Lesotho: Basic Data 1/

Area, population, and income

Area (thousand sq. km)	30,355
Population (2002; in millions)	2.1
Annual demographic growth rate (2002; in percent)	1.1
GNI per capita (2001; in U.S. dollars)	530

	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
National accounts	(In millions of maloti, unless otherwise specified)						
GDP at current market prices	4,220	4,770	5,082	5,669	6,137	6,839	7,731
Of which : agriculture	667	712	809	906	1,024	1,110	1,211
manufacturing	610	707	788	845	946	1,129	1,413
GNP at current market prices	5,631	6,311	6,492	7,183	7,685	8,374	9,466
Real GDP growth (percent)	9.5	4.8	-3.5	0.5	1.9	3.3	3.8
Real GNP growth (percent)	8.1	3.5	-6.5	-0.3	0.7	1.0	3.8
Prices							
Consumer price index (percent change; period average)	8.8	7.3	8.9	6.3	6.2	11.3	9.1
Employment	(In thousands)						
Migrant mine workers 2/	99.9	92.5	71.9	67.7	64.2	60.9	62.0
Central government finance	(In millions of maloti)						
Revenue	2,035	2,247	2,174	2,313	2,627	2,788	3,035
Of which : SACU 3/	1,006	1,173	1,034	1,183	1,126	1,438	1,470
Total expenditure and net lending	2,053	2,342	2,438	3,373	2,864	2,938	3,659
Current	1,179	1,474	1,943	2,319	2,434	2,312	2,857
Capital	874	868	496	480	473	746	834
Overall balance, before grants	-18	-95	-265	-1,061	-238	-150	-624
Grants from abroad	203	179	120	130	126	189	296
Overall balance, after grants	185	84	-145	-931	-112	39	-328
Foreign financing (net)	347	346	18	-71	-257	-54	56
Domestic financing (net)	-504	-474	182	1,048	390	16	272
Residual	-29	45	-55	-46	-21	0	0
Monetary survey	(In millions of maloti; end of period)						
Foreign assets (net)	2,393	3,170	3,754	3,583	3,670	5,229	3,722
Domestic credit	-754	-929	-881	54	424	432	321
Government (net)	-1,631	-2,044	-1,953	-938	-579	-511	-190
Rest of the economy	878	1,115	1,072	992	1,003	943	512
Money and quasi money	1,326	1,640	1,753	1,717	1,822	2,133	2,191
Other items (net)	314	600	1,120	1,920	2,272	3,528	1,852
Balance of payments	(In millions of U.S. dollars, unless otherwise specified)						
Current account deficit (-)	-285	-313	-219	-210	-153	-96	-138
Of which							
Exports, f.o.b.	191	197	191	188	223	294	399
Imports, f.o.b.	-989	-1,019	-781	-796	-717	-661	-840
Of which : LHWP 4/	-122	-147	-214	-51	-34	-34	-26
Miners' remittances	300	316	231	224	191	149	169
Unrequited transfers	186	202	140	156	127	122	140
Capital and financial account	52	191	431	306	209	201	129
Capital account	47	210	164	102	37	29	37
Financial account	5	-20	267	205	172	172	92
Direct investment	45	38	217	154	120	107	93
Other investment	73	24	-2	-31	-24	71	8
Change in reserve assets (minus sign indicates increase)	-113	-81	53	82	77	-6	-9
Errors and omissions	232	122	-212	-96	-57	-105	9
Gross official reserves (months of imports, f.o.b.)	5.8	8.7	7.9	8.8	7.2	5.3	4.4
External debt							
Disbursed and outstanding	573	600	639	671	581	537	601
Debt-service ratio (as percent of exports of goods and services, and factor income)	4.5	4.0	6.6	8.1	13.3	7.5	5.7
Exchange rate (maloti per U.S. dollar, end of period)	*4.4*	*5.0*	*6.2*	*6.6*	*8.0*	*11.4*	*7.9*

Sources: Lesotho authorities; World Bank; and staff estimates.

1/ Fiscal year is April-March.
2/ Average number employed in South Africa.
3/ Southern African Customs Union.
4/ Lesotho Highlands Water Project.

I. Textiles Industry: Performance, Constraints, and Future Prospects[1]

1. The growth of Lesotho's textiles industry is a success story. Lesotho is now the largest exporter of textiles and clothing in sub-Saharan Africa, and textiles has become the main source of economic growth and employment in Lesotho. With the phasing out of the Multi-Fiber Agreement (MFA) beginning in 2005, Lesotho will face intense competition from low- cost regions, notably Asian countries. In order to remain competitive and diversify its export base, Lesotho must define a clear strategy to reduce production costs, improve the investment climate, and attract sizable foreign direct investment (FDI).

A. Introduction

2. Lesotho's textiles industry has its roots in the early to mid 1980s, when East Asian entrepreneurs moved factories and production lines from South Africa to Lesotho to avoid international sanctions imposed on South Africa. In the late 1980s, the main impetus to growth was preferential market access to the European Union (EU) provided under the Lomé Convention and to the United States under the Generalized System of Preferences (GSP). Investment promotion efforts by the Lesotho National Development Corporation (LNDC), as well as the provision of infrastructure and fiscal incentives, the availability of an educated work force, and relative political stability, facilitated the process.

