital and usually subject to the control of foreign-based commercial interests;

- The indigenous private sector consisting of a very large number of enterprises, most of them in the informal sector of the economy and operating on an artisanal rather than an industrial scale, for the most parts servicing needs not met by larger producers or importers.

b. The state-owned sector

These are mainly import-substituting projects,[1] concentrated in the agro-industrial sector, and tend to be highly capital-intensive - this despite the fact that Lesotho's main economic resource is a substantial supply of relatively low-cost labour. The original economic justification of particular projects was often dubious, especially given the small size of the Lesotho domestic market. In addition, Lesotho's membership of the SACU meant that it was never possible to insulate them from outside competition by the usual tariff and non-tariff barriers - although this was arguably to Lesotho's ultimate benefit. Those that were commercially viable - such as the brewery and the milling complex - were eventually contracted out of public sector management; the others remain a drain on the public purse and it is now government's policy to privatize their management and their ownership - although the exact mechanism for achieving this has yet to be determined. Until it is done, the existence of a large, subsidized public sector continues to discourage private investment in the agro-industrial area of activity.

c. The private sector

c.1 General

The privately-owned industrial sector consists of labour-intensive, export-oriented projects. They are mainly concerned with the manufacture of mass-market, low-value garments, but also include ventures which produce umbrellas, shoes, structural steel products and electronic items - notably TV receivers. The unwillingness of the Lesotho sector to invest in industrial projects, in part a consequence of the lack of professionally-qualified managers and technicians, means that the companies concerned are foreign-financed.

The chief benefit conferred on the Lesotho economy by these projects is employment generation. Their commitment to Lesotho in terms of fixed assets is relatively small - largely because the acquisition of land is forbidden - and they can be easily relocated out of the country. Furthermore, nearly all the materials and components they process are imported and the value added in the manufacturing process low. They have developed few linkages with the indigenous economy either in terms of material supplies or contracted services. To all intents and purposes they are enclave industries.

c.2 The textile and garment industry

As already indicated, export-oriented garment production was the main beneficiary of the investment surge that ran roughly from the late-1970s until the early-1990s. These companies have been the most dynamic element in manufacturing value added (MVA) - although in absolute terms that of the largely state-owned (and heavily state-subsidized) agro-industrial sector was usually greater. However, activity in this area was more affected than any other by the changes in external circumstances that affected the whole of the manufacturing sector. There are good reasons for concluding that the industry is under severe financial pressure with which individual companies are coping more or less well and that there seems to be something of a crisis of *morale*.

d. Indigenous activity

Despite the failure of indigenous entrepreneurs to participate in major industrial projects in Lesotho, there is in fact a substantial, largely informal sector engaged in manufacturing activities of various kinds.

1/ The export-oriented cannery is an exception to this.

This is very important to the economy in terms of employment generation. However, almost without exception, the enterprises involved are under-capitalized and most of them are artisanal operations and, thus do not enjoy economies of larger-scale production.

They are not able to compete with South African imports in terms of price or quality - although the operation of the SACU common external tariff (CET) insulates them from competition from external suppliers. This means that they are largely confined to the production of items not supplied from the republic, either because the market is too diversified to make this an economic proposition (e.g. schoolgirls' uniforms), or because they are idiosyncratic to Lesotho (e.g. national dress and native craft products).
The characteristic weaknesses of the enterprises in this sector are:

- Poor access to materials and components - which usually have to be sourced in RSA - because of the failure to develop an adequate specialist distribution network;

- Low quality standards and lack of homogeneity in output reflecting not only inadequate training, but also ineffective management;

- Lack of marketing expertise - particularly as regards external markets other than the Sesotho-speaking regions of the RSA;

- Inadequate access to capital either for development or operating purposes - reflecting lack of creditworthiness than shortage of credit.

The main thrust of GoL's present industrial strategy is to broaden and diversify the existing industrial base. It is recognized that the domestic market is too small to provide a sustainable base for development which must therefore come about as a result of export-led growth.

It is also accepted that export-led growth can only come about as a result of private sector initiatives. Given the lack of a native entrepreneurial class and the shortage of requisite technical and managerial skills, this requires the promotion of foreign investment in export-oriented projects.

However, GoL is also concerned to avoid the development of what would amount to an enclave industrial sector. By this is meant a sector dominated by enterprises which are not only principally concerned to service foreign markets, but are also essentially isolated from the domestic economy on which they impinge only as employers of labour and generators of limited official revenues - limited because of the costs to the government of the operation of the incentives system needed to attract them to Lesotho in the first place. Rather they should act as engines of activity within the country, firstly by developing backward linkages into the economy and encouraging the growth of local enterprises which become an integral part of their operations, secondly by providing the economic impetus which encourages and sustains the operations of a viable small-scale manufacturing sector.

C. MAIN DETERMINANTS OF INDUSTRIAL DEVELOPMENT

a. Socialist planning

The original justification for the development of the public sector enterprises derived from the ideology of "African socialism" which was the prevailing endeavour of the first generation of post-Independence regimes in sub-Saharan Africa.[2/] It became evident as early as the 1970s that

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2/ This is essentially a development of the Leninist economic philosophy of the former COMECON which stresses national self-sufficiency based on central planning. In its African form, its fullest exposition was in the Arusha Declaration of President Julius Nyerere of Tanzania in 1968.

industrial self-sufficiency based on socialist planning was particularly inappropriate given the objective economic circumstances of Lesotho and the policy was tacitly abandoned.

Nevertheless, the underlying thinking still influences industrial policy in that GoL has identified certain key projects which it considers should be developed "in the national interest". The emphasis is on commercial viability and these projects will only go ahead on the basis of private sector participation. However, to encourage this, GoL - through the LNDC - is willing to take a share in the equity.[3] Somewhat surprisingly given its general market-oriented approach, such an approach is countenanced in the general industrial strategy formulated in the Agro-Industrial project developed in concert with the World Bank which came into effect in 1991.

b. Exogenous factors

The main reasons for the development of the major private sector projects must be sought in exogenous factors - i.e. external to Lesotho and over which GoL exercised virtually no influence. These were:

- The imposition of trade and investment sanctions on the RSA - mainly by the USA. This compelled export-oriented companies in the republic to relocate to Lesotho;

- The operation of the international textile trade regime (the MFA) which meant that no obstacles were placed on exports of textile products to the USA from Lesotho at a time when exports of such products from other more economic manufacturing locations were heavily restricted. This also had the effect of driving producers in major garment supplying countries to relocate to Lesotho - amongst other LDCs in similar circumstances.

It is indisputable that, without these factors, very few of the projects that did come to Lesotho would have come.

The lifting of the US sanctions on the RSA has, therefore, done away with a major reason for investing in the country. The imposition of quotas on the most traded of Lesotho's garment exports to the USA, had a similar effect on its attractiveness as a location for investment in this area and also adversely affected the level of production already being carried on in the country - see below.

D. LESOTHO AS AN INVESTMENT LOCATION - COMPARATIVE ADVANTAGES AND DISADVANTAGES

a. Incentive regime

Despite its early flirtation with the concept of national self-sufficiency and state control of "strategic industries", the GoL has never placed any formal obstacles in the way of foreign investment in the manufacturing sector. Indeed, since the weaknesses of its socialist development became evident, it has expressly set out to attract such investment by developing an incentive regime in fact if not in theory largely aimed in that direction.

However, the benefits it offers in this regard are very similar to those offered by most of the other LDCs with which Lesotho competes for investment. They are arguably less generous than those available in many such countries and less effectively implemented. They are certainly less generous than those currently available in respect of the so-called tribal homelands in the RSA - see below.

Labour costs: The main comparative advantage Lesotho enjoys as an investment location is the existence of a large supply of cheap labour. However, this is in relation to the RSA. Lesotho wages are not low compared to other LDCs, particularly those in East Asia, where labour is also

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3/ The wool/mohair processing project is of this nature. See Chapter 4.2.

perceived to be more productive. Furthermore, Lesotho's comparative advantage in this respect seems to be reduced by restrictive labour legislation. Even in comparison to the RSA, basic wage levels in Lesotho are no lower than those in the former tribal homelands, the bantustans. For reasons argued in Section 1.F.a it is considered unlikely that low-cost, labour-intensive industry will be allowed to develop in these regions when this threatens established industry in the more developed regions of the republic.

Whether or not Lesotho enjoys a comparative advantage over RSA in terms of labour costs if account is taken of such factors as productivity as well as hourly wage-rates is debateable with insufficient objective evidence to support a firm conclusion. The UNIDO mission is inclined to the opinion that, even on this basis, the Lesotho workforce is still less costly than the great bulk of that employed in the South African clothing industries. It is also inclined to suspect that workforces in the former bantustans will not be permitted to undercut the wage-levels established in such major centres of the industry as Cape Town and Durban.

Infrastructure and utilities: In addition, the industrial infrastructure in Lesotho is inferior to that of the RSA. Inland communications in much of the country are poor - although they have been greatly improved in recent years with international technical assistance - and utilities (water, electricity and telecommunications) are considerably more costly than in the RSA and less reliable. The main advantage that Lesotho enjoys in this respect is its access to the highly-developed South African roads and railways and ocean-going port facilities in Durban. The completion of the LHWP should make it possible to reduce electricity and water costs in the kingdom.

Preferential market access: The other comparative advantage enjoyed by Lesotho is preferential access to the markets of the main industrialized economies. However, its position in this respect is no better than that of other LDCs around the world - including its African neighbours. Its access to the South African markets through its membership of the SACU is its most significant trading privilege, although, as already suggested this is counterbalanced by its exposure to South African import competition. (Lesotho's preferential access to other African markets under the SACU and the SADEC is of little practical benefit given the present condition of the other sub-Saharan economies which means that the bulk of their foreign trade must be with the RSA and the developed world.)

E. GoL INDUSTRIAL POLICY

The GoL has a very clear idea of the realities of the present situation of the Lesotho manufacturing sector and has pursued an appropriate strategy in the light of this. The main features of this strategy are:

- The role of GoL is to create a favourable investment environment by managing the macroeconomy to this end. This includes encouraging industrial training programmes, although much training will be carried out in-house. However, there is a prejudice against encouraging uneconomic ventures by offering incentives with an element of subsidy;

- GoL is also responsible for promoting Lesotho as a location for industrial investment. Its efforts in this regard should be suitably targeted to those types of industrial project identified in general terms as those most appropriate for Lesotho - i.e. labour intensive - but it is envisaged that, as industrial activity becomes more securely based, and a native management and technical *cadre* begins to emerge it will be possible to attract more sophisticated projects with a higher local added-value;

- The identification and development of particular industrial projects is the responsibility of the private sector, although - as already noted - GoL reserves the right to encourage investment in "national interest" ventures by taking an equity stake;

- Major projects are to be encouraged to develop backward linkages with indigenous enterprises able to supply materials and components and sub-contracted services;

- Indigenous SMEs are to be assisted to take advantage of the range of supportive services available to them. This includes the identification of market opportunities - particularly those arising from the Lesotho Highlands Water Project (LHWP).

However, having agreed that this is probably the correct industrial strategy for Lesotho, the UNIDO mission acknowledges that, so far, it has had little impact on the pattern of industrial development which has been largely driven by exogenous factors outside the control or the national government. Nevertheless, it would still maintain that there is no alternative to relying on foreign investment as the main engine of growth and this will only be attracted in an environment which broadly reflects the strategic principles outlined above.

F. PROSPECTS

a. The South African market

Although the lifting of sanctions on the RSA has removed the main incentive that caused export-oriented industries to relocate from the republic, it is considered unlikely that this will result in the republic becoming an active competitor for investment in the type of labour-intensive manufacturing activity that Lesotho has attracted in recent years.

This conclusion reflects the UNIDO mission's analysis of the implications of South African membership of the GATT and the probable effect of this on industrial policy - in particular the investment incentives that can be offered. It also reflects the logic of the RSA's internal economic and political situation. In particular, it is considered likely that there will be considerable opposition to the development of enclaves of labour-intensive industrial activity in the former bantustans based on low-cost labour because of the threat this will pose to standards of living achieved elsewhere.

In the case of the manufacture of garments for the international market, it is concluded that lower labour costs will continue to give Lesotho an advantage in the production of basic, mass-market clothing. As at present, this factor will be only partly set off by the higher cost of utilities in Lesotho and it seems likely that the completion of the LHWP should enable the GoL to reduce or even entirely reverse this comparative disadvantage in the case of electricity and water costs. In addition, Lesotho producers servicing South African markets will benefit as much as those in the RSA from any reductions in fabric costs as a result of the RSA dismantling the very high levels of tariff protection consequent on its accession to the GATT. The main advantage enjoyed by South African-based garment-makers as opposed to those in Lesotho are the very generous investment and export incentives - especially in the former bantustans. However, as already suggested, the UNIDO mission concluded that the continuation of these in their present form is unlikely - at least will definitely be phased out over the next five years. The politically powerful textile and garment trade union in the RSA is likely to resist any attempt to develop an industry in the former homelands based on very low labour costs.

The implication of this is that, not only will Lesotho remain competitive with the RSA as an attractive location for labour-intensive industrial activity aimed at international markets in general terms, but it will also continue to enjoy comparative advantages as a location for labour-intensive production oriented primarily towards the South African market in particular. The main area of opportunity will continue to be garment production, as at present, but the advent of substantial Chinese investment in consumer electronics production indicates prospects for diversification into other areas.

b. Non-SACU markets

It is likely that Lesotho will find it extremely difficult to diversify the range of industries presently oriented to the wider world market and, in particular, the USA and EU. This reflects the intense competition from other LDCs for the type of investment in labour-intensive production that Lesotho must hope to attract and the provenance and prejudices of the most likely investors. Many of these will come from East Asian Newly Industrializing Countries (NICs) and will be chiefly motivated by the need to identify sources of low-cost and reliable labour to carry out processes which it will become increasingly less economic for them to carry out in their own countries. Such potential investors will probably prefer to establish labour-intensive, off-shore assembly and finishing operations in East and South East Asian LDCs, rather than in more exotic locations with which they are less familiar and which, rightly or wrongly, they consider to be less dependable. Nevertheless, operations set up mainly to service South African markets could develop other outlets once successfully established.

2. INDUSTRIAL STRATEGY - UNIDO/UNDP RECOMMENDATIONS FOR GOVERNMENT ACTION

A. OVERALL STRATEGY

The overall industrial strategy of GoL outlined above is considered highly appropriate to the situation currently prevailing in Lesotho and should continue to guide the development of policy in general terms. As already argued, there is probably no alternative to such an approach given the need of the country to attract foreign investment and technical expertise as the prime condition of industrial growth.

The only reservation the UNIDO mission wishes to express refers to the readiness of GoL to promote by way of an equity stake through the Lesotho National Development Corporation (LNDC) in the development of ventures perceived to be "in the national interest", but which private interests are reluctant to support. This seems to be contrary to the overall thrust of industrial strategy which is seen as essentially market-driven. UNIDO's objections to such projects are not ideological, but reflect its concern that the reluctance of private interests to assume all the risk will usually arise from genuine doubts about their commercial viability.

Additionally, it is suggested that GoL should formulate its investment promotional endeavours on the basis that the most likely export markets for Lesotho industry will be, firstly, the RSA and, secondly, the USA and Canada and the EU. It should therefore concentrate on trying to attract ventures oriented primarily to these markets. This does not, of course, mean that all investment will come from these regions, still less that investment promotion projects undertaken by GoL should be concentrated there: as will be seen below, the one such project specifically recommended on the basis of this report will be centred on Mauritius and Hong Kong.

B. SPECIFIC POLICY MEASURES TO DEVELOP AN ENABLING INVESTMENT ENVIRONMENT

In the context of GoL's overall development strategy a number of specific measures are recommended which are considered likely to contribute to the achievement of the aims of industrial policy. These relate to the manufacturing sector in general and the textile and garment sector in particular.

a. **Industry in general terms**

The following measures:

- The introduction of an investment code and, under this heading, detailed consideration of the appropriateness of the various investment incentives made available through the LNDC, and of the role of the Investment Promotion Centre (IPC)/LNDC as the administering agency. Ways in which organizations of small- and medium-scale enterprise (SME) producers could be brought under the ægis of the incentive regime would form part of this review;

- Consideration of the potential for the GoL to promote the diversification of the industrial base by encouraging investment in projects other than those relating to export-oriented garment production. The UNIDO team envisages that, on the basis of a study of the above, it would be possible to prepare a report for publication which could be used in promoting investment in the kingdom ;

- A review of the appropriateness of minimum wage legislation, albeit a review which takes into account the strong possibility that any reform will provoke painful political consequences which may be considered to outweigh the economic benefits of such a reform;

- Consideration of the laws covering land tenure to enable individuals and companies to get a better title to industrial sites;

- Systematic monitoring of the operation of the Labour Code and consideration of additional restraints on lawlessness in the work-place.

- To address major weaknesses in the small-scale/informal sector, very specific reviews of:

    - The adequacy and appropriateness of industrial training courses - in particular the apparent emphasis on mechanical skills as opposed to commercial, technical and professional qualifications;

    - The availability of credit to organizations and persons involved in the SME sector who have difficulty in fulfilling the credit criteria of the commercial banks;

    - Ways in which the legal system and the administration of the tax system may unintentionally discriminate against small-scale producers.

- The development and publication of formal criteria for assessing applications for work-permits for expatriate staff in the interests of transparency and minimizing administrative discretion. There should be a general presumption in favour of allowing industrialists to employ the staff they consider they need;

- Consideration of the supply of water, electric power and telecommunications services with a view to:

    - Bringing their cost into line with those prevailing in the RSA;

    - Improving reliability.

- A review of the calendar of public holidays having regard to the economic costs of having so many of these. The scheduling of *ad hoc* national celebrations to take place, as far as possible, on Sundays or existing holidays and not on normal working days.

b. The textile and garment sector

The following measures:

- Having regard to the difficulty of finding private sector finance for the wool/mohair processing project without GoL taking an equity interest, reconsideration of the project in the light of overall industrial strategy;

- The establishment of a joint government/industry Garment Council (JGIGC) to act as a forum for the consideration of matters of common concern and to assist in the formulation of government economic policy as this effects the industry. SME producers to be involved as one way of promoting linkages between these and the major ventures;

- Concentrating on Hong Kong and Mauritius, the identification of possible new investors in a knitwear plant oriented towards the European as well as the US market and consideration of an appropriate promotional effort to persuade such companies to invest in Lesotho;

- The following actions in preparation for anticipated negotiations on a renewal of the US-Lesotho textile trade agreement:

    - The completion of all necessary measures relating to Lesotho's accession to the GATT and the WTO as a matter of the utmost urgency in the ordering of government business;

    - An investigation of complaints about the fraudulent attribution of Lesotho origin to non-Lesotho imports of garments into the US market and, if considered appropriate in the light of this, a high-level enquiry to resolve this problem;

    - A review of procedures for authorizing the export of textile and garment products with a view to making any necessary improvements in the present system;

    - Retention of expert advisers on the negotiation of textile trade agreements with the USA under the MFA with a view to preparing a brief for the GoL for the anticipated negotiations;

- An approach to the High Commission of the European Communities in order to:

    - Seek EU agreement to an extension of the present derogation from the Lomé Convention rules of origin for certain garment categories for five further years from early-April, 1996;

    - Explore the possibility of an additional derogation for knitted sweaters etc (EU MFA category 5) manufactured from cotton, wool, silk and silk blends, etc., allowing for the export of these items to EU markets on a duty-free basis of these items when manufactured from imported panels, but for one year only. This derogation should be capable of being brought into force by the GoL at any time during the extended agreement (see previous sub-recommendation) simply by giving notice to the European Commission.

- Amendment of the present quota allocation system with a view to achieving the most efficient use of garment export quotas and encouraging exports of non-quota products.

C. PROPOSED TECHNICAL COOPERATION PROJECTS IN THE ABOVE CONNECTION

UNIDO proposes the following technical cooperation projects to assist the GoL in carrying out the above recommendations:

- Relating to the proposed introduction of an Investment Code and review of the investment incentive regime, a project involving:

  - A critical review of existing investment incentives leading to proposals to amend/extend these; in the light of this

  - Preparation of a detailed report with recommendations which, subject to government approval, could be used as the basis of a brief for Parliamentary Counsel in drafting the necessary instruments;

  - Consideration of the function of the IPC/LNDC in investment promotion;

  - Assistance to IPC/LNDC in developing its role.

- Relating to the diversification of investment promotion efforts to cover non-garment industries, a study of the likely potential for this. In addition, the findings of such a review might be written up in the form of a promotional publication for use by the IPC/LNDC in developing an awareness of Lesotho as an investment location in international business circles. To this end an Industrial Development Review of Lesotho will need to be prepared and with the assistance of UNDP and the Ministry of Trade and Industry a workshop may be organized to introduce the Review to international investors.

- Relating to the proposed JGIGC, assistance to the IPC/LNDC in setting up the council and in establishing its procedures and agenda.

- Relating to the proposed promotion of a knitwear project, assistance in formulating and carrying out an appropriate programme.

- Relating to the enquiry into the fraudulent certification of foreign goods as being of Lesotho origin, assistance in determining the extent of this problem and, if necessary, carrying out an in-depth enquiry;

- Relating to the proposed review of procedures for managing the national garment export quotas and for allocating these to Lesotho suppliers, assistance in carrying out the review and training the department responsible for these functions;

- Relating to the negotiation of a new Lesotho/US textile trade agreement, assistance in preparing a negotiating brief.

The study concludes with an assessment of the priority that should be accorded to these various projects as between themselves.

PART ONE

OVERVIEW OF THE INDUSTRIAL SECTOR

CHAPTER 1. THE MACROECONOMIC ENVIRONMENT

1.1. SUBREGIONAL CONTEXT

A. ECONOMIC DEPENDENCE ON THE RSA

It is an ineluctable consequence of its geographical relationship with the Republic of South Africa (RSA), the dominant economy in the subregion, that Lesotho's economic condition should be almost entirely dependent on developments in the country which completely surrounds it. It follows that the economic changes in the republic consequent on the replacement of the internationally-execrated apartheid regime by the Government of National Unity (GNU) with its impeccable democratic credentials are also a major influence on Lesotho.

Lesotho's economic dependence on the RSA is reflected in a number of areas:

- Net factor income from abroad, mostly the remittances of migrant workers in South Africa's coal and gold mines has historically accounted for 40-45 per cent of GNP;

- Over 100,000 Basotho, or over 35 per cent of the country's labour force has traditionally been employed in South African mines at any one point in time;

- Payments to Lesotho under the SACU treaty, which include Lesotho's share of revenue from the common customs duty pool plus a "subsidy element" above that share, has typically accounted for more than half of the Government's non-grant revenue;

- On the other hand, membership of the SACU means that Lesotho cannot pursue an independent trade policy while the high levels of common external tariff - in many instances over 100 per cent *ad valorem* - effectively tie it into the South African market and isolate it from the rest of the world;

- The RSA is Lesotho's largest trading partner. Historically, nearly all imports (about 94 per cent in 1991) have originated from the RSA. Special factors have allowed it a greater degree of independence in the development of its export trade - see below. It accounted for 78 per cent of total exports in 1988 as opposed to only 51 per cent of an appreciably larger total in 1992. However, as will be seen, developments in the RSA and the World Economy appear to have called even this achievement into question;

- Although no longer legal tender in Lesotho, the Rand still circulates freely in the country and is at par with the local currency, the loti, because of Lesotho's membership to the Common Monetary Area (CMA.) This means that Lesotho can have no independent exchange rate policy and interest rate movements are tied closely to developments in the RSA;

- The viability of Lesotho's multi-billion dollar Lesotho Highlands Water Project (LHWP), the largest engineering and construction project presently under implementation in the whole of Africa, is dependent on the RSA as the sole customer for the water to be produced.

B. THE CHANGES IN THE RSA

The changes in the RSA have affected the Lesotho economy in two ways. Firstly, the replacement of the apartheid regime under the Nationalist Party by a democratically-elected Government of National Unity (GNU) has altered the way in which the republic is perceived in the outside world, ending its status as an international pariah. Secondly, the republic is going through a revolution in economic management which is intended to turn it from autarky - partly self-imposed, partly a consequence of its rejection by the international community - and integrate it into the wider world economy.

This latter process was in fact begun by the National Party government in the late 1980s and was symbolized by the RSA's accession to the GATT and the World Trade Order (WTO). This will require the dismantling of the structure of tariff protection built up around the domestic economy which had become the condition of its survival as a self-sufficient entity.

However, the revolution is being continued by the new regime. The GNU has proclaimed the primacy of a social agenda in economic policy in the Reconstruction and Development Programme - its major statement to date. This is intended to advance the status of the black majority of the population which was so systematically discriminated against under the apartheid regime. However, by its actions the GNU has made it clear that it recognizes that such advancement can only be secured as a consequence of economic development on the capitalist model.[4/] If this involves postponing the elevation of the deprived majority in favour of preserving existing patterns of the distribution of wealth and a conservative fiscal policy designed to attract the confidence of domestic and foreign investors, this seems to be the price the government is willing to pay. Whether such attitudes will survive the criticism of the more radical members of the ruling élite and the impatience of the politically active members of the movement which carried it to power is, of course, another matter and one which poses the greatest threat to the current thrust of government policy and to the RSA's bid to join the number of the world's Newly Industrializing Countries (NICs).

C. CONSEQUENCES FOR THE LESOTHO ECONOMY

a. Introduction

The changes in the RSA are affecting the Lesotho economy in a number of ways:

- By changing the emphasis of international technical assistance funding coming into the subregion;

- By calling into question the number of jobs which Basotho workers have traditionally found in the South African mines - and the remittances they sent home to Lesotho which have been the country's main source of foreign exchange;

4/ The long exile of leading members of the GNU in such countries as Tanzania, Zambia and even Zimbabwe may have been one factor that convinced them that socialist self-sufficiency cannot be the model for development of the New South Africa. However, the effective abandonment of socialist *dirigisme* in such countries as the former USSR, China and India in favour of more market-driven economic policies and the success of the Asian 'tigers' (i.e. Republic of Korea, Singapore, Taiwan and Hong Kong) must also have influenced their thinking in this regard.

- By bringing about changes in the relationship of Lesotho and the RSA in the main subregional institutions - particularly the Southern African Customs Union (SACU) and the Common Monetary Area (CMA);

- By creating a new focus for investment in the subregion.

b. Foreign Embassies and Aid Missions

Lesotho-based foreign aid missions and embassies are closing office. The German, US, Swedish and Canadian Government embassies and their related aid agencies which together accounted for two-thirds of bilateral aid to Lesotho have already closed, or are in the process of closing down their offices in Maseru. Their operations will now be run largely from the RSA.

It is, of course, the case that Lesotho has had difficulty in absorbing some of the aid that has been made available to it in recent years. Projects have been abandoned due partly to the delay in introducing agreed institutional and incentive policy reforms.[5/]. However, the move to the RSA will almost certainly mean that aid programmes will become more regionally-focused as opposed to being specifically targeted on Lesotho.

Apart from any other consideration, the removal of some scores of highly-paid executives of the funding agencies and the loss of jobs for local support staff must have serious implications for consumer expenditure in Lesotho. This will probably directly affect the provision of services more than manufacturing activity in the kingdom, but is likely to have knock-on consequences in most areas of the economy.

c. Employment

The RSA's reduction in its dependence on foreign migrant workers began in the 1980s. Employment of Basotho miners peaked around 1990 since when low gold prices and mine obsolescence have brought about a steady fall their numbers. The effect of cyclical factors on employment was exacerbated by what seems to have been a secular change in official employment policy as the National Party became reconciled to the inevitability of majority rule.

Whether or not the reliance on Basotho and other foreign workforces in the mines was an aspect of a deliberate policy of Divide and Rule practised against the Bantu peoples by the apartheid regime is largely irrelevant. Division and ill-feeling were its practical consequences and this undermined the struggle against the minority government. The ill-feeling between Zulu miners and local populations of different tribal groupings, an ill-feeling frequently resulting in bloodshed as the government became less willing/able to maintain a facade of peace in predominantly black areas of the country, is well-known. However, resentment at Basotho and other foreign workers doing jobs which might have been carried out by South Africans has become more pronounced as economic difficulties and population increases resulted in a steady upward trend in unemployment. In the changed political circumstances of the run-up to majority rule the government no longer had any political interest in the maintenance of such tensions in the majority population. If it did not actively promote reductions in foreign employment, it did little to discourage it.

5/ For instance, by the World Bank and USAID. See UNDP: "Strategic issues confronting Lesotho's economic development"; Maseru, August, 1994.

There has certainly been a concerted drive against illegal residents since the GNU came to office in 1994.[6] Furthermore, foreign workers in general terms, the majority of whom are Basotho, face retrenchment to make way for South African nationals. Whether this affects existing workers is uncertain, but it is likely to result in lower levels of recruitment.

According to official statistics, the number of miners employed in the RSA, which had averaged 126,733 in 1989, by 1993 had fallen to 116,129 and is likely to have been nearer to 100,000 at the end of 1994. In part the decline may reflect miners taking up South African citizenship, but it still implies a very substantial increase over this period in the numbers seeking employment in Lesotho given that the total population of working age was less than 1.1 million in 1994 and employment in the formal sector of the economy is thought to be nearer 70,000 than 100,000.[7] The attitudes returning miners have brought back with them may have contributed to the atmosphere of labour unrest that has characterized the Lesotho employment scene in recent years.

d. Miners' remittances

Although the consequences of the decline in employment in mining employment in the RSA may be most spectacular in their social context, the impact on the macroeconomy is likely to be equally profound both at once and in the longer term. Up until the end of 1993 total miners' remittances continued to increase, largely as consequence of increases in average wages. It is also likely that some of the miners who took up South African citizenship continued to send money back to their families in Lesotho. However, the rate of growth slowed down, partly because the numbers involved declined, partly because the miners successfully negotiated with the Lesotho Government that, as of 1 April, 1991, 30 per cent only of their total pay should be transferred automatically to Lesotho by the mining companies through the Deferred Pay Fund mechanism. (Formerly it had been 60 per cent.) This reflected their declining ties to their native country.

In real terms net factor income from abroad which accounted for 42.9 per cent of GNP in 1988 had declined to 26.5 per cent by 1993. This represents a serious fall in the purchasing power of the country's main source of foreign exchange.

e. Brain drain to the RSA

One employment-related issue arising from the changes in the RSA that has yet to be fully researched and documented is the brain drain from the BLNS[8] countries into the RSA where remuneration packages range from 2 to 5 times those available in other parts of the subregion. In Lesotho the brain drain comprises:

- New/young graduates who do not return home after completing their studies in South African technical colleges and universities; and

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6/ An official distinction is drawn between the employment of aliens residing illegally in the country and foreigners working with official permission - such as the Basotho miners. It is claimed that, because of their affiliations with South African Sesotho-speakers, these are regarded as less "foreign" than those of Mozambique and other nationalities. What this means in terms of administration of the regulations is not at all clear. Furthermore, it has not reconciled locals to the Basotho presence in the mines as is evidenced by reports of clashes between them and Xhsosa rivals. Given the fall-off in mining activity, it seems highly unlikely that mine-owners would see any advantage in maintaining their Basotho work-forces in these circumstances.

7/ According to Department of Labour estimates.

8/ i.e. Botswana, Lesotho, Namibia and Swaziland - the RSA's partners in the SACU.

- Seasoned professionals who are leaving Lesotho's civil service, parastatals, private sector and hospitals for what are perceived to be greener pastures in the RSA. The drain here is exacerbated by the fact that the concerned professionals leave with their spouses (themselves professionals) and their children (who are the most likely candidates to become the professional cadre of the future.)

The main constraint on this seepage of talent into the republic seems to be the increasing reluctance of the GNU to accept outsiders in officially-funded postings given the need to employ its own burgeoning population. However, there seems to be some sentiment in governing circles to the effect that the Basotho are "different" (i.e. less foreign) given their geographical circumstances and the large number of Sesotho-speaking South African citizens in the Orange Free State and elsewhere.

f. Renegotiating the SACU

As already noted, Lesotho's membership of the SACU which is, inevitably, dominated by its largest member-state, the RSA, has affected its economy in two ways:

- Its share of total SACU customs revenues has accounted for over 50 per cent of total government revenue receipts;

- It has bound it into a common market dominated by the RSA and effectively excluded it from access to lower cost goods available on the wider international market. This has tended to benefit the RSA economy rather than that of Lesotho which could supply very little of what the RSA required. Only in more recent years have Lesotho garment-makers begun to build up substantial sales in the republic on the basis of production cost advantages - see below.

The decision of the RSA to enter into membership of the GATT will, of course, affect both these factors as the republic begins to dismantle the present almost impenetrable barrier of customs tariffs. Revenues must decline relative to the volume of foreign trade as tariffs are reduced - although this could be off-set in absolute terms as imports increase.

Lesotho consumers, like those in RSA, will also have freer access to the international market. Given that the present Common External Tariff (CET) benefits producers in the RSA rather than Lesotho, this should be to the country's advantage. On the other hand, it will also mean that Lesotho producers who do supply the RSA market - mainly garment-makers - will face stiffer competition from international sources. Nevertheless, because of the slow phasing of the tariff reduction programme,[9/] the effects of the RSA's GATT membership will be felt only over the longer term.

Of more immediate consequence is the decision of the GNU to insist on renegotiating the way in which the common customs revenues are divided between SACU member states, in particular to phase out the subsidy element whereby the RSA hands over to the BSLN economies a greater share of the total income than would be justified by their own trade as compensation for forgoing their sovereign authority over tariff policy. How this will effect Lesotho Government revenues over the next few years is not at all clear. However, it underlines the need for it to restructure the revenue base.

9/ Which might, however, be speeded up in the case of textiles and garments. See Chapter 7.3 below.

g. Foreign direct investment

With the acceptance, once again, of the RSA as a full member of the international community, and the scrapping of all economic sanctions against it, the focus of interest for FDI in the subregion is already shifting away from the BSLN economies towards the RSA.

Admittedly, unlike Swaziland and Botswana, there is so far very little evidence of investment deserting Lesotho for the republic[10] and major new investors have so far proved slow to commit themselves to South African projects. There seem to be two factors here:

- Unlike Swaziland and Botswana, Lesotho never succeeded in attracting the sort of capital-intensive investment in projects that are more advantageously located in a more developed country.[11] Most of the investment that has gone to the "New South Africa" has been of that formerly located there which moved away only to avoid US sanctions against the apartheid regime;

- Potential foreign investors are undoubtedly waiting to see how the GNU will be able to deal with social unrest as the Bantu population comes to appreciate the consequences of its austere economic management - see above - and the political opposition that this might fuel.

The removal of US trade and investment sanctions against the RSA coincided with the imposition of US export quotas on a number of Lesotho-made garment categories. As a result, two of Lesotho's main attractions for South African producers as a location for clothing investment projects (unimpeded and quota free access into the U.S. market) were seriously diminished in quick succession. At the same time, Lesotho had to begin to compete with the RSA in the same arena when promoting to investors outside the subregion.

In this context, Lesotho has the comparative advantage of much lower wage costs. However, the RSA offers investment incentives - particularly incentives for export-oriented projects - that could not be matched by Lesotho. Services, particularly power, water and telecommunications are also less costly and more reliable. (For a discussion of the implications of developments in the RSA for Lesotho as a location for investment in clothing projects, see below, Chapter 7.5).

Furthermore, the RSA is very actively lobbying to be accepted as an ACP member of the Lomé Convention - i.e. to be considered by the EU as a developing rather than as a developed economy. The EU is very reluctant to grant the republic ACP status both in view of the size and potential of its economy. However, it seems willing to offer it many of the advantages of association in terms of market access and investment support. This would certainly serve to further enhance its attractions for foreign investment relative to other countries in the subregion.

h. Membership of the CMA

Lesotho's membership of the CMA means that the government has no control over the exchange rate of the national currency which is automatically aligned with the rand at par. The steady decline of the rand against the US dollar probably benefited Lesotho exports to the USA, its main non-SACU market throughout the second half of the 1980s and early 1990s. However, the effect of this will have been off-set by increasing the rand/loti cost of the fabrics and other components imported from non-SACU sources. (As will be seen, Lesotho's only significant exports to the USA

10/ This was certainly the case when the UNIDO mission visited Lesotho in January-February, 1995.

11/ The US investment in Lesotho Brewery is, arguably, an exception.

are of garments and most of the fabrics used in the manufacture of garments for the US market are imported from the Far East.)

An even more important consequence of Lesotho's membership of the CMA was that the GoL was unable to address the problem of its fiscal deficit in the mid-1980s by a unilateral devaluation of the loti and movements in interest rates, but was forced to cut public spending and increase taxation. It is, of course, arguable that this was to the longer term benefit of the economy.

1.2 RECENT TRENDS IN LESOTHO ECONOMIC PERFORMANCE

A. GDP IN CONSTANT PRICE TERMS

Information on the performance of the Lesotho economy is available up to 1993 only. As may seen from Table I.1 below, the rate of growth of GDP considered in constant price terms fell away consistently for three years from 1990-1992, but recovered somewhat in 1993.

B. THE PRIMARY SECTOR

Much of the falling-off in the rate of growth of GDP can be attributed to the poor performance of the primary sector where output fell away each year from 1990-1992. This was largely a consequence of the effects of drought on agricultural production which did not recover until 1993. The recovery in food production and reduced dependency on food imports had a positive impact on the balance of payments position. In addition, because of the substantial weighting given to food in the calculation of price trends, the improvement in supply also relieved domestic inflationary pressures.

C. THE SECONDARY SECTOR

The secondary sector of the economy comprises manufacturing, electricity and water supply and building and construction. The largest of these is the latter, much of the input relating to work on the LHWP. The massive increase in output in 1989 was largely a result of the start of this programme. Similarly, the fall-off in 1993 occurred because of a fall in LHWP activities - mainly related to the delay in the construction of the 'Muela hydroelectric power station.

Manufacturing value added (MVA), the other main component of the secondary sector, grew steadily in absolute terms throughout the period, but insufficiently to compensate for the effects of the fall in construction activity on overall secondary sector output.

Electricity and water comprises a relatively small proportion of value added in the secondary sector. However, this is expected to grow in relative as well as absolute terms in the near future as the advancement of the LHWP makes possible sales of water to the RSA and domestic electricity generation.

D. THE TERTIARY SECTOR

This represents the largest component of GDP. Growth in absolute terms was fairly consistent throughout the period under review. The most important subsector consisted of government services, public administration, education and health. Together these accounted for 42.1 per cent of total sector added-value in 1993. There was a slight fall in the contribution of public administration in 1993 as compared to 1992, but that of the other subsectors increased.

Table I.1. **GDP by economic activity, 1988-1993**
(M. million - constant 1980 prices)

Activity	1988	(%)	1989	(%)	1990	(%)	1991	(%)	1992	(%)	1993	(%)
Primary sector	**68.3**	**(18.66)**	**76.5**	**(18.38)**	**76.4**	**(17.38)**	**56.8**	**(12.67)**	**47.0**	**(10.33)**	**58.8**	**(12.37)**
Agriculture	67.3	(18.38)	72.0	(17.30)	73.8	(16.79)	54.7	(12.20)	43.7	(9.61)	56.9	(11.97)
Mining and quarrying	1.0	(0.27)	4.5	(1.08)	2.6	(0.59)	2.1	(0.47)	3.3	(0.73)	1.9	(0.40)
Secondary sector	**84.5**	**(23.08)**	**119.0**	**(28.59)**	**32.1**	**(30.05)**	**145.5**	**(32.46)**	**155.6**	**(34.21)**	**153.6**	**(32.32)**
Manufacturing	39.8	(10.87)	52.5	(12.61)	52.8	(12.01)	55.9	(12.47)	58.4	(12.84)	60.4	(12.71)
Electricity and water	3.2	(0.87)	3.3	(0.79)	3.1	(0.71)	3.6	(0.80)	4.3	(0.95)	4.8	(1.01)
Building and construction	41.5	(11.34)	63.2	(15.19)	76.2	(17.33)	86.0	(19.19)	92.9	(20.43)	88.4	(18.60)
Tertiary sector	**194.3**	**(53.07)**	**209.1**	**(50.24)**	**224.5**	**(51.07)**	**230.4**	**(51.41)**	**233.4**	**(51.32)**	**241.7**	**(50.85)**
Unadjusted GDP at factor cost	**347.1**	**(94.81)**	**404.6**	**(97.21)**	**433.0**	**(98.50)**	**432.7**	**(96.54)**	**436.0**	**(95.87)**	**454.1**	**(95.54)**
Less												
Imputed bank charges	30.1	(8.22)	38.3	(9.20)	41.0	(9.33)	37.4	(8.34)	34.8	(7.65)	34.3	(7.22)
GDP at factor cost	**317.0**	**(86.59)**	**366.3**	**(88.01)**	**392.0**	**(89.17)**	**395.3**	**(88.20)**	**401.2**	**(88.21)**	**419.8**	**(88.32)**
Plus												
Indirect taxes, net	49.1	(13.41)	49.9	(11.99)	47.6	(10.83)	52.9	(11.80)	53.6	(11.79)	55.5	(11.68)
GDP at market prices	**366.1**	**(100.00)**	**416.2**	**100.00)**	**439.6**	**(100.00)**	**448.2**	**(100.00)**	**54.8**	**(100.00)**	**475.3**	**(100.00)**

Source: Central Bank of Lesotho, Annual Report, 1993.

1.3. OUTLOOK

A. IMMEDIATE PROSPECTS FOR ECONOMIC GROWTH

a. Primary sector

There seems to be little prospect of a significant increase in the agricultural production in the near future. Development here is largely ruled out by a rugged terrain that limits farming activity in the eastern half of the country and climatic uncertainties that affect crop production and grazing in the more favoured western areas. With substantial external assistance this situation could be transformed by the introduction of commercial farming based on large-scale irrigation, but this would require reformation of the present land-tenure system. In the short run, Lesotho agriculture is likely to continue to be characterized by small-scale subsistence farming and extensive grazing.

b. Tertiary sector

There has been steady growth in the **tertiary sector** in constant price terms in recent years, but it is probably correct to suppose that the prospects for a significant expansion of services output given the present state of economic development are limited. This could change if there were to be a large-scale growth in tourism, but that is likely to happen only in the longer-term. It is also supposed that the completion of the LHWP could generate the need for further services, but there are presently no indications of what these might be.

c. Secondary sector

With regard to the **secondary sector**, as already suggested, there are prospects for growth in the **electricity and water subsector** - presently only a minor contributor to GDP. It is anticipated that the completion of the LHWP will result in the sale of water to the RSA and increased sales of cheaper electricity to the domestic economy reducing the need for imports from the RSA. This will, therefore, have a very beneficial impact on the balance of payments position, compensating for expected declines in miners' remittances and SACU import duty revenues, as well as allowing for much needed improvements in the reliability of the power and water supply in Lesotho itself.

On the other hand, as was seen in 1993, **building and construction output** is very sensitive to activity in relation to the LHWP and the completion of the major works will probably see a significant downturn in this area. Other infrastructural development and residential and commercial building could take up some of the slack - but the latter will be largely dependent on demand created by expansion elsewhere in the economy.

Any significant expansion in **manufacturing activity** will be generated by export-led growth. The domestic market afforded by a population of 1.8 million cannot sustain a substantial manufacturing sector. The present predominance of the domestically-oriented food and beverages industry in the manufacturing sector (see Chapter 3.3) is dependent on a very high level of government subsidy. Privatization of the main parastatals will increase efficiency in this area, but is likely to result in a decline in output.

Growth will occur, therefore, only as a result of investment in export-oriented enterprises. These will be labour-intensive reflecting Lesotho's chief comparative advantage and large dependence on foreign direct investment given the absence of a native entrepreneurial class. It is realistic to expect that such enterprises will be overwhelmingly in the textile and garment (mainly garment) sector as at present.

The endeavour is that these leading export-oriented enterprises will/should develop **linkages** with locally-owned organizations, which would be ideally concerned with the processing of local raw materials. However, to perceive such "linkages" as desirable is one thing: to identify quite where they might arise and to will the inputs of capital and managerial talent required to make them happen is another.

Another area where development is perceived to be possible is **"resource-based" processing** activity. Again, however, to note that Lesotho has resources of textile fibre, agricultural raw materials, animal products, minerals etc is one thing; to find markets for goods that might be made from these things which local industries can economically supply in the face of South African (and wider international) competition is another; and to bring together the required capital and managerial inputs to process and market the resources another still.

B. PROSPECTS FOR FOREIGN DIRECT INVESTMENT IN EXPORT-ORIENTED PROJECTS

a. The development of the manufacturing sector

The upward trend in manufacturing output in the period 1988-1993 was largely due to a massive expansion of foreign direct investment - particularly in the garment sector. This was due mainly to external factors over which Lesotho exercised little, if any, control. Considerations of comparative advantage were relatively unimportant.

a.1 Exogenous factors

The main causes were

- The imposition of US trade and investment sanctions on the RSA in the mid-1980s;

- The absence of any quantitative restrictions on exports of textile and garment products to the USA, the only category of goods from Lesotho for which there has ever been a significant US market;[12]

- The absence of quantitative restrictions on exports of textile and garment products to EU markets;

- Tariff-free access to the EU market arising from Lesotho's status as an African-Caribbean-Pacific state under the Lomé Convention. The value of this preference was largely vitiated by the fact that exports of garments were excluded by the Lomé rules of origin which required a level of processing in Lesotho which no potential investor was willing to undertake.[13] It was not until 1993 that GoL negotiated a series of derogations from these rules in respect of the most traded products which won for them duty-free access to EU markets for 3 years.

Of these various factors, that which was most dynamic in determining the surge of investment projects in Lesotho in the mid-1980s was the first. The closure of the US market to South African

12/ As an LDC, Lesotho enjoys reduced-tariff access to the US market under the Generalised System of Preferences (GSP). However, US policy specifically excludes textile products from GSP treatment and Lesotho exports very little else to the USA. Those products are admitted under normal Most Favoured Nations terms which implies a tariff of around 13.4 per cent in the case of textiles and 14 per cent in the case of clothing. No Lesotho garment producer has ever benefited under item 807 of the US tariff system which allows a duty-break on reimports of goods manufactured from US-supplied components in respect of the value added outside the USA.

13/ For a more extensive discussion of the Lomé Convention rules of origin for garment imports see Chapter 6.2.d below.

exports meant that **South African-owned** companies (mainly clothing producers) with major US trading interests had to move out of the republic if they wished to retain their market in that country. The BSL[14] economies were an obvious location for such companies for a number of reasons:

- These countries were prepared to accept South African investment;
- They enjoyed the benefits of SACU membership;
- If they relocated to a BSL country, South African manufacturers could still make use of the RSA infrastructure;
- The usual additional cost associated with foreign investment projects relating to the support of managers and their families in exotic locations did not apply in the case of Lesotho. South African managers could work in Maseru or Maputsoe and conveniently live in the Orange Free State;[15]
- Lesotho enjoyed access to the US and EU markets on the terms outlined above.

Another category of companies which was driven out of the RSA by the US sanctions were **Far Eastern**, mainly Taiwanese, garment-makers. These had been tempted to set up mills in the South African "bantustans" by the combination of very low wages, the extremely generous investment and export incentives made available by the apartheid regime specifically to attract investors to these regions and by the RSA infrastructure.[16] Like their South African counterparts and for much the same reasons - saving easy access for expatriate managers - the BSL countries appeared a good place in which to ride out the storm.

a.2 Internal comparative advantages

The most important comparative advantage which Lesotho could offer these investors inherent to its own economic situation was a **low level of wages**. However, wages in the kingdom were no lower than those in the bantustans. This factor alone would not have lured from the RSA the categories of producers mainly responsible for the expansion of Lesotho manufacturing activity without the compulsion of sanctions.

Lesotho wages are low in relation to those applying in the RSA - other than the bantustans. However, the kingdom was in competition for foreign investment in labour intensive industrial projects with such countries as China, Indonesia and other Asian economies where wages tended to be even lower and with other African countries where they were probably comparable. However, relocation to the Far East or to sub-Saharan Africa was not an option for the South African groups and probably not for the Taiwanese either - if for no other reason in the latter case

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14/ BSL - Botswana, Swaziland and Lesotho. Namibia did not join the SACU until it gained its independence from the RSA towards the end of the 1980s.

15/ In fact, as will be noted in Chapter 4.3.B of this report, at least one South African company for a time chose to contract out the management of its Lesotho subsidiary to a Filipino contractor. However, it eventually abandoned this intention.

16/ An uncertain factor in the interest shown by Taiwanese investors in the RSA in the early 1980s is the extent to which their national origin made LDC economies reluctant to host them for fear of annoying China. (Since then, of course, Chinese regime's own willingness to accept Taiwanese investment behind the flimsiest of veils has become an increasingly open secret, but how far this has affected its diplomatic stance on Taiwanese investment is not at all clear).

than that most of the countries in that region already endured quantitative restrictions on their exports of textile products to the USA and the EU.

Lesotho also offered a number of **investment incentives** likely to appeal foreign investors such as access to credit at preferential rates, staff training grants, dutybreaks on imports of components, tax advantages and serviced industrial development locations. (See Chapter 2.2). These were reasonably generous by normal LDC standards, but were nowhere near those offered by the South African Government, particularly in respect of investment in the bantustans - see Chapter 7.4. The Lesotho incentives were probably a necessary condition of attracting investors to the kingdom - if only because similar incentives were available in the other BSL economies - but, there is no reason to suppose that they were a major element in motivating the surge that took place in the mid-1980s.

b. The present situation

Given the importance in that development of the imposition of trade and investment sanctions on the RSA, the removal of those sanctions - a process that seems to have been largely complete by the end of 1993 - had a significant impact on Lesotho's hopes of attracting further investment and even of retaining that which it had already secured.[17] Furthermore, given that most of the projects that came to Lesotho as a result of the sanctions were concerned with the manufacture of garments for the US market, the imposition of quantitative limits on exports to the USA of the main categories of garment was bound to have a severe impact on the output of the export-oriented clothing industry. This was exacerbated by the effect of the economic recession on US consumption of clothing - a factor which also affected the EU market (see Chapter 6.2).

Lesotho maintains its comparative advantage *vis-à-vis* the RSA of relatively low labour costs. This means that there is an economic logic in locating labour-intensive production of items for the South African market in the kingdom. Admittedly, it is still possible to enjoy comparable wage-costs in the former bantustans, but how long this will last given the hostility expressed by the South African trade unions is a matter for conjecture. The uncertainty regarding this situation is likely to deter potential investors primarily interested in accessing a source of low-cost labour from relocating to the republic.[18]

However, as already noted, wage costs in Lesotho, are not particularly low in comparison to other LDC economies which compete with it for investment in labour-intensive projects. Furthermore, the imposition of quotas on garment exports to the USA vitiated the main argument for going to Lesotho rather than to those countries in the case of the industry which attracted by far the greatest proportion of labour-intensive investment. Although the US quotas expired at end-1994, it seems reasonable to suppose that they will eventually be reimposed.

In addition to which, Lesotho is perceived to suffer from a number of positive disadvantages which reduce its attractions as an investment location. These affect chiefly the garment industry and are dealt with in detail in Chapter 5.3 below, but the main points may be rehearsed as follows:

17/ It is understood that a number of companies that moved from the RSA to Swaziland when sanctions were imposed returned to the republic when they were removed. So far this has not occurred in the case of Lesotho. It seems that some at least of these transients were US-owned - a category not attracted to Lesotho - and were engaged fairly capital-intensive operations aimed at the South African market which, on grounds of economic logic, were best carried out in the republic. The Coca-Cola subsidiary is one example of this type.

18 Lesotho's manufacturing wage-rate is, on average, 40 per cent lower than in the RSA. As will be seen in Chapter 6.2.B, the discrepancy seems to be greater in the case of the clothing industry - especially if the wage-rates in the former bantustans are excluded.

- Relatively costly and unreliable services - water, electricity and telecommunications;[19]

- Poor attitudes on the part of workforce and employers in some factories, with a high degree of propensity to engage in disputes;

- Inappropriate policies in a number of areas which adversely affect the investment environment.

The UNIDO mission does not at this point wish to make any comment on the accuracy or otherwise of the perceptions of labour unrest in a number of factories, but merely points out that these factors do not seem to influence potential investors' views on the country as an investment location. The country's success in attracting new investment into export-oriented projects will, however, depend on how far GoL is able to address the issues underlying these attitudes.

Finally, given that the country now faces a situation in which the main factors that enabled it to attract investment in the past no longer apply, it is important that GoL reconsider its industrial strategy, particularly with a view to making the investment environment more enticing. This matter is considered in the following chapter.

19/ Lesotho imports all its electricity from the RSA and its per unit consumer charges in the latter part of 1994 were consequently higher - on average four times higher. Water charges too were double those in the republic and telephone charges 30 per cent higher. (Lesotho also compares badly with Swaziland in terms of water and telephone charges, although electric charges are roughly comparable.)

CHAPTER 2. INDUSTRIAL POLICY AND INVESTMENT ENVIRONMENT

2.1 THE POLICY BACKGROUND

A. POVERTY ALLEVIATION AS THE MAIN CONCERN OF ECONOMIC POLICY

The main guides to the GoL's thinking on economic policy are the Five-Year Development Plans. The latest of these for the period 1990/91-95/6 was formally adopted towards the end of 1994. From this it may be deduced that the chief concern is the alleviation of poverty. Industrial policy is viewed mainly as a way in which this objective can be addressed by creating new jobs. The Plan estimated unemployment at around 45 per cent in 1991 and set a target of 40 per cent for 1996. The inadequacy of statistics relating to employment, formal or informal, means that this statement of objectives seem to have little value either as a prescriptive target or as a forecast.

B. MAIN THEMES OF INDUSTRIAL STRATEGY

a. Principal determinants

The main thrust of GoL's present industrial strategy is to broaden and diversify the existing industrial base. It is recognized that the domestic market is too small to provide a sustainable base for development which must therefore come about as a result of export-led growth.

It is also accepted that export-led growth can only come about as a result of private sector initiatives. Given the lack of a native entrepreneurial class and the shortage of requisite technical and managerial skills, this requires the promotion of foreign investment in export-oriented projects.

However, GoL is also concerned to avoid the development of what would amount to an enclave industrial sector.[20/] By this is meant a sector dominated by enterprises which are not only principally concerned to service foreign markets, but are also essentially isolated from the domestic economy on which they impinge only as employers of labour and generators of limited official revenues - limited because of the costs to the government of the operation of the incentives system

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20/ In the jargon of development economics, the term "enclave industry" has acquired a technical meaning which refers to industries located in LDCs to take advantage of low-cost local labour, but servicing foreign markets only and, on the strength of this, enjoying immunity from the host-country's customs duties - and often from other fiscal impositions and exchange control regulations as well. They may be geographically isolated from the Customs territory in so-called export free zones or (in China) Special Enterprise Zones, but the legal immunity from dues paid by companies dealing with the domestic market is the essential distinguishing feature. The technical enclave status of much of the industry located in Lesotho arises from the "in bond" warehouse system - see Chapter 2.2 - whereby they pay no duty on imports of capital goods and consumables used in the manufacture of goods for export to non-SACU markets.

needed to attract them to Lesotho in the first place. Rather they should act as engines of activity within the country, firstly by developing backward linkages into the economy and encouraging the growth of local enterprises which become an integral part of their operations, secondly by providing the economic impetus which encourages and sustains the operations of a viable small-scale manufacturing sector.

b. Elements of the industrial strategy - the Agro-Industrial Project

The industrial strategy developed on this basis was finally formalized in the World Bank financed Agro-Industrial Project which commenced in November 1991, and is due to finish in fiscal 1996/97. The principal strategy elements supported by this project were:

b.1 A policy reform programme

This was to address the disincentives and distortions inherent in GoL's current macroeconomic management so as to provide a more attractive enviror :nt for private sector investment projects. This was to be the basis for the investment promotio. .ocus of the Agro-Industrial Project;

b.2 Promotion of foreign investment and linkages

Further foreign investment was to be attracted by the provision of an adequate infrastructure - i.e. serviced industrial parks - the availability of a skilled work-force (developed by training programmes undertaken under the project) and active promotional efforts which would focus on Lesotho's attractiveness as an investment location arising from very low wage costs and its preferential access to the RSA and other export markets.

It will be noted that a system of tax-breaks and subsidies was not seen as a major attraction for foreign investment. In fact, as will be seen, the Agro-Industrial Project considered that tax-holiday at that time offered to new investors had a dangerously distorting effect on the pattern of investment and could be justified only as a means of compensating for the effect of costly regulations which would be addressed under the policy reform programme.

Although the investment promotion strategy would initially capitalize on labour-intensive projects, it was envisaged that as the measures taken under the project began to take effect, it would be possible to attract higher added-value industry with backward linkages to other parts of the economy and, in particular, the agricultural base. Promotional programmes would be specifically targeted to such industries.

The development of linkages would be encouraged by matching foreign companies with local enterprises in so-called on-going advisory relationships. This was intended to improve the capacity of local entrepreneurs to play a sub-contracting role thus deepening Lesotho's industrial base. Such a building of capacity and transfer of technology and expertise would also help insulate the country's industrial base against the impact of external factors that might tend to undermine Lesotho's attractiveness to foreign investors.

b.3 Development of small and medium-scale indigenous enterprises

The establishment of foreign investment projects and the LHWP were seen as offering opportunities for the development of small business ventures. These were seen primarily as employment-generating. The programme would develop institutions to advise entrepreneurs on the opportunities arising and about the various support services available to assist them in taking them up.

The recently published White Paper on Improvements of Investment Climate to Create Employment spells out the official policy pronouncements for fostering the expansion of small-scale industries in Lesotho (see Appendix 5).

b.4 Expanded access to financial services

The objective here was to increase the access of local businesses to financial services by rendering the commercial banking system more adventurous (i.e. amenable to lending to organizations without collateral or a commercial track-record) and supporting the development of sources of venture and equity capital. Preferential interest rates were not seen as desirable. Resources would be better employed in funding improved services to encourage the development of viable businesses.

2.2 INVESTMENT INCENTIVE REGIME

GoL has developed an investment incentive regime with the following main features:

A. PROTECTION OF FOREIGN INVESTMENT

Lesotho has no history of nationalizing foreign assets. However, as a confidence-building measure, GoL has signed the convention on the settlement of investment disputes which allows foreign nationals to gain access to the International Centre for the Settlement of Investment Disputes. Any decision of the Centre would be legally binding on the GoL.

B. EXCHANGE CONTROL

As a member of the CMA, Lesotho's currency is freely convertible with the South African rand at par. This obviates all administrative controls on access to foreign exchange. The central bank deals with foreign currency transfer applications as speedily as possible.

C. TRAINING GRANT

Under this incentive GoL makes a newly-established manufacturing company a non-repayable grant of 75 per cent of operatives wages for the first six months of its operation to cover the cost of training. It does not apply to the wages of technical and managerial staff.

D. SERVICED INDUSTRIAL SITES

Serviced industrial sites are made available at Maseru West and Thetsane in Maseru and at Maputsoe and Ha Nyenye (Maputsoe). Other estates are under development at Teyateyaneng and Mafeteng. At all these estates shell factories are provided in order to shorten the investment cycle by eliminating the unnecessarily long lead-time between investment decision and beneficial occupation of a factory building, to reduce the initial capital investment and to commit the potential investor's interest in Lesotho as quickly as possible.

The land tenure system in the kingdom does not allow for land to be bought or sold, but investors may sub-lease from the LNDC on a thirty-year basis. Factory buildings may be leased or purchased. There is a debate in government circles whether or not the land law should be changed in order to allow direct purchase of the land, although this would run counter to very deep-seated social prejudices. It is felt by those who favour some relaxation of the 1979 Land Law that, if foreign investors were allowed to purchase their factory sites, this would strengthen their commitment to Lesotho. Private ownership of land by Lesotho citizens would also allow them to use this to acquire an equity stake in industrial projects.

E. FISCAL INCENTIVES

a. Company income tax

Company income tax in Lesotho is set at a standard 15 per cent which is less than half the average rate in the RSA and is understood to be lower than in other SACU economies and, indeed, in any other African country. The attraction of the incentive is increased in respect of the RSA by a double-taxation agreement - also negotiated in the case of the USA and some European countries.

Until 1991 new investors in industrial projects in Lesotho were offered a tax-holiday. However, the system for granting this was complex and allowed for a considerable exercise of administrative discretion. Potential beneficiaries complained of excessive bureaucracy, extensive delays and profound uncertainty.

These weaknesses probably reflected hostility in many quarters in the civil service. Certainly, the measure was disliked by the Ministry of Finance which resented the revenues forgone and it was felt that the projects attracted by such a measure were essentially "foot-lose", tending to move on when the holiday expired. This has indeed often been the case in other LDCs - for instance Jamaica - although whether it was ever a serious problem in Lesotho is less certain.

It was also criticized by the World Bank in the report which underlay the Agro-Industrial Project (*op. cit.*) as an excessively costly way of compensating investors for costly regulations, the implication being that it would be better to dispense with these or, at least, ameliorate their impact and thus do away with the need for the tax-break.[21/] This was certainly World Bank orthodoxy at that time and the same logic was applied against similar measures in Jamaica and Uganda *inter alia*. Getting rid of the tax-holiday was a major requirement of the Agro-industrial Project. However, the argument against it in terms of revenue forgone seems somewhat dubious in that, in the case of new projects, the income to be taxed might not be generated at all had the investor not been attracted to Lesotho.

Whether a tax-holiday is ever an effective incentive is, of course, another matter. The World Bank report remarked, correctly in the view of the UNIDO mission, that it had no influence on the surge of investment which took place in Lesotho in the latter 1980s which was prompted almost entirely by external factors. However, if Lesotho had not offered it, there was always the possibility that those projects might have gone to another country that did - although, as suggested above, the options for the companies that relocated as a result of the US sanctions on the RSA and quota-free access for Lesotho originating products in the US garment market were probably limited.

According to the LNDC, most - not all - of the companies located in Lesotho accepted the new measure when it replaced the tax-break, voluntarily forgoing their holiday. However, it is uncertain how far this reflected their dissatisfaction with the old system. In the case of the Taiwanese companies there are also doubts how many of these actually make profits in Lesotho and are therefore liable to pay corporate tax anyway.[22/]

21/ See Staff Appraisal Report, Lesotho - Industrial and Agro-Industries Development Project: Industry and Energy Operations Division, Southern Africa Department, World Bank Report No. 8990-LSO, 5 November 1990.

22/ Of the Far Eastern garment companies, it is understood that only CMG and Lesotho Hawk actually repatriate the whole of their earnings to Lesotho. In most cases they are merely compensated by their parent groups for the costs of fulfilling orders passed to them.

b. No withholding tax on dividends

This applies to dividends distributed by manufacturing companies to local and foreign shareholders.

c. Free repatriation of profits

See comments under heading E.a above in relation to the extent to which profits made by investors from industrial activities in Lesotho are realized in the kingdom for taxation purposes.

d. Duty rebate on imports of consumables

This applies to materials and components used in the manufacture of goods exported to non-SACU markets. It is operated in effect as an "in-bond" warehouse scheme thus avoiding the bureaucratic complications that can arise from this sort of concession. The UNIDO mission heard no complaints of this nature in Lesotho, even from companies which serviced SACU as well as non-SACU markets.

e. Ten per cent sales tax break on imports of capital equipment

The UNIDO mission had no useful feedback from the managements of foreign-owned projects on the attractions of this incentive. In the circumstances in which these projects came to Lesotho it appeared to be almost of little consequence.

F. CONCESSIONARY LOAN FINANCE

As already noted, those who conceived the Agro-Industrial Project were hostile to the notion of concessionary finance where this includes an element of subsidy. Despite this, there are three schemes offering preferential access to credit among the GoL's range of investment incentives:

a. Export Finance Scheme

This is essentially a revolving credit scheme financed by the Central Bank's Export Development Fund which guarantees loans undertaken to meet the pre- and post-shipment costs of fulfilling confirmed orders. This appears to be a very popular scheme judging by the volume of business done under it - see Chapter 3.3.B. The procedures for accessing support under the scheme were, however, said to be over-bureaucratic. There were also reports that over-exposure under it had resulted in two companies ceasing to trade early in 1995 - see Chapter 6.3. The UNIDO mission was unable to confirm such speculation.

Disbursements under the scheme amounted to M.119.6 million in 1993 as opposed to M. 62.6 million in 1992. (Repayments were M.96.9 million in 1993 representing a rate of 81.0 per cent, the comparable figures in the previous year were M.55.6 million and 88.8 per cent). LNDC exposure in the form of loan guarantees increased from M.25.4 million to M.33.9 million in 1993/94. These were counter-guaranteed by the Central Bank to the extent of 95 per cent.

a.1 Long-term loans

Loans to finance the purchase of fixed assets are available at a rate of interest fixed 1 per cent below prime over periods of five-eight years. These can cover up to 40 per cent of total project costs. Outstanding loans at end-1992/93 were M.1.8 million as opposed to M.3.3 million at end-1991/92.

In addition to direct loans, GoL through LNDC guarantees loans from the commercial banks and other financial institutions, making a handling charge of 2 per cent. Total loan guarantees at end-1992/93 were M.4.8 million as opposed to M.6.7 million in the previous year. These totals are understood to include the 5 per cent of the loan guarantees made under the Export Finance Scheme not counter-guaranteed by Central Bank.[23]

b. Equity finance

The LNDC does not take equity shares in development projects. The only exception to this policy relate to projects judged to be "in the national interest" for which no private investor can be found or for which the private investor insists on GoL participation. (The wool/mohair project - see Chapter 4.2 - is an example of this).

c. Financial rand financing

This incentive also derived from Lesotho's membership of the CMA and was available only to non-residents of the area - its original purpose was to encourage foreign investment to remain in the area in the face of trade and investment sanctions against the RSA under the apartheid regime. Its basic feature was that finance for the purchase of equity could be secured at a discount as compared to the normal rand/foreign currency exchange rates. The incentive was operated by the South African central bank and access was said to be highly bureaucratic. Nevertheless, a large number of the non-South African investors in Lesotho benefitted under it - see Table II.8 for those in the textile sector. However, the facility was finally abandoned by the GNU in March 1995, as a consequence of the ending of international sanctions.

2.3 THE INSTITUTIONAL FRAMEWORK

A. INTRODUCTION

The primary organizations involved in the formulation and implementation of industrial policy within the guidelines of the Agro-Industrial Project are the Ministry of Trade and Industry (MTI) and the Central Bank of Lesotho (CBL). However, the detailed realization of the broad lines of policy is in the hands of two quasi-non-governmental organizations, the Lesotho National Development Corporation (LNDC) and the Business Advisory and Promotion Service (BAPS). Also involved in various aspects of the policy are the three commercial banks, and a plethora of other financial institutions, quangos and industry bodies.

B. MINISTRY OF TRADE AND INDUSTRY (MTI)

Under the Agro-Industrial Project, MTI is responsible for formulating industrial policy and services. As already indicated, the Ministry has, in large measure devolved the industrial development to the LNDC and BAPS - see below - but still maintains a policy coordinating role.

In addition, MTI still has responsibility for administering a number of regulations which impinge on the industrial sector. This includes the licensing of companies and the administration of the export regime under Lesotho's textile trade arrangements with the USA and Canada (under the Multifibre Arrangement)[24/] and with the EU (under the Lomé Convention). This latter responsibility is largely concerned with the allocation of national garment export quotas between individual producers - see Chapter 5.3.D below. However, the issue of certificates of origin to specific garment shipments of garments to the USA and the EU (visas in the case of consignments destined for the USA) is effectively in the hands of the Customs department.

23/ See LNDC Annual Report, 1992/93.

24/ MFA - see Appendix I.

The MTI also operates a Trade Promotion Unit (TPU) which, apart from authorizing garment shipments to Canada, has a general responsibility for promoting Lesotho exports. The TPU is understood to be under-resourced and its ability to develop non-traditional exports accordingly severely limited.

C. CENTRAL BANK OF LESOTHO (CBL)

Under the Agro-Industrial Project, the CBL manages the line of credit which fur the project, supervises commercial bank training to enable these to play the role envisagec or them and implements the financial sector strategy. The broad thrust of this latter was to encourage the commercial banks to adjust the emphasis of their lending policies away from lending to the government to lending to private sector projects. This is the responsibility of the Development Finance Division.

D. LESOTHO NATIONAL DEVELOPMENT CORPORATION (LNDC)

The LNDC is the principal organization responsible for industrial development. It has wide-ranging powers to promote and finance industrial projects and to assist foreign investors to set up in Lesotho. To this end the LNDC has a broad responsibility for administering the benefits available under the package of incentive measures outlined above, especially the provision of concessionary loan and equity finance and the provision of serviced industrial sites and factory shells. It has also invested in real estate in the form of shopping centres, commercial premises and a hotel.

In its investment promotion role, until the mid-1980s the LNDC actively encouraged investment in the food and agro-industry, textiles and clothing, wood and furniture, light engineering, electrical and construction materials sectors with some success. However, after the imposition of sanctions on the RSA, promotional activity became largely superfluous as manufacturers relocated from the republic of their own accord - a phenomenon already noted. However, the sort of investment that came at this time (mainly in garment projects) was criticized for the low local added-value of its activities and for its lack of substantial commitment to Lesotho expressed in terms of backward linkages to the domestic economy. There was a persistent sentiment that, because it had been driven to locate in the kingdom for reasons that were mainly exogenous it would move away again when those factors ceased to apply.

It was for this reason that the Agro-Industrial Project posited a return to a more active promotional programme aimed at attracting more substantial investment. (Additional garment projects were not explicitly rejected, but it was implicit in the overall promotion strategy that they would be more securely linked into the Lesotho economy and that, in the longer term, the focus would be on projects with a higher local added-value). To carry out this programme, the project called for the establishment of a semi-autonomous unit within the LNDC, the Lesotho Investment Promotion Centre (IPC).

E. LESOTHO INVESTMENT PROMOTION CENTRE (IPC)

The role of the IPC was envisaged as follows:

- The promotion of Lesotho as an investment location. This would concentrate on generating investment interest in the RSA, the EU, the USA and the NICs (Newly-Industrializing Countries). It was envisaged that it would result in at least 100 site visits per annum;

- The provision of investor services. This included investment counselling, expediting the processing of applications and permits, assisting with the development of linkages between foreign investors and local suppliers goods and services, fostering investors' participation in "patron" and "mentor" programmes with indigenous SMEs;

- Public relations, specifically through developing and disseminating promotional materials and other "image-building" activities;

- Research on the development of the Lesotho economy, supporting the IPC's other activities and advising on the effect of policy changes on the investment environment. Whether or not it was actually intended, it seems implicit that this activity should have a positive impact on the overall development of GoL macroeconomic policy, helping to ensure that, as far as possible, this was formulated with a view to encouraging industrial activity.

In practice, the IPC was initially concerned with providing formal and on-the-job training, not only for its own members, but for other agencies involved in industrial development with a view to making them aware of their collective role in successful industrial promotion. Later, promotional campaigns were launched in the RSA and the Far East. These latter had very limited success, an outcome which was considered to reflect the unfavourable international environment - especially as this affected the garment industry - the need for policy reform in Lesotho (on which IPC had made representations to various agencies of GoL).

F. BASOTHO ADVISORY AND PROMOTION SERVICE (BAPS)

BAPS was established under the Agro-Industrial Project to promote indigenous investment. The main objects were to:

- Inform indigenous investors about the various support services available to meet the needs of small businesses;

- Inform them about market opportunities for goods and services as the economy developed. There was particular emphasis on SMEs developing of contractual relationships with larger companies to provide specialist services or to carry out particular activities within the overall manufacturing process. The large contractors associated with the LHWP were mentioned in this context.

In April, 1994, BAPS completed a five-year action plan which examined some thirty agencies offering advisory and support services to the SME sector. Of these, about one third were involved exclusively with rendering support services to the general business community, one third vocational schools offering limited services and one third sundry organizations, including technical assistance agency projects, also offering some services, but usually to specifically defined target groups. The plan specified in detail the objectives to be achieved over the plan period in terms of the promotion of indigenous investment, the role of the supporting institutions and the reforms needed and the resource requirements (human, physical and financial) to enable them to play that role.

G. BASOTHO ENTERPRISE DEVELOPMENT CORPORATION (BEDCO)

BEDCO was established in 1975 as a parastatal under the MTI with the objective of establishing and developing Basotho-owned business enterprises. Its functions were statutorily established in 1980. Under the Agro-Industrial Project, its role was more narrowly defined as the provision of industrial and workshop space for nascent enterprises. It was also envisaged that it would strengthen its project preparation capacity to enable it to assist entrepreneurs prepare viable projects for submission to the commercial banks.

The role of BEDCO as a promoter of indigenous entrepreneurial capabilities is crucial particularly for the development of the informal sector. This could significantly facilitate the indigenous industrialists' endeavour to emerge as major players in the ongoing industrialization process.

CHAPTER 3. STRUCTURE AND PERFORMANCE OF THE INDUSTRIAL SECTOR

3.1 BACKGROUND

The industrial structure in Lesotho consists of a relatively small number of relatively large companies, including a number of parastatals and some forty three ventures[25/] which are "assisted" by the LNDC under the incentive regime, including five companies in which LNDC has a controlling interest and four in which it has a substantial equity stake - see Table I.3 below. These companies are licensed by the MTI and constitute the core of the formal sector. Contrasted to this group there are some 60,000 small-scale enterprises deemed to be involved in industrial activities, most of them unlicensed and therefore in the informal sector. Typically, these produce goods of relatively low value and poor quality for the domestic market.

The formal sector consists of two main categories of enterprise:

- Ventures established by the government, processing local resources and concentrated in the agro-industrial sector. These tend to be relatively capital-intensive in their operations and import-substituting;

- Ventures established largely as a result of foreign investment. These are concentrated in the clothing and footwear sector - mainly the former - but also in light engineering, principally in electronics. These enterprises tend to be labour-intensive and are usually concerned with the processing of imported materials and components into finished products for export. Local value added is relatively low.

By the mid-1970s most of the state-owned ventures were irredeemably loss-making necessitating a change in the government's fundamental industrial strategy towards reliance on private sector initiative. Given the difficuity of attracting indigenous private sector capital into substantial industrial projects, this meant, in effect, that the government was compelled to rely on foreign investment to continue the process of industrial development. The investment incentive regime noted above was the ultimate consequence of this change of policy. The government's role in relation to industrial development became promotional as opposed to prescriptive.

As already indicated, there was a substantial volume of foreign investment in the 1980s and early 1990s. This was the origin of the second category of companies noted above. It was the arrival of these enterprises that fuelled the growth in manufacturing activity in both absolute and relative terms in these years. However, this development occurred for reasons which lay outside the control of the GoL. As changes in international circumstances rendered these reasons no longer effective

25/ Position as in March 1994, according to the LNDC. The forty three companies referred to do not include all those in which LNDC has equity holdings, notably those in the services sector.

in the early 1990s, it has become a matter of urgency to discover other ways of attracting industrial investment to Lesotho if the momentum of growth is to be sustained.

3.2 INDUSTRIAL STRUCTURE AND OWNERSHIP

A. THE FORMAL SECTOR

a. Sectoral distribution of industrial activity

Table I.2 below shows the sectoral distribution of the LNDC-assisted companies. This indicates the overwhelming importance of the textiles and clothing sector in terms of companies involved, numbers of jobs, wages, and investment.

b. Ownership

Table I.3 below indicates the ownership of the main LNDC-assisted companies by national origin. It will be seen that both the textile and clothing and leather (footwear) sectors are overwhelmingly foreign-owned. The only indigenous enterprise in this area was Seaka Components which was listed as employing 18 workers on a BEDCO estate in March, 1994. The dominant influence in the footwear sector was South African - although there was a Dutch interest in the largest company (Mustang Shoes). The clothing sector had two dominant influences, South African and Far Eastern (mainly Taiwanese). The composition of this sector is considered in greater depth in Part Two.

Of interest are the three electronic companies in the light engineering sector, Kiota Electronics (South African), Giant Electronics (Chinese) and African Electrics (British) which were established in 1989, 1991 and 1992 respectively. Kiota is understood to be a fugitive from sanctions, but the others seem to reflect the success of LNDC in diversifying investment away from the textile and garment sector. These companies are oriented mainly towards African markets, particularly the RSA.

The Table includes a number of parastatals in which LNDC now has a substantial holding or a majority share. These are concentrated in the agro-industrial sector, although, as will be seen, Loti Brick in the light engineering sector is an LNDC subsidiary and Lesotho Sandstone an associate.[26/] Holdings include the brewery, the flour-maize mill, the feed mill complex and the cannery. They do not include Lesotho Dairy and the National Abattoir.

It is understood that, despite the restructuring that has taken place - LNDC-holdings are run under professional management contract, or, as in the case of the brewery, by a US company which has acquired 49 per cent of the equity and these companies are understood to be well-run- the parastatals in general terms are still a source of weakness in the industrial sector. As already indicated, this arises from poor management which in part reflects interference from the parent ministry - usually the Ministry of Agriculture - and the use of the parastatals to achieve specific, non-commercial policy objectives, and as instruments of social policy and income distribution. This tends to enhance the inherent weakness of these organizations in the SACU context - i.e. that they cannot be insulated from South African competition.

Some of the most important parastatals, notably the abattoir, the dairy and the cannery, only survive because of massive and increasing levels of public subsidy which support a distortion of the market which has tended to discourage private participation in these areas of activity.

26/ i.e. LNDC owns a controlling interest in the case of subsidiary companies and more than 20 per cent of the equity stock in the case of associates.

The current policy agenda for the agro-industrial sector has the object of further increasing private sector participation through additional management contracts and privatization thus reducing the need for government support. However, the situation is complicated by the desire to ensure adequate participation by indigenous investors in the privatization process. There is still a visceral sentiment in government circles that these are "strategic" industries, the "commanding heights of the economy" which must be under national control even if this means no more than control being exercised by Basotho nationals.

c. Location

Activity in the formal sector is concentrated around Maseru and the two industrial estates established there, Maseru West and Thetsane. The other great concentration is around Maputsoe where there are two estates, in the town itself and at Ha Nyenye a few miles away on the main north-south road - although so far there is only one company established on the latter site.

The emphasis on Maseru is largely determined by the fact that this is the major population centre and market and by the railhead which facilitates communications with the RSA market and Durban for overseas markets. The development of Maputsoe - which is colonized by export-oriented clothing and footwear companies - was similarly determined by its easy access to the railhead in Ficksburg across the border in the Orange Free State. It is probably significant that the two companies established on more internal sites, Lesotho Pharmaceuticals in Mafeteng and Lesotho America Hybrid Seed in Teyateyaneng are more concerned with the domestic market and deal with products with relatively high value-to-volume ratios.

B. SMALL- AND MEDIUM-SCALE ENTERPRISES (SMEs)

a. Sectoral distribution, numbers, employment and location

The only reliable census of the SME sector was that carried out by Gemini on behalf of USAID in 1990. According to this, there were some 59,650 manufacturing enterprises which fell into this category at that time. Together they employed 82,567 persons - *circa* 1.4 persons per enterprise.

By far the most common SME activity is **beer-brewing** followed by **garment-making**. (The latter is considered in more detail in Part Two of this report). These two sectors accounted for 81 per cent of all enterprises and 71 per cent of employment. Beermaking in particular is a one-man - or, more often, a one-woman operation.

In the case of each category of activity, numbers of enterprises and employment were found to be in the remoter rural areas. This suggests that these enterprises are mainly concerned with addressing needs not adequately supplied by the conventional goods and services distribution network which are concentrated in the bigger towns, particularly, of course, Maseru. It will be noted that the ratio of workers to enterprises is much higher in Maseru than elsewhere in the country, indicating that the capital is host to a greater number of ventures which are truly industrial in their scope - albeit on a very small scale - as opposed to the obviously artisanal operations which generally characterize the informal sector.

b. Difficulties of the informal sector

The weaknesses of the informal sector are discussed in more detail in Part Two, but they may be broadly categorized under the following heads:

- The low level of management skills, particularly in the areas of costing and marketing. Technical skills also tend to be poor except in some of the craft areas;

- Difficulties of access to either long-term or short-term credit arising from difficulties in providing collateral or realistic business plans, exacerbated in the case of women by discriminatory practices often enshrined in law;

- Many aspects of the taxation and business environment which tend to discriminate against SMEs. (The lax imposition of the Sales tax on importers of goods in particular puts local producers at a disadvantage);

- The poor supply situation for raw materials, particularly textiles, yarns and tanned hides and skins. Not only do these have to be imported from the RSA in almost every instance - thus reducing local value added - but the lack of adequate middlemen trading ventures means that it is usually more practical for the small operator himself to visit the republic to secure what he needs.

- The inadequate supply.

As noted above, the Agro-Industrial Project intends to address these problems through BAPS - although the main function of this organization is to advise on the support services offered by other agencies. There is no evidence that it has as yet had a major impact on the situation.

Table I.2. Sectoral distribution of LNDC-assisted companies

Sector	Companies (Number)	Jobs (Number)	Wages (M. million)	Total investment (M. million)
Textiles and clothing[a/]	26	9,565	37.91	40.77
Leather	5	2,293	10.03	52.70
Light engineering Of which:	6	642	2.31	12.50
- Brickmaking	1	148	1.10	..
- Structural steel	1	75	..	..
- Sandstone	1	66	..	..
- Electronics	3	353	1.21	12.50
Agro-Industry Of which:	11	2,114	1.99	24.00
- Wheat milling	1	352	..	..
- Vegetable canning	1	626	0.46	..
- Ice cream	1	120	..	..
- Brewing	1	570	..	..
- Confectionary	2	203	1.20	5.20
- Tanning	1	53	0.05	2.00
- Edible oil	1	45	0.03	6.30
- Pharmaceuticals	1	120	0.25	..
- Paints	1	5	..	..
- Hybrid seeds	1	20	..	10.50
	48	**14,614**	**52.24**	**129.97**

Source: LNDC (March, 1994).

a/ See Table II.3 for detailed listing of textile and clothing enterprises.

Table I.3. Investment stock in LNDC-assisted companies, 1994

Sector	Country	Projects	Investment (M. million)
Textiles and clothing	USA/RSA/UK/	1	0.64
	RSA/German	1	2.10
	Swiss	1	2.00
	Hong Kong	3	2.10
	RSA	5	1.97
	Taiwan Province	8	30.81
	RSA/UK	1	0.85
	Philippines	1	0.30
		21	**40.77**
Leather (shoes)	RSA/Dutch	1	35.00
	RSA	3	17.70
	Lesotho	1	..
		5	**52.70**
Light engineering Of which:			
- Brickmaking	Lesotho a/	1	..
- Structural	RSA	1	..
- Sandstone	Lesotho b/	1	..
- Electronics	RSA	1	..
	China	1	10.00
	UK	1	2.50
		6	**12.50**
Agro-industry Of which:			
- Wheat milling	Lesotho/RSA c/	1	..
- Vegetable canning	Lesotho d/	1	..
- Ice cream	RSA	1	..
- Brewing	Lesotho/USA e/	1	..
- Confectionary	Germany/Lesotho	1	..
	Lesotho/RSA f/	1	5.20
- Tanning	Zimbabwe	1	2.00
- Edible oil	RSA/Lesotho g/	1	6.30
- Pharmaceuticals	Lesotho/SADC h/	1	..
- Paints	Lesotho/RSA i/	1	..
- Hybrid seeds	Lesotho/RSA j/	1	10.50
		11	**24.00**

Source: LNDC, March 1994.

a/ Loti Brick, 51 per cent LNDC.
b/ LESACO, 49 per cent LNDC.
c/ Lesotho Milling, 39.7 per cent of 50 per cent.
d/ Canners, 100 per cent LNDC.
e/ Lesotho Brewing, 51 per cent LNDC.
f/ Lesotho Bakery, 51 per cent LNDC.
g/ Maluti Oil & Cake Mills, 35 per cent LNDC.
h/ Lesotho Pharmaceuticals, 21 per cent LNDC.
i/ Parthenon Paint, 100 per cent LNDC.
j/ Lesotho American Hybrid Seed, 20 per cent LNDC.