3. Textiles exports registered a steady growth of about 24 percent a year during the decade through 2002; the industry has also attracted new investment and experienced an exceptional growth in production and employment during the period, particularly after 1999. This has been possible largely because of the duty- and quota-free access to the U.S. market that the African Growth and Opportunity Act (AGOA) has provided since 2000. Less-developed African countries that qualify for AGOA have received so-called LDC status, which relaxes the complex rules of origin until 2004. The LDC (less developed country) status is set to expire in 2004, even though AGOA itself will remain valid until 2008.

4. **Lesotho's textiles industry is at a critical juncture** because of the envisaged phasing out of both the LDC status under AGOA and the quota regime under the MFA, which governs global textiles exports (see further discussion below). There are two pressing issues facing the industry: (i) how to adjust and compete in a changing international market, in particular after the LDC status has expired and all MFA country quotas have been abolished; and (ii) how to diversify into new products while improving Lesotho's investment climate and its ability to compete, in order to continue to attract FDI and maintain steady growth.

5. This chapter discusses these and related issues in detail and is organized as follows. Subsection B provides an overview of trends and performance, highlighting export growth, value added, and employment during the decade through 2002. Subsection C presents an

[1] Prepared by Shahabuddin M. Hossain.

account of the structure and evolution of the textiles industry (profiles of entrepreneurs and the production process), highlighting key determinants of its growth—FDI induced by trade preferences and domestic incentives. Finally, section D discusses future prospects and key issues. In particular, it discusses the possible implications of the phasing out of AGOA and quota regimes and how Lesotho could diversify its exports by improving its competitive position in the world market. The paper is based on extensive discussions with representatives of Lesotho's textiles industries, officials in the Ministry of Trade, Industry and Marketing, and it draws as well from a number of background studies and reports listed in the reference section.

B. Trends and Performance of the Sector and the Global Trade in Textiles

6. **The textiles sector has become the major source of economic growth and employment in Lesotho.** Textiles exports in U.S. dollar terms increased at an average annual rate of about 24 percent during 1992-2002, while textiles value added grew at an annual rate of 15 percent during the same period.[2] Textiles had emerged as a major source of income and employment by 1997, and its share of GDP increased from about 3 percent in 1991 to about 8 percent in 2002 (Figure I.1 and Table I.1). Employment also grew from 7,400 in 1991 to about 39,000 in 2002, when it exceeded public services as the most important generator of employment in Lesotho (Figure I.1 and Table I.2).

7. **Growth has been extraordinary since 1997** (Figure I.1). The value of exports to the United States has increased in exponential terms in response to the duty- and quota-free access provided under AGOA. Lesotho's textiles exports increased from US$100 million in 1999 to US$262 million in 2002 (an average annual growth of about 54 percent) (Table I.3).

8. At present, more than 90 percent of Lesotho's textiles exports are directed to the U.S. market. There are some exports to the Southern African Development Community (SADC) countries, but exports to the European market are virtually nonexistent.

9. **Lesotho is the largest exporter of textiles and clothing (T&C) in sub-Saharan Africa (SSA),** and its exports exceeded those of South Africa. Table I.4 presents exports of T&C by individual countries across different regions. It shows that the market shares of SSA countries are small. For Lesotho more critical is the fact that its dependence on T&C exports is one of the highest in the world—T&C exports constituted as much as three-fourths of total

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[2] The available statistics on exports (value and volume) are incomplete and often inconsistent with the import data of the United States, the main destination of exports. They do, however, reveal the extraordinary growth in exports during the last decade. The reported statistics on textiles sector value added also include leather and footwear. The latter is a very small subsector.

exports in 2002 (Table I.3). This makes Lesotho extremely vulnerable to changes in the global textiles market.

C. Structure and Evolution of the Industry and Determinants of Its Growth

The production process and international marketing

10. **Lesotho's textiles sector is dominated by the ready-made garments industry,** which is divided into two distinct segments: factories producing garments manufactured from woven cloth (including denim jeans) and those producing garments manufactured from knitted cloth. One major factory producing fabric (jeans) has also emerged in 2003. Activities in ready-made garments are usually divided into cut, make, and trim (CMT). Consistent with the global trend to relocate labor-intensive operations to low-cost countries, only physical manufacturing takes place in Lesotho. Head offices overseas take care of design, sampling, purchase of raw materials, marketing of products, and financing of the operations.

11. The first stage of the production process is sampling and cutting the raw materials against specific orders. The next stage is printing or embroidery, if required; this is either done in-house or sent to subcontractors. The cut work is then loaded into the sewing floor. In the final stage, the garments will either receive a wash treatment, if needed, or they will be sent directly to pressing and packing. Most jeans require specialized washes to give them the desired finish. They are then sorted according to their orders and packed in cardboard cartons for transportation and shipping.

12. Sufficient orders are needed for uninterrupted production. More than 90 percent of Lesotho's textiles exports are directed to the U.S. market, and there are two major sources of orders for that market: those placed directly by major brands and retail stores and those placed by direct importers. The major brands and retailers usually have their own design and range development departments, which produce technical specification sheets for each garment to be purchased. These "tech sheets" specify the quantities, size breakdown, delivery date, fabric, trims, seam measurements, tolerance measurements, printing, embroidery, washing, and packaging, as well as a host of other data.

13. Selling prices are determined on the basis of quotations provided by manufacturers in different countries and the technical specifications of the product. Reliability factors based on past relationships and loyalties also play a critical role. The overseas holding company, which owns the factory in Lesotho, has the full information on raw materials, labor, and overhead costs of all its manufacturing operations and usually quotes the price of garments produced in Lesotho.