Table I.4. Geographical distribution of LNDC-assisted companies, 1994

Sector	Location	Companies	Jobs	Percentage
Textile and clothing	Maseru West	6	2,147	14.7
	Thetsane	7	5,081	34.8
	Maputsoe	7	2,211	15.1
	Ha Nyenye	1	126	.9
		21	**9,565**	**65.5**
Leather (shoes)	Maputsoe	4	2,275	15.6
	BEDCO estate	1	18	.1
		5	**2,293**	**15.7**
Light engineering	Maseru	3	311	2.1
	Thetsane	3	331	2.3
		6	**642**	**4.4**
Agro-industry	Maseru	6	1,773	12.1
	Thetsane	3	201	1.4
	Mafeteng	1	120	.8
	Teyateyaneng	1	20	.1
		11	**2,114**	**14.5**
All sectors	Maseru	15	4,231	29.0
	Thetsane	13	5,613	38.4
	Maputsoe	11	4,486	30.7
	Ha Nyenye	1	126	.9
	BEDCO estate	1	18	.1
	Mafeteng	1	120	.8
	Teyateyaneng	1	20	.1
		43	**14,614**	**100.0**

Source: LNDC, March 1994.

Table 1.5. Distribution of SMEs by activity and geographical location, 1990

Activity	Location					
	Maseru	Small towns	Rural towns	Rural areas	Total	(% total)
Beer brewing						
Enterprises	1,571	1,124	453	31,131	34,279	57
	(4.6)	(3.3)	(1.3)	(90.8)	(100.0)	
Employment	1,681	1,383	571	33,933	37,568	46
	(4.5)	(3.7)	(1.5)	(90.3)	(100.0)	
Garment-making						
Enterprises	1,460	1,020	275	11,797	14,552	24
	(10.0)	(7.0)	(1.9)	(81.1)	(100.0)	
Employment	2,511	1,632	404	16,044	20,591	25
	(12.2)	(7.9)	(2.0)	(77.9)	(100.0)	
Straw/bamboo-based						
Enterprises	111	77	15	2,785	2,988	5
	(3.7)	(2.6)	(0.5)	(93.2)	(100.0)	
Employment	118	109	17	4,734	4,978	6
	(2.4)	(2.2)	(0.3)	(95.1)	(100.0)	
Leather/plastic based						
Enterprises	359	133	44	1,474	2,010	3
	(17.9)	(6.6)	(2.2)	(73.3)	(100.0)	
Employment	1,124	231	62	2,520	3,937	5
	(28.5)	(5.9)	(1.6)	(64.0)	(100.0)	
Ceramics						
Enterprises	173	119	22	1,557	1,871	3
	(9.2)	(6.4)	(1.2)	(83.2)	(100.0)	
Employment	709	568	116	4,873	6,266	8
	(11.3)	(9.1)	(1.9)	(77.6)	(100.0)	
Wood-based						
Enterprises	186	78	17	1,311	1,592	3
	(11.7)	(4.9)	(1.1)	(82.3)	(100.0)	
Employment	798	178	51	1,914	2,941	4
	(27.1)	(6.1)	(1.7)	(65.1)	(100.0)	
Repairs						
Enterprises	223	112	17	410	762	1
	(29.3)	(14.7)	(2.2)	(53.8)	(100.0)	
Employment	1,313	332	34	410	2,089	3
	(62.9)	(15.9)	(1.6)	(19.6)	(100.0)	
Foods						
Enterprises	148	49	39	492	728	1
	(20.3)	(6.7)	(5.4)	(67.6)	(100.0)	
Employment	663	153	73	1,082	1,971	2
	(33.6)	(7.8)	(3.7)	(54.9)	(100.0)	
Metal-based						
Enterprises	161	70	5	164	400	1
	(40.3)	(17.5)	(1.3)	(41.0)	(100.0)	
Employment	768	146	7	164	1,085	1
	(70.8)	(13.5)	(0.6)	(15.1)	(100.0)	
Other manufacturing						
Enterprises	74	63	3	328	468	1
	(15.8)	(13.5)	(0.6)	(70.1)	(100.0)	
Employment	598	101	6	436	1,141	1
	(52.4)	(8.9)	(0.5)	(38.2)	(100.0)	
Total						
Enterprises	**4,466**	**2,845**	**890**	**51,449**	**59,650**	**100**
	(7.5)	**(4.8)**	**(1.5)**	**(86.3)**	**(100.0)**	
Employment	**10,283**	**4,833**	**1,341**	**66,110**	**82,567**	**100**
	(12.5)	**(5.9)**	**(1.6)**	**(80.1)**	**(100.0)**	

Source: Gemini Report No. 14: Small-scale enterprises in Lesotho: 1990.

Figures in parentheses indicate percentage of total sector.

3.3 INDUSTRIAL SECTOR PERFORMANCE

A. PATTERN OF MANUFACTURING VALUE ADDED

Table I.6 below indicates the overwhelming importance of the food and beverage and textile, clothing and leather sectors in the overall structure of manufacturing value added. It is not possible to distinguish between textile and leather output, but both the export performance of these two industries and the employment pattern suggests that the first is by far the larger.

There was a secular trend for food and beverage output to decline in relative importance over the period 1984-1993 - but not in absolute terms. However, this general pattern tended to fluctuate from year-to-year, most recently in 1993 when there was a substantial increase in over 1992 in relative as well as absolute terms. This reflected the ending of the drought which ensured a substantial increase in the raw materials becoming available for processing.

Similarly, textile, clothing and leather tended to increase in relative and absolute terms over the period reflecting the surge of investment from the mid-1980s. Again, however, there could be quite wide fluctuations away from the general trend from year to year. For instance, there was a substantial downturn in activity in 1993 which is likely to have reflected the imposition of the US export quotas and the more general weakness of the US market for garments. It remains to be seen whether this was, in fact, merely a cyclical fluctuation or whether it will prove to have marked the end of the expansion of the textile and garment industry output which had characterized the past decade.

B. EXPORTS

a. By merchandise category

The period 1989-1993 saw a massive increase in manufactured exports, not only in absolute terms, but also relative to other merchandise items. According to the latest available data, they accounted for 88.2 per cent of total exports in value terms in 1993 - as opposed to 58.9 per cent in 1989. This increase is largely due to the performance of the SITC Heading 8 (Miscellaneous products) category which is largely accounted for by exports of garments. The other significant products in this category are footwear and umbrellas. The performance of these was disappointing in the period covered by the Table.

Unfortunately, the UNIDO mission had no access to detailed data for 1993 and it is impossible to determine how exports of garments were affected by the imposition of US export quotas in that year. There was a massive increase in SITC Heading 8 exports, but this conflicts with the subjective reports of many clothing manufacturers that there was little or no increase in the value of their exports in real terms in recent years. It is possible that some of the increase shown in the Table could be accounted for by growth in exports of umbrellas and footwear, but, as already suggested, the earlier performance of these categories makes this unlikely. However, the continuing decline of the loti/US dollar exchange rate would also have produced an increase in the value of exports expressed in loti without any real growth in their dollar value. As will be seen, there was also an upturn in the value of exports to the EU, most of which are understood to consist of garments.

It will be noted that there was a substantial increase in exports of TV receivers in 1992 over 1991, although preliminary figures suggest that this surge may not have been sustained in 1993. This is understood to reflect the commissioning of the new electronic products assembly projects noted above. Thus there were signs that the LNDC efforts of the late-1980s/early-1990s to diversify the manufacturing base away from the overweening dependence on garments was not entirely unsuccessful although there is as yet no evidence that any of these new industries have been able to develop an impetus of growth and some, as in the case of footwear and umbrellas, that they may have run out of steam.

Table I.8 overleaf indicates the level of approvals, disbursals and repayments of loans under the Export Finance Scheme in 1993 and the first quarter of 1994. This indicates that, that clothiers secured the greatest proportion of total approvals, the levels being approximately similar to the disbursals made to them. However, their repayment record is very poor. (This seems to confirm subjective reports that these companies tend to be seriously over-exposed in this respect - see Chapter 6 below.)

The other major users of this facility are the electronic companies (in respect of TV and radio exports), by far the greatest proportion of actual disbursals goes to TV and radio suppliers. In fact disbursals made to these companies are far higher than the level of approvals. On the other hand, their repayment record is much better than that of the clothing manufacturers, suggesting that these companies are also performing better in financial terms.

There were massive increases in both approvals and disbursements under the scheme in year to end-March, 1994 - thus reinforcing the evidence of the export data. Despite the poor performance of the clothing sector, the rate of repayment rose from 82.6 per cent of disbursements to 82.9 per cent.

b. By destination

Africa is by far the most important destination for Lesotho exports although it has been declining in relative terms in recent years. However, the only African market of any significance is the RSA. Trade with other countries is minuscule and it is in this context that the relatively substantial upturn in shipments to SADC destinations (excluding the SACU bloc) in 1993 is noted.

Exports to the Americas, mainly the USA, grew very substantially in both relative and absolute terms in the period 1988-1993. This reflected almost entirely the trade in textile and garment products. Given this, the upturn of 76.5 per cent in 1993 over 1992 is somewhat disconcerting when it is considered in light of the downturn in value added for textile and leather output noted in Table I.6 above and the gloomy reports from clothing exporters. The upturn reflected, of course, the impact of the declining value of the loti against the dollar, but, even if this is taken into account, the increase was still a remarkable 56.0 per cent.

The other major destination is the EU. It is understood that, again, the trade here consists largely of garment products. The main outlets are Germany and the UK, although exporters told the UNIDO mission they had also trade with France and Spain. However, although the value of exports to these countries increased in absolute terms, they decreased in relative terms over the period.

Table I.6 **Structural composition of value added by manufacturing industries, 1988-1993**
(Percentage)

Sector	1984		1989		1990		1991		1992		1993	
Food and beverages	64.0	(17.41)	47.2	(24.78)	55.8	(29.46)	49.8	(27.84)	39.5	(23.07)	50.9	(30.74)
Textile, clothing and leather	14.5	(3.94)	38.4	(20.16)	29.0	(15.31)	36.1	(20.18)	49.9	(29.14)	34.8	(21.02)
Furniture and fixtures	3.5	(0.95)	1.6	(0.84)	1.5	(0.79)	1.4	(0.78)	1.6	(0.93)	2.4	(1.45)
Printing and publishing	2.6	(0.71)	2.4	(1.26)	2.3	(1.21)	2.2	(1.23)	1.7	(0.99)	2.4	(1.45)
Other chemical products	5.2	(1.41)	2.8	(1.47)	2.5	(1.32)	2.7	(1.51)	1.9	(1.11)	2.4	(1.45)
Non-metal products	4.1	(1.12)	3.8	(1.99)	4.8	(2.53)	4.3	(2.40)	2.9	(1.69)	3.8	(2.30)
Iron and steel products	3.2	(0.87)	1.6	(0.84)	1.9	(0.97)	1.4	(0.78)	1.1	(0.64)	1.4	(0.85)
Other industries	2.9	(0.79)	2.2	(1.16)	2.3	(1.21)	2.0	(1.12)	1.5	(0.88)	1.9	(1.15)
Total	100.0	(27.20)	100.0	(52.50)	100.0	(52.80)	100.0	(55.90)	100.0	(58.40)	100.0	(60.40)

Source: Central Bank of Lesotho.

Figures in parentheses indicate M. million at constant 1980 prices.

Table I.7. Exports of manufactured products, 1989-1993
(M. million)

SITC category		1989		1990		1991		1992		1993	
6	**Manufactured goods by material**	**10,800**	**(6.3)**	**17,626**	**(11.5)**	**10,200**	**(5.5)**	**9,600**	**(3.1)**	**13,400**	**(3.1)**
	Leather goods	98	(0.1)	355	(0.2)	853	(0.5)	874	(0.3)	..	
	Tanned & soft			312		730		..		..	
	Leather articles			541		144		..		..	
	Rubber goods	451	(0.3)	762	(0.5)	393	(0.2)	217	(0.1)	..	
	Wooden goods	221	(0.1)	9		28		5		..	
	Textile yarn etc[a/]	6,714	(3.9)	8,214	(5.3)	4,928	(2.6)	1,184	(0.4)	..	
	Non-metal mineral goods	5,315	(3.1)	7,227	(4.7)	4,459	(2.4)	4,121	(1.3)	..	
	Diamonds	4,641	(2.7)	6,507	(4.2)	3,287	(1.8)	3,389	(1.1)	..	
	Bricks	309	(0.2)	150	(0.1)	607	(0.3)	260	(0.1)	..	
	Metal manufactures	97	(0.1)	1,059	(0.7)	1,050	(0.6)			..	
7	**Machinery and transport equipment**	**1,200**	**(0.7)**	**1,600**	**(1.0)**	**5,200**	**(2.8)**	**35,000**	**(11.3)**	**25,500**	**(5.8)**
	TV receivers	84				1,974	(1.1)	28,655	(8.9)	..	
8	**Miscellaneous**	**89,700**	**(52.0)**	**90,300**	**(58.8)**	**129,300**	**(69.4)**	**220,100**	**(70.8)**	**348,200**	**(79.3)**
	Furniture	424	(0.2)	604	(0.4)	1,319	(0.7)	2,886	(0.9)	..	
	Garments[a/]	76,411	(44.3)	64,812	(42.2)	118,734	(63.8)	172,628	(55.5)	..	
	Footwear	12,832	(7.4)	14,308	(9.3)	8,633	(4.6)	2,181	(0.7)	..	
	Umbrellas etc	7,607	(4.4)	4,686	(3.0)	4,811	(2.6)	8,018	(2.6)	..	
Total manufactured exports		**101,700**	**(58.9)**	**109,526**	**(71.3)**	**144,700**	**(77.7)**	**264,700**	**(85.1)**	**387,100**	**88.2**
All merchandise exports		**172,600**	**100.0**	**153,700**	**100.0**	**186,200**	**100.0**	**310,900**	**100.0**	**438,900**	**100.0**

Source: Bureau of Statistics.

a/ Textile and garment exports are analysed in detail in Part Two.

Table I.8. **Approvals, disbursals and repayments of loans approved under the export finance scheme by type of industry, 1993-94**
(M. million - end of period)

Sector		Period 1993 First quarter		Second quarter		Third quarter		Fourth quarter		1994 First quarter	
Leather	Approvals	3.3	(4.0)	4.0	(4.3)	4.3	(4.5)	3.3	(3.3)	3.3	(2.3)
	Disbursals	4.5	(3.6)	4.9	(3.4)	5.1	(2.6)	5.1	(2.2)	5.1	(1.9)
	Repayments	3.6	(3.5)	4.1	(3.4)	4.3	(2.9)	4.3	(2.3)	4.3	(2.0)
Clothing	Approvals	29.5	(35.9)	37.3	(40.1)	40.5	(42.1)	43.0	(43.6)	66.5	(45.9)
	Disbursals	21.6	(17.3)	25.3	(17.8)	37.3	(19.3)	44.5	(19.4)	55.5	(21.2)
	Repayments	9.2	(8.9)	13.4	(11.1)	19.9	(13.3)	24.7	(13.1)	29.3	(13.5)
Canning	Approvals	12.2	(14.8)	12.2	[illegible]	12.2	(12.7)	12.2	(12.4)	15.0	(10.3)
	Disbursals	14.0	(11.2)	14.0	(9.8)	14.1	(7.3)	16.4	(7.2)	17.0	(6.5)
	Repayments	13.0	(12.6)	13.9	(11.6)	14.4	(9.6)	14.4	(7.6)	15.9	(7.3)
TV and radio	Approvals	35.9	(43.7)	38.9	(41.8)	38.9	(40.4)	38.9	(39.4)	58.9	(40.6)
	Disbursals	83.5	(67.0)	96.7	(68.0)	135.3	(70.1)	161.4	(70.5)	183.4	(69.9)
	Repayments	76.4	(74.2)	88.0	(73.2)	109.9	(73.6)	144.4	(76.4)	166.9	(76.7)
Crafts	Approvals	1.3	(1.6)	1.3	(1.4)	1.3	(1.4)	1.3	(1.3)	1.3	(0.9)
	Disbursals	1.2	(1.0)	1.2	(0.8)	1.3	(0.7)	1.3	(0.6)	1.3	(0.5)
	Repayments	0.7	(0.7)	0.8	(0.7)	0.8	(0.5)	1.1	(0.6)	1.2	(0.6)
Jewellery	Approvals	0.1	(0.1)	0.1	(0.1)	0.1	(0.1)	0.1	(0.1)	0.1	(0.1)
	Disbursals	0.1	(0.1)	0.1	(0.1)	0.1	(0.1)	0.1	(..)	0.1	(..)
	Repayments	0.1	(0.1)	0.1	(0.1)	0.1	(0.1)	0.1	(0.1)	0.1	(..)
Total	**Approvals**	**82.2**	**(100.0)**	**93.0**	**(100.0)**	**96.2**	**(100.0)**	**98.8**	**(100.0)**	**145.0**	**(100.0)**
	Disbursals	**124.7**	**(100.0)**	**142.2**	**(100.0)**	**193.1**	**(100.0)**	**228.8**	**(100.0)**	**262.4**	**(100.0)**
	Repayments	**103.0**	**(100.0)**	**120.2**	**(100.0)**	**149.4**	**(100.0)**	**189.0**	**(100.0)**	**217.7**	**(100.0)**

Source: Central Bank of Lesotho.

Table I.9. **Lesotho exports by destination, 1988-1993**
(M. million)

Region	1988		1989		1990		1991		1992		1993	
World	144.9	(100.00)	172.6	(100.00)	153.7	(100.00)	186.2	(100.00)	310.9	(100.00)	438.9	(100.00)
Africa	115.4	(79.64)	91.5	(53.01)	93.3	(60.70)	76.9	(41.30)	154.4	(49.66)	206.0	(46.94)
SACU	115.2	(79.50)	90.4	(52.38)	91.5	(59.53)	73.7	(39.58)	152.7	(49.12)	201.3	(45.86)
SADC					1.5	(0.98)	2.8	(1.50)	1.5	(0.48)	4.4	(1.00)
Other	0.2	(0.14)	1.1	(0.64)	0.3	(0.20)	0.4	(0.21)	0.2	(0.06)	0.3	(0.07)
Europe	10.9	(7.52)	57.7	(33.43)	31.1	(20.23)	55.9	(30.02)	72.3	(23.26)	82.6	(18.82)
European Union	9.7	(6.69)	49.9	(28.91)	30.1	(19.58)	50.6	(27.18)	70.5	(22.68)	80.0	(18.23)
Other	1.2	(0.83)	7.8	(4.52)	1.0	(0.65)	5.3	(2.85)	1.8	(0.58)	2.6	(0.59)
America	18.2	(12.56)	23.0	(13.33)	28.5	(18.54)	52.1	(27.98)	83.3	(26.79)	147.0	(33.49)
Asia	..		0.3	(0.17)	0.6	(0.39)	1.0	(0.54)	0.8	(0.26)	2.0	(0.46)
Oceania	..		0.1	(0.06)	0.2	(0.13)	0.3	(0.16)	0.1	(0.03)	1.3	(0.30)

Source: Central Bank of Lesotho.

Figures in parentheses indicate percentage of total exports in the year.

PART TWO

THE TEXTILE AND GARMENT MARKET

CHAPTER 4. THE MAIN CONSTITUENTS OF THE TEXTILE AND GARMENT INDUSTRY

4.1 INTRODUCTION

The textile and garment industry in Lesotho comprises the following main activities:

- The production of wool and mohair fibre, mainly for export as an unprocessed commodity; and

- The manufacture of garments and other textile products.

Those concerned with the **production of fibre** are the shepherds who own the goats and sheep which grow it and the middlemen who purchase the crop and export it to South Africa where it is auctioned. Local processing of these materials is minimal and, such as it is, largely confined to mohair which is scoured, combed, spun into yarn and dyed for use by artisan manufacturers of textile products and knitted garments. This product is not exported.

The **textile and garment manufacturing industry** is divided into two wholly discrete parts consisting of:

- Relatively large enterprises, all of them foreign-owned, producing garments on an industrial scale, oriented towards export markets and with few backward linkages into the Lesotho economy;

- Small-scale enterprises, operating on a mainly artisanal scale.

The small-scale enterprises are divided into two main categories:

- Those producing clothing made up from woven cloth, either on a ready-to-wear or dressmaking basis, or by machine-knitting, usually for the domestic market, but sometimes for export;

- Those producing hand-knitted clothing and woven craft items (i.e. tapestries, shawls etc), almost always oriented to export sales even if these are achieved via sales to tourists.

There is no industrial scale spinning, weaving, fabric-knitting or fabric processing. A company known as Lesotho Fabric Processors was established by the South African-based Kluk Textile Industries (KTI) in 1990 to knit cotton fabric for the local and the international market using imported yarn. However, this project went into liquidation towards the end of 1991 having failed to establish adequate sales levels in very depressed local (SACU) and international market conditions and it proved impossible to agree suitable terms for selling it to a Hong Kong group or establish a local funding package with government backing.

4.2 WOOL AND MOHAIR

A. SOURCES

Mohair is derived from goats, wool from sheep. The latest available data on the national flocks of these animals are as follows:

Table II.1. National flocks of sheep and goats, 1988-1992
(Thousand)

	Sheep	Goats
1988	1,650	1,124
1989	1,505	1,068
1990	1,378	994
1991	1,467	729
1992	1,382	649

Source: Ministry of Agriculture, Livestock Division.

Mohair is taken in the period March-July, wool in September-December. The fibre is sent to auction in South Africa once a year, irrespective of when the clipping takes place. It is always sent in an unprocessed form.

B. EXPORTS

The export value of the two fibre types was as follows in the period 1988-1992. It will be noted, there is no apparent correlation between the size of the flocks and the value the export shipments - see Table II.2.

Table II.2. Exports of wool and mohair, 1988-1992
(R. million)

	Wool	Mohair	Total
1988	19.1	4.6	23.7
1989	23.8	7.3	31.1
1990	24.3	7.2	31.5
1991	3.6	6.1	9.7
1992	19.1	15.2	34.3

Source: Trade data

C. DISTRIBUTION

The fibre is marketed by middlemen who purchase the material from the shepherds. They include private traders and farming cooperatives/associations. There are about ten such organizations operating some fifty trading posts. They include both South Africans and Basotho.

Alternatively, the farmers may send their clip to the Livestock and Produce Marketing Service (LPMS) of the Ministry of Agriculture. The LPMS sorts and blends the clips as a free service before sending it to auction. The farmer is paid once the fibre has been auctioned.

The price paid by the middleman is determined before the auction and must take account of the following marketing costs:

-	Wool testing laboratory cost	5.00 per cent clip value
-	SA Wool Board Levy	2.00 per cent clip value
-	Commission	R.31.32/bale (150kg)
-	Lesotho dipping fees	R.0.21/kg
-	Insurance	0.50 per cent clip value
-	Transport cost (road)	R.0.43/kg
-	Packaging	R.13.50/bale

The wool auction prices reflect world market prices. The main determinant of merino-type wool prices (most Lesotho wool is of the merino-type) is Australia. The price-leaders for other types of wool are Russia and China.

D. LOCAL UPGRADING

The GoL through the LNDC has carried out a feasibility study for a project for adding value to Lesotho's wool and mohair crop by scouring and combing. The product would be sold directly on the world market instead of, as is presently the case with the material in its untreated form, being sent to auction in the RSA. It has been determined that this could be done profitably and a company has been formed for the purpose in conjunction with Bradford Technology Partnerships Ltd known as the Lesotho Wool & Mohair Processing Co (Pty) Ltd (LWMPC.) It is understood that the financing of this project is still under discussion between the parties.

It is noted that no entrepreneur has been willing to undertake a project of this nature without government financial backing.

4.3 EXPORT-ORIENTED GARMENT-MAKING

A. INTRODUCTION

The development of this segment of the textile and garment industry came about as a result of government measures which were specifically designed to attract investment into labour-intensive, export-oriented projects. Such enterprises are usually termed "LNDC-assisted", referring to the fact that they are beneficiaries of the range of investment incentives offered by the government and administered by the Lesotho National Development Corporation - see Chapter 2.3.D. In Lesotho, as in most other developing countries which have pursued a strategy for economic development based on export-led growth, garment-making has proved by far the most important area for inward investment. This reflects the labour-intensive nature of the apparel industry which gives considerable comparative advantages to countries with large supplies of relatively low-cost labour.

There are two main categories of LNDC-assisted garment sector investors:

- Those of South African origin or otherwise having strong connections with the South African garment industry;

- Those from countries which are major suppliers of the world market for ready-to-wear apparel. In the case of Lesotho the most important of these are of Taiwanese and, to a lesser extent, Hong Kong origin.

Table II.3 below indicates the companies established in Lesotho by these two categories of investor as in March, 1994 - since when Morija Textiles and Southern Cross has ceased trading. It will be seen that five of the thirteen South African-originating companies identified by LNDC as in the textile sector are, in fact, involved in shoemaking. If these are excluded, a comparative analysis of the two groups reveals the following main characteristics:

- **Employment per company** is around 286 in the case of the South African and around 558 in the case of the Far Eastern companies. The differential may, in fact, be less than this comparison suggests as the Far Eastern companies have an incentive to inflate their actual employment figures because they tend to be more interested in producing quota products for the US market than do their South African counterparts. (As will be seen in Chapter 5, section C, the method of allocating these quotas is heavily weighted towards the larger employers.) However, the difference between the two groups seems too great to be wholly explained away by this factor;

- **Investment per company** is M.0.95 million in the case of the South Africans and M.2.55 million in the case of the Far Easterners. Average investment per job created is M.414.85 and M.351.38 respectively;

- **The value of exports per company** is M.10.09 million and M.3.90 respectively. The much greater value of the South African exports is, perhaps, partly explained by the fact that the bulk of their trade is with the republic where average prices per unit are much greater than in the USA or the EU. However, these data depend very much on the value assigned to the Lesotho company inputs by the groups to which they are attached. With the exception of Lesotho Hawk and CGM Garments, the Far Eastern companies only pay their Lesotho establishments the costs of production and themselves undertake all component purchase and marketing costs. Given the much higher level of company income tax in the RSA, there may be an incentive for the South African companies to take more of their profits in Lesotho.

- **Average annual wages per worker** in 1993 were M.4,061 and M.3,933 respectively. The similarity of these outcomes suggests that, if the Far Eastern companies do in fact inflate their employment figures as suggested above, it is not to any great extent.

Table II.3. LNDC-assisted companies, March 1994

Company	Ownership	Location	Year established	Product	Main markets	Workers (Number)	Investment (M million)	Exports[a] (M million)	Wages (M million)
Textile products									
RSA origin									
Lesotho Clothing	USA/UK/ RSA[c]	Maputsoe	1981	Ladies/ children	USA/RSA/UK	420	0.64	16.00	2.40
Lesotho Umbrella	RSA/ Germany	Maputsoe	1973	Umbrellas	Germany/RSA	300	2.10	12.00	0.67
Maseru Clothing	Swiss[d]	Maputsoe	1985	Leisure	USA/RSA	377	2.00	23.77	2.73
Lesotho Textiles	RSA/EU[d]	Thetsane	1986	Slacks	RSA/EU	190	0.61	3.70	0.46
Indi-Ocean	RSA	Maseru	1990	Diapers	USA	160	..	..	..
Lee Mfrs.	RSA	Maputsoe	1988	Jeans	RSA	254	1.31	9.83	1.26
Dicon	RSA	Maputsoe	1992	Ladies/ children	RSA	126	0.05	1.38	0.18
Morija Textiles[b]	RSA/UK	Thetsane	1988	T-shirts	RSA/EU	463	0.85	14.05	1.60
Mustang Shoes	RSA/NL	Maputsoe	1978	Shoes	RSA	1,311	35.00	34.00	5.78
Tempo Shoes	RSA	Maputsoe	1988	Shoes	RSA	540	10.00	11.00	2.00
Budget Shoes	RSA	Maputsoe	1989	School shoes	RSA/Lesotho	364	4.70	17.00	1.90
Lesotho Components	RSA	Maputsoe	1989	Shoe soles	Lesotho	60	3.00	-	0.35
Seaka[c] Components	Lesotho	BEDCO	1991	Shoe components	RSA/Lesotho	18	..	..	..
Sub-total						4,583 (27.9)	60.26 (47.2)	142.73 (62.8)	19.33 (37.1)
Of which: Garment-makers						2,290 (14.0)	7.56 (5.8)	80.73 (35.6)	9.30 (17.9)
Far East origin									
Poltex	Hong Kong	Thetsane	1986	Jeans	USA/EU	260	2.00	4.50	1.08
Lesotho Haps	Taiwan	Maputsoe	1987	Shorts/ shirts	RSA/EU	770	2.00	8.83	2.81
CGM	Taiwan[e]	Thetsane	1988	Jeans	USA/EU	1,691	2.90	5.50	7.90
Lesotho Hinebo	Taiwan	Maseru	1988	T-shirts	USA	350	2.30	2.58	1.67

(continued)

Table II.3. (continued)

Company	Ownership	Location	Year established	Product	Main markets	Workers (Number)	Investment (M million)	Exports[a/] (M million)	Wages (M million)
Crayon Garments	Hong Kong	Maseru	1990	Jeans	USA	572	..	..	2.25
Lesotho Apparel	Taiwan	Thetsane	1990	Shirts	USA/EU/ Canada	450	..	..	..
Lesotho Hawk	Taiwan	Maseru	1990	T-shirts	USA	530	2.51	2.90	0.84
Super Knitting	Taiwan	Maseru	1990	T-shirts	USA	385	3.00	6.00	1.62
C&Y Garments	Taiwan	Thetsane	1991	Jeans	EU/USA	1,300	15.00	8.00	6.60
Southern Cross[f/]	Taiwan	Thetsane	1991	Knitted shorts	USA	727	3.10	7.20	3.60
Invictus Clothing	Philippines	Maputsoe	1992	T-shirts/ shorts	USA/EU	60	0.30	0.85	0.18
Trans Africa	Hong Kong	Maputsoe	1991	Screen printing	RSA	30	0.10	4.32	0.11
Lesotho Eagle	..	..	1994	Flannel shirts	USA	150	..	..	..
Sub-total						**7,275** (44.4)	**33.21** (25.6)	**50.68** (22.3)	**28.61** (55.0)
All textile product mfrs.						11,858 (72.3)	93.47 (72.0)	193.41 (85.2)	47.94 92.1)
Other assisted companies						4,544 (27.7)	36.32 (28.0)	33.66 (14.8)	4.10 (7.9)
All assisted companies						**16,402** (100.0)	**129.79** (100.0)	**227.07** (100.0)	**52.04** (100.0)

Source: Lesotho National Development Corporation and company interviews.

Figures in parentheses include percentage total all assisted companies.

a/ FOB value. (This may differ from the foreign exchange actually entering Lesotho.

b/ Company now not trading.

c/ In February 1995, wholly British.

d/ In February 1995, wholly South African.

e/ In February 1995, Hong Kong.

f/ It is understood that, since the UNIDO team visited Lesotho, this enterprise has ceased trading.

B. SOUTH AFRICAN ORIGINATING INVESTMENT

a. Reasons for investing in Lesotho

In many, or even most, instances the original motive of South African-oriented investors in coming to Lesotho was to side-step the sanctions imposed on the foreign trade of the Republic in the 1980s - in particular by the USA and member-states of the European Community (henceforth referred to as the European Union (EU).) Lesotho was very appropriate for this purpose being a sovereign state not subject to sanctions, but geographically proximate to the RSA so facilitating control.

Although the original motive in investing in Lesotho may have been to produce for non-SACU markets, Lesotho, with its relatively low cost labour and investment/export incentives was also an advantageous location for the manufacture of garments for sale in the RSA itself - although some of the incentives, notably duty-free import of fabrics, are not available for exports destined for the republic.

The RSA is an attractive export market for Lesotho originating products for a number of reasons:

- As Lesotho is a fellow-member of the SACU, garment-makers established there can sell into South African market without having to pay the very high rates of duty imposed on imports from outside the SACU area;
- Proximity;
- Established links with South African buyers;
- Prices which tend to be above world market levels because of high levels of protection;
- A less competitive marketing environment, again as a result of protection.

There are significant instances of South African companies which established manufacturing enterprises in Lesotho in order to produce for markets closed to South African-originating goods which now look on the RSA as their main market while exports to Third Countries are a relatively minor part of their total business.

b. Review of companies in Lesotho

b.1 The function of Lesotho-based enterprises in the wider corporate context

Companies established in Lesotho by South African or South African oriented groups are not autonomous marketing entities. This function is carried on from offices located within the RSA. Fabric sourcing is also outside their control. (The managers of Maseru Clothing claimed to take the decisions about the sourcing of fabrics, but the individuals concerned tend to move freely across the international frontier between offices in Lesotho and South Africa and it is probably more appropriate to see this function as concentrated in them than in any geographical location.) Accounting and financial control is in all cases carried out in the Republic.

In fact the factories in Lesotho are concerned solely with fulfilling orders secured for them by their head offices. Sometimes the owners will have another factory in the RSA and the filling of orders will be allocated between the production units on either side of the frontier as is judged most commercially appropriate. However, there seems to be a tendency for production to be concentrated in Lesotho as the more economic manufacturing location.

b.2 The manufacturing operations carried out in Lesotho

The Lesotho companies do not usually **design** the clothes they produce. This function may be carried out by the group of which they form a part, but, increasingly, production is to customer specifications. Similarly, **patterns and markers** are usually supplied from the republic, although Lesotho Clothing has the capacity to produce these in Lesotho.

The main function of the factories in Lesotho is to manufacture garments according to the specifications supplied by their head offices in the RSA. This means that they are, for the most part, involved in cutting fabric, making up and finishing garments, and packing these and dispatching them to their final destination.

None of the plant are engaged in outward processing operations - in so far as by this is understood sewing, finishing and packing cut goods supplied by customers - which is the least costly of garment manufacturing processes, but also the least profitable. Maseru Clothing will occasionally sew, finish and pack cut goods supplied by the South African sister-operation, but this is understood merely to reflect production convenience.

b.3 Organization of production

The companies operated what is known as the progressive bundle system whereby bundles containing large numbers of identical fabric components are moved up the production line. This is the most common way of organizing the mass-production of low-value clothing using workers of limited skills. Its disadvantages are that it requires large fabric inventories and cannot respond quickly to changes in the market which makes the system less suitable for supplying higher fashion items with relatively short production runs and frequent range changes. However, the industry in Lesotho, as in most developing economies, is little concerned with that end of the market.

Maseru Clothing also operate what is known as the chain system whereby the more bulky items of their product range - i.e. padded jackets - are moved along the production lines suspended on chains. This is understood mainly to overcome the problems of moving such unwieldy loads from work-station to work-station and does not affect the basic organization principle. (Maseru Clothing also operates the conventional bundle system for other items.)

b.4 Capital assets

All the South African-originating companies interviewed operated from LNDC factory shells - as do all LNDC-assisted enterprises. The main capital assets consist, therefore, of production equipment.

The latter falls into two main categories, that relating to the production of cut goods from the fabric and that relating to the sewing up of the cut goods into garments. To this might be added button hole machines and special items for adding trim, such as buttons, zips etc.[27/]

There have been advances in **cutting technology** in recent years, notably the introduction of computer control to assist in laying out the fabric. This can result in substantial economies in material usage, both by improving the laying out process in general terms and avoiding mistakes in actual cutting operations. None of the factories visited had such facilities and it seems to be felt that, given the limited range of items produced in Lesotho, the savings secured would not justify the additional capital expenditure. All the factories visited claimed to have equipped their plant with new cutters on establishing their operations and to replace them when necessary. In all the factories visited cutting facilities were more than adequate to keep up with the capacity of the sewing lines. The companies tended to be rather vague on the subject of capacity utilization, but it was generally reported to be reasonably utilized.

27/ In the case of denim apparel, there is also a requirement for laundry equipment to add the right finish to the made-up garment and to ensure an even colour. In Lesotho no factories - South African or Far Eastern - systematically launder garments made from lighter fabrics: those which become unacceptably dirty in the course of cutting and making up are washed by hand. None of the South African companies we interviewed had a laundry.

Table II.4. Cutting capacity of South African oriented garment-makers, 1995

Company	Units/day
Lesotho Clothing	3,100 (shorts) or 600 (jackets)
Maseru Clothing	4,000 (shorts/jeans)
Lesotho Textiles	1,800-2,000 (trousers/shorts)

Source: Company interviews.

With regard to the **making up processes**, there have been no significant technological developments since the development of the sewing machine in the nineteenth century. (This is why garment-making remains a labour-intensive industry in every country in the world and why low-cost labour countries, such as Lesotho, retain a substantial comparative advantage over the advanced economies as locations for this industry.)

Two of the factories visited had been equipped with new machines on commissioning and these were replaced as necessary. It is understood that a well-maintained sewing machine can last for up to twenty years.

Lesotho Textiles stated that some of its equipment had been transferred from a plant formerly operated by the group in Cape Town, but the rest were new. It is understood that the company now leases its machines rather than purchasing them outright. Why the company should prefer to incur higher operating costs than to purchase its equipment outright - thereby, of course, tying up capital - is uncertain, but it suggests a cash-flow problem. This accords with other reports of the difficulties faced by all Lesotho producers in the present commercial environment.

All the factories had specialized equipment for button holing and adding trim and claimed this was "state of the art". However, this probably has only limited relevance to the economics of their operations.

Table II.5. Sewing machines operated by South African oriented garment-makers, 1995 (Units)

Lesotho Clothing	400
Maseru Clothing	206
Lesotho Textiles	120

Source: Company interviews.

b.5 Employment

Lesotho Clothing and Lesotho Textiles stated that their work-forces were 400 and 214 respectively, slightly down on the numbers reported to the LNDC as being employed in 1993 - see Table II.3 above. Of the 400 employed by Lesotho Clothing, 206 were said to be machinists. Maseru Clothing claimed to be employing 475, nearly 100 more than they reported to LNDC. Of these 270 were said to be machinists. The company employed 13 expatriate staff altogether, six of them at supervisory level.

Lesotho Clothing's plant in Maputsoe was at one time operated by a Filipino company under contract. The circumstances why it abandoned this arrangement were not made clear, but there was an implication that one factor may have been the pressure exerted by the GoL through the LNDC to recruit more local staff. Lesotho Clothing admitted that many of the problems which the company now endures result from the inadequacy of its existing management.

b.6 Fabric sources

All three companies interviewed purchased fabrics from a wide range of sources in the Far East, India and southern and eastern Africa (Mauritius, Botswana and Zimbabwe). However, the RSA still seems to be the main source.

To the extent that the groups to which Lesotho Textiles and Lesotho Clothing belong both do a high proportion of their work under CMT contracts,[28/] they have no choice over their fabric sourcing. The importance of South African sources reflects the fact that, because a significant proportion of their sales are made in the republic, they cannot take advantage of the Lesotho in-bond incentive to import non-SACU originating fabrics duty-free. It seemed to be assumed that the RSA would have to lower its present very high levels of duty on fabric imports (see Chapter 7.3 below) and that, as a result, they would use less South African materials in the future.

b.7 Products

All three South African companies interviewed concentrated on the production of trousers and shorts for the low value end of the market. These were the only items produced by Lesotho Textiles - thus confirming the information in Table II.3. Maseru Clothing and Lesotho Clothing also produced padded jackets and woven sports shirts, but in relatively small quantities - although the production of these requires much more labour input. Output in 1994 was said to be as follows:

Maseru Clothing -	Trousers	535,000 pieces
	Shorts	477,000 pieces
	Jackets	47,000 pieces
	Shirts (woven)	25,000 pieces
Lesotho Clothing -	Shorts	400,000 pieces
	Trousers	30,000 pieces
	Shirts	30,000 pieces
	Jackets	50,000 pieces
Lesotho Textiles -	Trousers/shorts	250,000 pieces

b.8 Main markets

The three companies interviewed claimed that their main purpose in establishing production facilities in Lesotho was to avoid sanctions or possible sanctions on their exports to the USA and the EU. However, by early 1995, both Lesotho Textiles and Lesotho Clothing had abandoned their export trade and sold only to South African customers. In both cases they claimed that they found overseas markets too difficult to service. Lesotho Clothing once sold items of clothing aimed at

28/ CMT - Cut-make-and-trim. This refers to a type of contract whereby the customer supplies the garment-maker who makes up garments according to the customer's specifications using fabrics and trimmings supplied by the customer. The customer remains the owner of the garments and is responsible for marketing and distributing them. The advantage of this system for the producer is that he does not have to finance the purchase of the fabrics - usually the largest single item in clothing production costs - nor the marketing of the product. The disadvantage is that he receives only a small share of the total selling price.

the US "surfing" market under the 'Instinct' label of the Durban-based group to which it belonged, but the collapse of US consumer demand in 1991-1992 had destroyed the market for such leisure goods. Lesotho Textiles had abandoned its market in Germany for much the same reason.

Both companies take in a high proportion of CMT work from large customers in the RSA. In the case of Lesotho Textiles this accounts for 50 per cent of its total business, and in the case of Lesotho Clothing 75 per cent. In the latter instance, this seems to have been adopted in 1994 as a strategy of desperation necessitated by the company's deteriorating commercial situation which rendered it unable to undertake the financial costs of more profitable forms of operation.[29/] It is understood that CMT customers of both companies in the RSA exported outside the SACU area.

Maseru Clothing still exported 70 per cent of its total output outside SACU, but had shifted the emphasis of its trade from the USA to the EU. According to official data, this company received a major allocation of the EU trouser derogation quota, but only small proportion of the US trouser quota.[30/] Available information does not suggest that the company was ever a substantial exporter of trousers to the USA.

b.9 Financial performance

None of the companies interviewed were willing/able to give meaningful information about its financial performance. Lesotho Clothing admitted to having very serious problems which it attributed to internal management weaknesses - perhaps related to the termination of its Filipino contract (see Chapter 4.3). Its turnover in 1994 was R.10 million as opposed to R.22 million before it converted itself to a mainly CMT, South African-oriented operation. Lesotho Textile's turnover in 1994 was around R.600,000 and its profit 14 per cent. Maseru Clothing did not make available any financial information, but claimed that there had been no increase in international prices for three years while its costs had continued to increase. It was implied that the Lesotho operation made only a marginal contribution to group profits.