14. In 2002, the structure of Lesotho's textiles sector was as follows: (i) four company groups made denim jeans and employed about 11,000 people; (ii) nineteen company groups were manufacturing knit garments and employed about 18,500 wage earners; (iii) four company groups manufactured a mix of woven and knit garments and employed 2,200 employees; and (iv) two companies were pure service providers, supplying printing and

embroidery services. All companies were foreign owned, and FDI played a key role in the establishment and growth of the industry.

Trends in FDI and its role in the development of the subsector

15. **Lesotho does not possess the usual location advantages to attract FDI.** It is landlocked, of small size, and with a relatively underdeveloped infrastructure. Lesotho has, however, been successful in attracting sizable inflows of FDI, due to the preferential market access as well as government efforts and investment promotion activities undertaken by the Lesotho National Development Corporation (LNDC). FDI flows jumped in 1994 and peaked more recently in 2001-02. FDI inflows have been concentrated in export-oriented textiles manufacturing and activities related to the Lesotho Highlands Water Project (LHWP). Foreign entrepreneurs have been instrumental in setting up the textiles industry in Lesotho. Of a total of 40 textiles factories in 2002, owners of 26 were based in Taiwan Province of China, and another four had their headquarters in Hong Kong, China (mainland), and Singapore.

16. **About 90 percent of the FDI has gone into export-oriented garments manufacturing,** but firm estimates are not available. According to the UN Conference on Trade and Development (UNCTAD), inflows of FDI excluding LHWP related investment were relatively stable at low levels through most of the 1980s with a peak of US$21 million in 1988 (Figure I.2). A surge occurred in 1994, when FDI reached US$41 million, mainly because of investment in the garments sector. After having remained relatively stable during the second half of 1990s, the flows have peaked again during 2001–2003 as a result of trade preferences awarded under AGOA. It is estimated that FDI created 14,000 new jobs in 2001 alone. Beginning in 2001 a Taiwanese investor has started the largest single investment project in the textiles sector estimated at about US$90 million over three years, thereby adding about 5,300 people to the workforce.

Preferential market access: ACP-EU agreement, AGOA, and the ATC (Agreement on Textiles and Clothing)

17. Preferential market access provided under trade arrangements with the EU and the United States is the critical factor that has determined the flow of FDI into the garments sector. In addition, the global quota regime under the MFA has also influenced the evolution of the industry. These trade agreements and the nature of market access are summarized below:

ACP-EU agreement

18. Lesotho was a signatory of the Lomé Convention, which allowed duty-free access of clothing originating in ACP (Africa, Caribbean, Pacific) countries to the EU. Initially, the manufacturers were allowed to buy their inputs (mainly fabrics) from the cheapest source (e.g., East Asia). In the late 1980s, however, the EU began to apply "cumulation" to all ACP countries, requiring at least two stages of production (e.g., fabric making and garment manufacturing) to be carried out in the country of origin or another qualifying ACP country.

Lesotho received a special dispensation for eight years, and a new wave of FDI, mainly by Taiwanese companies, followed. After the end of the dispensation, several foreign investors downsized or closed their factories. Others shifted their exports to the U.S. market and took advantage of Lesotho's unused quota under the MFA. The exporters had to pay a duty of 17 percent on average, which applied to all exporters from developing countries, but they were allowed to buy their raw materials from the cheapest sources.

African Growth and Opportunity Act (AGOA)

19. As noted above, the AGOA was enacted in 2000 and has provided a major boost to the expansion of Lesotho's textiles sector. Under AGOA, qualifying SSA countries receive duty- and quota- free access to the U.S. market for a number of products, including textiles until 2008. The input (fabric) used by the garment sector must originate from either the United States or another qualifying SSA country.

20. An exception has, however, been provided to countries like Lesotho with an LDC status. The rules of origin do not apply to their clothing exports until 2004. This has driven the growth of the garments sector and supported a few big investment projects, like a denim jeans factory and two knitting factories, which are expected to be completed in 2004 and will produce fabrics for the production of ready-made garments. If the LDC status is not extended after 2004, Lesotho's garments sector must rely on fabrics produced in the United States, locally, or in another qualifying SSA country in order to maintain the duty-free access.[3]

Agreement on Textiles and Clothing (ATC) and the phasing out of quotas under the MFA

21. The industrial countries used to apply widespread and restrictive quotas against imports of textiles and clothing from developing countries under the MFA. In the Uruguay Round of Multilateral Trade Negotiations, it was agreed to integrate and liberalize the trade in textiles and clothing over a period of ten years, beginning in 1995.

22. The ATC is a transitional arrangement, regulating the trade in textiles over the transition period. Quotas are to be eliminated through a step-by-step removal of existing quotas ("integration") and expansion of remaining nonintegrated quotas ("liberalization"). Integration is to be carried out in three stages. Starting January 1995, World Trade Organization (WTO) members had to integrate 16 percent of the total volume of their 1990 imports. In January 1998, an additional 17 percent of the total volume of 1990 imports had to be integrated, and this was followed by another 18 percent in the third stage, which commenced in January 2002. Finally, the remaining 49 percent of the total volume of 1990 imports must be integrated in January 2005. The importing country can choose the products

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[3] Among others, Mattoo, A., D. Roy and A Subramanian (2002) indicate that the restrictive rules of origin imposed by AGOA significantly reduces the potential medium-term benefits to African countries relating to the textiles sector.

to integrate, but it must include at least one item from each of four major product groups: yarns and tops, fabrics, made-ups, and clothing. The ATC is binding for all members of the international trading system and administered and supervised by the WTO.