C. FAR EASTERN ORIGINATING INVESTMENT

a. Reasons for investing in Lesotho

Since the mid-1960s, garment producers in the established apparel exporting countries in the Far East - notably Hong Kong, Taiwan Province and the Republic of Korea, but also, to a lesser extent, Japan -have established off-shore manufacturing units. They have done this for two main reasons:

- The main importing countries (the USA, the EU member-states and Canada) have imposed physical quotas on exports of more and more categories of garments originating in their home countries under bilateral agreements under the Multifibre Arrangement (MFA) and preceding textile trading regimes.[31/] Their main purpose in moving off-shore was to by-pass such restraints.

29/ i.e. Where a company has to purchase its own fabrics and undertake marketing costs, it has to be able to carry these for at least six months before they can be recovered from the sales turnover.

30/ For a detailed discussion of Lesotho's EU and US export quotas for clothing, see Chapter 6.2 and Appendices II and III.

31/ See Appendix I for a detailed discussion of the international textile and garment trade regime.

- In addition, in recent years the economic success of such garment-supplying countries as Hong Kong, Taiwan Province and the Republic of Korea has brought about rapid increases in wage levels which makes it increasingly difficult for them to produce clothing for the high volume/low value end of the international market - especially in competition with the new industry in China. Possession of production capacity in countries with lower labour costs enables them to undertake orders which it would not be economic to fill in their domestic mills.[32]

It should be noted that some at least of the companies owned by Far Eastern groups (notably the Taiwanese) had originally been located in the RSA, in particular in the bantustans. The low cost of labour in these regions and its relative docility, the extremely generous investment incentives offered by the old Nationalist government and the RSA's excellent internal infrastructure and shipping facilities may in themselves be sufficient explanation for the presence of Chinese companies in these exotic locations. However, it is also possible to speculate that Taiwanese companies may have been drawn to the republic because of the uncertain diplomatic relations between most black African states and their mother-country. Whatever the explanation, they were forced to leave by the US investment and trade sanctions and Lesotho proved a satisfactory alternative - so much so that in the later 1980s and early 1990s they were prepared to urge other Taiwanese and Hong Kong Chinese groups to join them.

Invariably, as soon as LDCs in which Far Eastern producers establish manufacturing facilities themselves begin to ship garments in substantial volumes, they too are obliged to accept quotas on their trade in garments with major markets. This happened in the case of Lesotho in 1992 when the USA and Canada both imposed bilateral agreements under the MFA. As already suggested, this seems to have had a very serious impact on their operations in the kingdom - see Chapter 3.C above, but this outcome was not predictable.

Hong Kong and Chinese garment-makers have learned to live with this risk which, until quite recently at least, has in any case been ameliorated by the operation of the international textile trade regime. The MFA does not, for instance, allow the quotas imposed in bilateral agreements to be lower than historical export levels except in the most exceptional circumstances and, indeed, usually provides for annual increases from the initial base which, in the case of least developed economies and other countries which are relatively small suppliers to the country imposing the quota must be higher than those allowed the more established suppliers - see Appendix I. Furthermore, in allocating their national export quotas between individual suppliers within their boundaries, most governments ensure that the shares of established traders are proportionate to their historical export performance.

In general terms, even after quotas are imposed, Taiwanese and Hong Kong garment-makers still find their off-shore investments beneficial while the host-countries continue to benefit from the capital and expertise these organizations bring in terms of employment created and foreign exchange generated. That the US imposition of quotas on exports from Lesotho seems to have had a more serious impact on garment production in that country can be largely attributed to international market conditions in the early 1990s and the mishandling of the quota allocation. Neither of these factors could have been foreseen when the original investments were made.

b. Review of companies in Lesotho

b.1 The function of Lesotho-based enterprises in the wider corporate context

Most of the Far Eastern companies are production-centres only, filling orders passed to them by their overseas head offices which also supply the design-specifications and fabrics. The main

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32/ See EIU Special Report No. 2028, 1990, pp. 101-105 (Hong Kong clothing - waiting for China: by P.J. B. Steele) for a more detailed discussion of this matter.

exception to this rule is CGM Garments. In the case of that company, the Thetsane office carries out all marketing and fabric sourcing operations while payments are made into its local account with the Hong Kong office acting only as an agent.

In the case of Lesotho Hawk, although the company is only a production-centre, 50 per cent of group profits is returned to the Lesotho operation for distribution to the staff. (The factory in Maseru is the only manufacturing operation in the group which no doubt facilitates this process.) Lesotho Hawk is also negotiating to open a Letter of Credit so that it can undertake its own sourcing operations, but it claimed that interest rates were too high to make this a practical proposition - even under the Export Finance Scheme.

b.2 The manufacturing operations carried out in Lesotho

Like their South African-owned counterparts, the Far Eastern companies in Lesotho are concerned only with cutting, making up and packing dispatching operations. None of th that were interviewed undertook original design work.

b.3 Capital assets

The main categories of capital asset owned by these companies relate to cutting and making-up operations. In addition, those companies which have specialized in the production of denim trousers and shorts also have laundry facilities

b.4 Organization of production

Production was organized on the progressive bundle system. It is understood that this is the common practice in garment-making establishments in East Asian countries.

b.5 Fabric sources

Typically top-weight fabrics are sourced in the Far East. China was the usual source of cotton materials on grounds of cost, although quality was variable. More sophisticated fabrics, mmf and blends, are sourced in Taiwan Province - in the case of C&Y, from the group's own textile mill. Denim, the main bottom-weight fabric, was also sourced in China, but, according to CGM, although this was the cheapest source, the quality was unreliable and Mauritius and Botswana supplied superior material.

Southern Cross had investigated South African sources and, when the Lesotho knitting mill was in operation had considered this as well, but had ultimately rejected them both on grounds of cost. Lesotho Haps is considering knitting top-weight fabrics in Maputsoe, but has made no decision on whether to undertake the necessary investment.

b.6 Products

All the companies interviewed in the course of the field-research came to Lesotho to manufacture T-shirts and/or jeans and shorts for the US market. With the introduction of quotas on these products under the USA/Lesotho textile trade agreement of 1992 most of them were compelled to diversify their product range and/or their markets - see below. Dresses, flannel shirts (a heavy, woven cotton product, popular in the USA) and tracksuits were among the alternative products being produced (Table II.6.)

Companies would prefer to be able to concentrate on the production of standard knitted tops and denim jeans and shorts. This reflects the difficulties experienced in getting the workforces to adapt in order to produce a wider variety of products and the loss of efficiency that occurred each time a new line was introduced.

Table II.6 below indicates the information about export volumes to major markets. These data should be compared with that on shipments given in Tables II.12 and II.14 below.

b.7 Main markets

Sales by main markets in 1994 are indicated in Table II.6 which shows the overwhelming importance of US outlets. Only CGM can be regarded as properly established in the EU. Other companies which are now attempting to develop EU markets to compensate for the restrictions imposed by the USA referred to the relatively small size of orders and the demanding nature of the buyers. These are understood to be complaints in common currency among Far Eastern garment-makers and are one of the reasons why these usually prefer to operate in the US market other things being equal.

There was no suggestion that the demand for jeans and knitted tops had been greatly undermined by the US recession and the devaluation of the dollar in the early 1990s.[33] Here the experience of the industry in Lesotho appears to accord with that of other suppliers which has been that the demand for these low value/mass market items is the last to be affected by such factors. However, a number of the Far Eastern companies in Lesotho reported losing business to South African suppliers. They were not certain whether this was a result of commercial factors or was an effect of the quotas imposed on Lesotho.

None of the companies had been tempted to diversify into the South African market. Even more than in European countries, the relatively small size of the orders compared to those forthcoming from the USA was a disincentive.

b.8 Financial performance

The companies interviewed were either unwilling to discuss their financial performance or were unable to because financial control was exercised by the headquarters in the Far East and the Lesotho establishments were not expected to act as profit-centres. The main exception to this rule was CGM Garments which pronounced itself profitable despite the increasing expense of operating in Lesotho and the many unpredictable costs that had to be born. There were general complaints that, although the international market prices for garments had not risen for three years, costs, had continued to rise.

It is understood that since it was interviewed by the UNIDO team in late-January, 1995, Southern Cross has ceased trading. The reason for this is not at all clear as this company had succeeded in getting by far the largest single allocations of the US shirt quota - see Table II.12. - and it shipped more than its original allocation. On the other hand, its actual shipments in quota-year 1994 were below those which it achieved in 1992 as were those of trousers. It was suggested by a Lesotho government source that the company may have become over-exposed as a result of its borrowings under the Export Finance Scheme. This was not confirmed by the company when interviewed and, while it may have been a factor, it seems likely that the decision would have been taken by the owners in Taiwan Province largely on the basis of their understanding of their future prospects in the US market.

33/ In relation to other major currencies, not the rand.

Table II.6. Sales by Far Eastern garment-makers by destination. 1994
(Thousand dozen items)

Company	Product	Market United States	European Union	Canada
Lesotho Hawk	Knit shirts - cotton[a/]	160	-	-
	Knit shirts - mmf[b/]	6	-	-
	Tracksuits[c/]	)	-	-
	Dresses[c/]	)	61	-
	T-shirts[c/]	)	-	
Lesotho Hinebo	Knit shirts[a/b/]	121.5	-	-
	Shorts[c/]	14.3	-	-
C&Y	Jeans/shorts[c/]	200	30	40
	Jackets and skirts	3.3	-	
Southern Cross	Knit shirts[a/b/]	)		
	Shorts[c/]	)		
	Dresses[c/]	)		..
	Flannel shirts[c/]	)		
	Men's underwear[c/]	)		
CGM	Jeans[b/]	240	25	..
Lesotho Haps	Knit shirts[a/]	240	-	-
	Jeans[b/]	20	-	-

Source: Company interviews.

a/ Under quota in the USA - item 338B/339B/638B/639B.
b Under quota in the USA - item 347/348.
c Not under quota in the USA.

4.4 SMALL-SCALE PRODUCERS

A. GENERAL

The last detailed study of small-scale textile and clothing producers in Lesotho was that carried out by GEMINI on behalf USAID in 1990.[34/] Time and cost constraints meant that it was not possible to update the review of these producers in the course of the present project.

B. MAIN CATEGORIES OF SMALL-SCALE PRODUCERS

a. Garment-makers

a.1 Woven clothing producers

The GEMINI project identified 14,552 producers of woven clothing who employed 20,591 persons. (This is sufficiently indicative of the very small size of these operations.)

34/ 'Lesotho small and micro-enterprise strategy': Growth and Equity through Microenterprise Investments and Institutions (GEMINI) Project: Technical Report No. 9, November 1990, *op. cit.*

The core of their business is the production of uniforms, especially for girls' schools. The numbers of such schools and the idiosyncratic nature of their uniform requirements makes it uneconomic for large-scale producers to supply this market. (Boys' uniforms tend to be more homogenous as between schools and a far greater proportion of that market was supplied by industrial-scale producers operating in the RSA.) The production of school uniforms in general could be a thriving manufacturing activity in the informal sector. An in-depth study of this important informal manufacturing activity is undoubtedly required for further expanding this promising segment of the manufacturing sector.

Apart from uniforms, small-scale manufacturers also produce women's dresses both on a ready-to-wear and bespoke basis. These items have to compete with cheap dresses coming from the RSA and secondhand garments imported by the ecclesiastical charities which dominate the lower-cost end of the market and, as a result, small manufacturers in Lesotho are largely confined to responding to the demand for more expensive one-off items.

Many of these manufacturers also produce traditional Basotho dresses. These are mainly for the domestic market, but there is a demand for them in the RSA, particularly in those areas with significant concentrations of Sesotho-speaking populations.

Small-scale woven clothing producers usually purchase their fabrics and other necessaries in the RSA - travelling themselves to the textile-producing districts rather than paying middlemen's markups. However, fabric for the Basotho national dress is imported from the UK.

a.2 Knitters

According to GEMINI, there were around 6,000 producers of knitted garments in 1990. These employed 8,000 people, again indicating the small-scale of the great majority of these operations.

Again the core business of these producers is the supply of jerseys for school uniform. In addition, they supply fashion-wear at the upper end of the market on a ready-to-wear, but, more often, on a one-off basis.

Almost invariably, these producers use mmf yarns sourced in the RSA.

b. Craft item producers

According to GEMINI, most craft items are produced by organizations which are very large indeed by Lesotho SME standards. It was estimated that there were no more than a dozen of these, firms and cooperatives, who between them employed about one thousand full-time workers.[35/] It was also estimated that they supported another thousand part-time employees or outworkers engaged in the processing and spinning of mohair yarn.

These organizations produce hand-knitted garments and woven items such as tapestries, rugs, scarves and shawls. Their output is intended mainly for the export market, although indirect exports - i.e. sales to foreigners in Lesotho to take home with them - are said to be larger than direct.[36/] In-country sales are mainly to tourists, although constant flow of expatriate staff associated with the numerous technical assistance programmes from which Lesotho has benefited must also have provided a substantial domestic market. (There are indications that the scaling down of these programmes is beginning to have a significant effect on sales.)

35/ Helang Basali Crafts claimed to employ around 100 staff.

36/ Helang Basali Crafts, for instance, said that direct export sales accounted for no more than 30 per cent of its total turnover.

The products are luxury items and this may have, to some extent, insulated them against the consequences of the economic recession in the major markets which has seriously affected exports from Lesotho of the more basic clothing categories.

According to GEMINI, the most successful firms are those owned by foreigners. This is said to reflect their easier access to credit and superior marketing which better enables them to align their output to the international market requirements.

C. THE PROBLEMS OF SME TEXTILE PRODUCERS

According to GEMINI, the difficulties of SME producers of **knitted and woven clothing** (other than hand-knitted "craft" sweaters and cardigans) are of the same nature as those which afflict indigenous manufacturers as a whole:

- The low level of business and technical skills;
- Difficulties of access to capital - especially working capital;
- The unreliable supply and high cost of raw materials, and components;
- A business and taxation environment which effectively discriminates against SMEs;
- Lack of market intelligence and marketing experience.

Over and above these specific problems, the small garment manufacturers are in an extremely competitive market situation reflecting the large number of organizations involved. Most of these have no proper awareness of the cost of their operations and tend to set prices at highly uneconomic levels resulting in a high level of failures. However, as noted earlier, these activities are extremely attractive to entrepreneurs - probably because of the low levels of initial capitalization and the possibility of combining the work with house-wife functions (most of those involved are women). According to GEMINI, the number of organizations in this area was exceeded only by those brewing sorghum beer.

The situation of the **craft** producers is somewhat different in that these are much larger organizations, often foreign-owned and financed, professionally-managed and not subject to the same competitive pressures. The main problems reported to the UNIDO mission - in the course of a wholly inadequate survey - were difficulties of coming by mohair yarn and the inadequacies of the telecommunications system which had led at least one of the owner-managers to establish her base in Ladybrand in the Orange Free State.

a. Training

Training is offered by numerous organizations, most of them now supported by GoL (sometimes with technical assistance funding). However, the level of training is said to be fairly basic. There is also a tendency to concentrate on imparting skills more likely to be required by operatives than by potential commercial, technical and managerial staff.

b. Loan finance

Lack of collateral and the low level of business skills also means that most of the enterprises are denied access to loan capital from the banking system. However, there are a number of schemes which address this problem, including the UNDP-funded Small-Scale Industries Project.

This latter is based on a fund of $1.5 million which is used to guarantee loans through the Business Development Unit of the Lesotho Bank on the basis of credit-worthiness criteria specially formulated for SMEs. As recommended in the Agro-Industrial Project for all such schemes, interest is charged at prime rates. It is understood that between 1992 and 1994 out of 272 loan applications totalling R.3.6 million 186 had been approved totalling R.2.6 million and 175 disbursed totalling R.2.2 million, clothing producers being the chief beneficiaries.

One of the chief objects of the scheme is to persuade the commercial banks that SMEs are not necessarily a bad risk and between 1992 and mid-1994 some progress was made in this direction. In 1993 the rate of repayment was 105 per cent of disbursements. However, this record was affected by the political upheavals in the latter part of 1994 after which the rate fell to 50 per cent.

The other object of the scheme was to teach the business community how to become credit-worthy. To this end it is promoted through government agencies such as MTI and BEDCO and, more recently through NGOs, such as Women in Business, which have a close rapport with SMEs. These encourage entrepreneurs to develop business plans which are then submitted to the bank for decision.

Finance has also been made available through the Manufacturers' Assistance Programme operated through the Lesotho Manufacturers' Association. Compared to the funds disbursed under the Small-scale Industries Project, this is a very small operation. Total disbursements in 1994 amounted to no more than R.4,000.

However, the scheme has interesting self-help features in that the revolving fund is financed by R.200 share-capital put in by members of the association and loans are made to those who have been registered members for 6 months, have paid R.250 annual subscription, contributed to the share-capital, keep proper books and can show proof of an order. Again interest is charged at prime. Twelve loans were made in 1994 and the rate of repayment was 70 per cent. It seems likely that the educational value of this scheme is far greater than the amount of funds so far disbursed.

c. Materials and components supply

Except for the hand-spun mohair yarn used by the craft weavers and knitters, all the main materials and components used by the garment producers have to be sourced in the RSA. Because of transport and distribution costs and the small scale of the orders, prices are very much higher than in the republic. The UNIDO mission was informed that polycotton fabric for school uniforms could cost up to 70 per cent more in Lesotho which explains why almost all the standardized items required by boys' schools are supplied by importers leaving local producers only the more heterogenous school girls' market.

The high cost of yarns and fabrics supplied through such companies as Metro leads many producers to prefer to buy their requirements at source in the republic. Attempts by the Lesotho Manufacturers' Association to buy material in bulk on behalf of its members have had only limited success in that it is permitted to finance this only through the self-financed revolving fund.

d. Taxation and business environment

One of the elements in the very high cost of materials and components in Lesotho is that sales tax is charged on these items when imported even though VAT has already been paid in the RSA. The LMA has suggested that relief be given on sales tax in the case of imported consumables by way of an extension of the double-taxation agreement with the republic, but this has yet to be accepted by the Ministry of Finance.

The LMA has also attempted to persuade the GoL to give local manufacturers preference in placing public procurement orders - a 30 per cent price-weighting in contracts was suggested. LMA believed that such a measure would be acceptable under the SACU, but it had so far failed to interest GoL in the scheme.

e. **Market intelligence and marketing**

The small size of most of the garment-making operations makes it very difficult for them to gain an understanding of their domestic market, still less that in the RSA. Export promotion of suitable products is one of the functions of BAPS, but has so far failed to address effectively. The Trade Promotion Unit of the MTI is also unable to offer much assistance, particularly since the project funded through the International Trade Centre came to an end in 1993. Private sector initiatives through the LMA had similarly failed to make much impact through lack of resources.

CHAPTER 5. PERCEPTIONS OF THE INVESTMENT CLIMATE IN LESOTHO

5.1 GENERAL

This chapter is concerned with the advantages and disadvantages of Lesotho as a location for investment in garment manufacturing facilities oriented towards export markets as these were perceived by the managements of mills interviewed by the UNIDO team in the early weeks of 1995.

It is important to bear in mind that these are perceptions, in other words not necessarily always the result of objective analysis. However, this is not to say that, because they may sometimes lack a certain element of intellectual rigour, these views of the situation should be dismissed as of no account. They reflect the opinions of men (and women) intimately involved with the problems of producing clothing for world markets in Lesotho - in so far as they were prepared to discuss them - and as such they would carry weight with their companies when these consider further investment or the continuation of existing enterprises. They would also influence the climate within which other potential investors would consider the country as a location for new projects.

However, the general point should be made that most of the managers were working in a deteriorating market situation largely brought about by the restraints suddenly imposed on them in their principal market in 1992 and the fall-off in business occasioned by economic recession in all major markets. Partly as a result of poor financial circumstances they were also experiencing increasing difficulties with their workforces. There is no doubt that these factors were influencing their subjective assessments of the situation in Lesotho, causing them to down-play or even discount more advantageous factors - for instance, the low cost of labour in Lesotho, and the incentives made available by the government there.

5.2 LESOTHO AS A LOCATION FOR SERVICING MAJOR WORLD MARKETS

A. GENERAL

The lack of physical restrictions over access to the US market was one of two principal reasons given by export-oriented garment-makers for establishing manufacturing enterprises in Lesotho. (The other was the low cost of labour - see below.)

The imposition of quotas by the USA has certainly had a perverse influence on the usefulness of Lesotho as a garment manufacturing base as this is perceived by the Far Eastern investors now located in the country - far more so than the very limited range of products to which the quotas apply might suggest. The removal of US trade sanctions against South Africa has also taken from Lesotho the main advantage it enjoyed over the republic in this respect. It is also important to remember that the lifting of US sanctions was preceded in 1992-1993 by a serious downturn in the US market for clothing which affected sales of other products not under quota - most notably, perhaps, the surfingwear marketed by Lesotho Clothing - and made it more difficult for the manufacturers of the categories under quota to develop markets for other lines.

The absence of quotas on Lesotho products in the EU market and the success of the GoL in winning duty-free access for the main textile products the industry has supplied that market - albeit for a limited period - has by no means compensated for cutbacks sustained in US sales in the eyes of most companies. The main European economies also suffered the consequences of the world-wide recession.

B. LABOUR EFFICIENCY

a. Wage rates

That a country has relatively low wage levels particularly recommends it to organizations looking for off-shore locations for export-oriented apparel investment projects. This reflects the labour-intensive nature of the industry - particularly in the making up (sewing) stages of the manufacturing process which have proved remarkably resistant to technological change. Labour is almost invariably a major element in the overall cost structure - coming second only to the purchase of fabrics. It is this that gives LDCs their main comparative advantage over developed economies in the manufacture of clothing.[37/]

Producers in Lesotho seem to consider that relatively low wage levels were the single most important comparative advantage the country enjoyed as a supplier of apparel.[38/] However, this was in comparison with the RSA. Not surprisingly, therefore, this consideration was more important to companies interested in the South African market - i.e. those established by South African investment - than it was to those from the Far East. For the latter, the possibility of unrestricted access to the US market had been the main reason for coming to Lesotho rather than mainland China - where wage-levels were still very much lower than in Lesotho[39/] - or other low-cost Asian locations, most of which have attracted a very wide range of quota restrictions in the US market. However, even for these companies, relatively low wage levels were still a factor giving Lesotho an advantage over the RSA as an investment location - even though the RSA was no longer subject to trade sanctions.

The South African companies's appreciation of Lesotho's advantage in terms of basic wage costs was, however, tempered by an awareness that, whereas these were very much higher in the republic in general terms, actual levels could vary quite widely in different areas of the country. Whereas the actual wages of skilled machinists might be twice as high in the traditional clothing

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37/ It is important to note that the same considerations do not apply in the manufacture of textile products. Here all stages of processing from fibre preparation through spinning, weaving/knitting to fabric finishing have proved very susceptible to improvements in technology which considerably reduce the labour element in total production costs. It is not without significance that Germany is the largest supplier of world markets for fabrics, exceeding China which is increasingly affected by the technological backwardness of its industry.

38/ During the UNIDO mission to Lesotho it was found that average wages ranged between R.400-450/month. (Rates were invariably quoted in Rand.) The legal minimum wage for a sewing machine operator was M.307.97 for a trained sewing machine operator and M.293.69 for a trainee. The basic wage for a trained operator in the RSA was said to be around R.400/month, but it seems likely that most receive far more than this. It seems generally agreed that the differential between Basotho and South African minimum wages is reflected in that between those actually paid.

39/ According to Lesotho Haps, wages in China are only 25-35 per cent of those in Lesotho.

centres around Durban[40] and Cape Town and the actual costs of employing labour three times as high, the differential was very much less marked in less developed areas - especially the former "Homelands". (For instance, it is understood that wages being paid in clothing enterprises in the area around Ladybrand in the Orange Free State were comparable with those across the border in Maseru.)

There was also a general impression that wages in Lesotho were under considerable upward pressure, partly as a consequence of Minimum Wage legislation in the kingdom, partly as a result of labour agitation. In reality, the Minimum Wage legislation does not seem to have been a major factor in increasing wage costs in recent years.[41] The latest available objective evidence of wage-levels in Lesotho does not suggest that there were substantial increases in the average levels in 1994. However, the costs of employing labour - overheads rather than actual pay packets - have probably increased as a result of new obligations imposed on employers by the Labour Code of 1993.

b. Labour productivity

b.1 International comparisons

Producers are, of course, keenly aware of the distinction between wage rates as such and actual labour costs in production which take into account labour productivity.

Most companies interviewed were of the opinion that Basotho workforces could be trained to operate at levels of productivity which were reasonably high by international standards. Far Eastern employers spoke of achieving levels of efficiency fairly close to those prevailing in factories in the Special Enterprise Zones of China proper (80 per cent) and even in Hong Kong.[42] Given the general attitude of Chinese garment-makers towards foreign work-forces in other African countries and the Caribbean,[43] it is likely that those in Lesotho were not so much dismayed that their own employees were less efficient than those in the Far East, but agreeably surprised that they were not that much less efficient.

40/ According to Maseru Clothing, the wages of a machinist might average around R.100/week in Maputsoe while in Durban they would be R.180.

41/ According to the Labour Commissioner, the last substantial hike in minimum wages occurred as long ago as 1990.

42/ The most precise comparison was given by CGM which claimed that it took 1,700 employees in their mill in Thetsane to produce the same volume of items as it took 1,200 to produce in Hong Kong - i.e. the Thetsane work force was 71 per cent as efficient as that in Hong Kong. On the other hand, one of the South African companies claimed that a line of 38 workers could produce 1,400/day in Durban whereas in Maputsoe a line of 59 could only produce 900/day. In other words, output per man-day in Durban was rather more than twice that in Maputsoe.

43/ There is a persistent prejudice amongst Chinese managers - especially those without specific experience - that non-Chinese workforces in apparel industries can never achieve the manual dexterity or be motivated to work as hard and as productively as their Chinese equivalents. This seems to apply particularly to African and Afro-Caribbean workers. In these cases an apparently instinctive distaste for what are perceived as the distinctive physiognomical characteristics of black people is often reinforced by one-sided reports of the bad experiences of some Chinese managements in countries such as Jamaica and Nigeria. However, this generalised prejudice is usually modified by direct experience.

South African employers were of the opinion that workforces in Lesotho were less productive than those in the traditional clothing centres around Durban and Cape Town, but more so than those in other parts of the country.[44] How far these opinions were based on objective analyses is unclear.

In fact, there seemed to be general agreement that given that most of the Basotho workforces were composed of first generation employees with no culture of industrial discipline and that most contained a large proportion of relatively inexperienced workers and even trainees, efficiency could be brought to quite creditable levels. (On the other hand, the corollary of this would seem to be that, other things being equal, as they gained experience, workforces outside the traditional clothing centres in the republic where wage levels were comparable with those in Lesotho, could become as productive as those in the kingdom.)

However, it is important to note that, while Basotho workers could be reasonably efficient, it was generally agreed they were not adaptable. When they were asked to produce categories of clothing with which they were unfamiliar, productivity fell off alarmingly in a way that did not happen with Far Eastern workforces or those in Durban/Cape Town. (This seems to be a factor in the difficulty experienced by of the Lesotho garment-makers in adapting to the production of other than basic items such as trousers and knitted shirts for the US market or any items for the EU markets.) Furthermore, this phenomenon is not attributed to mere inexperience, but to a stubborn refusal to learn to carry out operations to which they were unaccustomed.

b.2 Workforce attitudes

It was generally acknowledged that industrial indiscipline was currently far more rife in South Africa than in Lesotho. The managements of South African companies still seemed to find this an important comparative advantage enjoyed by the kingdom as a location for garment-making.

An immediate cause of the discontent reported by managements in many of the mills visited seems to have been a perception on the part of the workforces that terms and conditions of employment were inadequate. Such a sense might be exacerbated by the high cost of living in Maseru and Maputsoe, which approaches South African levels, together with an awareness that their wages are lower than those being paid for doing comparable work in industrial centres in the republic such as Johannesburg, Durban and Cape Town - a fact with which they are likely to be quite familiar. It is also commonly believed that managers have dismissed trainees before the completion of their apprenticeships and skilled workers before they qualified for severance pay, not for the given reasons of incompetence or malpractice, but as deliberate cost-cutting policy.[45]

The official record of labour disputes might suggest that the garment-makers' perceptions of their difficulties are exaggerated. Table II.7 below indicates that in the period covered only in 1993 was there a significant number of industrial stoppages - a time in which the ordinary causes of disputes are likely to have been aggravated by political turmoil - and it would seem that the hours lost per man involved in that year were very small. (In that respect the stoppages in 1991 were far more

44/ As in the case of the managers of the Chinese-owned companies, there is undoubtedly an element of racial prejudice here. There is a perception that producers with African work forces - in South Africa or in Lesotho - cannot expect to achieve the levels of efficiency achieved by the work forces of the traditional centres of clothing activity in the republic which employ a high proportion of workers of Indian ethnic origin. On one occasion this comparison was made in explicit terms.

45/ The UNIDO mission was told of practices of this nature by senior government officers who obviously felt that they were often justified.

serious.) However, it is acknowledged that these data do not record the loss of production caused by labour unrest that never became formal strikes.[46]

Table II.7. Industrial unrest in Lesotho, 1990-1994

	Strikes	Workers involved	Man-hours lost
1990	14	2,098	6,504
1991	9	2,374	83,551
1992	7	1,082	12,389
1993	38	6,440	61,240
1994	6	2,773	10,380

Source: Official sources.

In interviews the managements of the Far Eastern companies complained more of industrial unrest and the often boisterous indiscipline that can accompany it than their South African counterparts. This could reflect a greater cultural remoteness of managements from their workforces. Many of the senior managers interviewed were not entirely fluent in English. This factor could also be exacerbated by the fact that many of the supervisors in the Far Eastern companies who work most intimately with the line-operatives were of Chinese or other Asian origin who are perceived as more foreign than whites or Indians - especially if their command of English is poor. Far Eastern managements seemed to expect the authorities to play a more decided role in suppressing turbulent manifestations of workers' discontent than is the custom Lesotho - just as they would in Taiwan Province or China.[47]

The Labour Code introduced in 1993 represented an attempt to civilize relationships between managements and workforces by introducing formal channels of communication and arbitration between the two. However, the need to train staff meant that the Code did not become operational in this respect until the closing months of 1994 and it has still to be shown that it can be effective. A violent dispute erupted in at least one garment factory during the period of UNIDO field-research in Lesotho.

b.3 Incentives

The majority of managements interviewed claimed to pay their workforces above the basic minimum wages ordained by the government. This might indeed be in response to workforce pressure, but it also suggests an awareness that wage levels are indeed inadequate.

46/ It is also noted that a dispute in 1989 in a second factory run by Lesotho Textiles at that time was sufficiently serious to cause the group to close down that establishment permanently. (On the other hand, we do not know how far the occasion of the strike was seized upon as an excuse to get rid of capacity that had become a financial embarrassment for other reasons.)

47/ However, there was an awareness on the part of the Exporters's Association that this would not happen and that it was up to the companies to take things as they were and do their best to come to terms with their people.

Incentive schemes to encourage productivity were in place in a number of factories. In most cases, these did not seem to have the desired effect. Far Eastern managements sometimes regretted that they were not able to introduce piece-rate wage schemes, such as they found efficacious in Hong Kong and Taiwan Province. In fact, so far as could be discovered, there was no government regulation specifically forbidding this as long as all workers received the basic minimum wages. There may have been trade union opposition to the notion of piece-work in some cases, but the main obstacle to such schemes would seem to be the poor financial situation of many of the companies.

By its own account at least, the company that has most successfully addressed the problem of labour relations is Lesotho Hawk. The key-element here appears to be the productive relationship of the Chinese Managing Director and the Masotho works manager which could not, of course, be reproduced to order. However, it is also understood that the management in Taiwan Province has been persuaded to remit to Lesotho half the profits of the group operation - a process no doubt facilitated by the fact that the Maseru plant is its sole manufacturing unit - and workers are allowed to purchase shares in the company which (so the management asserted) gives them a very real interest in its success.[48/]

5.3 AN APPRAISAL OF GOVERNMENT POLICY AND ADMINISTRATION

A. INVESTMENT AND EXPORT INCENTIVES

The managements of Lesotho companies interviewed had frequently to be reminded of the incentives made available by the GoL. In other words these were not immediately perceived as giving the kingdom any particular advantage as an investment location. It was also felt that the Government of South Africa was more generous in this respect.

One reason for the lack of enthusiasm shown may be that financial control is not exercised in Lesotho, but in companies's headquarters in the republic or Taiwan Province. Managers, therefore, do not seem to be always fully aware of the significance of particular measures.

The **in-bond scheme** allowing the duty-free import of fabrics and other materials for export goods was generally appreciated as was the 75 per cent **training grant**. However, managers were not generally inclined to cite the 15 per cent level of company income tax as a particular advantage - although they would acknowledge that it compared very favourably with South African levels. Most of them had willingly transferred from the old tax-holiday incentive.

The view of the **Export Finance Scheme** was often affected by the fact that companies working on a CMT basis claimed not to use it. There were also complaints that the rate of interest was too high - the rate is set at prime. Companies also complained about the bureaucratic nature of the proceedings governing access to the fund, but did not encounter this ourselves. It was suggested that over-borrowing had been instrumental in causing both Morija Textiles and Southern Cross to cease trading and underlay the problems being experienced by Lesotho Clothing. It was not possible to confirm this from information from the companies themselves. (Indeed, Southern Cross reported that it did not use the scheme.)

Long-term loans at a fixed rate of interest 1 per cent below prime did not seem to be considered as an incentive for investment. Lesotho Hawk indicated that it was currently paying 18-19 per cent

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48/ Lesotho Hawk gave the UNIDO mission no information about its financial performance. It is possible that its sanguine comments on its activities and prospects might not have been unconnected with a desire to influence GoL in its search for lower rates of interest on short- and long-term loans. Nevertheless, it seems undeniable that the company's labour relations are better than most.

on its loans. It suggested that it would have to be able to secure capital at 10 per cent payable over five years if it was to proceed with its factory expansion plans.

B. THE FINANCIAL RAND

As Lesotho is a member of the Common Monetary Area (CMA), investors have in the past benefitted under the Financial Rand Mechanism which allowed for the purchase of rands for fixed capital investment to be carried out at a discounted rate against the prevailing market exchange rate (the "Commercial Rand"). Clothing manufacturers which have been able to raise capital in this way are indicated in Table II.8 below. The differential between the Financial Rand and the Commercial Rand tended to narrow once sanctions against the RSA were lifted and the advantages of using the mechanism declined correspondingly. The Financial Rand was in fact abolished in March 1995.

None of the companies involved made any reference to their Financial Rand transactions or in any way suggested that this facility added to Lesotho's attractions as an investment location. The bureaucratic procedures involved in using the mechanism are said to have been an increasing deterrent.

Table II.8. Financial Rand applications by Lesotho clothing producers approved by the South African Reserve Bank, 1991-1994

Year	Applicant	Thousand rand
1991	Lesotho Apparel	617.2
	TransAfrica Textiles	902.7
	C&Y Garments	259.1
	Basotho Jeans	349.3
	Royal Eagle Textiles	227.3
	Crayon Garments	977.7
	Southern Cross	385.0
	Super Knitting	867.6
1992	Crayon Garments	904.8
	Royal Eagle Textiles	13,997.4
1993	TransAfrica Textiles	920.6
	Lesotho Hawk	430.4
1994	C&Y Garments	120.7

Source: Official sources.

C. PUBLIC UTILITIES

There were general complaints about the so-called 'WET' factor - water, electricity and telephones. These complaints related both to the poor service, which, it was said, frequently disrupted production and the high cost - especially in comparison to South Africa. This was frequently cited as a major factor off-setting the relatively low wage costs in Lesotho. As far as could be determined given the limitations of the data made available, utilities rarely accounted for more than 15 per cent in total manufacturing costs, but the hidden costs of irregular supply in terms of lost and delayed production must be considerable.

D. GOVERNMENT ADMINISTRATION

a. General

Apart from the government's perceived laxity in dealing with outbreaks of industrial unrest, there were three areas of public administration which seemed to give particular concern to garment manufacturers in Lesotho. These related to:

- The issuing of work permits for non-national members of staff;
- The administration of the US export quotas; and
- The granting of public holidays.

b. Work permits

The cautious response of the Department of Labour to requests for work permits for foreign members of staff, especially at the more junior management levels, reflects its awareness of the magnitude of unemployment in Lesotho and the resentment caused by the presence of large numbers of foreigners doing work which it is felt could be carried out by locals if only companies would undertake to train them.

It is claimed that the Far Eastern companies in particular were bringing in staff to work at supervisory levels who had no specific qualifications for the jobs they were ostensibly to perform. This appeared to be related to the suspicion that the main purpose of the company managements was to introduce relatives or other clients for the purpose of establishing businesses in the retail and catering sectors which would compete with local enterprises.

Industry sources countered these accusations by asserting that they would not undertake the considerable additional cost of importing staff if indeed they could fill the positions with nationals.[19] However, suitable persons were not readily available in Lesotho. The point was often made that local training schemes were not designed to produce potential managers. Managements also argued that, while their expatriate appointees might lack formal qualifications, they were usually highly experienced and in the garment industry at supervisory level experience was all.

There were general complaints about the failure of the Department of Labour to publish objective criteria on which they considered applications for permits. It was implied that this lack of transparency made for corruption, although no specific instances of this were cited. It was also felt that the Department took far too long in dealing with requests.

c. Administration of US export quotas

The allocation of the US quotas on exports of knitted shirts and trousers among the Lesotho manufacturers was a fruitful cause of discontent. (The less desirable Canadian quotas on the same products and EU derogation quotas raised nothing like the same degree of passion. Indeed, the government has not felt it necessary to introduce any system for allocating the Canadian quota.

19/ There is some validity in this argument. In Mauritius Chinese-owned companies preferred to use local managers who were found far more effective than Chinese expatriates in getting the best out of the workforce. One of the largest of these companies, Afasia, was entirely local from a very early stage in its operations.

and export certificates are simply issued by the Trade Promotion Unit in the Ministry of Trade and Industry on a first-come-first-served basis.)[50]

Allocations of Lesotho's US export quotas are determined not on the basis of historical performance as in most countries where these are in force, but according to a complex system which weights each applicant on the basis of its employment, the volume of its exports and their value[51] with by far the greatest emphasis being placed on employment. (The Department of Labour believed that this had the effect of causing those seeking quota to inflate their reported employment.)

The operation of system had resulted in reduced export opportunities for those companies which prior to 1992 had been prominent in developing US trade in the quota products - because their allocations of the national quotas were below their historical export levels - and had given valuable quota to those without adequate experience of the market. This outcome had roused suspicions that the allocation process was subject to political influence.

The Ministry of Trade and Industry had indeed shown itself willing to reallocate unused quota to the more successful exporters during the course of the year, but the inadequacy of its monitoring systems meant that it did not become aware quickly enough when companies were under-utilizing their quota. In any case it had no powers to encourage or compel companies which did not use their initial allocation to surrender the unused portion in good time to allow those which needed it to accept orders and plan their production programmes. One result of this was that the trouser quota tended not to be fully used.

d. Public holidays

Companies criticized the number of regular public holidays each year which added considerably to production costs. However, they found the government's habit of announcing new ones on an *ad hoc* basis, usually at very short notice, more than usually disruptive and costly.

E. POLITICAL UNREST

The industry found the political turmoil that occurred in 1993 and 1994 particularly disruptive. It seems to have seriously undermined its confidence in Lesotho as a secure base from which to carry on its business. Nevertheless, it seems to be tacitly acknowledged that the situation in this respect is far less disturbing than that prevailing in the RSA and that there have been considerable improvements since the installation of a democratically-elected government.

50/ So relaxed was the TPU (and, presumably, Canadian Customs) that when the UNIDO mission was in Lesotho it had still to develop new documentation for certifying export shipments to Canada and was using those which had been designed for administering shipments under the Generalized System of Preferences (GSP).

51/ See Appendix II for an explanation of the system.

CHAPTER 6. EXPORTS OF TEXTILE PRODUCTS

6.1 EXPORT PERFORMANCE

According to Lesotho Customs data indicated in Table II.9, there are three main categories of textile product exports, textile fibres, textile yarn, fabric etc and apparel and clothing.

Of these, **apparel and clothing** is by far the most important. It is, in fact, the largest single component in the country's overall export trade. Exports increased in absolute terms each year between 1988 and 1992, although there was a slight decline in their relative importance in the latter year.

Trousers are shown to be the most important item. This accords with the pattern of Lesotho's export trade in clothing developed from discussions with trade sources. However, while shirts were the largest item in 1991 - also supported by information from trade sources - it is not possible to identify what these were in other years. The size of babywear shipments in 1992 is surprising, but is reflected in US import data - see Table II.10.

Exports of **textile fibres** varied quite considerably in value from year to year over the period covered by the table. This reflects the normal behaviour of a commodity market. Although full data are not available, it is understood that shipments of wool are usually larger than those of mohair, but not invariably so.

Although the items comprehended in the **textile yarn, fabric etc** category differ from year to year, it would appear that specialized fabrics and yarns are the most important, despite the value of exports varying from year to year. As might be expected given that these are, for the most part, luxury items, shipments seem to have fallen off in 1991 and 1992 with the onset of the world recession.

6.2 EXPORT DESTINATIONS

A. GENERAL

It is not possible to determine the main destinations of export shipments from the Lesotho trade statistics. However, subjective evidence from trade sources suggested that the main outlets were the RSA, the USA, the EU and Canada.

B. THE RSA

a. Trade relations with Lesotho

The RSA and Lesotho are both members of SACU. This means that producers in both countries have duty-free access to other's market. In addition, there are no quantitative restrictions on cross-border trade. There is a double-tax agreement which means that companies which pay company income tax on their earnings in one country need not pay it in the other. (Given that the level of corporate income tax is 15 per cent in Lesotho and 40 per cent in the RSA, this constitutes a considerable incentive for South African companies to manufacture garments in Lesotho for their home market.)

Table II.9. Exports of textile products by Lesotho, 1988-1992
(Thousand M.)