23. Review of the implementation through end-2001 showed that little real progress had been achieved. Although 33 percent of the volume of 1990 imports had been integrated to fulfill the minimum legal ATC requirement, the process had contributed little toward realization of the main objective of ATC — the progressive phasing out of quotas and the liberalization of trade. In the seven years since 1995, products selected for integration had been concentrated in lower-value-added items, such as tops, yarns, and fabrics, that is, products that were of little importance to the major importers. This back-loaded implementation strategy may make it difficult to implement the ATC on schedule without causing large disruptions in the market.

Infrastructure and the domestic business environment

24. **Domestic incentives** – like infrastructure, proximity to South African ports, fiscal incentives, and a well-organized workforce – **also played an important role in the development of the textiles sector.** Industry representatives and LNDC officials noted, however, that some of these factors had now begun to pose constraints to further growth:

- **Legal framework for FDI.** Lesotho's FDI policy and legal framework are weak. A foreign investment law and, with one exception, foreign ownership restrictions in sectoral licensing laws are missing. In practice, the government has promoted FDI in manufacturing activities, including the textiles sector.[4] Foreign investors are treated the same as national investors in most areas. A clear and major exception is the treatment of land leases. Only Lesotho citizens and commercial entities that are majority controlled by Lesotho citizens may lease land. Foreign investors may only sublease land from Lesotho citizens. All transactions in leases and subleases, including issues, transfers, and mortgages, require ministerial approval.

- **Factory shells, land, and water.** The LNDC has provided factory shells and utilities in the industrial estates, which has helped to develop the industry. However, because of the spurt of growth in recent years, the shortage of serviced factory shells and water supply is now constraining the expansion. To address this problem the LNDC has begun building additional industrial estates with factory shells. It has also facilitated land transfers to the denim mill company and a few other companies that are willing to build their own factory

[4] Lesotho's track record is, however, not perfect. In 1999, new trading enterprise regulations introduced reserve licenses that prohibited FDI in 17 business activities, mainly in the retail business and service sectors. Existing business activities were given 12 months to exit, and a number of businesses were closed as a result.

sites. Water is, however, a major constraint. The poor supply of groundwater and lack of adequate funds for investment have prevented the water company from expanding its network to new industries.

- **Container facility.** Severe capacity constraints at Mascon (Maseru Container Terminal) have emerged as the key constraint on the timely movement of raw materials and finished products. Expansion and development of the facility require sizable investment, which the private sector is willing to undertake only if appropriate land and property rights are provided.

- **Labor costs, labor markets, and regulatory environment.** All industry representatives cited labor costs, minimum wage regulations, and constraints on hiring and firing of workers as major problems. Every year, the industry is engaged in tripartite wage negotiations with the trade unions, which is both a time-consuming and difficult exercise. In addition, expatriate employees have difficulties in obtaining work and resident permits that are valid beyond three months.

D. Future Prospects: Key Issues

25. As noted at the outset of the paper, the two most pressing issues facing the industry are the following: (i) how to adjust and compete in a changing international market, in particular after the LDC status has expired and all MFA country quotas have been abolished; and (ii) how to diversify into new products by improving Lesotho's ability to compete, to continue to attract FDI, and to maintain a steady growth.

Impact of the phasing out of AGOA 1

26. Under AGOA, Lesotho has LDC status, which enables it to sell all products duty and quota free to the United States, while non-LDC countries pay duties averaging about 17 percent, and to procure inputs without restrictions until and including 2004 (AGOA 1). In the second phase (AGOA 2), from 2005 to 2008, Lesotho's garments industry will still be allowed to sell its products duty and quota free to the United States, but it must purchase its inputs locally, from the United States or from other qualifying SSA countries, including South Africa. It is possible that AGOA 1 could be extended beyond 2004, even though there is no indication that the United States authorities will do so.

27. The time-bound nature of AGOA 1 has provided incentives for Lesotho's textiles industry to integrate backward. One company has set up a denim mill, at a cost of about US$90 million over three years, which is expected to be fully operational in early 2004. The mill is expected to produce about 2 million meters of fabric a month out of a total demand in Lesotho estimated at 2.5 million meters a month. Another company has acquired a denim mill in KwaZulu Natal, South Africa, with a current capacity of 600,000 meters a month, which it will be eligible to use under the AGOA preference system.

28. The situation is more worrying in the knitted garments segment of the industry, which employs about 60 percent of the garments industry workforce. Some industrialists have stated that they would leave Lesotho if the advantages under AGOA 1 were lost, while others have discussed plans to manufacture knitted fabrics if the need should arise. A knitted fabric mill is smaller than a woven fabric mill, and the time span required for an investment is shorter. The industrialists are, therefore, in a position to defer any decision to set up knitted mills until they know the outcome of the negotiations to extend AGOA 1.

The impact of elimination of quota under the ATC

29. The elimination of ATC quotas, beginning in January 2005, is a potent threat to Lesotho and other smaller textile exporters. If current country-specific quotas are withdrawn, an influx of T&C exports from low-cost producers in China and South Asia will pose a competitive threat to small producers. Countries like Lesotho will face stronger competition, even if the AGOA tariff preference in favor of LDCs remains.