Product	SITC[a/] heading	Period 1988	1989	1990	1991	1992
Textile fibres	2	23,608	31,614	17,629	9,769	19,159
		(16.3)	(17.7)	(11.5)	(5.2)	(6.6)
Wool			24,361	14,253	3,648	15,293
Mohair			7,253	3,376	6,112	3,816
Used clothing		..	-	-	9	50
and textiles			-	-		
Other NES					0	0
Textile yarn, fabrics etc	65	4,302	6,714	8,214	4,928	1,184
		(3.0)	(3.8)	(5.4)	(2.6)	(0.4)
Yarn and thread	651		971	111	525	168
Woven cotton	652		2,881	2,114	679	118
Woven mmf	653		10		0	176
Tulle, lace etc	656		..		..	1
Special yarns, fabrics etc	6579	..	..	..	2,630	509
Tarpaulins tents etc	6582		..		2	7
Tapestries	765891		768	559	376	198
Carpets, rugs etc	659		7	11	2	7
Other NES			2,072		714	0
Apparel	84	49,272	76,411	64,812	118,734	172,628
		(34.0)	(42.8)	(42.5)	(63.4)	(59.4)
Suits and ensembles	8412		23,082	7,585	5,496	1,327
Jackets and blazers	8413		912	1,752	899	2,162
Trousers etc	8414		20,695	24,786	54,850	94,163
Underwear etc	8416		1,145	2,814	4,587	9,077
Dresses and skirts	8424	..	10,965	7,232	6,080	5,370
Babywear	8451		..	..	..	20,589
Knitted jerseys	8453		7,559	1,417	11,069	6,876
Accessories	8461		..	..	..	2,327
Headgear	8484		..	2	2	0
Shirts and blouses			2,828	11,553	24,789	..
Other apparel			9,275	7,693	35,751	30,737
All textile products		72,883	108,029	82,446	128,506	191,787
		(50.3)	(60.6)	(54.0)	(68.6)	(66.0)
All exports		144,859	178,392	152,661	187,249	290,755
		(100.0)	(100.0)	(100.0)	(100.0)	(100.0)

Source: Bureau of Statistics

Figures in parentheses indicate percentage of total exports.

a/ These headings were first used in 1992 so it is not always possible to compare that year with earlier periods.

b. RSA imports from Lesotho

The RSA does not record imports from Lesotho. The UNIDO mission was informed by South African official sources that the trade statistics of the RSA are prepared on the premise that, as such imports originate from within the SACU, they are, in fact, domestic.

C. THE USA

a. Trade relations with Lesotho

In 1992 the US and Lesotho Governments agreed that Lesotho exports of a number of textile products should be subject to quantitative restrictions as indicated in Table II.10 below. These quotas were imposed according to the provisions of the MFA. (Although Lesotho was not a party to the MFA, the US Government, as is its usual practice in such cases, proceeded as though it was. Ostensibly, the US Government could claim that this was a concession in that Lesotho was given the protection for supplier countries inherent in the MFA which it would be denied if the USA stood on its rights and chose to abide by the provisions of its relevant domestic legislation as embodied in the Agriculture Act, 1956.)

The quota on **knit T-shirts and tops** was inspired by a rapid increase (62 per cent) in Lesotho exports to the USA of these items in the year to end-July, 1992, as opposed to the same period in 1991-1992. Furthermore, shipments were accelerating. In the seven months to end-July, 1992, imports were 97 per cent higher than in the same period in 1991. It was this evidence of rapid growth in imports from Lesotho together with other, more subjective criteria that satisfied the US Government that those imports disrupted or threatened to disrupt its domestic market.[52/] It accordingly proposed that in the first quota-year shipments should be limited to the level achieved in the year to end-July, 1992, i.e. 810,000 dozen. However, this meant, effectively, that not merely was growth arrested, but it was necessary for the Lesotho industry to retrench because the annual rate of shipments in 1992 was above this level.

As from September 1993, basic T-shirts, tank tops and sweat shirts were taken out of quota. However, it seems that the Lesotho industry had not been greatly concerned with producing these items and, as the redefined quota was also reduced from 810,000 dozen items to 760 000 dozen, the industry did not gain much relief from this.

52/ Whether or not market disruption has occurred is determined in the USA by the Committee for the Implementation of Textile Agreements (CITA). Whether or not CITA takes action in any specific instance is determined first of all by the application of the so-called 30:20:1 formula.

1. **Either** total growth in US imports from all sources of the product or category in question was more than 30 per cent in the most recent year **or**, alternatively;

2. The ratio of imports of the product or category from all sources to domestic production was 20 per cent or more; **and** imports from the individual supplier country under consideration equalled 1 per cent or more of the total US production.

According to US official sources, the mere fact that one or both these criteria are met does not in itself necessitate the imposition of quotas on imports of the product under consideration. This is determined by CITA in the light of whether or not US producers are being caused serious damage, particularly in terms of employment - a subjective judgement in which CITA has historically allowed itself to be influenced by US industry opinion - and whether the landed prices of the imports are substantially below those prevailing in the USA for similar products.

The quota imposed on **trousers etc** manufactured from woven fabric was also inspired by US concern at the rapid expansion of its imports of this category from Lesotho. In the year to end-July, 1992, were 155 per cent higher than in the previous twelve month period and in the seven months to end-July 1992, 167 per cent higher than in the first seven months of 1992. Unlike US imports of knit shirts from Lesotho, those of trousers did not meet the objective criteria established by the US Government for determining *prima facie* market disruption. However, there was evidence that a very substantial proportion of those imports (some 80,000 dozen pieces out of total recorded imports in the year to end-July of 270,000 dozen) in fact consisted of transshipped goods - i.e. material made in other countries for which Lesotho origin had been fraudulently secured to avoid quota limitations imposed on exports from those countries in bilateral trade agreements with the USA. Most of those interviewed had little doubt that most of the dubious goods were in fact of mainland Chinese or South African origin and much of it may not even have entered the Lesotho Customs Territory.

The US Government was, therefore, in part at least, motivated by a desire to persuade the GoL to cooperate in checking this abuse. That this was so is indicated by its willingness to agree a quota which was substantially above its own record of imports in the year to end-July, 1992 - i.e. 375,000 dozen as opposed to 270,000 dozen. However, Lesotho shipments had so accelerated in 1992 that the outcome for that year at 377,100 dozen was to be in excess of the quota imposed in the period December 1992-November 1993, so, again, Lesotho producers were obliged to reduce their levels of activity.

The limitations imposed by the US Government on Lesotho trade, should probably be seen as part of its wider struggle to keep imports from China within the quota limits agreed with that country. (It seems unlikely that the USA was particularly concerned at the possibility that a few scores of thousands of dozen of South African products might somehow have been added to Lesotho containers in the course of their passage through the RSA to the port.) In addition, the restraints had the effect of neutralizing Lesotho as an off-shore production location for Taiwanese and Hong Kong manufacturers in their (wholly legitimate) efforts to circumvent the physical limitations imposed on their exports from their own countries and overcome steadily rising domestic labour costs. It was only in this context that Lesotho poses any threat to the US market. Like many other LDCs, Lesotho was an innocent victim of the conflict between the US textile and garment industry and suppliers in the three main Chinese economies which had long acquired global scope.

It is true, of course, that the US restraints covered these two products only and that it was open to Lesotho-based garment-makers both to develop sales of other garment categories in the USA and to find markets for all garment categories in other countries. Both these expedients have been tried. However, from the point of view of the Lesotho industry, the argument has several flaws:

- The relative inexperience of much of the Lesotho workforce means that its efficiency is much reduced when it starts to produce items with which it is unfamiliar.

- The other major garment markets are not only smaller than that in the USA, but also tend to be more difficult to service for reasons discussed below.

- Another consideration is that, in all the major world markets, sales of garments other than basic items, such as trousers and knit shirts, had been badly affected by the lingering effects of the recession of the early 1990s. 1992 was not a good time for new suppliers either to begin marketing other categories of garments in the USA or to attempt to develop markets in other countries.

The US moves were, therefore, to have very serious implications for Lesotho's chances of attracting further investment in the garment subsector.

It is understood that the USA tried to persuade the GoL to accept an extension of the 1992 agreement for one further year in 1994, increasing the quota levels by 6 per cent in each case and strengthening the anti-transshipment provisions in ways that might be construed as an invasion of Lesotho sovereignty. Officials suspect that, had it accepted the US Government's proposals, the Lesotho Government might well have found that it had forfeited the country's rights under the ATC to more generous treatment in respect of products not integrated into the GATT which remained under quota in agreements with importing countries.[53/] As matters stand at the time of writing, the situation regarding these quotas remains unclear.

Table II.10. Quantitative limits on exports of garments from Lesotho to the USA, 1992-1994 (Dozen pieces)

Category	01/12/92-30/11/93	01/12/93-31/12/94	Increase on a comparable 12-month basis (Percentage)
338B/339B /638B/639B (Knit shirts, cotton and mmf, excluding basic T-shirts)	760,000[a/]	872,733	6
347/348 (Men's and women's cotton trousers, shorts etc, including jeans)	375,000	430,625	6

Source: Official sources.

a/ Originally 810,000 dozen, but reduced to this level when ordinary T-shirts and tops were taken off-quota in September 1993. At the same time the level in the following year was reduced *pro rata* to maintain the 6 per cent increase originally provided for.

b. Exports to the USA

As already noted, it was not possible to secure detailed information regarding Lesotho exports of garments to the USA. However, Table II.11 below indicates US imports from Lesotho as recorded by US Customs. For the most part these categories relate to those covered by the US quotas noted above. **Trousers** (produced from woven fabric and coinciding with the MFA category 347/348/647/648) taken together are by far the largest item, the value of female articles exceeding those of the male. Of the **knit tops**, female blouses seem to be the largest single item.

53/ See Appendix I. In fact, this may be an incorrect interpretation of the ATC provisions. The requirement that the rate of growth be increased (by 16 per cent) applied to shipments of products that remained under restraint from agreements concluded under the MFA. The US/Lesotho agreement in fact terminated before the ATC came into force so it would appear that, if the US wanted to renew restrictions on the products affected by that agreement, it could do so under the transitional safeguard mechanism in Article 6. This provides (para 15) that in the case of products subject MFA restraint in the 12 months prior to the entry into force of the WTO agreement - i.e. in 1994 - the level of restraint shall be not less than the actual level of exports in the 12-month period terminating two months preceding the month in which the request for consultation was made. On the other hand as Lesotho is a least-developed country, the USA is obliged (para 6.(a)) to afford it significantly more favourable treatment than all other suppliers.

The value attributed to **jersey** exports is incredible. Those jerseys that are exported to the USA are most likely to be the high value, hand knitted wool and mohair items rather than those produced from acrylic fibres intended mainly for the domestic schoolgirl market and it seems most unlikely that those organizations which produce the former taken together have sales approaching those indicated even on a CIF basis. The Lesotho data - see Table II.9 above - would seem to confirm this. It is possible that the value of these is understated when leaving Lesotho, but the difference between the export values indicated in Table II.9 is still too great to be thus easily reconciled. The UNIDO mission was informed by the US Department of Commerce that the US did not have any records of imports of knitted jerseys which had been monitored for MFA purposes and it is inclined to conclude that the data under this head in Table II.11 are not to be trusted.

Table II.11. US imports of garments from Lesotho, 1989-1994, selected years ($ million)

Product	1989	1992	1993	1994 (January-November)
M&B trousers	2.6 (18.71)	3.9 (8.63)	8.5 (16.25)	13.9 (26.28)
Cotton shirts (not knit)	..	0.6 (1.33)	3.8 (7.27)	4.1 (7.75)
W&G trousers (not knit)	2.6 (18.71)	11.7 (25.88)	13.7 (26.20)	9.3 (17.58)
M&B shirts (knit)	..	0.7 (1.55)	1.0 (1.91)	1.1 (2.08)
W&G trousers (knit)	..	2.1 (4.65)	1.5 (2.87)	1.3 (2.46)
Blouses (knit)	5.9 (42.45)	2.8 (6.19)	2.8 (5.35)	2.6 (4.91)
Babywear (not knit)	..	..	1.8 (3.44)	0.9 (1.70)
Jerseys etc (knit)	2.1 (15.11)	23.4 (51.77)	17.3 (33.08)	18.1 (34.22)
T-shirts etc	0.7 (5.04)	2.1 (4.65)	3.4 (6.50)	2.9 (5.48)
Total	**13.9** (100.00)	**45.2** (100.00)	**52.3** (100.00)	**52.9** (100.00)

Source: US merchandise trade data.
Figures in parentheses indicate percentage of total imports for the year.

c. Shipments of products under quota

Exports to the USA

This was done according to a formula that was weighted in favour of employment rather than historical export performance.[54/] This was justified on the grounds that the objective of government policy was to generate employment rather than exports. However, the outcome was that it discriminated against the companies which had most effectively serviced the US market. As may be seen from Table II.12 below, the major shippers - Southern Cross, Super Knitting, Lesotho Hawk and Lesotho Haps in the case of Knit Shirts and C&Y Garments, Southern Cross, Lesotho Haps, Lesotho Hawk, and Crayon in the case of Trousers etc - had a lower allocation in 1994 than they had shipped in 1992. On the other hand, a number of companies that had not been

54/ See Appendix II for the formula used and the allocations calculated on this basis.

in the market in 1992 or only small shippers received substantial quotas. (The comparison is not altogether exact as the 1992 shipments included T-shirts, tank tops etc and mmf trousers, both of which were taken off quota in September, 1993. However, as may be seen from Table II.12, these latter products accounted for only 6.44 per cent of total recorded US imports from Lesotho of category 338/339/638/639. It is evident that the market open to the larger suppliers was considerably reduced.)

As can be seen from Table II.12, the more efficient producers were, in fact, able to ship in excess of their initial allocations because quota not being fully utilized by the other companies was reallocated in the course of the year. This relieves the worst feature of the system, but it also means that the larger companies find it difficult to plan their production programmes because of their uncertainty as to whether or not they will get additional quota. (The system has no built-in incentives or penalties to encourage those companies which do not fully utilize their allocations to surrender the unwanted portions in good time.)

The quota allocations and their utilization by the companies in 1992-1993 could not be determined because of inadequate data. In 1994 it appears that the knit shirt quota was overshipped - although within the limits prescribed by the flexibility provisions within the agreement which allowed for a 6 per cent increase in any quota year subject to corresponding adjustments in the other years - but the trouser etc quota was under-utilized and fell substantially below the 1992 level.

Table II.12. Shipments of US quota products by Lesotho companies, 1992 and 1993-1994
(Thousand dozen pieces)

Category	1992		December 1993-November 1994	
	Shipments	Allocation	Shipments	Of which: percentage of allocation
Knit shirts (Cat. 338B/339B/638B/639B)				
Southern Cross	253.1	205.6	240.0	116.73
Lesotho Hinebo	123.3	122.8	132.6	107.98
Super Knitting	264.7	142.8	172.0	120.45
Lesotho Hawk	169.2	97.9	162.0	165.47
Invictus	-	5.3	7.0	132.08
Morija Textiles	-	53.3	45.0	84.43
Lesotho Clothing	-	22.2	-	
Lesotho Haps	246.4	155.7	100.0	64.23
National quota	**1,056.7**	**805.6**	**858.6**	**106.58**
Trousers etc (woven) (Cat. 347/348/647/648)				
Southern Cross	35.0	29.5	20.0	67.80
Lesotho Haps	35.8	18.8	-	
Lesotho Hawk	18.8	8.2	-	
CGM Industrial	30.3	96.2	50.0	51.98
Wing On	-	-	-	
C&Y Garments	173.2	115.5	179.0	154.98
Maseru Clothing	11.9	24.7	-	
Lesotho Hinebo	6.0	6.7	5.0	74.63
Lesotho Clothing	2.5	12.2	-	
Poltex	3.0	8.7	3.0	34.48
Crayon Garments	60.6	55.4	61.0	110.11
Lee Clothing	-	11.6	-	
National quota	**377.1**	**397.5**	**318.0**	**80.00**

Source: Government of Lesotho data.

US imports from Lesotho

Table II.13 below indicates the US record of imports of Lesotho quota products. It is not possible to compare this with the Lesotho data considered in Table II.11 directly. The first imports in any quota period will have been shipped from Lesotho in the previous period whereas the last exports from Lesotho in any period will not be recorded in the USA until the following period. Nevertheless, one would expect these differences to balance themselves out to a certain extent so the comparison can still be instructive.

With regard to **knit shirts** the most obvious features of the US record are:

- Even if T-shirts, tank tops etc (taken off quota in September, 1993) are included, the level of Lesotho exports was still 14.7 per cent higher in 1992 than that of US imports. This could possibly be explained by very high shipments towards the end of the year as producers tried to beat the beginning ta. It could also reflect optimistic reports by Southern Cross, Lesotho Hinebo, Super Knitting Lesotho Hawk and Lesotho Haps - all of them experienced in the negotiation of MFA restraints - to secure the highest possible national quota from the USA and the highest possible individual allocations from the GoL.

- In the 12 months December 1993-November 1994 - the first period for which data are available from the GoL - the US record shows that shipments of knit shirts were only 0.24 per cent above the agreed quota as opposed to the 6.59 per cent suggested by the Lesotho data.

Shipments of the quota products in quota-year 1992/93 were significantly below those achieved in calendar year 1992, but grew in the subsequent quota-year roughly in line with the 6 per cent allowed for in the US/Lesotho trade agreement.

With regard to **trousers etc** made from woven cloth, recorded imports grew in both quota-years over the preceding period. This is directly contrary to the evidence of the Lesotho data indicated in Table II.10. Furthermore, the US record shows a remarkably high level of shipments in December, 1994, so that, whereas those in the twelve months to end-November, 1994, were roughly within the agreed quota, those in the thirteen months to end-December were nearly 6 per cent higher. Again this does not accord with the Lesotho data which suggests that a substantial proportion of total shipments consisted of items which were not in fact of Lesotho origin. In other words, the level of transshipment which had been the original justification put forward by the USA for introducing the restraint was again becoming a problem.

This evidence appears to give some support to the subjective complaints that transshipment was occurring, which were made by some of the suppliers interviewed in Lesotho.

However, it is worth noting that the most detailed statement in this regard related to shirts and not to trousers.[55/]

55/ According to the UNIDO mission's informant, additional cartons of shirts were being added to containers dispatched from Maseru while in transit through South Africa. This despite the fact that the containers were sealed by Lesotho Customs. He was inclined to credit this to suppliers in the bantustans. However, such suppliers were not permitted to trade with the USA because of the sanctions against the RSA. This latter situation no longer applied at the time of UNIDO mission.

Table II.13. US imports of quota products from Lesotho, 1992-1994
(Thousand dozen pieces)

Product	1992	December 1992-November 1993	Quota period December 1993-November 1994	December 1993-December 1994
M&F shirts knit, c,w & mmf				
338	242.0	299.1	207.8	236.2
339	652.8	562.3	638.8	710.5
638	9.4	-	8.0	8.0
639	17.3	33.3	21.8	21.8
	921.5	**894.7**	**876.4**	**976.5**
Of which:				
338B	232.3	277.4	193.2	210.8
339B	603.1	455.7	597.8	660.3
638B	9.4	-	7.3	7.3
639B	17.3	33.3	9.2	9.2
	862.1	**766.4**	**807.5**	**887.6**
(Percentage export quota)	..	(100.85)	(100.24)	(101.75)
T-shirts, tank tops etc	**59.4**	**128.3**	**66.9**	**88.9**
M&F trousers and shorts, NK				
347	109.3	103.8	203.5	225.0
348	220.2	255.6	197.9	230.9
	329.5	359.4	401.4	455.9
(Percentage export quota)	..	(95.84)	(100.94)	(105.88)

Source: US Department of Commerce, Bureau of Census.

D. THE EUROPEAN UNION (EU)

a. Trade relations with Lesotho

As an ACP (Africa-Caribbean-Pacific) member-state in a special relationship with the EU under the Lomé Convention, Lesotho's trade in textile products with the union is not constrained by any quantitative restrictions. However, its exports of garments do not benefit from the duty-free access provision of the convention because they do not meet the additional origin criteria laid down in this connection. (To qualify for duty-free access to the EU as a right, garments from ACP countries must be manufactured from ACP fabric. This means, in effect, that it must be produced from yarn in an ACP state. As already seen, most fabric used in the manufacture of Lesotho garments comes from the Far East or from the RSA and so does not fall into this category. Some companies are using material sourced in Mauritius or Botswana, but it is understood that no producer relies wholly on such sources.)

However, in 1993, it was agreed in effect to waive this provision in respect of Lesotho in respect of certain garments produced there.[56] (This was done under Article 31 (9) of the Lomé Convention which allows for derogations from its general provisions, in particular to facilitate the development of existing industries or the creation of new ones.) Thus Lesotho was granted duty-free access for specified quantities of the categories itemized in Table II.14 below for 3 quota years from March 1993 to February 1996. These are referred to as the "derogation quotas".

It should be noted that in almost every instance there was no provision for any increase in the volumes exported duty-free over this period. The only exceptions were knitted shirts (6105.10/.20 and 6106.10/.20) where the volume was increased by 200,000 pieces in respect of 1994/95 and 1995/96 and briefs and panties (6108.21/.22 and 6207.11) where it was increased by 500,000 pieces in respect of 1995/96 alone.

b. Shipments of products under quota

As may be seen from Table II.14, any provision for an increase in duty-free exports over the period covered by the ACP-EEC decision would have been otiose. In most instances, the industry in Lesotho was quite unable to use even the basic volumes it was granted and, in the second year, the national quotas for certain products were not allocated at all.

The only category where the national derogation quota was anywhere near fully utilized was woven trousers (H.S. 6203.42/3.) 60.53 per cent of the underpants (H.S. 6107.11) quota was utilized in 1993-1994, but, was hardly touched by the end of the third quarter of 1994-1995. Less than half the T-shirt (H.S. 6109.10) quota was used in 1993-94, but the situation was much improved in 1994-95. There was a similar outcome in the case of knitted shirts (H.S. 6105.10/.20) and M&B Jackets (H.S. 6203.32/3), although in both instances, even in the second year usage was well below the national quota levels.

As may be seen from Appendix III, the EU record of shipments imported accords with the Lesotho record of those exported.

There are a number of factors underlying this poor response to the opportunity which the ACP-EEC decision represented for the Lesotho industry:

- For most of the period covered by Table II.14 the EU market was still suffering the after-shock of the economic recession. As in the case of the US market, this severely affected sales of all but the most basic items of clothing. (This is one reason why Lesotho's utilization of the quotas for categories such as trousers, T-shirts and underpants was reasonably high - the fall-off in Morija Textiles's exports of underpants in 1994-1995 obviously related to that company's internal difficulties - while those of items more sensitive to consumer spending constraints, such as leisure and sportswear, was poor.) This was definitely not a good time for suppliers to attempt to develop new outlets in EU member-countries.

- It is generally recognized by companies supplying the world market that the EU garment market is at any time much more 'difficult' than that in the USA.[57] This reflects, in part:

56/ Decision No 1/93 of the ACP-EEC Customs Cooperation Committee of 16 April, 1993, derogating from the definition of the concept of "originating products" to take account of the special situation of Lesotho with regard to its production of certain garments. (93/319/EEC)

57/ See P.J.B. Steele: The Hong Kong clothing industry: waiting for China, *op. cit.*

- Unlike the USA, the EU garment market still consists of twelve relatively small national markets in which only Germany, the UK and the Netherlands have any real tradition of trading with the wider world. Distribution is still organized on a national and not on a community-wide basis with very few importers dealing with more than one country. This means that orders are smaller and more numerous so marketing costs are higher.

- In addition, EU importers tend to be much more particular than their US counterparts in insisting that suppliers adhere to contractual specifications - especially in such matters as standards of finish of the garments - and yet they also expect a higher degree of supplier input into the development of those specifications. US importers are accustomed to issuing highly detailed specifications which producers can simply follow.

- Nevertheless, it could be argued that the failure fully to utilize most of the derogation quotas related at least in part to the poor choice of companies chosen to receive allocations. For instance, Invictus and Lesotho Apparel quite failed to make any impression on the market even though Invictus was given a substantial allocation of the quota for T-shirts - a product for which demand remained relatively lively. On the other hand, CGM, Maseru Clothing and Morija Textiles made reasonable use of their quotas. Furthermore, whereas it might be argued that the success of Lesotho Hawk, C&Y and Super Knitting in developing sales in the second year demonstrates that they should have been given allocations in the first year, there is no reason to suppose that any of these companies wanted derogation quota at that time. In fact, except for CGM, Lesotho Clothing and Lesotho Textiles, none of the Lesotho companies had any real experience of the EU market and they were prepared to resort to it only when they began to experience difficulties in their more traditional outlets. (As far as could be established, Lesotho Textiles did not ask for any quota in either year having already pulled out of the German market, basically because it was too much trouble to supply it.) Thus, how far the government was able to pick and chose in its allocation of EU derogation quota is not at all clear.

Table II.14. Usage of EU derogation quotas, April, 1993-November, 1994 (Lesotho record) (Thousand pieces)

Product	Tariff heading	1993-1994 Company	1993-1994 Allocation	1993-1994 Usage (%)	1994-1995 Company	1994-1995 Allocation	1994-1995 Usage a/ (%)
M&B woven trousers etc. cotton and mmf	6203.42/3		**800.0**	**83.36**		**800.0**	**81.54**
		Maseru Clthg	395.0	25.32	Maseru Clthg	120.0	67.52
		CGM	395.0	139.83	CGM	396.0	100.59
		Lesotho Clthg	10.0	145.63	Lesotho Clthg	50.0	-
					C&Y	264.0	30.51
					Lesotho Hawk	-b/	
T-shirts, knitted	6209.10		**180.0**	**40.09**		**180.0**	**70.47**
		Morija Txtls	43.0	167.83	Morija Txtls	180.0	70.47
		Invictus	137.0	-			
Shirts, woven, cotton & mmf	6205.20/30		**40.2**	**10.23**		**40.2**	**.07**
		Lesotho Appl	11.0	2.46	Lesotho Appl	20.0	-
		Lesotho Clthg	12.0	32.01	Lesotho Clthg	20.0	.14
M&B underpants, cotton	6107.11		**1,000.0**	**60.53**		**1,000.0**	**1.49**
		Morija Txtls	1,000.0	60.53	Morija Txtls	1,000.0	1.49
M&B jackets	6203.32/3		**94.0**	**7.12**		**94.0**	**36.06**
		Maseru Clthg	Not spec.	..	C&Y	30.0	-
		Lesotho Clthg	Not spec.	..	Lesotho Clthg	34.0	99.7
M&B swimwear	6211.11		**18.0**	-		**18.0**	-
		Maseru Clthg	16.5	-	Maseru Clthg	2.0	-
		Lesotho Clthg	1.5	-	Lesotho Clthg	16.0	-
M&B, W&G trousers knitted	6103.42 6104.62		**500.0**	**.64**		**500.0**	**[illegible]**
		Morija Txtls	500.0	.64	Lesotho Haps	100.0	-
					Lesotho Clthg	50.0	.02
Shirts, knitted, cotton and mmf	6105.10 6106.10		**1,200.0**	**5.87**		**1,400.0**	**30.71**
		Morija Txtls	1,200.0	5.87	Morija Txtls	600.0	30.1
					Super Knttg	250.0	82.59
					Lesotho Hawk	100.0	42.83
Nightwear	6107.21/2 6108.31/2		**100.0**	-		**100.0**	-
		Morija Txtls	100.0	-	Not allocated		
Briefs and panties	6108/21 6207.11		**3,000.0**	**1.91**		**3,000.0**	-
		Morija Txtls	3,000.0	1.91	Morija Txtls	3,000.0	-
Tracksuits	6112.11/2		**100.0**	-		**100.0**	-
		Morija Txtls	100.0	-	Morija Txtls	20.0	-
Swimwear, M&B, W&G	26112.41/9		**50.0**	-		**50.0**	-
		Morija Txtls	50.0	-	Not allocated		

Source: Lesotho Customs.

a/ March-November only.

b/ Lesotho Hawk was not given any quota in the original allocation. However, it shipped 92,400 pieces after a subsequent reallocation.

E. CANADA

Canada is a relatively small market for Lesotho apparel compared to the other main destinations. Although it entered into a two-year agreement which imposed quotas on Lesotho exports of trousers etc and knit tops in 1992, this does not appear to have created any difficulties for Lesotho producers. The administration of these quotas by the Ministry of Industry and the Customs department is also quite lax compared to that of the US quotas. Available data on the quotas and the usage made of them are indicated in Table II.15.

Table II.15. Lesotho exports of quota products to Canada, 1993-1995
(Thousand pieces)

	Allocation	Usage
1993	531.0	453.1
1994	562.8	294.9
1995	Not known[a/]	120.1 (to end-January)

Source: Official sources.

a/ The extension of the agreement with Canada had not been finalized by end-January 1995.

CHAPTER 7. DEVELOPMENTS RELATING TO GARMENT PRODUCTION IN THE RSA AND THE IMPLICATIONS FOR LESOTHO

7.1 GENERAL

Until quite recently the South African garment industry did not compete with that in Lesotho for international markets (and, therefore, for investment in projects targeted at those markets) for a number of reasons already noted at various points in this report:

- International trade sanctions aimed at the apartheid regime, of which those applied by the Governments of the USA and the EU were by far the most significant;[58/]

- The inward orientation of the country's clothing trade which had been encouraged by the very high levels of protection afforded the industry since the 1940s and earlier;

- The relatively high costs of clothing manufacture in the RSA brought about by tariff protection, which allowed for wage-levels well above those in Lesotho - and LDCs in general - and the high cost of fabric resulting from the tariff protection afforded the South African textile industry;

- The inefficiency of the South African industry by international standards - again a consequence of its insulation from international competition.

However, all these factors have been affected by recent developments which could have profound implications for Lesotho as a location for garment industry investment as they undoubtedly will for the RSA itself.[59/]

7.2 ACCESS TO INTERNATIONAL MARKETS

A. THE USA

There are no quotas on exports of clothing from the RSA into the USA. However, under the terms of the Uruguay Round agreement on textile trade which has succeeded the MFA, the so-called Agreement on Textiles and Clothing (ATC), the US Government could still introduce such quotas in the course of the ten-year transitional period beginning 1 January 1995, during which

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58/ There do not seem to have been any specific prohibitions on imports of garments from the RSA into EU markets. However, there seems to have been a perception amongst garment-makers that sanctions of this nature were imposed or were likely to be imposed - although it is likely that the UK would have resisted such a measure.

59/ It was not possible to undertake direct research in the RSA in preparing this section of the report which is based, therefore, on a review of secondary sources and discussions with officers of the South African High Commission in London.

textile trade is to be "integrated into the GATT" (see Appendix I, para I.) on grounds of market disruption.[60]

Usually the sensitivity of successive US administrations to the influence of the US textile and clothing industry has made them very ready to use quotas to curb imports from even the poorest of LDC suppliers - Lesotho is a case in point. It is as yet too early to tell whether it will be any more difficult for the USA to introduce restrictions under the ATC regime than it was under the MFA.[61] However, for political as much as for technical reasons, the USA may be reluctant to appear to be taking an over-austere attitude towards trade with the new RSA in the next few years. Considerations that might induce a relatively tolerant attitude to signs of burgeoning imports of South African clothing include:

- The substantial reserves of moral capital accruing to the South African Government of National Unity (GNU) in the eyes of western governments and western opinion formers;

- The conservative orientation apparent in the GNU's approach to economic policy which is very much in line with that the US Government has urged on developing countries since the early 1980s and the need to keep the RSA "on-side" in this respect.

It is possible, therefore, that exports from the RSA to the USA will remain free of quotas. This would constitute a significant advantage to the republic as compared to Lesotho as a location for investment in the garment industry.

B. THE EUROPEAN UNION (EU)

The EU too imposes no physical restrictions on imports of South African clothing. Again, while it is open to it under the ATC to introduce these in cases of market disruption, it likely that the EU Commission will be particularly reluctant to do so in the case of the RSA for the same reasons as those likely to influence the US Government. In any case, in recent years the EU has shown itself less inclined than the USA to exercise its rights under the MFA.

It is at the moment uncertain whether the RSA will be able to negotiate duty-free access for textile products under the provisions of the Lomé Convention. The general attitude of the EU is that the republic is too rich to qualify as an ACP state in general terms. However, it may be willing to make an exception in the case of this particular industry. Should this be so, South African clothing made from locally-produced textile fabrics would qualify for duty-free entry without the need for a derogation such as that secured by the GoL. However, the advantages of this in practical terms may prove less real than apparent given the relatively high cost of South African fabrics compared to those from the Far East and their frequently inferior quality.

60/ This would be done under Article 6 of the ATC which sets out a transitional safeguard mechanism to deal with such eventualities.

61/ For instance, what practical weight will the WTO's new Textile Monitoring Body (TMB) put on Article 6, para 6.(b) of the ATC which stipulates that importing states shall give differential and favourable treatment to relatively small exporters in fixing quota levels in bilateral agreements, taking due account of the "... future possibilities for development of their trade and the need to allow commercial quantities of imports from them"? It remains to be seen whether the TMB will be any more effective in curbing manifestations of US protectionist instinct than the old GATT Textile Surveillance Body.

7.3 THE MANUFACTURE OF CLOTHING FOR EXPORT

A. PRESENT MARKET ORIENTATION

The South African garment industry is concerned almost exclusively with supplying its own domestic market. There were indeed a number of projects established by Taiwanese entrepreneurs in the late-1970s and early 1980s to service the US market, usually located in the old "homelands" where they took advantage of the low-cost, non-unionized labour to be found there. However, it is understood that these were abandoned after the imposition of US trade and investment sanctions on the RSA. Other groups wishing to develop overseas sales had to set up in BSLN locations, where they could not only to avoid sanctions, but enjoy the benefits of cheap labour while retaining the advantages of membership of the SACU and the CMA. A number of such enterprises have been considered in this report.

The inward-looking posture of the bulk of the South African industry can be partly attributed to the RSA's economic isolation in the 1970s and 1980s, but the main factor was the stringent protectionist policy of the former Nationalist Party (NP) government, pursued over many decades. The apparatus of protectionism is still in place, although it is now on the verge of being dismantled.

According to the Textile Federation of South Africa, current tariffs on imports of clothing into the republic average 90 per cent and effective protection is likely to be far higher than this. This has enabled the local industry to secure virtually all of its domestic market for these products[62] despite the fact that South African textile producers enjoy tariff protection averaging 45 per cent - thus enabling it to keep the prices of its own internationally mediocre products well above world market levels - and the garment producers' own wage costs are well above those in most of the developing world with which they have to compete in any attempt to develop overseas markets. Given this situation, it was almost inevitable that the industry would concentrate on the domestic market and show little interest in making export sales.

It is also recognized - not least by the garment-makers themselves - that the secure environment in which the industry operates in the RSA has been bought at the expense of its international competitiveness. While quality is reasonable, productivity is poor by international standards.[63]

B. TOWARDS A MORE INTERNATIONALLY COMPETITIVE INDUSTRY

By the early 1990s the NP government was thinking in terms of a reduced level of tariff protection. In part, this had to be accepted, as a price that had to be paid for the RSA's accession to the GATT which was considered desirable on general economic grounds. However, it also seems likely that the government had become genuinely convinced that to strip the industry of much of its tariff protection was an essential prerequisite for the development of an internationally competitive textile and garment industry. In order to allow the industries time to adjust, the NP administration

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62/ According to the World Bank, in 1991 domestic production accounted for 98 per cent of South African demand for apparel. (See Paper No 1, Informal discussion papers on aspects of the economy of South Africa. "How can South African manufacturing efficiently create employment? An analysis of the impact of trade and industrial policy." Brian Levy: Southern Africa Department, World Bank, January 1992.) Increased imports from Lesotho and other SACU member-states since then are likely to have had only a marginal impact on this situation.

63/ According to Arnold Weberlof, Deputy Director of the National Clothing Federation, as quoted in the FT of 1 March 1995. It will be noted that this contradicts the rather up-beat assessment of the South African companies based in Lesotho discussed in Chapter 5.

negotiated a fairly generous 12-year transitional period in which to achieve the GATT final duty levels on imports of textiles and garments - which, in any case, remained fairly high by the standards of the western industrialized economies with which the RSA was ranked for GATT negotiation purposes.

Subsequently the government agreed with the textile and clothing industry that rather lower duty levels should be achieved over a somewhat shorter time-period in return for a subsidy of R.4.5 billion for reinvestment and training. (This was the main burden of the so-called Swart Proposals after the head of the commission that developed them.) That the government was prepared to buy a more rapid and extensive surrender of tariff protection at this price is indicative of the importance it attached to such a surrender as a means to securing a more efficient industry.

The GNU seems to have adopted this view with even fewer reservations. When it had reconsidered the Swart proposals in the light of the other calls on its budgetary resources under its Reconstruction and Development Programme, it announced that it could not afford the subsidy, but that the faster run-down of tariff levels would have to proceed anyway.

This official *volte-face* produced a breakdown of the previously united front which had been maintained by the apparel and textile subsectors. The National Clothing Federation (NCF) responded to the government's new ultimatum by proposing the removal of nearly all tariff protection from the textile industry (i.e. as opposed to the garment industry) over a period of 5 years. The NCF claimed that the reduction of its members' operating costs resulting from the availability of fabrics from the international market at rates of duty averaging no more than 15 per cent would allow the clothing industry to achieve the required improvements in productivity without the need for government subsidies.

The NCF proposals would have severe implications for employment in the textile subsector - apart from the knock-on effect on those employed in capital goods and other industries servicing the textile industry whose numbers the Textile Federation put at 260,000.

This would normally be expected to provoke very strong objections from the powerful South African Clothing and Textile Workers' Union (SACTWU.) However, 60 per cent of the SACTWU's 164,000 members are in the clothing industry and, as will be seen, it is also attempting to bring under its ægis the non-unionized workers in the remoter parts of the country. SACTWU also, no doubt, had regard to the NCF estimate that, with its fabric costs substantially reduced, the clothing industry would be able to create 65,000 new jobs. These considerations seem to have ensured some modification in the reaction that might have been expected of the union. Instead of rejecting the proposals outright, it has so far only called for government support in retraining workers made redundant by any change in the structure of tariff support.

How the GNU reacted to the NCF proposals is not known. The fact that they would require no additional public expenditure is, no doubt, an attraction given the many other calls upon government finances. The promise of 65,000 new jobs must also be of interest given the need to create employment in the RSA - even though this outcome is highly speculative. On the other hand, it is not easy to see any government contemplating with equanimity the more certain impact on employment by the national textile industry - and by ancillary industries - of the withdrawal of virtually all tariff protection over a very short period. There is also the consideration that, in the longer term, the RSA, as an advanced economy, will have a greater comparative advantage in the case of more capital-intensive industries, such as textile production, than it will in the labour-intensive garment subsector.

It is unlikely, therefore, that the GNU will adopt the drastic proposals of the NCF in their entirety. However, it might introduce measures to ensure that the clothing industry has easier access to imported fabrics on a duty-free basis for export production while maintaining higher levels of protection for the textile industry as envisaged under GATT 1994 and the Swart proposals.[64] Whatever is decided in this connection, the government is committed to running down the clothing industry's own levels of tariff protection which will force it to become more outward-looking and export-oriented.

Table II.16. Proposed tariffs on South African imports of clothing and textiles

Product	Current duty levels (Percentage)	GATT final duty levels (Percentage)	Swart final duty levels (Percentage)	NCF-proposed final duty levels (Percentage)
Fibres	25	10 (12)	7.5 (10)	0 (2)
Yarn	32	17.5 (12)	15 (10)	0 (4)
Fabrics	45	25 (12)	22 (10)	15 (5)
Clothing	90	45 (12)	40 (10)	40 (10)

Source: Textile Federation of South Africa (quoted in the FT, 1 March 1995).

Figures in parentheses indicate phase down period in years.

C. ENCOURAGING GARMENT EXPORTS

The encouragement of a more outward-looking posture on the part of the garment industry was government policy even before it was prepared to grasp the nettle of protectionism. This was indeed the central theme of the Structural Adjustment Programme (SAP) for the industry which was introduced in 1989. At that time the government's approach may be compared with that of the Governments of the Republic of Korea and Taiwan Province in the mid-1960s when they began to encourage export-led growth by industries which continued to enjoy the security of highly-protected domestic markets.

The main instrument of South African Government policy to this end was the General Export Incentive Scheme (GEIS). This replaced a range of export incentives introduced in the 1970s and early 1980s which had largely failed in their purpose. However, there were two measures more specific to the garment industry introduced under the SAP which are understood to be valued more highly by garment producers. (For a discussion of these various measures see below, section B.)

Unlike similar measures in the Republic of Korea and Taiwan Province in the mid-1960s, these do not appear to have had much success in promoting an export orientation among South African garment-makers. Factors here may have been that, whereas the textile industries in the Far East were still very new and efficient in the mid-1960s and able to supply high-grade fabrics at

64/ One measure that might be used to this end would be the introduction of export processing zones (EPZs) as proposed by the Industrial Development Corporation in 1992. These could take the usual form of industrial parks insulated from the rest of the economy behind a customs fence - or, after the Mauritian or Chinese examples, individual factories with EPZ privileges, again behind customs fences. The essential feature of such parks would be their freedom from the usual impositions on foreign trade which apply in the South Africa Customs Territory proper.

internationally low prices, the same was not true of the South African textile industry in the early 1990s. In addition, whereas garment industry wages in the Republic of Korea and Taiwan Province in those days were among the lowest of any country with ambitions to export garments, those in the RSA were already in the medium range by international standards - thanks largely to the failure to abandon protectionism at a much earlier stage. In addition, the labour force was sufficiently well-organized to be able to resist measures to raise industry productivity.

In this situation, garment-makers tended to regard the new incentives as a useful occasional windfall, but not as a basis for a complete revision of established marketing strategy which remained essentially inward-looking.

7.4 PRICE COMPETITIVENESS OF THE INDUSTRY

A. LABOUR COSTS

a. Wage levels

Whether the industry could become internationally competitive by becoming more efficient and gaining access to fabrics at prices set closer to international levels - the basic assumption of both government policy and the NCF proposals - is open to conjecture. Certainly, given the importance of labour costs in total garment production costs, it seems unlikely that the South African industry could compete with those in other African countries - let alone those in such low-wage economies as China, India, Indonesia and Viet Nam - in supplying low-cost, high volume products such as those in which the Lesotho industry specializes.