30. At the same time, Lesotho's tariff advantages will probably be eroded through new rounds of WTO talks, as United States and other major importers are expected to reduce their average level of tariffs on textiles products. It is not clear what kind of safeguards will be in place to prevent large exporters like China and India, from dominating the export market. Possible impacts are as follows:

- Removal of ATC quotas on yarn, fabrics, and clothing (ready-made garments) will open up international markets and expose exports from developing countries to increasing competition from countries that produce efficiently have large export capacities, and fully utilize their current quotas. Major competitors in different lines of production are as follows: (i) for yarn, India and Pakistan; (ii) for fabrics, East Asia (Malaysia, Thailand, Korea, and Hong Kong); and (iii) for clothing, China, India, Bangladesh, and Pakistan.

- Elimination of quotas—which have provided guaranteed market access for small and less efficient producers—will open markets to more efficient and larger suppliers that have filled their previous quotas. Countries (or product lines) that have been facing more binding quota restrictions will become more competitive, while those that have been less restricted by quotas may find it difficult to maintain their current market share.

31. Simulations by IMF staff indicate that the removal of MFA quotas would have a sizable negative effect on exports of Southern Africa Customs Union (SACU) countries. As much as one-fifth of the export of T&C could be eliminated, while the negative welfare impact would be about US$200 million. The information is not detailed enough to assess the possible impact on Lesotho, but industry representatives have indicated that profit margins are thin. A comparison of wages, which is a major cost element, shows that Lesotho is better placed than some countries in the region, but Lesotho's wages are higher than in Asian countries like Bangladesh and Indonesia (Table I.5). More critically, these countries have less stringent labor

laws that allow significantly longer working hours and set few limits on **minimum wages**, overtime, and the **hiring and firing of labor**.

Measures to improve competitiveness and promote diversification

32. To promote diversification into new product lines (within and outside the T&C industry), Lesotho must implement a systematic strategy to reduce production costs and improve its global competitiveness. Several elements are important:

- In the area of infrastructure, there is a need to provide land rights (long-term lease) to foreigners so as to attract private investment in infrastructure. In addition, a sizable up-front investment to expand water supply will pay off.

- There is a need to introduce more flexibility in the labor market and to improve the regulatory environment governing employment and investment. In particular, more flexibility in setting minimum wages without the use of centralized tripartite negotiations and a relaxation of hiring-and-firing rules may help the industry to cope with the competitive pressure.

- Industry representatives welcomed the recent liberalization of the foreign exchange regulations and capital account, in particular the relaxation of rules allowing Lesotho residents and nonresidents alike to hold foreign currency accounts in banks.[5]

- It was also suggested that selective time-bound fiscal incentives could be provided to promote few sectors/product lines in which Lesotho has a comparative advantage. Developing credit institutions and marked based instruments to improve access to finance while reducing its cost can also help diversify the export and production base of Lesotho.

- Diversification into higher grade products within textiles, into other products within light manufacturing (leather and footwear, consumer electronics, furniture and agro-processing), and diversification to other markets such as SADC will strengthen the industry's position in a competitive global market. This hinges on public policy to improve infrastructure and utilities, strengthen property rights, flexibility in the labor market and developing formal credit institutions noted above as well as simplifying regulations and facilitating the development of technical and entrepreneurship skills. Proactive measures, such as public-private initiatives in training, are needed to

[5] Lesotho is considering reintroducing the Duty Credit Certificate (DCC) scheme, which was withdrawn owing to misuse, to encourage regional backward linkages. The DCC scheme would grant exporters an import duty credit based on a percentage of their exports. As a result, fabrics from South Africa may become price competitive with East Asian products.

promote diffusion of skills from the export sector to the rest of the economy and create institution for vocational/technical training.[6]

33. **Recent trade initiatives may favor Lesotho and other countries in the region.** Lesotho is likely to benefit from the ongoing negotiations of a free trade agreement (FTA) between the U.S. and the SACU countries, which is expected to be concluded in 2004 and become operational in 2005. The FTA will allow duty-free access of potentially thousands of product lines to the U.S. market, thus providing a great opportunity for export diversification. Lesotho should also gain from EU's Everything-But-Arms initiative, once the rules of origin are made clear. To seize the opportunity, Lesotho and other regional countries must improve their investment climate in order to attract sizable FDI in new product lines within the T&C industry, as well as in new industries.

E. Concluding Remarks

34. **The ready-made garments industry is a success story.** Rapid FDI-induced growth was facilitated by preferential trade arrangements and domestic incentives. This provided a much- needed boost to economic growth and employment in the face of declining workers' remittances and agricultural productivity. After more than a decade of steady growth, the industry now stands at a critical juncture. There is considerable uncertainty about the likely impact of the phasing out of AGOA 1 and global MFA textiles quotas.

35. **The key challenge is how to adjust and compete in a changing international market,** in particular when Lesotho's current LDC status under AGOA expires in 2004 and all MFA country quotas are abolished in 2005. The competitive pressure on smaller producers like Lesotho is likely to intensify, unless safeguards are introduced to minimize the disruptions caused by entries of big players like China and India. Lesotho cannot influence developments in the global market, but it can take measures to improve its ability to compete and to continue to attract a sizable amount of FDI in textiles. Such measures would be an improvement in property rights, up-front sizable investment in infrastructure, and improvement in the regulatory environment and labor markets. These measures, combined with efforts to reach out to new markets in the EU and the United States can provide the basis for a continued expansion of textiles exports, as well as a much-needed export diversification into new products.