As already noted, South African garment industry wage rates are around twice as high as those in Lesotho and may be even higher when the overheads of employing labour are taken into account. Although managements in Maseru and Maputsoe seemed to believe that these differentials might be narrowing, they were still very wide and likely to remain so. This would be even more certain if, as seems possible, there are substantial lay-offs of Basotho nationals in the South African mines and these displaced workers are forced to return to Lesotho.[65/]

As noted, there are pockets of the garment industry in remoter areas in the republic where wages are more nearly comparable to those in Lesotho. However, it seems likely that SACTWU would bitterly oppose any effort to allow the development of garment enterprises outside the Durban and Cape Town centres which pay their workers substantially below the going rate for the industry as a whole. The bulk of the South African garment workforce is unionized to such an extent that SACTWU is able to insist on negotiating on behalf of its members on an industry-wide basis. It is difficult to believe that it will readily acquiesce in the undermining of this position of strength. On the contrary, it seems likely that it will seek to draw workers in the outlying regions into its orbit - especially as the Regional Industrial Development Programme constitutes a powerful incentive for new enterprises to set up in provincial locations. It is likely that the eagerness of SACTWU to complete and consolidate its "closed shop" may be one factor in the present unrest in the industry.

65/ South African government sources claimed that, as citizens of a BLSN (Botswana-Lesotho-Swaziland-Namibia) state within the SACU, the Basotho miners would not be affected by the current drive against aliens living illegally in the republic. (The main targets here seemed to be economic refugees, in particular those from Mozambique, and criminal elements from Nigeria. However, reduced levels of mining activity are likely to put at risk even legal workforces. Furthermore, there are reports of conflict between Basotho and Xhsosa miners which may create a situation the GNU cannot control. There are understood to be some 100,000 Basotho miners in the RSA. Total employment in the Lesotho formal sector is around 70,000.

Despite its fiscal conservatism, it is difficult to accept that the GNU would be willing to see the industry become more competitive internationally if the price for this was significant reductions in wage levels for large numbers of workers.

In short, it is unlikely that it will be possible to recreate the sort of export-oriented garment enterprises based on cheap labour such as were beginning to appear in some "homeland" regions before the imposition of US sanctions against the old apartheid regime.

b. Labour productivity

It was suggested by some of the Lesotho garment industry managements that the South African workforce was more productive than that in the kingdom which could, to some extent, compensate for its higher basic cost. This was denied by other managements who claimed that the productivity of their Basotho workers was closer to the Chinese benchmark than those in the RSA.

The UNIDO mission is unable to adjudicate on these conflicting claims. However, whereas it is possible that the industry in Lesotho is as productive as that in the RSA when producing standard items, such as trousers and knit tops, its relative lack of experience and reluctance to learn new skills (for whatever reason) may mean that it is less adaptable and, therefore less efficient when called upon to respond to frequent changes in the product-line.

Industry productivity in the RSA seems to be affected by the present unrest in the industry, especially as this may reflect political as well as industrial factors - in particular, the unhappiness of the more radical wing of the ruling Africa National Congress party at the current stance of the GNU on economic policy. However, it cannot be assumed that this unrest will be a factor in the long-term development of the industry.

B. FINANCIAL INCENTIVES

a. General

Many of the managements interviewed in Lesotho appeared to believe that the incentives made available by the South African Government went some way to compensating for the high cost of factors such as material components and wages compared with those available to the Lesotho industry. These included general investment incentives and export incentives. As noted above, some of the latter were specific to the garment industry.

As will be seen, most of the incentives take the form of direct or indirect subsidies rather than tax concessions. The former were obviously judged to be more effective than the latter. However, they are more expensive in immediate budgetary terms - it can be argued that tax concessions represent the forgoing of impositions on income that might never have been generated without those concessions whereas subsidies are upfront payments which may be compensated by increased tax revenues, but only at a much later stage. In addition to which, the international trade regime now frowns on subsidies as unfair competition while it is more ambivalent about tax-based incentives. As will be seen, the South African Government's flagship export incentive is having to be phased out for this reason.

b. Investment incentives

b.1 Loans and grants

Through the **Industrial Development Corporation** the government makes capital available to encourage industrial investment at preferential rates of interest. Schemes of interest to garment industry investors include:

- Scheme for the promotion of exports - for the acquisition of machinery and equipment

- Multi shift scheme - to finance additional working capital and equipment purchases
- For the promotion of employment - to finance new and industrial production capacity.

The first two schemes make finance available at 9 per cent per annum (60 per cent of the fluctuating IDC interest rate) for three years and the third at 5 per cent for three years.

The **Regional Industrial Development Programme (RIDP)**, offers a package of tax-exempted incentives for investment outside the main industrial centres. These include:

Reimbursement of certain relocation expenses

The latter incentive only applies to relocations from outside the Rand Monetary Area.

There is also a **Simplified Regional Industrial Development Programme (SRIDP)** for investments totalling less than R.2.5 million which would also be an attraction for small-scale projects. The payments are similar to those under the RIDP, but do not include the relocation grant.

There are Regional Development Corporations which offer financial and other incentives for the establishment of new and the expansion of existing industries in their areas. These are established in:

- Gazankulu
- KaNgwane
- KwaNdebele
- Kwazulu
- Lebowa
- Highlands

b.2 Tax incentives

Depreciation is allowed against company income tax (35 per cent) at 20 per cent of the cost of plant and machinery over five years. Five per cent of building or improvement costs are allowed on industrial buildings.

Wear and tear allowances in the use of non-manufacturing plant, machinery, office equipment, furniture and motor vehicles is granted at the discretion of the tax authorities.

Lease premiums on buildings or machinery may be written off over a period of twenty five years or the length of the lease.

Twenty-five per cent of the cost of approved **scientific research** may be deducted each year.

Double taxation avoidance agreements have been entered into with the UK, Israel, the Netherlands, Switzerland, Sweden and Germany as well as with a number of African economies. **Sea and air transport** agreements have been entered into with Belgium, Brazil, Taiwan Province, Denmark, Finland, France, Greece, Ireland, Italy, Japan, Norway, Portugal and Spain.

c. Industrial export incentives

c.1 The General Export Incentive Scheme (GEIS)

By the later 1980s the government began to encourage the industrial sector to put more emphasis on exports. Its main instrument to this end was the General Export Incentive Scheme (GEIS) which was introduced in 1990.

Under the GEIS exporters qualify for a tax-free cash payment calculated in such a way as to encourage local value added. (Garments qualify for the highest payments - up to 19.5 per cent of the fob export value. Because the payments are tax-free the effective incentive value is calculated at 65 per cent.)[66] Hand-in-hand with the GEIS went a number of export marketing assistance schemes covering such areas as primary export market research, outward selling trade missions, inward buying trade missions and exhibition assistance.

The GEIS has been identified as incompatible with the RSA's membership of the WTO and it has been agreed that it should be phased out by 1999. In fact, it is now regarded as not cost-effective in government circles. The fairly extensive phasing out period was negotiated in order to give those industries which depended on it to make themselves export-competitive sufficient time to restructure themselves.

c.2 Textile industry specific incentives

There were also other incentives specific to the garment industry introduced as part of a Structural Adjustment Programme (SAP) for the textile and garment industry in 1989-90:

- Companies achieving export sales equivalent to 5 per cent of total sales were permitted to import their textile requirements free of duty up to 10 per cent by value of export sales;

- Exporters were permitted to import textiles and garments duty-free worth up to 70 per cent by value of total export sales. These can then be sold at local prices.[67]

It will be noted that the value of these incentives depends on the high levels of protection presently enjoyed by the South African textile and garment industries which ensure that the prices of these products remain high on the domestic market. The reductions in the levels of duty to which the GNU is committed under the GATT - if not as a result of internal reforms - will substantially undermine their value in the next few years.

In addition, exporters were permitted to import duty-free the inputs used in export production. This is similar in effect to the in-bond concession granted producers in Lesotho. However, as it was available only as an alternative to the SAP incentives it was almost never used - probably at least in part because of the complexity of the bureaucratic procedures required to administer it.

7.5 THE IMPLICATIONS FOR LESOTHO

A. EXPORTS OUTSIDE THE SACU AREA

It is possible that the RSA will continue to enjoy quota-free access to both the major world markets for garments and secure the same duty-free access to EU markets which Lesotho has only by temporary derogations. This will give it an important comparative advantage vis-á-vis Lesotho which has been seriously affected by the restraints imposed on its trade with the USA.

However, whether or not this will have the effect of attracting to the RSA investment in export-oriented projects that might otherwise have gone to Lesotho is doubtful. As has been seen,

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66/ See "Trade policy and industrial restructuring in South Africa", Merle Holden, Department of Economics, University of Natal, Durban, 1994.

67/ It will be noted that this scheme is very similar to the more broad-based "import-to-export" scheme introduced by the Government of Tanzania in the early 1980s, again as an export incentive which depended on the virtual impossibility of importing highly-valued items by conventional means.

Lesotho is seen primarily as a location for producing basic items of low-cost clothing. This reflects very low wages by international standards coupled with access to low-priced fabrics from the international market on a duty-free basis.

Of these two factors, the latter seems the less important. Lesotho producers can compete in the South African market for certain basic products despite having to pay South African prices for fabric on the basis of their lower wage costs. This advantage is only partly off-set by the so-called WFT-factor - more costly and less reliable utility services. The corollary of this would seem to be that, even if South African-based producers had access to fabrics at international prices for export production, this would not necessarily be a decisive factor in determining their competitiveness as compared to Lesotho-based producers.

Everything depends, therefore, on whether South African producers will be able to secure lower costs per unit of production than their counterparts in Lesotho and, thus, compete with them as suppliers of the sort of apparel which the Lesotho industry is presently able to supply more competitively.

It is argued above that they will not be able to do this by employing labour at wages comparable to those paid to garment workers in Lesotho. In addition, the Lesotho industry is fairly efficient by international standards in producing large volume/low value items and the industry in the RSA enjoys little if any comparative advantage in this respect.

Thus, the competitiveness of South African-based producers compared to those in Lesotho depends entirely on whether the incentives offered by the Government of the RSA are sufficiently more valuable than those available in Lesotho to compensate for higher labour costs.

It is difficult to make a direct comparison of the relative advantages of the two systems, largely because the Lesotho system is, on the whole, tax-based whereas that in the RSA is subsidy-based - especially if access to credit at preferential rates of interest is counted as a subsidy. (This is acknowledged to be a rather sweeping generalization - for instance, the Export Finance Scheme and the long-term loans at preferential rates of interest offered by the LNDC - when lines of credit are available - and the 75 per cent training grant are as much subsidies as the payments offered by the Industrial Development Corporation of the RSA and the Regional Industrial Development Programme. Nevertheless, it has a certain validity.)

Certainly, some managements in Lesotho appeared to believe that the South African incentives were sufficiently valuable to compensate for the acknowledged disadvantage of the higher wage costs the industry had to bear in the RSA. It was also true that many of the Lesotho companies did not benefit from the whole range of LNDC incentives because they operated on a CMT basis - i.e. their head offices supplied them with the fabrics they used and undertook all marketing costs, thus dispensing with most of the advantage of the Export Finance Scheme and they did not make profits in Lesotho to benefit from the lower rate of company income tax in the kingdom. However, the assertions concerning the greater value of the South African incentives were made without benefit of detailed cost-benefit analysis of possible relocation to South Africa. Whether such perceptions would survive such analysis it is not possible to determine on the basis of the information available.

However, as already noted, subsidy-based incentives - especially direct payments such as the GEIS - are frowned upon by the GATT. (GEIS has already been condemned to a somewhat prolonged death for that reason yet it was most frequently cited by those with whom we discussed these matters in Lesotho as exemplifying the superiority of the South African system.)

It is also doubtful whether the RSA will be able to afford to maintain some of these incentives even if they are allowed by the WTO. Its sudden rejection of the payments provided for in the Swart proposals has already been discussed. It seems reasonable to assume that the need to create new employment will encourage the GNU to retain them if possible. However, it would seem more appropriate for the garment industry to use these payments to enable them to compete to supply higher-value areas of the market where its wage cost-structure is less significant in total costs than to challenge Lesotho producers - and those in India, Pakistan and the Far East - in those low value areas where margins of profit are minimal.

As already suggested, the industry-specific SAP incentives will become less attractive over the next few years as a result of the reduction in the high duties on imports from which they derive their value.

To conclude, present developments in the RSA are not leading to a situation in which it will be sufficiently more advantageous to produce low-cost/high volume garment categories for the international market there than in Lesotho as to encourage significant investment away from that country to the republic. The problems of the industry in Lesotho as a supplier of the international market result from developments in that market and within the kingdom itself and do not relate to what is happening to the industry in the republic.

B. EXPORTS TO THE SACU AREA

The position of Lesotho companies which serve only the South African market is more problematical. None of these companies went to Lesotho with the express intention of concentrating on what are, in effect, domestic sales - at least none of those interviewed - admitted to this: it was a strategic option resorted to only after these companies discovered that they could not operate profitably in the deteriorating international market of the early 1990s.

Because they are not exporting outside SACU, such companies are not able to use duty-free fabrics in their manufacturing process. This means that their only significant advantage over producers based in the RSA is lower wage costs. As noted above, it is perceived in some quarters that this advantage is reduced by lower levels of productivity and it is certainly off-set by higher costs in other areas - in particular the high cost and inefficiency of the public utilities. Given this, the incentives offered by the GNU, especially those designed to draw industry into the less-developed areas of the country may begin to seem very attractive. On the other hand, the attractions of these incentives will be short-term only. A likely outcome as the screen of protective tariffs surrounding the SACU market is progressively dismantled is that companies based in Lesotho will face increasing competition in the South African market not so much from the industry in the RSA itself as from low-cost imports.

PART THREE

AN ENABLING ENVIRONMENT FOR INDUSTRIAL DEVELOPMENT: FINDINGS AND RECOMMENDATIONS FOR GOVERNMENT ACTION

CHAPTER 8. POLICY FOR THE INDUSTRIAL SECTOR

8.1 FINDINGS

A. GUIDING PRINCIPLES OF AN INDUSTRIAL STRATEGY

a. Main problems of the economy

The two main problems facing the GoL in respect of the economy are:

- to increase domestic employment opportunities; and
- to increase foreign exchange earnings to compensate for the anticipated reductions in remittances from Basotho working in the RSA and the reduction in its share of Common Customs revenues consequent on the current SACU renegotiation.

The review of the macroeconomic situation in Lesotho in the light of current developments in the RSA in Part One suggests that the expansion and diversification of the manufacturing sector can help in resolving both these problems.

b. The need for export-oriented industrial investment

However, any attempt to increase the contribution of the industrial sector to the economy overall must rely principally on an expansion of export-oriented manufacturing activity.

This conclusion reflects the small size of the domestic market and the low level of *per capita* income which makes it impossible that Lesotho can sustain increased activity on anything like the scale required without substantial export sales. The withdrawal of large numbers of highly paid expatriate staff as a result of the scaling down of technical assistance operations in the kingdom - Chapter 1 above - will also adversely affect consumer expenditure.

In addition, the need for the RSA to reduce substantially its tariff levels both to meet the requirements of GATT membership and in the interests of improving the efficiency of its own industries means that the protection Lesotho manufacturing enterprises enjoy in their own domestic market and in the wider SACU against import competition from non-SACU sources will also be substantially reduced. (However, the significance of this factor is likely to be limited. In the case of the small-scale textile and garment manufacturers, these usually operate in areas of demand not supplied by importers, such as the production of school uniforms, national dress and craft items idiosyncratic to Lesotho.)

The main markets Lesotho industries should be seeking to serve are in the RSA and, further afield in North America and the EU. It would be unwise to expect to find significant markets in other sub-Saharan African economies at this stage in their development.[68] The implications of recognizing this for the disposition of Lesotho diplomatic representation and the formulation of foreign policy should be considered.

c. Labour-intensive industry

The main advantage Lesotho enjoys as a manufacturing location is low-cost labour. However, this is chiefly in relation to the RSA: labour inputs in Lesotho are understood to be more costly than in such competitors for investment capital as China, India, Indonesia and Viet Nam and comparable with those in other sub-Saharan African economies such as Uganda, Tanzania, Zambia, Zimbabwe and its LBSN neighbours. Nevertheless it is labour-intensive industries such as garment-making, shoemaking, component assembly and data-processing that are most likely to be attracted to Lesotho and should therefore be targeted in promotional programmes.

d. The main thrust of industrial policy

The industrial policy of GoL should, therefore, be largely concerned with promoting a general economic climate which gives the greatest possible encouragement to the export of manufactured goods and, even more important, to attracting additional investment in export-oriented labour-intensive industrial projects. This latter involves making potential investors aware of the advantages of Lesotho as an investment location for this type of industrial activity.

It is a mistake for the government to become involved directly in identifying specific export opportunities. This is the function of private sector agencies willing to risk their own capital resources. Nor should the GoL attempt to influence investment decision making processes in the supposed interests of policy goals such as increasing employment, generating foreign exchange, achieving backward linkages between export-oriented enterprises and other areas of industrial activity etc by intervening in the processes of microeconomic decision making. These objectives should be pursued through macroeconomic management only.

In other words, public resources should not be ventured on speculative investment projects nor should government attempt to impose its own patterns on investment decision makers. Experience in Lesotho and other LDCs suggests that such intervention is usually counter-productive because it is almost certain that it will come to be guided by political and social objectives rather than by commercial imperatives. (The garment quota allocation system is an example of this.) The role of the government in the development of the sector should, therefore, be in the areas of macroeconomic management, the provision of infrastructure and investment promotion.

It is argued that this does not rule out the promotion of Lesotho as an investment location for export-oriented, labour-intensive industrial projects in general terms. The promotion of Lesotho as an investment location should be a major aspect of industrial policy and can (and should) also involve specific promotional measures intended to attract investment in particular areas. (It will be noted that this report recommends one such exercise designed to attract investment in a knitwear project oriented towards the EU as well as the North American markets.)

It is understood that the GoL has already accepted this view of the objectives of industrial policy and of its own role in achieving those objectives. It is important, therefore, that policy decisions are always influenced by this understanding.

68/ The only exception here might be Kenya where there are limited opportunities for the sale of exotic African craft products. This might be an opportunity that could be examined by a strengthened Trade Promotion Unit.

B. GENERAL INDUSTRIAL POLICY - SPECIFIC MEASURES

The following matters are judged to require attention in the context of general industrial policy:

a. Investment code and the investment incentive regime

a.1 The advantages of codifying the incentive regime

It would be advantageous if the present investment and export incentives offered by the government and such other matters as unimpeded repatriation of profits and capital, security against expropriation of capital assets etc could be brought together into an investment code as has been done in many other countries.

The benefits of this would be in part promotional. The existence of such an instrument would assist in the work of drawing attention to Lesotho as an investment location. In addition, by being completely candid as to the benefits offered and the criteria that would be applied in granting them, they would address concerns (which are often expressed) about undue exercise of administrative discretion and unequal treatment of applicants. Developing a code would, therefore, be in the interests of transparency.

a.2 Review of the incentive regime

The drafting of an investment code would also be an occasion for detailed consideration of the investment incentives offered. Matters that might be considered include:

- The possibility of *pro rata* remissions of company income tax for export sales through a system of tax credits - this would require detailed knowledge of how much income tax LNDC-assisted companies pay under present arrangements to determine the cost of this concession in terms of revenue forgone;

- Expedited depreciation allowances for export-oriented companies;

- The use of the resources presently absorbed in the training grant to cover training in business practice and management in addition to the inculcation of mechanical skills as at the moment;

- The formalization of terms and conditions on which work-permits are issued to companies wishing to employ expatriate managers - see below.

It is recognized that Lesotho could not hope to compete with the RSA in terms of the generosity of the investment and export incentives it can offer. It is, indeed, doubtful whether the RSA itself can continue to afford them. In addition to which, the effect of its accession to the WTO has been to render a number of these incentives which depend upon grants or subsidies (as opposed to tax-breaks) doubtful - in particular, of course, the GEIS. Even if it could afford such measures, it is suggested that, given its own obligations under the GATT, the GoL would be ill-advised to attempt to compete with the South African GNU in this respect.

a.3 Inclusion of SME organizers and cooperatives

Consideration should be given to ensuring that the range of potential beneficiaries under the code includes companies which organize small producers - say of garments and craft products - either in their own industrial premises or on an outwork basis and cooperative ventures of this nature. (It will be recalled from the discussion of the SME sector in Chapter 4 above that, because of their superior managerial capabilities and access to credit, such organizations are generally more successful than independent SMEs.) Should this prove practical and acceptable, the terms and conditions under which such enterprises might achieve LNDC-assisted status would need to be determined.

a.4 Role of IPC/LNDC

Any consideration given to the introduction of an investment code would necessarily be accompanied by a review of the role of the IPC/LNDC which would, presumably, be the agency called upon to administer such a code and promote investment in Lesotho on the strength of it. This might include consideration of how that body could be made more 'pro-active' to the needs of investors - potential and actual - and whether or not, like the MEDIA in Mauritius, it should also assume an export promotion function. The continued need for a separate Trade Promotion Unit in the Ministry of Trade and Industry would form part of any such review.

b. Diversifying industrial investment projects

It is likely that Lesotho will continue to be mainly of interest to potential investors in garment projects and the main thrust of GoL promotional activity should be in this area. However, it would be desirable for it to seek to diversify the kingdom's manufacturing base and the emergence in recent years of a number of projects concerned with the manufacture of electronic products and the early indications that these are beginning to enjoy some export success suggests that this at least is an area that might be capable of further development. It is suggested that the prospects here should be reviewed and, if they are felt to be promising, a suitable promotional programme should be formulated.

It is proposed in the latter connection that such a study of the potential for investment other than in garment projects could also form the basis of a report on the industrial sector for use by IPC/LNDC as a promotional tool.

c. The small-scale/informal sector

The main function of the sector will continue to be the creation employment and this is the justification for government action to assist the organizations and individuals involved. However, the UNIDO team argues that, in formulating policy towards the sector, the GoL should not depart from the main tenets of its industrial strategy in order to promote outcomes considered socially desirable. The main aim of government action in this context is to assist the sector become better equipped to take advantage of the opportunities that arise. In particular it needs to address more specifically the main areas of weakness identified by the GEMINI report and confirmed by anecdotal evidence given to the team, i.e.:

- Inadequate technical and management skills. There are reasons for supposing that this may reflect disproportionate emphasis of available training programmes in imparting operative skills as opposed to those likely to be required by those in technical commercial and managerial positions;

- The difficulty in accessing credit for investment or working capital arising from the lending policies of the commercial banking sector. This is not to imply that the banks are wrong to emphasize the need for collateral or track-record, but to recognize that this creates difficulties for small businessmen (and women). This might be addressed by developing new types of credit agency, such as those promoted by the UNDP Small-scale Industries Project, and by expanding the present service which BEDCO offers small entrepreneurs in the development of business plans;

- Reported bias against small-scale producers in the operation of the system of justice - in particular as this discriminates against married women - and the administration of the taxation system. These matters need to be thoroughly rehearsed with such bodies as the

Lesotho Manufacturers' Association, the Lesotho Chamber of Commerce and Women in Business as a basis for government action.

It is suggested that, in the first instance at least, such a review should be undertaken by BAPS as part of its on-going functions under the Agro-Industrial Project.

d. Minimum wages

The advantages and disadvantages of having statutorily imposed minimum wages needs to be reconsidered. The chief advantage of such legislation is that, in conditions of high unemployment which exist in Lesotho, it protects employees from exploitation. (The term "exploitation" has, however, acquired tendentious overtones in this context.) It could, therefore, be argued to be a morally (as well as politically) justifiable intervention by the state in the operation of the market.

The disadvantages of such intervention are that it protects only those who can find work with employers willing and able to pay the minimum wage. It is an obstacle to the creation of employment opportunities that the unemployed might be willing to take up (say, women on a part-time basis). It discourages the development of incentive schemes based on rewarding productivity.

It is also a disincentive to foreign investors - even to those prepared to pay above the minimum wage in practice as many of the export-oriented garment-makers claim to. Hong Kong, Taiwanese and Mauritian entrepreneurs - who must rank high among those the government needs to attract to Lesotho - come from a culture in which worker's pay is decided by the balance of market forces as between management and labour. In all those countries, economic success and not official coercion has been the main factor ensuring a steady upward trend in wage-levels.

It could be argued that the abandonment of this mechanism in Lesotho would be in line with the overall industrial policy indicated above - i.e. that the government does not intervene in microeconomic decision making which is driven by market considerations. Although the UNIDO team is inclined to recommend reform, it recognizes that this could have a profound impact on the workers which benefit from the existing privilege - a minority of the whole, but politically influential - and on their dependents. And, even if the actual impact turned out to be less than might be feared, initially it would be perceived by those affected as an assault on their interests. Because of the political sensitivity and social implications, the issues pertaining to the minimum wage should be carefully reviewed.

e. Labour legislation

Perceived labour unrest is a major cause of disquiet among industrial managements in Lesotho at the present time. It is important to note that the reasons of labour unrest are partly ascribed to the attitude of the employer. However, it is not necessary to say that discontent is never justified to agree that the often violently rumbustious manner in which even justifiable grievances are expressed is unacceptable in the national interest (in that it definitely upsets foreign investors) or to acknowledge that feelings of dissatisfaction are often exacerbated by agitators for their own ends.

It could be that the provisions of the present labour code will address the worst manifestations of this problem: that legislation needs time to prove its worth in changing attitudes and behaviour. The process requires, however, to be monitored and the question of whether the code needs to be modified - say, by introducing some of the provisions of the British trade union legislation - considered.

f. Work permits for expatriate managers

The chief objection to the present system for determining whether or not work permits should or should not be issued is the lack of transparency surrounding the process.

In formulating its policy on this matter the GoL needs to take two factors into account:

- Resentment among locals at the perceived passing over of Basotho in favour of foreigners in appointments to (relatively) well-paid posts;

- The need of managers to be able to employ the staff they consider they need and are prepared to pay a high premium in order to attract - as well as meeting the additional costs associated with importing men (and women) with the required skills and experience.

Whatever decision the GoL comes on this matter needs to be clearly stated. The practical implications in terms of the numbers that companies can recruit and the terms and conditions of their employment also need to be wholly transparent. Scope for administrative discretion on the part of the Department of Labour in determining individual applications needs to be reduced to a minimum and strict time-limits set on the decision making process after which a favourable response should be presumed.

There would be advantages in covering this matter in the proposed Investment Code - see above.

g. Public utilities

Although the cost of such services as water, electric power and telecommunications (the WET factor) is said to be a relatively small item in overall industrial costs - see Chapter 5.3 above - that they are more costly than in the RSA seems to be considered a count against Lesotho as an investment location. Almost certainly more serious, the unreliability of these services - in Maputsoe more so than in Maseru or Thetsane - adds an element of uncertainty to manufacturing operations with unpredictable effects on costs in terms of days lost, production targets missed etc.

This is an issue that the government needs to consider urgently and to be known to be considering - perhaps by involving industry representatives in its deliberations. The completion of the LHWP would seem to offer an opportunity for fundamental reforms in the provision of these services.

h. Land tenure

Making it easier for individuals and organizations to acquire ownership or long-term leases on the land from which they operate would be advantageous in two respects:

- Foreign investors who have acquired the land on which their factory stands would have an increased sense of commitment to Lesotho as such - although it could be argued that such a sense, based on the commercial success of their ventures, is a motive for them wishing to acquire land in the first place. Nevertheless, facilitating the acquisition of land for industrial purposes will go some way towards addressing the common criticism of foreign-owned, export-oriented ventures that they are "foot-loose".

- Basotho entrepreneurs wishing to enter into joint-ventures with overseas investors would be able to offer the site as part of their contribution to the equity stock, thus facilitating the build-up of local participation in industrial development.

i. Public holidays

Industrialists in Lesotho claim that there are too many public holidays on which they are either obliged to pay for days not worked or to pay additionally to persuade their workers to ignore the break. They are, however, even more critical of the propensity of the government to declare additional *ad hoc* holidays at very short notice thus upsetting work schedules as well as adding to costs. Some order needs to be brought into this situation.

8.2 RECOMMENDED ACTION

A. OVERALL STRATEGY

Government policy with regard to the development of industrial policy should, as far as possible, be guided by the following strategic principles:

- Growth is only likely to occur if it is export-led;

- The role of the government in achieving this is to ensure a macroeconomic environment as far as possible favourable to export activity and the promotion of export-oriented projects;

- It should as far as possible eschew the temptation to involve itself in the processes of microeconomic decision making;

- In formulating its investment promotion activity it should:
    - Have regard to the fact that the main markets for Lesotho exports are likely to be found in the RSA, North America and Western Europe; and
    - It should have regard to the fact that Lesotho is most likely to attract investment in labour-intensive enterprises.

As already noted, these guidelines are already accepted as the basis of government policy in principle. However, it is important that they be acknowledged in practice as overriding criteria in formulating all aspects of industrial policy.

B. SPECIFIC POLICY MEASURES

a. Introduction of an investment code and review of the incentive regime

The government should consider the introduction of an investment code and use this as an opportunity to consider in detail the various incentives offered, the inclusion of suitable SME organizations and the role of the IPC/LNDC as the administering agency.[69/]

b. Diversification of industrial base

Consideration should be given to the potential for attracting further investment in projects outside the garment area. A preliminary review should be undertaken, concentrating particularly in the area of electronics products assembly projects, taking account of the experience of existing enterprises and the potential of the market in the RSA and elsewhere in sub-Saharan Africa.

It is further proposed that, if the preliminary suggests that there are opportunities for investment outside the garment area, that a report should be prepared on the industrial sector in general terms which could be used by IPC/LNDC for investment promotional purposes. It is suggested

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69/ One area in which it is understood that the IPC/LNDC is eager to expand the services it is able to offer investors and potential investors is in the assistance it is able to give them in complying with relevant regulations. In other words, it wishes to become an effective "one-stop shop" so that its "clients" do not, as at present, have to progress from office to office when they wish to establish a project.

that the series of reports on Third World countries which have been either prepared or are in course of preparation by UNIDO's Industrial Development Review Unit would be the most appropriate models for such a publication.[70]

c. **Land tenure**

The possibility of relaxing the land tenure law of 1979 in cases of industrial users should be considered. It could promote the emergence of a class of Basotho entrepreneurs if occupiers of industrial sites were able to use these to acquire equity in a venture or as collateral for loans. Similarly, the ability to own or acquire long leases on their sites could encourage a sense of commitment to Lesotho on the part of foreign investors.

d. **The small-scale/informal sector**

BAPS should be instructed to review the following matters with a view to making specific recommendations for government action in the overall context of industrial policy:

- The adequacy and appropriateness of existing industrial training courses, particularly having regard to the reported wide-spread lack of business and technical skills. Proposals should be made for redressing any imbalance, particularly in the case of courses offered by BEDCO;

- The need for alternative forms of credit agency giving the difficulty of many small-scale industrial operators in meeting the lending criteria of the commercial banks. it is envisaged that this review would take particular note of the experience of the UNDP-funded Small-scale Industry Project as well as of self-help initiatives such as that of the Lesotho Manufacturers' Association. It should also assess the experience of BEDCO in assisting small-scale producers prepare bankable business plans backed up by a systematic review of case studies;

- Ways in which the legal system and the administration of the taxation system may discriminate against small-scale producers in Lesotho, not excluding female small producers. In this connection BAPS should be directed to seek the cooperation of the LMA, the Lesotho Chamber of Commerce, Women in Business and other bodies representative of small business.

e. **Minimum wage legislation**

The existing requirement on employers to pay minimum wages should be reviewed taking into account the overall approach to policy measures which affect the industrial sector. However, the UNIDO recognizes the likely political sensitivity and social consequences of this matter and realizes the difficulties involved.

f. **Labour legislation**

The success of the existing Labour Code in introducing order into disputes between management and labour should be carefully monitored and the possibility of introducing additional restraints on lawlessness in the work-place considered.

70/ UNIDO Industrial Development Reviews focus on the emerging investment and trade opportunities across manufacturing subsectors and analyse the prospects that are of immediate interest to potential investors.

g. Work permits

Formal criteria for use by the Department of Labour in considering applications for work permits for foreign staff should be drawn up and the advantages of publishing these considered.

h. Supply of public utilities

The supply of water, electric power and telecommunications services should be considered with a view to:

- bringing their cost into line with those prevailing in the RSA; and

- improving reliability.

i. Public holidays

The present calendar of public holidays should be considered having regard to the economic costs of having so many of these. Any *ad hoc* national celebrations should, as far as possible, be scheduled to take place on Sundays or existing holidays and not on normal working days.

CHAPTER 9. POLICY FOR THE TEXTILE AND GARMENT INDUSTRIES

9.1 TEXTILE FIBRE

A. FINDINGS

The GoL has had carried out a feasibility study of a proposed plant for processing wool and mohair fibre in Lesotho which would then be put onto the world market as opposed to being sent to auction in the RSA as is presently done with the raw product. This study indicated that such a project would be commercially viable. However, no investors have been identified who are willing to assume the whole cost of developing this scheme and partial public financing would be necessary to enable it to get off the ground. This raises some doubts as to whether investment in this project would represent the best possible use of the public resources involved. The decision to support it should be reviewed in the light of this consideration and of the general principle that the government should not become involved in the process of microeconomic decision-making - see above.

B. RECOMMENDED ACTION

The decision to part-finance the wool/mohair processing project should be reconsidered in the light of other calls on the public purse and the government's overall industrial strategy.

9.2 EXPORT-ORIENTED GARMENT-MAKING

A. INTRODUCTION

The problems of export-oriented garment-making in Lesotho are, in general terms, those common to the manufacturing sector as a whole. This is to be expected given the importance of that industry as a contributor to manufacturing value added. However, there are a number of matters relating specifically to garment production to which GoL should give its attention. Perhaps the most important of these is to determine the role of garment-making in the context of its overall policy for the industrial sector.

However, the industry has, in addition, a number of problems peculiar to itself which also require attention. These arise from:

- The deterioration of the international apparel market exacerbated by the imposition of severe export quotas on the main products supplied by Lesotho producers in their main market - the USA;

- The deterioration in the industry's comparative advantage in terms of production costs - especially *vis-à-vis* the industry in the RSA. As already noted, it is difficult to determine how far its position has in fact deteriorated in this respect as opposed to companies perceiving that it has deteriorated. Whatever the facts the matter, it is suggested that some attention needs to be given to remedying the situation - which is, essentially, a matter of industry *morale*.

The ability of the GoL to influence the international market in which its apparel producers have to operate is limited. However, it can exercise a beneficial influence in several areas:

- By encouraging new investment in Lesotho having particular regard to the need to attract garment-makers with experience of European markets and the resources to develop exports to that region from a production base in Lesotho;

- By ensuring it secures the best possible terms in its forthcoming textile trade agreement with the USA. In this connection Lesotho should:

    - Finalize its membership with the WTO as soon as possible;

    - Consider its procedures for issuing certificates of Lesotho origin to export for export shipments;

    - Undertake a far-reaching enquiry of the reasons for discrepancies between its own record of its usage of the US export quota on trousers and that of the US Government;

- By extending its present agreement with the Commission of the European Communities setting aside the provisions of the Lomé Convention regarding the rules of origin for products seeking duty-free access to EU markets and expanding the number of products covered by that agreement;

- By changing the existing system for allocating US export quotas among Lesotho producers.

B. THE STRATEGIC ROLE OF THE INDUSTRY

a. Findings

a.1 The new international textile and garment trade regime

The growth of garment industries in developing countries such as Lesotho since the mid-1970s has been predicated on the basis of the MFA textile trade regime. By imposing limits on the development of textile and garment exports from any one source, this has encouraged suppliers who are unable to secure enough of their own national quotas to meet their marketing requirements to move production off-shore to locations less subject to such restriction. The decision to phase out the MFA regime and subject international trade to the normal rules of the GATT must be expected to remove this incentive. However, this will happen only over a ten-year period.

This raises the question as to how far foreign manufacturers in locations which must be considered fairly marginal in terms of the overall world market will wish to stay when the option becomes available of moving to locations which, rightly or wrongly, they perceive to be more advantageous to them in terms of production costs. Such locations include China, India, Pakistan, Indonesia, almost certainly in the near future, Viet Nam, and, quite possibly in the slightly longer term, Cambodia. Economic success will mean that wage costs in these countries will eventually increase. This has been amply demonstrated in the case of other one-time developing countries such as the Republic of Korea, Taiwan Province, Hong Kong, Mauritius etc. Even now in China, wage levels in the Special Economic Zones have begun to increase significantly. However, for some years to come the countries mentioned will be able to offer labour at appreciably lower costs than Lesotho which cannot entirely escape the consequences for industrial wages of a cost of living effectively linked to that in the RSA.

The question of accession to the WTO of China, by far the most formidable of these competitors for investment, has, of course, still to be determined. The organization of its economy still falls short of GATT requirements in a number of areas despite the revolution carried out by the Deng regime since 1979. How far the successors to the ailing Deng will be willing/able to pursue his liberalization objectives is also by no means clear. There is also the matter of China's human rights record. It is possible, therefore, that it will not be admitted to the WTO and that its exports will as a consequence continue to be subject to a special regime, including quota limits on textiles and garments.

However, the experience of recent years suggests that the GoL should work on the assumption that China will be admitted as a full member of the WTO. China is determined to be admitted and the governments of the west seem to regard this as a price worth paying in order to secure their industries' access to the massive investment opportunities of the Chinese economy. China will, therefore, eventually be subject to the ATC on the same terms as other textile and garment suppliers. This should mean that by 2005[71/] there will be no quantitative restrictions imposed on its exports of these goods.

a.2 Implications for Lesotho as a garment industry investment location

The phasing out of the MFA regime will mean that by 2005 it will no longer be possible for the USA to impose quotas on garment exports from Lesotho. However, this will apply to every single supplier country, many of which will have lower production costs than Lesotho and will certainly be regarded by the main international investors as more economic locations for the manufacture of these products. In these circumstances, Lesotho will find it difficult to attract investors interested in supplying low-value garments in bulk to one of the two main world market - i.e. the USA.

However, Lesotho will retain one important advantage over supply sources in the Far East, South East Asia and the Indian sub-continent in relation to the other main world market - i.e. the EU. As an ACP state it has access to the EU market on a duty-free basis. Even by 2005, the EU will still impose tariffs averaging 11.4 per cent *ad valorem* on imports from Asian sources - see Appendix I. Presently most Lesotho products do not qualify for duty-free access under Lomé Convention rules of origin, but, as has been noted, it has been able to negotiate derogations from this which can probably be extended. Furthermore, consideration should be given to attracting new investment that does qualify for duty-free access outright. These matters are discussed in more detail below.

Even accepting that Lesotho will find itself operating in a much more competitive international market from 2005 onwards, this is ten years away and restrictions on the main traded products will not be lifted until very near the end of that period. Therefore, the ATC creates no immediate incentive for existing producers to move elsewhere. Furthermore, the lead-times which Chinese garment industry investors normally allow for new projects to break even and to begin to make profits is certainly much shorter than this. It is, therefore, still possible that more short-term investment could be attracted to the country.

There is also no reason why Lesotho should continue to be regarded as a location suitable only for the manufacture of basic low-value garments where the question of the cost of labour inputs is particularly sensitive. To change this perception and to encourage the production of higher-value

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71/ i.e. the ending of the phase-out of the MFA textile trade regime. See Appendix I for a discussion of this.

products would, admittedly, require a transformation of workforce attitudes, but this need not be dismissed as impossible.

a.3 Implications for Government policy

The GoL should not neglect the export-oriented garment industry if only on the pragmatic grounds that there is no other activity which could be developed in a short time capable of absorbing so much labour or making a comparable contribution to the national economy in other ways. Attention should, therefore, be given to the specific problems presently troubling the industry which are discussed in the following section.

b. Recommended action

The GoL should continue to regard the manufacture of garments for export as a major contributor to GDP and give it appropriate encouragement.

A number of specific measures that might be considered in this connection are outlined below.

C. SPECIFIC MEASURES

a. Joint government/industry Garment Council (JGIGC)

a.1 Findings

Apart from a number of more specific problems, it is felt that the industry is suffering from low *morale* arising from a perception that the government is not aware of its difficulties, is not interested in learning about them and still less interested in taking effective action. One way of addressing this problem would be the establishment of a high level joint government/industry Garment Council which would meet regularly to discuss industry concerns and possible remedies.

It is argued that the garment industry is sufficiently important to the Lesotho economy to justify a the existence of a body concerned with its interests whose representations would carry weight at the highest levels of the government and would form an acknowledged part of the policy-making machinery. Such a body would complement the regular contacts maintained by the LNDC. (Industry representatives had high praise for the enthusiasm and professional approach of LNDC officers.)

The establishment of JGIGC would fulfil two purposes:

- By demonstrating the importance that the government attached to the industry's concerns, its mere existence would help restore producer confidence;

- It would give industry representatives an effective say in the formulation of government policy, thus making it more likely that the measures taken are appropriate to the needs of the situation. It is felt that this body should consider the specific recommendations for government action relating to the industry outlined below and, where it is concluded that these should be pursued, monitor their detailed implementation.

It is suggested that a JGIGC could also be an appropriate instrument for fostering linkages between export-oriented garment-makers and SMEs which has been a neglected aspect of the GoL industrial policy. At the very least it would provide a forum in which representatives of the two sectors of the industry could come into contact with each other and increase the likelihood that specific operations could be sub-contracted. (The embroidery of female tops and dresses is one possible activity that springs to mind.)

It is assumed that the council would not under any circumstances intervene in matters affecting the day-to-day operation of individual garment companies or in investment decision making processes which would be the sole responsibility of the management entrusted with these duties.

a.2 Recommendations

It is recommended that GoL should convene an early meeting with the senior managers of the export-oriented garment producers with a view to interesting them in the establishment of a JGIGC to act as a forum for the consideration of matters of common concern and to assist in the formulation of government economic policy.

It is recommended that this council should be chaired by the Minister of Trade and Industry, or by some suitable alternate, with the director of the LNDC or the Industrial Promotion Council as secretary. *Ex officio* members on the government side should include, *inter alia*, the head of the department responsible for managing the national textile quotas, the Chief Customs officer, a senior economist from the Ministry of Finance and the Labour Commissioner. On the industry side, the secretary of the Garment Exporters' Association should sit as of right and represent the garment-makers as a body. He should be supported by at least two of the general managers of garment producing companies, chosen to represent the South African and the Far Eastern investment interests.

Consideration should be given to the possibility of a representative of BAPS sitting as of right together with a member directly chosen by the SMEs. (Suitable machinery for selecting a suitable representative of the SMEs would need to be considered. It is suggested that the LMA which represents some 400 enterprises in this area should be involved in such deliberations.)

Meetings of the JGIGC should be regular and frequent (at least every two months) and be regarded as a prime call on the time of its members - particularly the Chairman and the Secretary. However, the exact timetable should be determined by the members at the first meeting.

b. Attracting additional investors

b.1 Findings

b.1.1 Why new suppliers are needed

The severe effect on the industry's export prospects of the imposition of US quotas on exports of trousers etc and knitted tops was exacerbated by the inability of the companies established in Lesotho either to develop sales for other products not under quota in the US market or (with some exceptions) take advantage of the improved access to the EU market negotiated by the GoL in 1993.

To a large extent, of course, this failure was a result of factors beyond the control of the companies. For instance, it was the decline in US consumer expenditure on clothing that destroyed the market for surfing wear developed by Lesotho Clothing.

Similarly, although one effect of recession in the EU economies in the early 1990s was to encourage an increase in imports of apparel from lower cost non-EU sources - such as Lesotho - the market was extremely competitive and this may partly explain Lesotho's limited success in finding new outlets in these countries in the first twenty one months of the lifetime of the derogation quotas.

Nevertheless, some aspects of the companies' performance are open to criticism. The difficulty many of them experienced in adjusting to the production of items other than basic trousers and knitted tops has been noted. This can be attributed in part to difficulties in persuading workforces to adapt to the production of other items. However, there is ample evidence that this problem can be resolved in Lesotho factories if the workers are properly motivated. The resistance to the need to learn new procedures in order to produce unfamiliar product lines observed in some factories does not relate to any inherent character defect which sets the Basotho apart from the rest of mankind. It has been adequately demonstrated that Basotho workforces are able to make the necessary adjustments if properly handled. The problems encountered by some companies are an expression of dissatisfaction with specific conditions some of which it is within the power of management to ameliorate.

It is also possible that the failure of companies to develop alternative outlets for clothing from their Lesotho factories is attributable, in part at least, to decisions to manufacture higher value items in other plant elsewhere in the world and to send the higher grade managers to those locations. (It is unlikely, for instance, that low value shirts and trousers would be made in high wage cost locations such as Taiwan Province, Hong Kong, Singapore and California where some of the groups operating in Lesotho also have factories.) Such decisions are, of course, taken on commercial grounds. It would be futile and probably counterproductive for the GoL to attempt to influence them other than by making Lesotho more attractive for investors. It is, after all, the basis of the LNDC's promotional appeal that producers should establish plant in Lesotho because it would be to their commercial benefit to do so.

It is also evident that many of the Far Eastern groups with production facilities in Lesotho have little experience of selling into European markets. Taiwanese producers in general terms have tended to concentrate more exclusively on the North American market than those in Hong Kong in particular. (It will have been noted that the Chinese company which most successfully responded to the new opportunities opened up in the EU market by the derogations secured there was the Hong Kong-owned CGM, although the enterprise of the Taiwanese-owned Lesotho Hawk and C&Y in developing sales in what is understood to be a new market for those companies is also remarked.)

A number of the South African groups with mills in Lesotho have historically had more developed links with EU markets than their Taiwanese counterparts. However, partly for internal reasons and partly because the international market had become more competitive in recent years, they now find it very difficult to sustain their position there and a number of them have given up the struggle.

b.1.2 Reasons for preferring a knitwear producer with experience of EU markets

These considerations suggest that the GoL should attempt to recruit another group to invest in an export-oriented garment manufacturing project in the country. However, any such effort should be very specifically targeted towards knitwear producers (i.e. companies producing items falling under MFA category 5, knitted cardigans, pullovers etc). Preference should also be given to identifying potential investors with experience of the EU market as well as the US market.

Knitwear project: The recommendation that preference be given to a knitwear producer, reflects the Lomé Convention rules of origin governing duty free access for garments from ACP countries. These state that such garments must be knitted from yarn or produced from textile fabric woven from yarn. As Lesotho has no industrial weaving capacity, any company seeking to manufacture apparel on the basis of locally woven fabrics would have to produce these itself. However, the capital and operating costs of a plant capable of performing these operations would be much higher than those of a commercially viable knitting mill.

Admittedly, woven garments originating from an ACP country can qualify for duty-free access to the EU under the Lomé Convention if they are made from fabric from another ACP country. However, the experience of existing Lesotho producers suggests that only denim from such sources as Mauritius and Botswana can compete economically with material from Far Eastern sources while top-weight fabrics are almost invariably more cheaply and more reliably sourced from that region. In any case, it is in Lesotho's interests that as much value as possible should be added in Lesotho itself.

For all these reasons preference should be given to attracting a knitting project. However, the failure of the KTI project - see Chapter 4.1 - suggests that it would be very difficult to attract another venture to produce knitted fabric in the present condition of the national and international market and it is for this reason that a knitwear project is proposed.

EU orientation: In suggesting that, in seeking potential investors, preference should be given to companies with experience of the European market, it is not proposed that experience of the US market should not also be a criterion in identifying potential investors. The USA will continue to be the world's largest single market serviced by a relatively small number of distributors and, for this reason, it will remain the most attractive outlet for garment producers. However, the EU markets taken together are already larger than that in the USA and it will increasingly take on the characteristics of a true single market with pan-European distributors equivalent to K-Mart, Sears, J.C. Penney etc. This process was encouraged by the economic recession of the early 1990s which also promoted a greater dependence on low-cost sources of supply outside the EU.[72] An additional consideration is that Mexican and Caribbean producers will enjoy an increasing advantage over other LDC suppliers in the US market, on the basis of preferential access under the NAFTA and their geographic proximity.

b.1.3 Criteria for selecting potential investors

Potential investors in new garment projects should, therefore, be sought among companies with the following characteristics:

- A track-record of producing knitwear for sale in European countries (particularly Germany, the UK, and France) as well as in the USA;

- A demonstrated capacity for producing higher-value as well as basic clothing items;

- The financial resources to sustain a project in Lesotho while this is being worked up to an efficient level of operation;

- Experience of manufacturing in off-shore locations, preferably beyond the Far East and South-East Asia - i.e. so it has a demonstrable capacity for training and motivating non-Chinese and, preferably, non-Asian workforces.

In addition, the companies identified for a specific promotional effort to persuade them to come to Lesotho should be under pressure from production costs and/or shortage of US and European quota in their present main production locations. These factors might be expected to predispose them to consider an additional off-shore manufacturing location where such pressures would be reduced.

b.1.4 Where potential investors should be sought

It is recommended that potential investors should be sought in Hong Kong and Mauritius.

Hong Kong: A manufacturing group conforming to these criteria would be most likely to be found in Hong Kong.

72/ See P.J.B. Steele, "Textile and garment sourcing and the single European market", Textile Outlook International No. 57, January 1995, Textiles Intelligence Ltd.

It is likely that by now, most Hong Kong garment producers have made their dispositions for the takeover of the British colony by China and those wishing to develop precautionary off-shore manufacturing locations beyond the reach of a Chinese Government determined to renege on its commitments in the Joint Declaration with the UK of 1984 and its own Basic Law will have already done this.

However, there will almost certainly be companies considering such a move for the reasons already suggested. Labour is now so costly in Hong Kong relative to almost any LDC manufacturing location that, for the most part, only the higher value ready-to-wear clothing lines are actually produced in the colony itself.[73] It is unlikely that such operations could be taken over by an inexperienced workforce in Lesotho. However, it might be possible to transfer appropriate work from locations such as China and other countries now experiencing pressure on quotas or to use the Lesotho plant to supplement the efforts of factories in such countries.

Mauritius: However, in addition to Hong Kong, suitable candidates might also be sought in Mauritius, possibly among garment-makers associated with Hong Kong groups. Mauritius might prove a fruitful source for a potential investor in Lesotho for a number of reasons:

- The Government of Mauritius is eager to diversify its industrial base away from what it now considers to be an excessive reliance on labour-intensive garment manufacture. It is understood that it might be prepared to encourage manufacturers to relocate away from the island, particularly the production of lower value items, by making available the marketing facilities of the Mauritius Export Development and Investment Authority (MEDIA) where this can supplement the companies' own capabilities in this area;[74]

- The very success of Mauritius since it passed its Export Processing Zone Act in 1970 in achieving export-led growth has put pressure on its labour resource with a corresponding impact on labour costs;

- The Mauritian clothing industry has particular experience of the EU market, particularly in the area of cotton and wool knitwear produced from yarn;

- Many of the Mauritian companies are associated with Hong Kong garment producers and are able to call upon their marketing expertise and, possibly, their resources.

b.2 Recommended action

It is recommended that the GoL take steps to identify possible new investors in Hong Kong and Mauritius to establish a knitwear plant oriented towards the European as well as the US market and then consider an appropriate promotional effort to acquaint these companies with the advantages of Lesotho as an investment location.

In order to ensure any such promotional effort has the greatest possible impact, it should be undertaken in concert with a determined effort to implement the other recommendations of this report.

73/ For a discussion of how Hong Kong companies allocate orders between production facilities in different countries according to production costs see P.J.B. Steele, "Hong Kong clothing: waiting for China", *op. cit.*

74/ The UNIDO mission understands that a number of Mauritian knitwear factories have relocated to Madagascar on this basis.

c. **Negotiating a new textile trade agreement with the USA**

c.1 **Background to recommended action**

General

It should be assumed that the US Government will insist eventually on negotiating a new textile trade agreement with Lesotho if producers in the kingdom maintain shipments of the products which were under quota until December, 1994, at 1994 levels. Furthermore, as indicated in Chapter 6.2.C above, there is good reason to suppose that the fraudulent transshipment items falling within the trouser etc category (TSUSA class. 338B/339B/638B/639B) to secure for these Lesotho origin continues apace - it is understood that the US Government's representatives have expressed this concern. In preparation for an approach by the Government of the USA, GoL should give attention to:

- Completing its accession to the WTO;
- Discouraging shipments to the USA in excess of national export quotas by tightening up the monitoring of garment exports, especially where this involves foreign-produced goods for which Lesotho origin is falsely established;
- Preparing arguments for maximizing quota levels.

Membership of the WTO

It would be to Lesotho's advantage to enter the negotiation of new textile trade agreement as a full member of the WTO having completed all national and international formalities to realize the decision that it is understood the GoL has already taken in principle.

Almost certainly, the US Government will frame its proposals as though Lesotho was a member of the ATC - just as it proceeded under the MFA rules in the 1992 agreement even though Lesotho was not then a member of the GATT. However, it would be better for the Lesotho negotiating position that the US representatives be obliged to proceed in this way - i.e. because its relations with Lesotho in respect of textile trade are by treaty governed by ATC rules under the GATT - rather that it should be able to present this as some sort of voluntary concession on its part for which it might reasonably demand a *quid pro quo* in the matter of lower quota levels and quota growth-rate and/or harsh anti-transshipment provisions. It is understood from the WTO in Geneva that the GoL had still to complete the formalities of joining the organization at end-March, 1995.

Measures to control the export of garment categories under quota

The bargaining position of Lesotho in negotiating a new textile trade agreement would be greatly strengthened if it were to be able to demonstrate that it had taken additional steps to ensure that goods do not arrive in the USA certified as being of Lesotho origin when they do not qualify for that description. The system most trusted by the US Customs in this respect is that operated by the Hong Kong Department of Trade. An overview of this system will be found in Appendix IV of this report. It is suggested that the GoL should adopt the system, modifying it according to its own specific needs.

In addition, the Lesotho Customs should be directed to seek the cooperation of South African Customs in investigating claims that South African goods are sometimes added to Lesotho containers on their passage through that country. It is difficult to understand why South African producers should wish to resort to this subterfuge now that they are free to trade directly with the USA - especially as South African garment exports to the USA are not limited by quotas - and enquiries should probably be made among the Lesotho producers who ship to the USA to determine whether this is still a problem before a formal approach is made to the Government of the RSA.

Finally, when the other measures have been put in train, the GoL should acknowledge that fraudulent transshipment outside the Lesotho jurisdiction may be a problem and offer to cooperate with the US Government in suppressing this in ways that do not punish the Lesotho industry as a whole for the possible transgressions of others or impinge on Lesotho sovereignty.

Future US export quota levels

It was not possible to discover whether the US Government will wish to proceed in renegotiating a renewal of its former textile trade agreement with Lesotho on the basis that the quotas should be an extension of those in force up until end-November, 1994, or whether it will prefer to seek new restrictions under the safeguard mechanism of the ATC.

In the former case, the US Government could argue that the 1993/1994 quotas should be the basis for calculating the 1994-95 base-level, although it would be obliged to allow a 16 per cent increase in the annual growth-rates in force under the last agreement - i.e. the 1994/95 quotas would have to be 6.96 per cent above the comparable 1993/94 level rather than 6 per cent. In this case the minimum levels Lesotho could demand would be:

-	Knit shirts etc (excluding T-shirts, tank tops etc)	861,669 dozen pieces
-	Trousers etc	425,166 dozen pieces

On the other hand, if the US Government were to wish to treat the quotas as new restraints under the Article 6 safeguard clause, the minimum level of restraint would be as laid down in para 8 - i.e. "... the level of restraint shall be fixed at a level not lower than the actual level of exports or imports from the Member or Members (of the WTO) concerned during the 12-month period terminating two months preceding the month in which the request for consultation was made.". Assuming that the US Note No. 94-25 to the Minister of Foreign Affairs dated 14 November 1994, be deemed the "request for consultation" and the US record of its imports in the year to end-September, 1994, be used for calculation purposes (as opposed to the Lesotho record of its exports), the quotas for 1994-1995 would be:

-	Knit shirts etc	785,503 dozen pieces
-	Trousers etc	376,154 dozen pieces

Prima facie, this suggests that it would be more advantageous to Lesotho that the quotas should be treated as an extension of those in force in 1992/94. However, under the safeguard mechanism, Lesotho would qualify for favourable treatment under para 6.(a) and 6.(b.) On the other hand, this provision might also apply in the case of extended MFA quotas. Specialist advice should be sought in this matter in preparing the Lesotho negotiating brief.

c.2 Recommended action

It is recommended that the following actions be taken by the GoL in preparation for negotiations on a renewal of the US-Lesotho textile trade agreement:

- That the completion of all necessary measures relating to Lesotho's accession to the WTO be treated as a matter of the utmost urgency in the ordering of government business;

- That an investigation of complaints about the fraudulent attribution of Lesotho origin to non-Lesotho imports into the US market should be undertaken and, if it seemed appropriate, this be followed up by a high-level enquiry to resolve this problem;

- That a review be undertaken of procedures for authorizing the export of textile and garment products with a view to making any necessary improvements in the present system;

- That advice be sought from an agency with experience of the negotiation of textile trade agreements under the MFA with a view to preparing a brief for the GoL for the forthcoming textile trade negotiations with the USA.

d. Extension of current derogation agreement with the EU

d.1 Background to recommended action

It is unlikely that in the foreseeable future it will be economic to produce woven or knitted fabric for garment production in Lesotho. It will not be possible, therefore, to manufacture garments conforming to the Lomé Convention criteria of origin for duty-free access to the EU market on the basis of local materials. Incentives to encourage the industry to locate fabric sources in ACP countries, the SACU and the EU itself, might be considered. However, it should be recognized that Indian and Far Eastern sources are usually more economic and that the Chinese-owned Lesotho garment-makers may have preferential access to these sources on the basis of commercial agreements entered into by their group head offices.

In view of this, it is recommended that the GoL should begin to think in terms of extending its present agreement with the EU for five more years. The same products should continue to be covered.

In addition, the possibility of introducing a shorter-term derogation covering knitwear (particularly sweaters, pullovers etc) might be explored with the EU. The purpose of this would be to allow a newly-established producer to export items based on imported panels for up to one year to allow it time to work up its production capacity in Lesotho to internationally competitive levels of efficiency. (Any derogation for this product should not be sought on the same terms as that applying to the products covered by the present agreement or the proposed future agreement - i.e. it should not be valid for an extended period - as it is desirable that any knitwear producer attracted to Lesotho should begin to export items with the highest possible local added value as soon as possible. This means that it should be knitting panels in Lesotho as soon as possible. To encourage this, the GoL might make it a condition of the new company's operation in the country that, after twelve months, panels cannot be imported from Mauritius or other ACP countries.)

d.2 Recommended action

The GoL should:

- Make preparations for requesting an extension of the present agreement derogating from the Lomé Convention rules of origin for certain garment categories for five further years from end-March, 1996;

- Explore the possibility of introducing an additional derogation for knitted sweaters etc (EU MFA category 5) manufactured from cotton, wool, mmf and silk and silk blends allowing for the import into the EU on a duty-free basis of items based on imported panels for one year only. This derogation should be capable of being brought into force by the GoL at any time during the extended agreement simply by giving notice to the European Commission.

e. Allocation of national export quotas to garment producers

e.1 Background to recommended action

The present system

The present system of allocating the US export quotas to individual garment producers is judged to be not entirely satisfactory and should be modified. It is considered that it was a mistake on the part of the GoL to have compounded the impact of a reduction in anticipated rates of growth on those companies which had been most successful in developing sales of affected products by insisting in addition on absolute reductions in their permitted export levels. It has been demonstrated that this was the consequence of the operation of the present system. This must have affected their ability to finance the development of alternative product lines and could have had a deleterious effect on their overall financial situation.

It is acknowledged that the Ministry of Trade and Industry has shown itself willing to reallocate unwanted quota in the course of a quota year, but the inadequacy of its system for monitoring quota usage and the lack of any mechanism at its disposal to compel or, at least, encourage, those with unwanted quota to surrender it in good time has made it difficult for those seeking additional quota to conclude possible export sales and plan their production programmes. This has meant that, according to Lesotho records if not those of the US Government, the national trouser quota has been under-utilized.

The object of the present system was to encourage the maximum employment of labour. It is argued that this would best be secured as a result of the commercial success of garment-makers rather than by direct government intervention. Garment-making is by its nature labour-intensive and higher levels of output almost invariably require additional employment. Admittedly, savings can be made as a result of improved manpower productivity, but it is in the long-term interests of the industry in Lesotho that this should be encouraged and not discouraged which is the effect of the present system. In addition, there is every possibility that the weighting put on the labour factor in allocating quota has encouraged companies to overstate the numbers they employ.

Suggested reforms

As Lesotho is likely to be compelled to accept continued restraint on its exports of certain products, the prime objective of government policy in this regard should be to ensure that the quotas are fully utilized. International experience suggests that this is best secured by:

- Basing the allocation of quotas *pro rata* on past performance;
- Ensuring that unwanted quota is surrendered to other producers, requiring his to be done as early as possible in each quota-year so that orders can be confident'y accepted and production planned;
- Encouraging producers to move from the manufacture of quota items to more profitable product lines.

The allocation system should be wholly transparent, i.e. based on known rules and criteria and administered in such a way as to minimize the discretion that can be exercised by the government department operating the system. The outcome of company applications for quota at the beginning of each quota-year should be highly predictable, allowing producers to develop their marketing programmes in full knowledge of the amount of quota they are going to be allocated.

The Hong Kong model

The most efficient way of allocating quota given the above *desiderata* is that of the Hong Kong government and it is recommended that this system should, as far possible be adopted by Lesotho. The main features of the system are these:

- Applicants for quota are granted an allocation for one year on the basis of their shipments in the twelve most recent months. If they then ship quantities equivalent to 95 per cent of their allocation they will be offered a similar allocation in the following year, subject to whatever growth-rate has been agreed for the national quota. If they ship less than 95 per cent they will lose their entitlement to quota in the following year in proportion to their failure to perform. (Thus, if, say, they ship only 80 per cent of their allocation, in the following year they will be offered 80 per cent of that allocation - subject to the national growth-rate.)

- Quota holders are encouraged to transfer unused quota to other companies or to surrender it to the Department of Trade for reallocation. A quota holder may transfer up to 50 per cent of its quota holding in any one year without losing its right to a full reallocation in the subsequent year - subject, of course, to the transferee making adequate use of it - and may do this for three successive years. Although the Department of Trade has to approve the transfer, there is no prohibition on quota being sold. The emergence of a class of "quota farmers" has been largely discouraged by the fact that the Department of Trade will only approve transfers to registered producers and exporters.

- When quota holders cannot transfer unwanted quota in a temporary transfer deal, they are encouraged to surrender it as quickly as possible. Those who do so within four months will be offered 50 per cent of the surrendered quantity in the following year. Those who delay are penalized - the longer the delay, the smaller the proportion of the surrendered quota offered in the following year.

Encouraging production of non-quota categories

It will be noted that there is no specific provision in this system for encouraging Hong Kong suppliers to transfer production activity from categories where the export quota is heavily subscribed to those where it is less utilized. This reflects the fact that, in the case of Hong Kong, almost all products for which there is any demand are already subject to quota, not only in the USA and the EU, but in most other international markets as well. In addition, it has never seemed necessary to give Hong Kong businessmen any artificial stimulus to encourage them to explore new market opportunities. In Lesotho there might well be an argument for giving producers such incentives. A scheme which links additional quota *pro rata* to sales of non-quota products in the same market might prove most effective in this respect.

e.2 Recommended action

It is recommended that:

- The present quota allocation system be amended along the lines of that operated by the Government of Hong Kong.[75/]

75/ It is suggested that, in the first year of the operation of the system, allocations should be made *pro rata* on the basis of their contribution to total shipments in 1992. (This is intended as far as possible to enable the most efficient exporters to recoup the losses in market opportunity they incurred in 1993 and 1994 as a result of the operation of the present system.)

- In addition, the possibility of linking additional quota-entitlement to exports of non-quota products might also be considered.

9.3 SMALL-SCALE PRODUCERS OF TEXTILES AND GARMENTS

A. FINDINGS

The main functions of Lesotho's small-scale textile and garment producers are:

- Substituting for imports from the RSA in the case of school uniform sweaters and dresses;

- Producing goods not available from foreign sources - i.e. national dress, bespoke garments for females;

- Supplying international demand for high-grade hand knitted garments and textile crafts - e.g. tapestries - either directly or through sales to tourists.

These activities employ some thousands of workers (mostly women) for whom such opportunities are presently severely limited. This must be considered the chief benefit they confer on the domestic economy and the chief reason for continuing the support they already enjoy and making this more effective.

Present GoL policy towards the indigenous sector as a whole is considered to reflect a realistic assessment of its development potential and no specific departures are recommended.

However, it is argued that SMEs in the garment sector would be the chief beneficiaries of the suggestion already made for considering ways of amalgamating such ventures into enterprises that could be brought within the scope of the investment incentive regime should this be considered practical in the light of the proposed review of that regime.

It is also suggested that these enterprises be invited to participate on the proposed JGIGC which would have the effect of strengthening their representations for specific changes in GoL policy - for instance as regards the imposition of sales tax on imports of yarns, fabrics and other consumables used in woven garment and knitwear production and the modification of the criteria on which official procurement policies are issued to favour local bids.

B. RECOMMENDED ACTION

No specific changes in current GoL policy are recommended other than those already discussed in this chapter under other headings. Given the importance of textile and garment production in the SME sector, producers in this area would be major beneficiaries of any improvements arising from the studies which it is proposed should be undertaken by BAPS in the preceding chapter which made recommendations for the manufacturing sector as a whole.

CHAPTER 10. PROPOSED TECHNICAL COOPERATION INITIATIVES

10.1 INTRODUCTION

The strategic review of the industrial sector in Lesotho with particular reference to the textile and garment subsector which has been the subject of this report has made a number of recommendations for action by GoL which might be considered as a basis for possible technical cooperation projects to be discussed with UNIDO/UNDP. These recommendations include:

- A study of existing investment incentives with a view to briefing Parliamentary Counsel on the drafting of an Investment Code;

- A study of the potential for further diversifying the manufacturing base by attracting investment in export-oriented projects not in the garment sector;

- As a possible spin-off from the above project, a review of the Lesotho industrial sector addressed to the international industrial community, investors in particular, focusing on subsectoral investment and trade opportunities;

- Assistance in establishing a joint government/industry Garment Council to formulate government policy as this affects the production of clothing for export;

- Identification of potential investors in a Hong Kong and Mauritius which might be persuaded to establish a knitwear plant in Lesotho oriented to the EU as well as the US market and the development of a promotional strategy to attract such potential investors to Lesotho;

- An enquiry into how non-Lesotho goods are entering the US market certified as being of Lesotho origin and to determine ways of preventing this;

- A review of certificate of origin procedures for exports of garments from Lesotho·

- The preparation of a briefing for the GoL negotiators in connection with the renewal of the textile trade agreement with the USA;

- A review of the system for allocating national garment export quotas to local producers.

10.2 PROPOSED PROJECTS

A. REVIEW OF INVESTMENT INCENTIVE REGIME

a. Recommendation

It is recommended that the government should consider the introduction of an investment code and, in preparing this, consider in detail the various incentives offered and the role of the IPC/LNDC as the administering agency.

This recommendation reflects the conclusion that such a code would facilitate the process of attracting industrial investment to Lesotho both by advertising the incentives on offer and by making more transparent the processes by which they are made available to *bona fide* investors. Its preparation would also afford an opportunity for a reconsideration of the incentive regime in the light of the new circumstances Lesotho has to contend with, especially following the readmittance of the RSA into full membership of the community of nations.

b. Evidence of government priorities

This recommendation is made in the light of the GoL's known wish to promote the expansion of the industrial sector of the economy. It is seen as a logical continuation of the process begun by the establishment of the IPC within the LNDC structure.

c. Nature of project and objective

It is proposed that GoL discusses with UNIDO/UNDP the possibility of initiating a technical cooperation project to realize this recommendation. The project would involve:

- A critical review of existing investment incentives leading to proposals to amend/ extend these. This might include recommendations that bodies which organize the activities of SME producers on an outwork or a cooperative basis should, in certain defined circumstances, be brought under the ægis of incentive regime; in the light of this review

- Preparation of a detailed report with recommendations which, subject to government approval, could be used as the basis of a brief for Parliamentary Counsel in drafting the necessary statutory instruments;

- Consideration of the function of the IPC/LNDC in investment promotion and the most appropriate relationship between investment and trade promotion functions;[76/]

- Assisting IPC/LNDC in developing its role.

B. REVIEW OF POTENTIAL FOR DIVERSIFYING MANUFACTURING SECTOR INVESTMENT

a. Recommendation

It is recommended that GoL consider the potential for expanding its industrial investment promotional activities to include projects other than those in the export-oriented garment sector.

76/ This could involve consideration of the role of the Trade Promotion Unit of the Ministry of Trade and Industry and the advantages of amalgamating that body with the IPC/LNDC.

b. Evidence of government priorities

This recommendation reflects the known wish of GoL to promote Lesotho as a location for investment in non-garment projects. The limitations of the export-oriented garment enterprises as regards their contribution to the development of the manufacturing sector were correctly identified in the Agro-Industrial Project - see Chapter 3 - and it was recommended that the that there be a conscious effort to diversify the investment promotion programme to reflect this. Furthermore, the present study attention has been drawn to developments in the international market situation, including changes in the international textile trade regime, which are considered likely to impact on the willingness of garment producers to establish production facilities in the kingdom.

c. Nature of project and objective

It is proposed that GoL discuss with UNIDO/UNDP the possibility of initiating a technical cooperation project to realize this recommendation. The project would be concerned to:

- Consider the extent to which Lesotho has been able to attract non-garment projects and the commercial performance of such projects;

- Review international circumstances bearing on the willingness of foreign industrialists to establish manufacturing facilities in LDC economies and the extent to which Lesotho might hope to benefit from these.

Without in any way wishing to pre-empt the findings of such a study, it is likely that particular attention would be given to electronic products assembly projects mainly oriented to the South African market. Other areas of light engineering might also be considered and data-processing.

Should there appear to be potential for attracting such projects, consideration would also be given to appropriate promotional programmes. In this latter connection, the findings of the study could be written up for publication in the form of a report on the industrial sector which could be published for use by IPC/LNDC in its overall promotional programme. There would be manifest advantages in thus making the expenditure of resources in this area serve two distinct purposes.

C. ASSISTANCE IN ESTABLISHING A JOINT GOVERNMENT/INDUSTRY GARMENT COUNCIL (JGIGC)

It is recommended that the government seek industry cooperation in establishing a high level Garment Council (JGIGC) to consider issues affecting the export-oriented garment industry and advise on the formulation of government policy affecting the industry. This recommendation reflects the empirical need for such a body to ensure that measures taken are, as far as possible, appropriate to its requirements and also the need to assure the industry of the importance the government attaches to its well-being.

a. Evidence of government priorities

The GoL is aware of the importance attaching to the export-oriented garment industry as a means of generating foreign exchange and providing employment for some 11,000 workers. It is also aware through the LNDC of the difficulties the industry currently faces and the effect this has had on *morale*. The establishment of the proposed JGIGC would demonstrate this awareness as well as creating a suitable instrument for formulating government policy and monitoring its implementation.

b. Nature of project and objective

It is proposed that GoL discuss with UNIDO/UNDP the possibility of initiating a technical cooperation project to realize the above recommendation.

The purpose of the project would be to assist the Director of LNDC/IPC (proposed as the secretary of the JGIGC) in setting up the council and in establishing its procedures and agenda.

It is considered that the JGIGC would be an appropriate agency for considering the need for the other garment-related projects outlined below, for formulating detailed project proposals and for supervising their execution. It is envisaged that the secretary to the Council would play a major administrative role in this work.

D. THE IDENTIFICATION OF POTENTIAL KNITWEAR INVESTORS AND PROMOTIONAL ACTIVITIES

It is proposed that suitable knitwear producers be identified and an appropriate promotional programme be devised in an attempt to persuade one or more of these to establish a project in Lesotho, oriented to the EU market as well as to that in the USA. It is proposed that this promotional effort be particularly directed towards Hong Kong and Mauritius.

It is felt that a knitwear project would be more viable in the Lesotho conditions than one based on woven fabric which has to be imported and so cannot always benefit from the provisions governing duty-free access to the EU market in the Lomé Convention. The stipulation regarding orientation to the EU market reflects the lack of experience of that market demonstrated by most existing producers in Lesotho and the perceived need to make more of the opportunities there. It is felt that companies of the type required are most likely to be found in Hong Kong and Mauritius.

a. Evidence of government priorities

It is known that GoL regards the attraction of additional foreign investment into Lesotho as a major plank in its overall strategy for the manufacturing sector. It is felt that a project of the kind outlined above is very appropriate to conditions in Lesotho and has a good possibility of achieving a successful outcome.

b. Nature of project and objective

It is proposed that GoL discuss with UNIDO/UNDP a technical cooperation project to help realize the above recommendation.

The project would be in two phases, the first to identify potential investors, the second attract such investors to Lesotho. It is envisaged that the search would concentrate on Hong Kong and/or Mauritius and involve visits to those countries. The subsequent promotional programme would be developed in the light of phase one.

In that particular connection, direct approaches to the companies identified as suitable candidates on an individual basis are likely to be a necessary first step. In both countries key figures in the business community will have to be persuaded on an individual basis. Only when this has been done should the need for and scope of a more formal promotional effort be considered.

E. ENQUIRY INTO FRAUDULENT CERTIFICATION OF NON-LESOTHO GOODS AS BEING OF LESOTHO ORIGIN

It is recommended that GoL initiate an investigation of complaints about the fraudulent attribution of Lesotho origin to imports of non-Lesotho garments into the US market should be undertaken and, if it seemed appropriate, this be followed up by a high-level enquiry by a Royal Commission to discover how fraudulent transshipment is carried on and the parties engaged in this trade.

a. Evidence of government priorities

It has been argued that the difference between the Lesotho record of products subject to US export quotas and the US record of imports of these items can be explained by fraudulent transshipment - especially in the case of the woven trousers category. This seems to have been a major factor that induced the US Government to "call" Lesotho in respect of its exports of knitted tops and woven trousers even though its shipments of the latter category did not meet the minimum quantitative criteria for determining market disruption. The measures proposed by the US Government for resolving this problem were also one reason underlying GoL's determination not to agree an extension of the current textile trade agreement at the end of 1994 on the grounds that these constituted an unacceptable infringement of Lesotho sovereignty. However, under Article 5 of the ATC, GoL is obliged to cooperate with the US Government in this connection[77] UNIDO is not aware that the US Government has made any specific approach to the GoL under Article 5, para 2, but it would be advantageous to appear to be anticipating such action.

b. Nature of project and objective

It is proposed that GoL discuss with UNIDO/UNDP a technical cooperation project to realize the recommended action. The project would take place in two phases, firstly, to determine whether there is substance in reports of large-scale transshipment and, if these appear to be justified, to advise on the form of enquiry to determine how transhipment is carried out and the persons involved. The second phase would consist of a Commission of Enquiry. It is proposed that this be undertaken by a senior member of the Lesotho Civil Bar who would be empowered to mandate the cooperation of the industry in Lesotho and the Lesotho Customs department and to seek that of the South African Customs department. (The government should be prepared give the commission every assistance in approaching the South African Customs as and when such assistance is required.) The possibility of cooperating with the US Customs service might also be considered. The enquiry should be able to take evidence on a confidential basis and be empowered to offer immunity from possible prosecution to witnesses.

It is suggested that this project be carried on in tandem with that involving the review of export authorization procedures - see below. It is likely that the expert appointed under that project could be usefully associated with the enquiry.

77/ The relevant text reads:

> "... parties should establish the necessary legal provisions and/or administrative procedures to address and take action against such circumvention (i.e. of the provisions of the ATC by transshipment, rerouting and false declaration concerning country or place of origin etc). Parties further agree that, consistent with their domestic laws and procedures, they will cooperate fully to address the problems arising from circumvention."

F. REFORM OF PROCEDURES FOR MANAGING EXPORTS OF GARMENTS - PARTICULARLY THOSE SUBJECT TO QUOTA RESTRICTIONS

It is recommended that GoL review its procedures for authorizing the export of textile and garment products with a view to making any necessary improvements in the present system. It is also recommended that the present system for allocating national garment export quotas be amended in the interests of securing maximum utilization of quotas. The review would include consideration of the most appropriate machinery for carrying out the recommended procedures and possibly involve a strengthening of the present mechanism within MTI.

a. Evidence of government priorities

This recommendation relates to the dissatisfaction expressed in some official quarters with the management of garment exports - particularly as these relate to exports of products under quota. It is suggested that improvements in this area could help in resolving possible fraudulent attribution of Lesotho origin to non-Lesotho products - the subject of a proposed separate enquiry - and also make for the more efficient allocation of export quotas. It should also allow GoL to exercise the kind of control over garment exports which is desirable given the current international textile trade regime.

b. Nature of project and objective

The two recommendations made under this heading are distinct, but closely related and it is felt that they would both be addressed by a reform of the procedures for managing garment exports as proposed. It is, accordingly, proposed that GoL discuss with UNIDO/UNDP a technical cooperation project to assist in the realization of both recommendations.

The project would involve:

- A review of the various procedures for authorizing exports of garment categories to all destinations,[78/] whether or not subject to export quotas, with a view to putting these on a uniform basis. The need to incorporate these procedures in regulatory form would also be considered and, if necessary, a briefing would be prepared for Parliamentary Counsel;

- A review of the functions of the various agencies currently involved in authorizing such exports with a view to improving the efficiency with which these are carried out. It is envisaged that responsibility for garment export authorization will be given to a single body, possibly to be known as the Textile Export Certification Unit;[79/]

- A review of the present system for allocating quotas between the various producers with a view to ensuring quotas are utilized as fully as possible and encouraging the export of products not under quota. It is envisaged that this part of the project would involve the development of an up-to-the minute data base indicating exports of all product categories

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78/ It is proposed that the certification procedures would apply similarly to exports to the USA, the EU, Canada and the RSA.

79/ The responsibility for carrying out textile export certification functions currently lies with MTI, but, in practice, some of the functions relating to the granting of a visa for shipments consigned to the USA fall within the Customs department. On the basis of Hong Kong and Jamaican experience, there would seem to be merit in separating textile export certification from those more properly belonging to Customs. However, this is not to pre-empt the conclusions of the proposed review.

by company of origin and destination. This would ensure that the proposed TECU was furnished with the data it required for the efficient management of export quotas.

It is likely that the system developed as a result of this project would based on the Hong Kong system as adapted to the idiosyncratic requirements of the situation in Lesotho.

G. PREPARATION OF A NEGOTIATING BRIEF FOR A RENEWED LESOTHO/USA TEXTILE TRADE AGREEMENT

It is recommended that GoL prepare to negotiate a textile trade agreement with the USA with a view to ensuring that any export quotas are set at the highest possible base levels with maximum annual growth rates and that there are no infringements of Lesotho sovereignty in the procedures for controlling fraudulent attribution of Lesotho origin.

a. Evidence of government priorities

Having postponed making a detailed response to the US Government's request that the existing textile trade agreement be renewed/extended, in November, 1994, GoL must expect this matter to be raised again. Given that the 1992 agreement which imposed export quotas on the two most popular items seriously diminished Lesotho's attractions as a location for manufacturing garments for the US market, it is desirable that more favourable terms reflecting the country's status as a relatively new supplier and one of the world's poorest countries be secured.

b. Nature of project and objective

It is proposed that GoL discuss with UNIDO/UNDP a technical cooperation project to assist in realizing the above recommendations. It is likely that the project would involve the preparation of a brief for the negotiating team and provision of advice while negotiations are in progress.

10.3 PROJECT PRIORITIES

It is recognized that all the projects recommended above could not be undertaken at one and the same time. The coordination of so many separate exercises would present massive problems of organization, both for UNIDO and for the GoL which, it is assumed, will be fully involved in implementing proposals formulated under the agro-industrial project. Furthermore, a number of these projects are dependent upon one of the others having been previously undertaken. Having regard to this, the projects are graded in some order of priority reflecting both their discrete importance and their relationship to each other.

In this context the **Preparation of and implementation of an investment code** and the **Establishment of a joint Garment Council** are considered to be those which it would be desirable to initiate as soon as possible.

It could be that the first has already been the subject of consideration under the World Bank's Agro-Industrial project in which case, of course, the effort should not be duplicated. The Garment Council is seen not only of important in itself, but it is also seen as a means of assessing the need for other projects relating to the garment sector and supervising their execution. For this reason it should logically be given priority over those projects.

However, it might be noted that the **enquiry into possible fraudulent transshipment** and the **reform of certificate of origin procedures** would be most usefully undertaken simultaneously. The negotiation of a **more favourable textile trade agreement with the USA** might also be influenced by the fact of these projects having been already commissioned which suggests that they should have some priority in terms of timing. Attracting **additional investment in garment projects** is seen as desirable, but is more likely to be successfully undertaken if some effort has already been made to address the other concerns of the industry in Lesotho. This project would, therefore, be appropriately postponed until the others have been largely implemented. Similar considerations would seem to apply in the case of the study of the potential for promoting Lesotho as a location for **non-garment** export-oriented industrial projects.

The preparation of an Industrial Development Review of Lesotho according to the established outline of UNIDO Industrial Development Review Series should be given utmost importance once an Investment Code is finalized. The proposed Review should be tailor-made to provide potential investors with information and analyses of subsectoral investment and trade prospects, and the document should be used for world-wide dissemination through the established UNIDO distribution network.

APPENDICES

APPENDIX 1

THE INTERNATIONAL TEXTILE TRADE REGIME

1.1 BACKGROUND

A. GENERAL

For thirty five years the international trade in textiles and garments has been subject to a special regime which has formally excluded it from the general drive towards a more liberal world trading order with respect to industrial products which has been pursued under the auspices of the GATT. This special textile regime has attempted to reconcile two contradictory objectives:

- That of **the main textile and garment importing countries** (i.e. the industrialized economies and, in particular, the USA and the EU member-states) to regulate trade in textile products in order to protect their domestic industries;

- That of **the main textile and garment exporting countries** (i.e. in general terms the newly industrialized and developing economies) to maximize exports.

To serve both these ends, a mechanism was evolved intended to secure orderly growth in the trade behind a screen of controls on the assumption that this could be a temporary measure which, ultimately, would become no longer necessary and textiles and clothing would be treated as any other internationally traded industrial products. In the Uruguay Round of the GATT it was determined that the time had come to begin a phased dismantling of the system of controls and that, within ten years of 1 January, 1995, the final vestiges of special treatment for the textile and clothing industry would be dispensed with. This is the present regime known as the GATT Agreement on Textiles and Clothing (ATC.)

B. THE BASIC PHILOSOPHY OF THE GATT

For most of the period since the end of World War II in 1945 the main ideological influence on the development of the trading regime governing relations between the advanced free market countries, and between these countries and other less developed economies, has been the GATT (General Agreement on Tariffs and Trade.) This seeks a progressive diminution in the barriers to the free movement of goods and services between its signatory nations. The GATT has been the international expression of a central tenet of classical liberal economic theory - that free trade is the surest way of securing to all nations the benefits of economic development.

This is, of course, largely a statement of an ideal - a pious aspiration. Most countries in the world maintain complex regimes to protect their domestic production. These are justified on the grounds that unfettered import competition can lead to serious short term consequences for established economic structures, with resulting political tensions. Furthermore, the efforts of many countries to bolster artificially the competitiveness of their exports perpetuates in the importing countries' view the need for protection. Preferential trading arrangements between GATT signatories have also proliferated since 1945 - the EU being only the most significant of many instances.

Nevertheless, successive rounds of multilateral trade negotiations (MTNs) under the GATT have established limited targets for the reduction of protective mechanisms to be achieved over periods of years. Considerable progress has been made in this direction, particularly with respect to fiscal controls (tariffs), less so with respect to physical (non-tariff) barriers.

More importantly, perhaps, the very existence of the GATT as a statement of an idea influences the way in which the major economies approach the whole problem of international trade in general terms and ensures that there is continual moral pressure on them to move it the direction of greater freedom. The effect of this concept of economic morality on the behaviour, and even the convictions, of governments cannot be dismissed.