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[6] World Bank, Lesotho – Growth and Employment Options Study, 2003.

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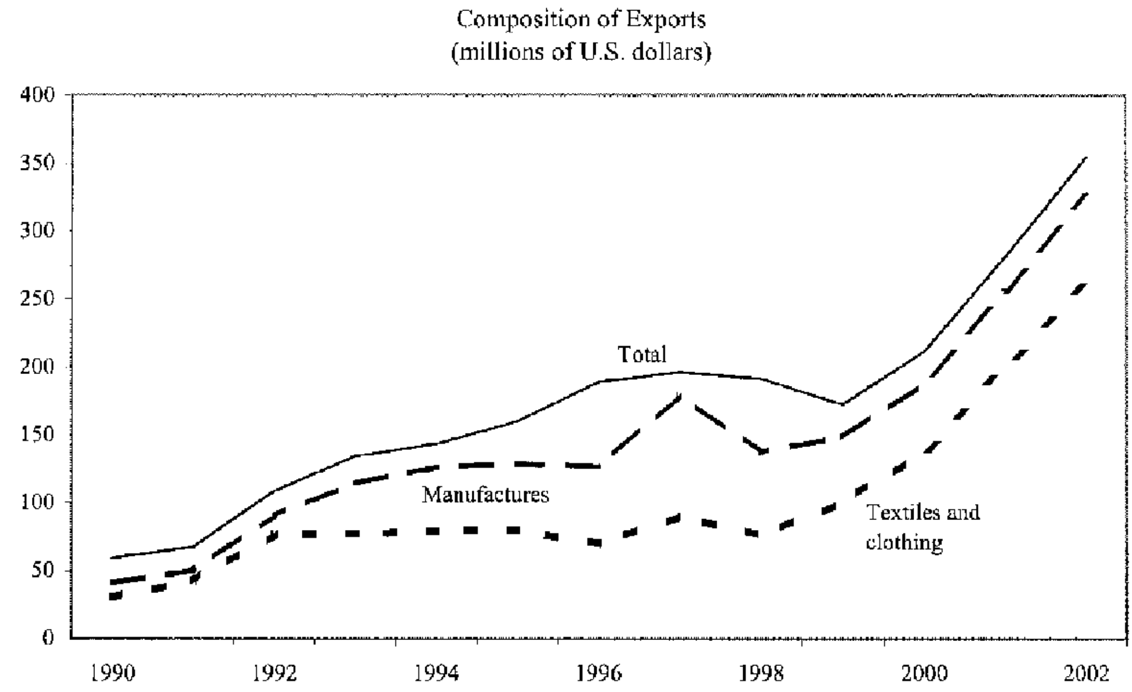
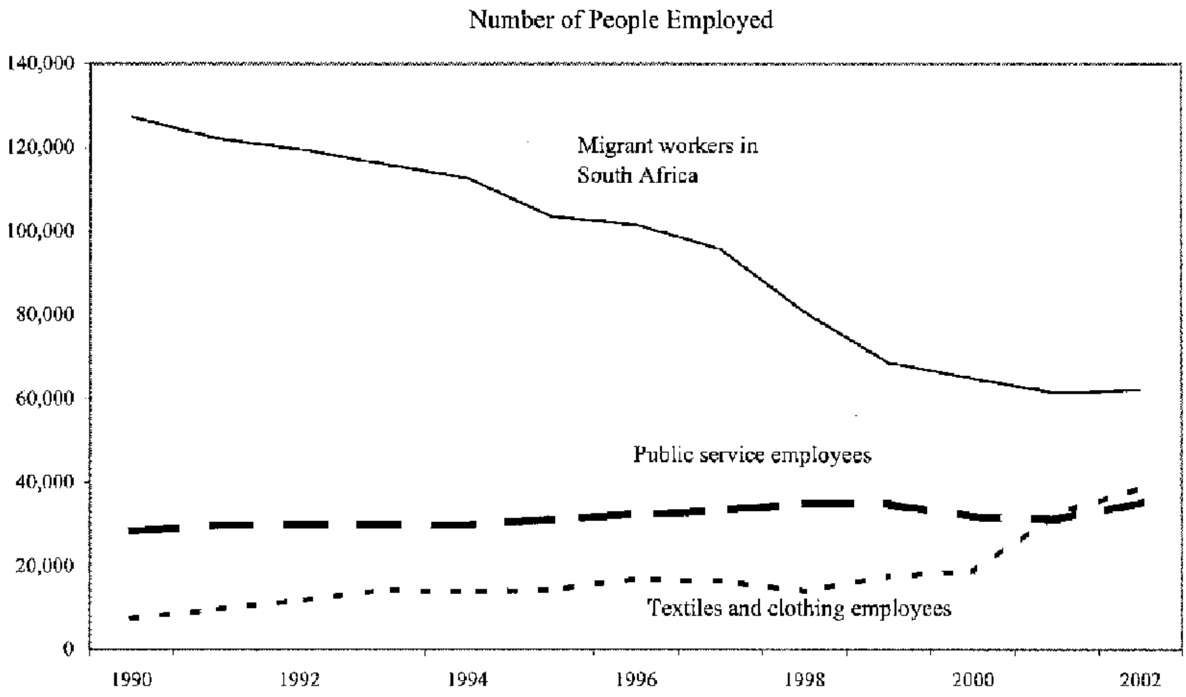
Figure I.1. Lesotho: Composition of Exports and Employment, 1990-2002

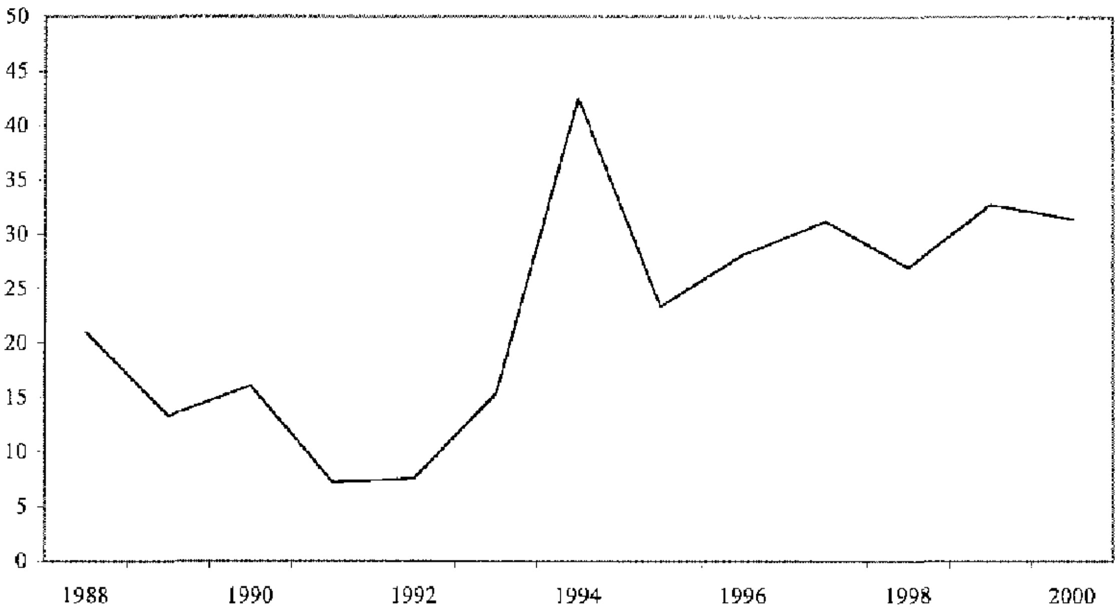




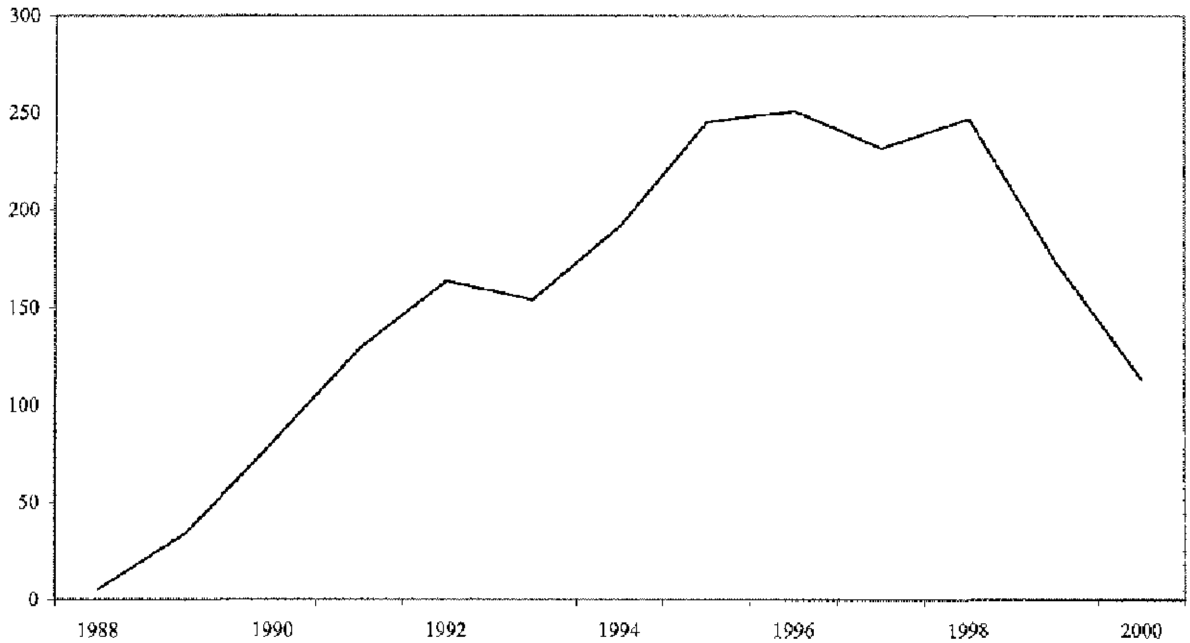
Sources: Central Bank of Lesotho; Ministry of Public Services; Lesotho National Development Corporation; and Fund staff estimates.

Figure I.2. Lesotho: FDI-and LHWP-Related Inflows, 1988-2000
(millions of U.S. dollars)

FDI Excluding LHWP-Related Inflows



LHWP-Related Inflows



Source: UNCTAD (2002).