C. THE SPECIAL POSITION OF THE TEXTILE AND CLOTHING INDUSTRIES

Until the Uruguay Round, less progress has been made towards the realization of the free trade ideals of the GATT in the case of textiles and clothing than with any other single category of goods, with the possible exception of agricultural commodities.

In the developed economies

In all the major free market economies, the textile and clothing industry, like the agricultural sector, is a major contributor to GDP - both directly, and indirectly through the industries which exist largely to serve it. The industry is also an important employer of labour in these countries. In addition, a substantial degree of national self-sufficiency in textiles and clothing is traditionally regarded as a strategic necessity. In the USA, certainly, the ability to cloth the armed forces from national resources is a virtual shibboleth - if not for administrations, certainly for politically influential groups whose views cannot be ignored.

a. In the developing world

Against this perception of the importance of textile and clothing production for the wellbeing of their own economies, western statesmen are also well aware of the importance of textile and clothing production in the efforts of developing countries to develop export-orientated industries. It is generally recognized that these industries - and particularly the clothing industry - with their relatively simple and labour intensive technologies, low capital requirements and massive assured markets, constitute a particularly suitable means by which developing countries with a substantial resource of low cost labour can take a first step towards higher levels of industrialization.

For may years developing economies have wanted to become more than mere suppliers of basic commodities in return for imports of high value processed goods. In recent years this has been reinforced, first, by the decline in the relative value of such commodities and, second, by the need to find additional sources of foreign exchange in order to service the massive burden of debt accumulated in the 1960s and 1970s as a result of efforts to develop an industrial base more orientated to the domestic market.

Western governments have, in fact, promoted economic restructuring to this end through international bodies such as the IMF (International Monetary Fund) and the World Bank, and through national technical assistance agencies. This has in effect, encouraged the development of export-orientated textile enterprises which would subsequently challenge their own industries in their domestic markets.

b. The dilemma of the West

The western countries have, therefore, found themselves in a dilemma. They need on the one hand, to protect themselves against the seemingly intolerable short-term economic, political and even strategic consequences of allowing their domestic textile and clothing industries to be disrupted by the competition of low cost imports; and, on the other, to allow such imports as one of the more obvious means of avoiding the calamity of large-scale default by their Third World debtors. Underlying these immediate concerns is an almost instinctive conviction that freer international trade would be to the long-term benefit of the world economy.

In an effort to meet both these concerns they have resorted increasingly to the regulation of the international trade in textile products.

1.2 FISCAL CONTROLS ON TEXTILE TRADE

A. THE REDUCTION OF TEXTILE TARIFF LEVELS BY WESTERN ECONOMIES

Before the Second World War tariffs were the main mechanism by which the industrialized economies protected their native textile (and garment) industries from import competition. However, since the advent of the GATT, the very high levels of the 1930s have been significantly reduced. This has been one aspect of a general tendency to reduce tariffs on industrial products. As will be seen from Table 1.1 below, this process was not much advanced by the Uruguay Round which suggests that the main western governments see their tariffs have now reached levels which are practically irreducible.

Tariffs on textile products still tend to be higher than those on other traded industrial goods. The general pattern is, the higher the value added, the higher the protection. This means that yarns have higher tariffs than fibres, fabrics than yarns, clothing than fabrics etc. The levels of protection afforded to clothing in particular reflect the labour intensity of clothing production which gives low labour cost countries a comparative advantage which cannot only be offset to a limited extent by increased capital investment in the advanced economies. (Which is why the garment industry in the USA cannot compete with that in Lesotho as a supplier of basic trousers and knit tops.)

The downward trend in all industrial tariffs can be seen in part as a measure of the deference accorded free trade virtue by protectionist vice. On the other hand, the willingness of the main textile importing countries to give ground here can be seen in a more cynical light - as an acknowledgement that fiscal controls are relatively inefficient in effecting the regulation that the textile trade is perceived as requiring.

B. TARIFFS AND THE DEVELOPING WORLD

Historically the West has been more tolerant of high tariffs set at levels intended to exclude all import competition in countries in the developing world. This was partly because it was accepted that these countries needed to erect some sort of protection for their nascent industries - the "infant industry" argument was specifically recognized in the GATT - partly, no doubt because western governments did not expect their own industries to sell large volumes of such basic items as clothing into poor countries. This attitude changed in the Uruguay Round and great pressure was put on such countries as the Republic of Korea and India to undertake to reduce their tariff barriers and also to increase the number of tariffs for which they fixed maximum rates that they were bound not to increase. (As was seen in the report, South Africa too was obliged to bring down its tariffs as part of the price of acceding to the GATT.) The need to bring the more successful developing economies and the newly industrializing countries into line may be one factor underlying the fairly limited reductions offered by the western governments in the Uruguay Round.

Table 1.1. Average tariffs on imports of textiles and clothing before and after the Uruguay Round
(Percentage *ad valorem*)

Country	Sector	Pre-UR Average tariffs[d/]	Sector bound[b/] (Percentage)	Post-UR[a/] Average tariffs[c/d/]	Sector bound[b/] (Percentage)	Reduction[d/] (Percentage)
European Union	Textile	9.4	99.6	6.6	100.0	26.2
	Clothing	12.9	100	11.4	100.0	11.9
United States	Textile	13.4	100	8.1	100.0	45.1
	Clothing	14.0	99	8.5	100.0	19.3
Canada	Textile	18.7	99.8	11.3	100.0	41.6
	Clothing	23.7	100	17.7	100.0	26.9
Japan	Textile	9.1	99.8	5.9	100.0	32.6
	Clothing	14.2	100	8.9	100.0	33.8
Republic of Korea	Textile	26.5	4	14.6	99.6	34.2
	Clothing	43.9	21.6	27.5	100.0	25.9
Indonesia	Textile	41.2	-	40.0	100.0	2.9
	Clothing	56.6	-	40.0	100.0	29.3
Malaysia	Textile	27.1	-	19.1	92.8	28.9
	Clothing	32.5	-	23.2	96.3	26.7
Thailand	Textile	61.5	0.4	28.2	91.7	42.3
	Clothing	96.1	-	30.5	99.0	69.3
Brazil	Textile	83.2	0.9	34.9	100.0	56.5
	Clothing	104.0	-	35.0	100.0	66.6
Argentina	Textile	37.2	0.4	35.0	100.0	4.0
	Clothing	37.8	-	35.0	100.0	7.9
Australia	Textile	33.6	2.7	17.5	89.5	46.6
	Clothing	59.7	0.2	40.7	95.1	40.1
New Zealand	Textile	19.6	60.2	13.4	100.0	36.1
	Clothing	57.0	35.1	39.7	99.7	32.9

Source: "Les offres tarifaires textile-habillement dans le cadre de l'Uruguay Round", Comitextil, Brussels, Bulletin 94/5, based on EU data.

a/ To be achieved by 1 January, 2005.
b/ Proportion of total tariffs defined by the Harmonized System that the country has bound itself not to increase above the stated level.
c/ Average of bound tariffs only.
d/ Average rates are trade-based. They are calculated on the basis of trade with non-preferential sources - i.e. such as ACP countries - in the case of the EU and on trade with the EU in the case of other countries.

C. LIMITATIONS OF TARIFF PROTECTION

a. Inflexibility

The main concern of western governments in developing textile trade policy has been to devise a system of regulation which, on the one hand, permits "fair trade" in these products - i.e trade based on fair competition between domestic industries and those in other countries in which neither party has any artificial advantage and is therefore beneficial to efficiency in both - and, on the other, can respond to sudden upsets in the prevailing balance between domestic production and imports caused by sudden unforseen increases in the arrivals of low cost products. Such surges of imports pose the greatest threat of economic disruption to domestic industries in terms of unanticipated mill closures, labour lay-offs, etc, and consequential political pressures. Tariffs are not an efficient safeguard against them.

b. Tariffs must be applied generally

Upsurges in imports tend to occur in the case of particular products. The tariff structure cannot anticipate which products will be endangered, and cannot ensure that protection is at a level sufficient to counter this. And if the generality of tariffs imposed by a major economy was high enough to allow for such specific emergencies, the importing country would lay itself open to retaliatory action against its export trade. In any case, to be effective in preventing specific instances of market disruption, all tariffs would have to be set at levels that would exclude all imports and it is generally accepted that import competition is beneficial to advanced economies - if it is not disruptive. (It is argued in this report that the efficiency of the South African industry has suffered from tariff protection which was deliberately set at a level which stifled all import competition.)

c. *Erga omnes*

Tariffs are also an ineffective instrument in dealing with market disruption by low-priced imports because they must be applied equally to all countries which enjoy Most Favoured Nation (MFN) status under the GATT - i.e. *erga omnes*. This is laid down in Article XIX of the agreement which deals specifically with permitted safeguards against market disruption by low-priced imports when these low prices are not a result of unfair trading practices, but reflect the genuinely low cost of one of the factors in production in the offending country - in the case of textiles and, more particularly, clothing, the labour factor. Thus, if a country imposes duties on products from such a source, it must apply a similar duty on the same product from a high-cost source.

1.3 PHYSICAL CONTROLS

A. THE IMPORTANCE OF THE QUOTA

The main instrument of control used to regulate the textile trade - certainly since the 1950s - has been the quota. The quota is a quantitative restriction imposed on imports of specific products from specific sources when these are deemed to threaten to disrupt domestic markets. In this context, disruption takes on a particular technical meaning in that the materials at issue are being imported in such volumes as to be likely to displace those produced domestically and, therefore, to force the closure of uncompetitive national mills and endanger the livelihood of national workforces.

B. MARKET DISRUPTION AND GATT

a. GATT decision on market disruption

The principle of **specific restriction** - the central feature of the international trade regime - was formulated in the GATT Decision on Market Disruption of 1960. This allowed restrictions to be imposed selectively by importing countries when a sharp increase in imports of specific products from a specific source had occurred because of prices that could not be matched by domestic suppliers. This could be done even though damage to the domestic market might not yet have occurred, but was only threatened.

As already implied, the element of source specificity in the imposition of these restrictions is directly contrary to the *erga omnes* principle of GATT Article XIX, the original measure intended to deal with market disruption. Thus, arrangements which take advantage of the 1960 decision are acknowledged as derogations from the GATT - i.e. deliberate departures from its principles and rules.

It is important to note that under the 1960 decision it was not necessary to prove that the low prices which were causing or threatening market disruption were themselves a consequence of "unfair trading" practices on the part of suppliers. Such practices may often be factors contributing to the low prices of imported products - indeed, garment producers in western countries claiming market disruption would argue that they are almost invariably the cause. But "unfair trading" as such was an issue quite distinct from market disruption and was dealt with separately by the GATT.

b. Use confined to western imports of textiles and clothing

The 1960 decision was applicable to all products, but has only been used in respect of textiles and clothing. Further, it has only been applied by major industrialized economies against imports from developing countries and the communist world. (As already intimated, these countries have usually preferred to exclude imports as far as possible and have therefore relied on crippling tariff protection (as in the RSA) or even administrative controls.) The main users of the protective measures which it permits have been the USA, the EC member states, Canada, the Scandinavian economies, Austria and Switzerland.

The fact that use of the market disruption principle has been confined to textiles and clothing is a reflection of the particular sensitivity of the advanced economies in this area for reasons that have already been rehearsed. As for why measures under it should have been directed only at Third World producers,[80/] this is often cited as an instance of the discrimination the West habitually practises against these countries.

Less cynically, it can be argued that only in the case of the developing country exports is the threat to national markets in the advanced economies based upon low prices rather that considerations of style, quality, etc. In addition, much of the trade between the western economies consists of exchanges between member states of the EC or between countries which have free trade agreements which preclude the use of non-tariff barriers.

C. THE MULTIFIBRE ARRANGEMENT (MFA)

a. A long lasting regime

The GATT Arrangement Regarding International Trade in Textiles - the Multifibre Arrangement (MFA) - was the last of a series of such arrangements entered into by GATT signatories since 1961. All of these arrangements set aside the GATT rules and provided a multinational framework within which individual importing countries could impose restrictions on imports of textile products from individual supplier countries. The main distinguishing feature of the MFA from its predecessors was its comprehensive nature - the earlier arrangements had covered only cotton products: the MFA covered cotton, wool and mmf and, eventually, silk products - and its longevity. Having come into force in 1974, it was renewed three times - in 1977, 1982 and 1986.

80/ In fact Japan accepted quotas on its exports of certain products to the USA in an agreement in 1987. The reason for this was that certain Korean manufacturers were thought to be avoiding quota limitations imposed on these products when they originated in the Republic of Korea by fraudulently passing them off as Japanese. The similarity of this case to that of Lesotho when it was obliged to agree quotas on its exports of trousers etc to the USA in 1992 because of the fraudulent transshipment of Chinese(?) trousers will be noted.

b. Objectives

The original format of the MFA was determined by the concerns of the western economies, particularly the USA and the EC member states. Its subsequent development was influenced by the particular nature of those concerns at those times when the arrangement came up for renewal. Its longevity was sufficiently explained by the continuing relevance of those concerns.

Essentially, the MFA had two objectives, as follows:

- to allow importing countries to protect their domestic industries from the damaging impact of unrestrained import competition based upon low prices:

- to allow an orderly growth of exports to those countries from low cost Third World producers, this being accepted as of benefit to both parties.

The corollary of the right to protect their domestic industries, which the arrangement secured for importing countries, was the obligation it imposed on them to ensure that these industries were restructured in such a way as to render them less vulnerable to low cost import competition. The assumption was that the special protection enjoyed by the industry would eventually become superfluous because it had become internationally competitive.

c. Main provisions of the MFA

Bilateral agreements

Under the MFA, two countries (or other recognized trading entities such as the EU) which were party to the arrangement could enter into bilateral agreements to impose restrictions on specific categories of products emanating from one of the countries which were disrupting, or threatening to disrupt, the domestic market of the other. The principal features of such agreements were:

Base quotas levels: The level of restraint applicable in the first year of the agreement had to reflect the supplying country's historical export performance - there could be no "roll back". Later versions of the MFA made special provision for new entrants to the market who would have suffered in terms of the opportunities open to them for the growth of their trade if strictly historical criteria had been adhered to in the determinations of base quotas.

Growth-rates: Products so restrained had to be allowed to grow at positive rates each year. Six per cent was stipulated in the MFA I, although exceptions to this were to become the rule in the case of agreements with larger suppliers, particularly for sensitive items. Again, new exporting countries, small suppliers and the least developed countries were often allowed more generous growth rates.

Flexibility: In order to allow for full utilization of quotas, there had to be flexibility in enforcing the maximum level of imports permitted in any one year. This was the origin of the concept of "swing" - by which the limits of one agreed quota (for a particular product) might be exceeded as long as the others were correspondingly adjusted. Flexibility also applied in the form of "carry forward", by which unused portions of the previous year's quotas could be carried forward to the present year, and "carryover", by which certain proportions of the quotas established for the coming year could be borrowed for use in the current year. Of course, all such flexibility provisions had limits restricting the amounts of quota which could be transferred in this way.

New quotas in the lifetime of a bilateral agreement

In the case of products not specifically covered, quotas could be introduced during the life of a bilateral agreement under the MFA if market disruption began to occur or was threatened. Where two countries could not agree to the imposition of quotas in these circumstances, or could not agree at what level they should be imposed, the importing country could unilaterally impose restrictions during the life of the agreement, but its rights to impose restrictions under this head were more circumscribed than where it acted in concert with the importer.

Market disruption criteria

Despite considerable efforts on the part of the original MFA negotiators, no objective criteria of market disruption were agreed in 1973 and subsequent experience served only to increase the degree of subjectivity surrounding this key concept. There were, however a number of guidelines, as follows:

Market disruption had to relate to serious damage which was being caused or threatened to the domestic industry. This could be assessed with reference to such factors as sales, market share, profits, employment and production.

The damage had to be clearly connected with a sharp and substantial increase in imports from a particular source. In addition, or alternatively, the prices of those imports had to be considerably lower than those prevailing on the domestic market for similar products from local and other import sources - and this had to be for reasons not attributable to subsidies or dumping. In other words the lower prices had to be attributable to comparative advantage or higher efficiency.

It will be noted that these criteria do not really advance the objective definition of what constitutes market disruption beyond the original 1960 decision.

Supervisory bodies

The Textile Surveillance Body (TSB)

An international grouping known as the Textile Surveillance Body (TSB) was set up to supervise the functioning of the MFA. The TSB reviewed all agreements and safeguard measures taken under the MFA. It was also the principle forum for settling disputes.

The developing countries - i.e. the countries chiefly affected by restrictions on textile products imposed by advanced western economies - considered that the effectiveness of the TSB was limited by the fact that four of the eight seats were allocated to "importers" and three of these are allocated to the USA, the EC and Japan on a permanent basis. (The fourth rotated between the Scandinavian countries and Canada.) The four "exporter" seats, on the other hand, were occupied by developing country representatives who normally only had a short posting. This meant that the western representatives could build up a body of personal expertise and they were, in addition, better serviced by their domestic governments. It was argued that, as a result, the deliberations of the TSB tend to be biased in favour of the West and criticism of actions taken by western governments was consequently muted. Whatever the merits of the complaint, the actions of western countries were rarely successfully challenged in the TSB.

Textiles Committee of the GATT

A textiles committee of the GATT was set up to monitor the operation of the Mc.i. It was the final arbiter under the MFA for interpreting its provisions and constituted a court of appeal for disputes that could not be resolved in the TSB. There is no record of the committee ever seriously thwarting the wishes of a major importing country.

d. Tightening of restrictions

There was a tendency for the protective provisions available to importing countries under the MFA to become more stringent with each successive protocol of extension. This generally reflected the preoccupations of the EU and the USA, with whichever of these two was currently most concerned by import trends setting the pace.

1.4 URUGUAY ROUND AGREEMENT ON TEXTILES AND CLOTHING (ATC)

A. BACKGROUND

a. The Punta del Este declaration

It was agreed at the initial meeting of the Uruguay Round of the GATT held at Punta del Este in 1986 that trade in textile products should be reintegrated into the GATT. This meant that trade in textile products would be governed by the general rules of the GATT and the Principle of Specific Restriction agreed in 1960 would no longer be applied as a derogation from the GATT in respect of textile products.

b. Underlying considerations

The view from the west

It is unnecessary here to speculate in depth on the many factors which persuaded western governments that they should at last give up the special protection formally afforded the textile and garment industry by multilateral agreement since 1960 - and informally on bilateral bases for many years before that. Suffice to say that it was considered an acceptable price to pay for bringing the developing economies - particularly the Newly Industrializing Countries - within the ægis of the GATT (which had been strengthened in the course of the Uruguay Round to enforce more liberal trading regimes on member states) and opening them up to western trade.

It is also fair to remark that the textile industry in western countries had made great strides in improving its efficiency on the basis of technological advances since the 1960s which went a long way to reducing the comparative advantage of the industry in developing countries derived from low cost labour. Similar changes had not taken place to anything like the same extent in the case of the clothing industry, but it was probably tacitly accepted that, eventually, the bulk of the West's requirements of basic clothing would be sourced in the Third World and that the developed countries would only produce very high value, short-run categories of apparel. The breathing space given the western industries had, at least, given them the opportunity of managing their decline in an orderly manner and of mitigating the worst social consequences.

Concerns of the LDCs

It should be noted that, as the Uruguay Round negotiations progressed, many LDC garment producers had become increasingly unhappy as they confronted the reality of the abolition of the MFA. They became aware that the MFA quotas guaranteed them a certain share of developed country markets - albeit inadequate in their own particular circumstances - which would be by no means assured in free trade conditions. It was reasoned by many governments that the real beneficiaries of the move to integrate textiles into the GATT would be very low cost producers such as India and, of course, China. It was India in particular which had pressed for the removal of MFA restrictions despite the doubts expressed by such minor players as Jamaica.

The position of China

The position of China under the new dispensation will be critical for other LDC producers given the massive size of the garment industry in that country and its very low wage costs. If China is admitted to the WTO with no special restraint placed on its apparel exports, it is feared that it would effectively swamp the world market for low cost clothing for many years. It remains to be seen how far the US and EU Governments in their eagerness to absorb China into the world economic order and open up its vast market to western investment are prepared to overlook its obvious limitations as a liberal economy worthy of GATT membership and privileges.

B. MAIN FEATURES OF THE ATC

a. Phased integration of textile and garment products into the GATT

The ATC agreed a transition period in three stages:

Stage I: As from 1 January 1995, each country would chose textile and garment products which accounted for at least 16 per cent of their total volume of imports of these products in 1990 and integrate these into the GATT - i.e. they could no longer subject them to specific restraint in the event of market disruption, but would have to rely on whatever protection the GATT Article XIX could afford.

Stage II: As from 1 January 1998, they would integrate products accounting for 17 per cent of their 1990 import volume.

Stage III: As from 1 January 2002, they would integrate products accounting for 18 per cent of their 1990 import volume.

All remaining products would be integrated on 1 January 2005.

In allowing the importing countries to chose which products they wished to integrate at each stage, the formulators of the ATC were well aware that the governments concerned would select those towards which their domestic industries were least sensitive.

b. Existing MFA restrictions

All quotas in place on 31 December 1994, would be carried over into the ATC and maintained until they were removed or the products integrated into the GATT. However, the annual rate of growth would be 16 per cent higher than envisaged under the MFA agreement, during Stage I. For stages II and III the rates would be 25 and 27 per cent higher respectively.

c. New restrictions

There was a specific safeguard mechanism that could be applied during the transition period to all products not yet integrated into the GATT. Under this, if an importing country could demonstrate that imports of a particular product category from a particular source were causing market disruption - or, of course, threatening to cause it - it could introduce quota restrictions just as under the MFA. This meant that such restraints could be introduced bilaterally in agreement with the supplier country or unilaterally. In any event, the new quota would be subject to review by the Textiles Monitoring Body (which had succeeded the old TSB). New quota levels had to be set at at least the level of imports in the twelve months ending two months before the importer asked the exporter for consultations. The quotas could remain in place for up to three years.

The criteria for determining market disruption under the ATC are no more objective than they were under the MFA before it. There is also no reason to suppose that the TMB will be any more critical of arguments submitted by importers than was the TSB.

New quotas imposed on LDCs and relatively small suppliers had to be "significantly more favourable" than those imposed on other groups of suppliers and "take account of the future possibilities for the development of their trade and the need to allow commercial quantities of imports from them".[81] Again, no effort was made to set out objective criteria for determining how these things should be done. However, countries such as Lesotho will be able to appeal to this statement of pious intent - particularly if they too are fully-fledged members of the WTO.

81/ The ATC, Article 6, para 6.

APPENDIX 2

THE CALCULATION OF COMPANY ALLOCATIONS OF US GARMENT EXPORT QUOTAS, FOR THE PERIOD 1/12/93-30/11/94

This refers to Chapter 5.2.C. on the US export quota and the way in which the total national quota is allocated as between the various garment manufacturers. The formula used by the Ministry of Trade and Industry for calculating the proportion to be allocated to each company was as follows:

$$\text{Allocation} = \left(\frac{e \times 55}{E} + \frac{q \times 25}{Q} + \frac{v \times 20}{V}\right) \%\ \text{of National Quota}$$

Where:

- e = numbers employed by the company
- E = numbers employed by all the companies seeking quota
- q = shipments to USA in 1992 by company
- Q = shipments to USA in 1992 by all companies seeking quota
- v = value of company's 1992 shipments to USA
- V = value of shipments by all companies seeking quota in 1992.

The outcome was as indicated overleaf:

US export quota allocation, 1993-1994

Item	National quota 1994	Company	Employees (Number)	Export to US 1992 based on formula (Thousand dozen)	($ million)	Proportion total quota (%)	Allocation to company (Thousand dozen)
Knit tops	805.6	Southern X	992	253.1	7.0	25.51	205.5
		Lesotho Hinebo	529	123.3	6.0	15.23	122.7
		Super Knttg	650	264.7	3.0	17.72	142.8
		Lesotho Hawk	439	169.2	2.5	12.16	98.0
		Invictus	48	-	-	.66	5.3
		Morija Txtls	481	-	-	6.62	53.3
		Lesotho Clthg	200	-	-	2.75	22.2
		Lesotho Haps	658	246.4	5.3	19.34	155.8
		Total	**3,997**	**1,056.7**	**23.8**	**100.00**	**805.6**
Trousers etc	397.5	C&Y Gmnts	1,122	173.2	4.9	29.05	115.5
		Crayon Gmts	612	60.6	3.1	13.93	55.4
		Poltex Gmnts	143	3.0	.3	2.19	8.7
		CGM Indust.	1,350	30.3	7.1	24.21	96.2
		Southern X	200	35.0	3.1	7.42	29.5
		Lesotho Hinebo	100	6.0	.1	1.68	6.7
		Lee Clthg	250	-	-	2.93	11.7
		Lesotho Haps	120	35.8	1.1	4.74	18.8
		Maseru Clthg	541	11.9	1.8	8.74	34.7
		Lesotho Clthg	200	2.5	.6	3.05	12.1
		Lesotho Hawk	48	18.8	.3	2.06	8.2
		Total	**4,686**	**377.1**	**22.4**	**100.00**	**397.5**

Source Official sources.

APPENDIX 3. USAGE OF EU DEROGATION QUOTAS BY LESOTHO GARMENT INDUSTRY BY QUARTER, MARCH 1993-NOVEMBER 1994 (EU RECORD)

Item	HS Code	MFA Cat.	Quota year 3/93-2/94 Quota	First quarter	Second quarter	Third quarter	Fourth quarter	Total	Quota year 3/94-11/94 Quota	First quarter	Second quarter	Third quarter	Total
M&B woven trousers etc, cotton	6203	6	800.0	156.0	262.4	23.6 (83.37)	225.0	666.9	800.0	320.8	263.3 (81.53)	68.1	652.3
Shirts (knit)	6109	4	180.0	32.7	11.6	0.7	27.2	72.21 (40.12)	180.0	112.0	14.9	-	126.8 (70.47)
Shirts Woven	6205	8	40.2	-	1.2	4.1	2.6	7.9 (19.68)	40.2	0.0	-	-	.. (0.35)
Briefs M&B, cotton	6107	13	1,000.0	131.2	145.0	329.1	- (60.53)	605.3	1,000.0	14.9	-	- (1.49)	14.9
M&B jackets	6203	17	94.0	-	5.4	-	1.3 (7.12)	6.7	94.0	0.0	33.9	- (36.06)	33.9
M&B, W&G trousers (knit)	6103 6104	28	500.0	3.2	-	-	-	3.2 (0.65)	500.0	0.1	-	-	0.1 (0.02)
Knit shirts cotton & mmf	6105 6106	4 7	1,200.0	2.9	-	61.4	6.2	70.5 (5.88)	1,400.0	206.5	155.7	67.7	429.9 (30.71)
Briefs and panties	6108 6207	13) 18)	3,000.0	-	57.3	-	-	57.3 (1.91)	3,000.0	-	-	-	-

Source: European Commission, DG XXI, Customs and Indirect Taxation.

Figures in parentheses include percentage of quota.

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APPENDIX 4

THE HONG KONG TEXTILE EXPORT CONTROL REGIME - A POSSIBLE MODEL FOR LESOTHO

INTRODUCTION

It was recommended that in Part Three, Chapter 9.2 of the report that Lesotho should reform its present export control regime in order to secure the confidence of the US Government and thus facilitate the negotiation of any renewal/extension of the Lesotho/US textile trade agreement. This was also proposed as a technical cooperation project to be undertaken with UNIDO/UNDP. It is considered that the Hong Kong system would afford the best model on which that in Lesotho might be based. The main features of that system are set out below.

DESCRIPTION

Objects

The Government of Hong Kong acknowledges three objectives in the system it has developed for administering exports of textile products. These are as follows:

- to ensure that Hong Kong discharges fully its obligations arising from the MFA and from the bilateral agreements it enters into;

- to ensure that it derives maximum benefits from the rights it has secured under the agreements;

- to provide accurate and up to date information on the pattern and destination of Hong Kong's exports and re-exports of textiles.

The third objective derives from the need for information on which to base the effective operation of the system and for intelligence for the exporting community (see The Textile Export Control System, Hong Kong Trade Department, 1987.)

Internationally acknowledged

The importing countries agree that the system developed in Hong Kong is highly effective in achieving the first of these objectives. The government is recognized as being thorough in its efforts to compel its exporters to observe the limits placed upon their trade and ship only products conforming to the agreed rules of origin.

The confidence shown by the importing countries in Hong Kong's ability to stick to the rules had been demonstrated in several ways. One was the granting by the USA in the 1986 round of a longer agreement term compared with the USA's two other major suppliers, the Republic of Korea and Taiwan Province. Another was the willingness of both the USA and the EC to accept Hong Kong's own export authorization system as the most effective means of monitoring and controlling shipments of products not subject to specific limits. (The export authorization system is described in more detail below.)

The legal framework

The textile export control system is based upon the requirement of the Import Export Ordinance and associated regulations that all textile products exported from Hong Kong should be covered by an export licence. The issue and use of such licences are subject to such conditions as the director of trade sees fir to attach to them. Hence suppliers of transport services must not accept a consignment of textile products for export without an appropriate export licence and that licence must be submitted to the Trade Department together with the export cargo manifest (list of items) within 14 days of shipment.

The licensing system

The control over textile exports exercised by the Hong Kong Trade Department is essentially bureaucratic in its nature depending on the procedures of the licensing system. Physical inspection of consignments by the customs service is intended only to reinforce the operation of this system and is only carried out at the discretion of the department and the service.

Registration a prior requirement

For exports of products which are specifically restricted according to Hong Kong's bilateral agreements under the MFA, licences to ship consignments (known as blue licences from the colour of the pro forma) are issued only to companies which are registered for textile control purposes.

To be registered companies must satisfy the government that they are actively engaged in the exporting of textiles either as manufacturers of products or as suppliers of export services. This requirement is intended to discourage the emergence of a class of rentiers mainly concerned with the exploitation of the licensing system rater than with the business of exporting textile products. Registration is not required in the case of products not specifically controlled or for re-exports. In these cases the licences are white.

Quotas also required -

The other major condition attached to the issue of the blue licence is that the licensee must be in possession of enough quota in the target market in respect of the controlled products to cover the volumes shipped.

- or export authorization

For a white licence - permits to ship products not subject to specific restriction - the requirement that the applicant be in possession of quota is, of course, not relevant. However, an appropriate export authorization from the Trade Department is required in cases where non-restricted products are subject to export authorization control under an international agreement. Export authorization is a system of monitoring exports of products not considered sufficiently troublesome by the importing country to justify a specific restraint but which cause it sufficient concern to make it seem desirable to keep them under continuous surveillance to guard against all possible market disruption. In the case of the EC all products subject to the basket exit mechanism require export authorization and, since 1977 all products not specifically controlled have been regarded as "in the basket". The USA introduced a similar comprehensive control in 1986.

For the Hong Kong exporter the authorization is, in effect, a licence to apply for a white licence which will cover specifically identified products. It lasts for three months. During the period of its validity, an importing country cannot refuse entry to products covered by it. Thus shipments are protected against the disruptive effects of a "call" to consult on possible market disruption made after a consignment is shipped.
Such "calls" are a continual source of concern among suppliers of uncontrolled products in other countries which have entered into bilateral textile agreements, particularly when there has been substantial growth in exports of such products over a relatively short period. (The apparent readiness of Cita in the USA in the mid-1980s to issue a call in respect of almost any product has been already noted.) The willingness of the EC and the USA to grant this unique privilege to Hong Kong is an open tribute to the perceived effectiveness of its monitoring and controlling procedures, and the scrupulous honesty with which Hong Kong discharges its agreements.

The issuing of licences

Licences are issued in quadruplicate. The original is retained by the Trade Department, the second copy is kept by the exporter, the third surrendered to the shipping company and the fourth dispatched with the consignment to the overseas importer. (The distribution of the copies is rather different in the case of exports to the EC, but for control purposes the use to which they are put is the same.)

Checking procedures

When the Trade Department issues a licence this is recorded in a computer data bank by a double keying procedure; not only does this almost eliminate the chance of error during entry, but it also provides a further opportunity for checking that the licence was correctly issued.

This record is then checked against the triplicate copy of the licence given to the shipping company and the cargo manifest when these are surrendered. This provides a check that what is licensed coincides with what is shipped and that there is no fraudulent alteration of a licence. Thus the system compels exporters and shippers to act as a check on each other obviating the need for a physical inspection of each cargo. In addition, the Trade Department is able to maintain a constantly updated record of Hong Kong's export performance in terms of both products and destinations.

Inherently effective

The effectiveness of the licensing system as a means of controlling what are highly sensitive textile and clothing exports is to a great extent due to the essential simplicity of its concept, and the unlikelihood of shippers and exporters colluding to defeat its purposes. Its effectiveness also depends on the intelligent and close attention of those operating it at every level - much depends on fairly junior data entry clerks, although the system has a multiplicity of built-in checks against error.

A shared interest

Probably more important than the inherent strength of the system is the shared interest of the government and the export community in its effective operation. Both parties are aware that the compensating benefits that Hong Kong has been able to secure within otherwise restrictive agreements depend on the confidence of its trading partners that it discharges its obligations scrupulously. Industry organizations are, accordingly, as eager as the government itself to ensure the integrity of Hong Kong's trade - if not more so.

APPENDIX 5

POLICY FOR THE DEVELOPMENT OF SMALL-SCALE INDUSTRIES (SSI) IN LESOTHO (Annex I to the White Paper)

1. INTRODUCTION

1.1 The GEMINI baseline survey conducted in Lesotho in 1990 indicated that micro and small enterprises form a sizeable component of Lesotho's economy. The results of the survey showed that there were 103,000 micro and small enterprises employing 161,000 people. This finding means that approximately 20 per cent of the labour force is engaged in the micro and small enterprises' activities given that the labour force is estimated at 800,000 people. The survey further indicated that approximately 30 per cent of the households had some micro or small-scale activity and 75 per cent of the micro and small enterprises obtain more than half of their household income form their business activity.

1.2 The vast majority of the micro and small enterprises (MSE) in Lesotho are located in the rural areas. The manufacturing and trade sectors account for over 90 per cent of the MSEs. These activities dominate within the manufacturing sector: food and beverages, textile and apparel and woo and grass products.

1.3 The survey indicated that women play a dominant role in the MSEs, seventy five per cent of the entrepreneurs as well as the labour force are women. However, female ownership is concentrated in certain sectors, particularly food and beverages, straw and grass handicraft, knitting and trade. Female ownership is non-existent in metalworking and repair.

1.4 It is apparent from the above background that small-scale industries have been found to play an important role in the economy of Lesotho in creation of employment especially for the semi-skilled and unskilled labour force. Small-scale industries serve as the base for entrepreneurship development. Due to their suitability to be set up in areas without sophisticated infrastructure, they have a potential to provide better possibilities for the geographic distributions of industries.

1.5 A number of policy measures are needed to enhance the development of the SSIs in Lesotho. They include creation of a conducive environment by removing physical, administrative, political as well as psychological real or perceived barriers in order to motivate entrepreneurs to make long-term investments in the SSI sector, clear definition of SSIs, a package of incentives and institutional arrangement for the implementation and follow-up. With a view to developing small-scale industries the following policy measures will be implemented immediately by the Ministry of Trade and Industry.

2. POLICY MEASURES

2.1 Definition of small-scale industries in Lesotho

2.1.1 Any activity manual or otherwise which transforms a product in size, shape and appearance by adding value is termed a manufacturing small-scale industry provided that:

a) the employment is not more than 25 employees,
b) the investment is not higher than M.100,000 in plant and equipment, and
c) the annual turnover is not higher than M.500,000.

2.1.2 It is assumed that:

a) the majority of the employees will be local people.

b) the ownership will be preferably local.

c) the business will be operating in Lesotho under the laws and regulations of Lesotho.

2.2 Financial incentives for the small-scale industries

The Ministry of Trade and Industry (MTI), the Basotho Enterprises Development Corporation (BEDCO), the financial institutions and the non-government organizations (NGOs) will help small-scale industrialists in the preparation of viable bankable proposals for soliciting loans from financial institutions. The Institutional credit flow to the SSI sector will be significantly increased by easing collateral requirement and by giving more weight on the viability of the project, the assets to be generated in the project and the competence of the entrepreneur. For projects with good merits, the financial institutions will finance them with increased debt equity ratio up to 9:1 for SSIs. The MTI will bring into operation credit Guarantee Schemes in the Central Bank of Lesotho to be funded by the donor agencies and the Government of Lesotho in order to reduce the risk of the financial institutions. The banks will be directed to strengthen their SSI financing section with competent staff to assisting the SSI sector. The BEDCO and banks will be encouraged to buy equity in the SSI projects at the initial stage with a view to making provisions for the SSI promoter to acquire such equity, in stages out of profits generated by the project. Banks will be given specific financial targets by the Central Bank of Lesotho to finance the SSI projects.

2.3 Industrial estate

Most of the small industries do not have sufficient fund to invest in land, buildings and physical infrastructure such a s electricity, water and access roads. To enable the SSI entrepreneur to use his capital in acquiring the productive assets and providing for working capital, and to keep up with the decentralization and rural development programmes, the Ministry of Trade and Industry will take a lead role to see to it that industrial estates are established throughout the country in suitable locations and on the basis of demand from the SSI sector. Only need-based common service facilities will be provided in these industrial estates. The developed industrial and or industrial estates will provide only the standard infrastructures as per requirement of the industrialists. The common service facilities will be given on a lease basis and the subsidized rates will be increased to commercial rates within a reasonable time of 3 years of initial usage of the facility.

2.4 Subcontracting

Large industries which are more amenable for subcontracting or ancillarization will be given preference for promotion and incentives. To maintain the competitiveness of the cooperating large-scale industries, inputs acquired by the large industries from ancillary SSIs will be exempt from sales tax or purchase tax, if any. The large-scale industries will be encouraged to provide for extension services in training and technology. There will be no sales tax on raw materials used by the SSIs and appropriate tariff rebate will be given on imported raw materials required by the SSIs. Government will always endeavour to encourage direct contracting and subcontracting to small-scale enterprises engaged in manufacturing, construction, transportation and service industries.

2.5 Bulk purchase of raw materials

To sell raw materials at a competitive price to the SSIs, there is a dire need to acquire materials in bulk by a suitable organization as there are hardly any manufactures of raw materials required by the SSIs in Lesotho. Small-scale units often require varied types of raw material in small lots and sizes. Considering the fact that the cost of raw material is an important cost component in pricing of the end product, it is essential to ensure steady supply of raw materials and components in small lots timely and at reasonable price to the SSIs by a bulk-store. The MTI will promote a private sector organization for this scheme. Finance will be provided at concessional rate of interest which is 5 per cent below the prime rate for supplying design, material and finance and marketing of finished products of small-scale industries (project "n" in the White Paper).

2.6 Price preference in government purchase and procurement programme

As the industrial sector is in a nascent stage, to make the small-scale industries' units competitive within a short gestation period, all government departments, contractors, suppliers and purchasing agencies will subject to quality and specifications, and be given preference in procurement of goods manufactured in Lesotho. In this connection, procurement policies and rules will be developed or amended to provide for price preference for the SSIs.

2.7 Human resource development

i) Entrepreneurship development training at secondary and high school level
Syllabus of secondary and high schools will include subjects relating to entrepreneurship development. Besides, suitable training programmes will be introduced in these schools.

ii) Entrepreneurship development training at vocational/technical schools
The emphasis of the training courses in the vocational/technical schools is mainly to make the trainees suitable to be employed by the maintenance contractors and manufacturing industries. A paid internship programme of one year will be part of the training course during which business and management training will be coupled with the practical, technical training.

iii) Entrepreneurship development training at teachers training colleges
The introduction of this training at teachers training colleges will serve as a training for teachers who will teach entrepreneurship development at secondary and high schools.

iv) General entrepreneurship development programme (EDP)
Entrepreneurship development training programme in business management, accounting, marketing, public relations and allied matters will be drawn up and implemented by the Business Training Centre and Institute of Extra Mural Studies (IEMS) and such other training organizations like Lesotho Institute of Public Administration (LIPA), Centre of Accounting Studies (CAS), Lesotho Opportunities Industrial Centre (LOIC), banks, Basotho Enterprises Development Corporation (BEDCO), Lesotho National Development Corporation (LNDC), Ministry of Trade and Industry (MTI), Ministry of Education and Ministry of Employment which are currently encouraging and are engaged in management training. These programmes will be coordinated and standardized by the Ministry of Trade and Industry and the Ministry of Education. The Basotho Enterprises Development Corporation (BEDCO) will be the coordinator in the implementation of standardized programmes approved by the Ministry of Education and the Ministry of Trade and Industry. As far as practicable and useful, BEDCO will maintain samples of business profiles for potential entrepreneurs in the small-scale industry sector with emphasis on value added industries.

Training grants

2.7.1 For all these programmes to succeed the government will provide training grant to cover institutional training, apprenticeship training of workers in factories and Entrepreneurship Development Programme (EDP) training specifically for the SSI sector development through the Ministry of Trade and Industry and the Ministry of Education. The training fund will be created out of government budget and contributions from cooperating partners.

2.7.2 Training of trainers

In order to enable the Ministry of Trade and Industry, BEDCO, commercial banks and private sector management consultants to play their respective roles effectively in Entrepreneurship Development Programme, officers of these organizations shall be trained from time to time to act as effective trainers with the financial and technical assistance of international cooperating agencies.

2.8 Enabling environment

2.8.1 The bureaucratic licensing, registration and taxation procedures will be simplified to ensure that they do not hinder development of small-scale industries and the informal sector.

2.8.2 Micro enterprises like flea market stall holders, pavement vendors and artisans will be provided with the required facilities in their work places to ensure hygiene, safety and congenial working conditions without creating problems to others.

2.9 Institutional arrangement

2.9.1. Within the policy directives of the Ministry of Trade and Industry set out in the White Paper, the responsibility of spearheading and coordination of activities for the development of small-scale industries and the informal sector will be entrusted with Basotho Enterprises Development Corporation (BEDCO) working hand in hand with the Department of Industry of the Ministry of Trade and Industry and the concerned institutions and non-governmental organizations.

2.9.2 To enable BEDCO to play this important role in the small-scale industry and informal sector development, the Board of Directors of BEDCO will be appropriately restructured by the Ministry of Trade.