Table I.1. Lesotho: Sectoral Shares of Economic Activities, 1990-2002
(Percent of GDP)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Primary industries 1/	26.8	20.8	19.6	20.8	19.5	17.9	19.2	17.7	19.0	19.6	19.7	19.3	18.0
Secondary industries	32.6	38.4	39.9	37.4	37.9	39.2	39.0	41.6	38.1	38.0	39.2	39.8	41.1
Manufacturing	12.4	13.1	13.8	15.1	15.5	15.9	16.6	15.9	16.0	15.8	16.1	16.9	17.5
Of which : textiles and clothing 2/	3.1	3.9	4.6	5.4	5.0	4.9	5.8	5.6	5.8	5.5	5.8	6.6	8.2
Utilities and construction	20.1	25.3	26.1	22.2	22.4	23.2	22.4	25.6	22.1	22.2	23.1	22.9	23.5
Tertiary industries	40.7	40.7	40.5	41.8	42.6	42.9	41.7	40.7	42.8	42.4	41.1	40.9	41.0
GDP at producers' prices	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Sources: Lesotho Bureau of Statistics; and staff estimates.

1/ Includes, crops, livestock, and mining.
2/ Includes also the category "Leather and footwear", which represents less than 5 percent of the value added of the subsector entitled "Textiles and clothing."

Table I.2. Lesotho: Number of People Employed in Public Service and Textiles and Clothing and Number of Migrant Workers, 1990-2002

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002 Est.
Public service	28,571	29,815	30,137	30,077	29,963	31,262	32,495	33,494	35,039	34,984	31,930	31,337	35,338
Civil service 1/	14,919	15,498	15,376	15,521	15,686	16,780	17,685	18,436	18,436	18,271	16,567	14,473	17,515
Defense and public order	4,983	5,581	5,669	5,653	4,881	4,881	4,942	4,942	6,394	6,288	4,677	5,572	6,669
Teachers	8,669	8,736	9,092	8,903	9,396	9,601	9,868	10,116	10,209	10,425	10,686	11,292	11,404
Migrant workers in South Africa	127,400	122,200	119,600	116,100	112,700	103,700	101,700	95,900	80,900	68,600	64,900	61,400	62,200
Textiles and clothing sector	7,400	9,640	11,760	14,210	13,750	14,261	16,961	16,373	14,023	17,593	18,690	32,605	38,780

Source: Ministry of Public Service and Lesotho National Development Corporation.

1/ The established civil service posts exclude teachers, members of armed forces, and daily-paid workers, but include chiefs, parliamentarians, senators, and statutory positions.

Table I.3. Lesotho: Composition of Recorded Exports (Including textiles and clothing), 1990-2002
(In millions of U.S. dollars, unless otherwise indicated)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Manufactures	40.7	50.4	90.7	114.6	126.2	128.7	126.5	179.4	137.6	148.6	188.4	256.1	326.3
Of which: textiles and clothing	30.6	42.2	76.9	77.1	79.2	79.6	70.1	90.1	76.2	100.7	137.5	200.4	261.1
Foodstuffs, etc.	9.4	11.4	8.5	7.9	5.9	9.0	5.4	9.1	7.4	19.5	16.1	16.4	18.8
Live animals	0.5	0.6	0.1	2.7	2.0	1.1	0.4	1.0	1.3	1.1	0.9	1.5	1.9
Livestock materials	6.0	3.7	6.8	6.8	9.1	9.6	5.8	6.3	3.4	2.5	5.3	7.0	6.1
Diamonds	2.5	1.2	0.7	1.3	0.1	1.6	0.4	0.3	0.1	0.1	0.2	0.2	0.4
Unclassified	0.3	0.0	2.1	1.0	0.1	10.1	50.5	0.1	41.8	0.7	0.5	0.6	1.3
Total value	59.4	67.4	109.0	134.3	143.4	160.1	188.9	196.2	191.5	172.5	211.5	281.8	354.8
Memorandum items:													
Growth in value of exports (in percent)	...	13.5	61.7	23.2	6.8	11.6	18.0	3.9	-2.4	-9.9	22.6	33.2	25.9
Growth in value of textile exports (in percent)	...	37.7	82.3	0.3	2.7	0.5	-11.9	28.5	-15.5	32.2	36.6	45.7	30.3
Share of textiles in total exports (in percent)	51.6	62.6	70.5	57.4	55.2	49.7	37.1	45.9	39.8	58.3	65.0	71.1	73.6

Sources: Central Bank of Lesotho; and staff estimates.

Table I.4. U.S. Imports of Textiles and Apparel (Clothing) from AGOA Beneficiary Countries, 2001-03
(In millions of U.S. dollars)

	2001	2002	2003 1/ Est.
SACU countries	460.2	622.8	613.6
Lesotho	214.9	320.7	282.6
South Africa	194.9	200.0	199.0
Botswana	2.5	6.3	4.9
Namibia	0.0	6.7	23.7
Swaziland	48.0	89.1	103.3
Other sub-Saharan Africa	493.9	484.1	520.0
Ghana	0.3	0.5	3.6
Ethiopia	0.7	1.3	1.4
Kenya	64.7	125.9	145.7
Tanzania	0.4	0.3	1.3
Mauritius	238.3	254.7	216.6
Mozambique	0.2	0.5	1.8
Madagascar	178.1	89.4	131.0
Malawi	11.2	11.4	17.6
Uganda	0.0	0.0	1.0

Source: U.S. Department of Commerce.

1/ Refers to imports during the first nine months of 2003.