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SmartLessons
real experiences, real development

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Africa Can Compete! The Miracle of Tiny Lesotho—Sub-Saharan Africa's Largest Garment Exporter

Over the past two decades, the tiny landlocked mountain Kingdom of Lesotho, located in the center of South Africa, has grown to be Sub-Saharan Africa's largest exporter of textiles and garments. The sector has become the country's largest employer—with about 40,000 mostly female workers who represent 20 percent of the formal workforce—and makes a significant contribution to reducing poverty in a country with 25 percent unemployment and where the majority of the population works in subsistence agriculture. This extraordinary success was fueled by foreign investors, principally from Asia, who were attracted by the country's comparative advantages: productive labor and favorable trade arrangements. These advantages were supported and enhanced by a World Bank project, and this SmartLesson describes aspects of that intervention and recalls some of the lessons learned.

A factory in Lesotho's thriving textile sector.

Background

Lesotho is completely dependent on South Africa's extensive infrastructure (roads, ports, telecommunications, and airports). Its population of about 2 million has a high literacy rate (75 percent) but limited secondary education, and high informal sector employment. As of 2008, the largest formal employment sectors are the government (35,000), migrant workers in South African mines (50,000), the garment and textile sector (about 40,000), and limited employment opportunities in subsistence agriculture, tourism, and other industrial activities.

The little-known miracle of Lesotho is its surprising dominance of Sub-Saharan Africa's textile and clothing production and export. Here are the basics of the country's achievements:

Export growth and contribution to GDP. Sector exports have grown from $6 million in 1985 (2 percent of total exports) to an average of over $500 million in the last 10 years. Garments and textiles now represent over 50 percent of Lesotho's total exports (Table 1). More than 60 percent of Lesotho's textile and clothing exports are to the United States (Figure 1). Over the period 1999–2008, the textile and clothing sector was responsible for about a third of GDP growth in real terms.

Female employment growth in well-paid jobs. In 1990, the sector employed 7,400 mainly female workers, a number that reached about 40,000 by 2010. Today's garment and textile sector provides well-paying jobs to female household members, reducing the previously heavy reliance on the wages of male migrant workers to South Africa. In 2007, the average earnings of an employee in the textile sector were $103 per month, and the official minimum wage for a general textile worker was $93 per month. The average gross national income per capita in 2008 was $83 per month (see Table 2 and Figure 2).

Table 1: Lesotho's Textile and Clothing Exports, 1985–2007

Year	$ Million	As a percentage of total exports
1985	6	2
1990	35	5
1995	80	50
2000	138	65
2005	528	78
2008	487	52

Source: Computed from Central Bank of Lesotho, Annual Reports, and from International Monetary Fund, International Financial Statistics.

Table 2: Impact of the Textile and Clothing Sector in Lesotho, 1990–2008

Year	Employment	Share of total GDP in current prices
1990	7,400	3.1
1995	14,260	4.9
2000	18,860	7.9
2005	37,600	13.0
2008	41,750	11.9

Source: Employment, Lesotho's Bureau of Statistics. GDP, Computed from Central Bank of Lesotho, Annual Reports, and from International Monetary Fund, International Financial Statistics.

Figure 1: Textile and Clothing Exports to the United States, 2000–09

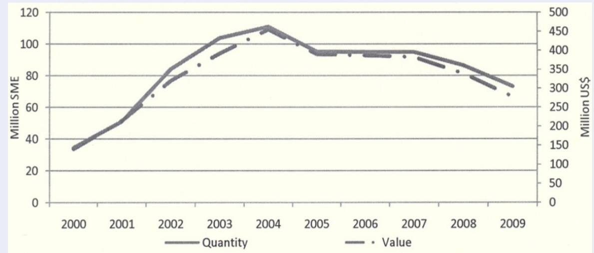
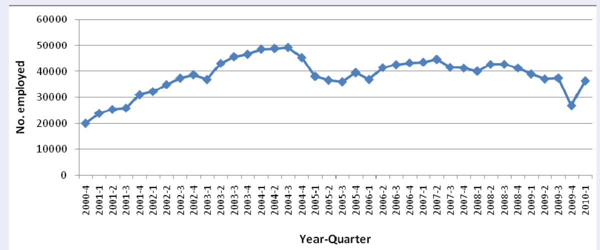


Figure 2: Quarterly Employment in Textile and Clothing, 2000–10



Project Approach and Activities

In 1990, the Investment Climate Advisory Services of the World Bank Group carried out a Diagnostic Assessment of Lesotho's Investment Environment that identified opportunities for the country to develop a modern export-oriented manufacturing sector by departing from its early strategy of import substitution, restrictions on foreign investment, and direct government investments in agro-industries, small handicrafts, printing presses, and other basic commercial services such as garages and the hotel industry.

In addition to Lesotho's important comparative advantages, the diagnostic identified flaws to be addressed in the country's investment environment, in particular: 1) a 10-year tax-holiday program intended to attract foreign investment in manufacturing, but which in fact deterred stable investment due to administrative complexity and unpredictability; 2) increased cost of investment due to restrictive work-permit and visa processes for foreign investors and their supervisory staff; and 3) political pressures to follow South Africa's heavily unionized wage-setting arrangements.

In 1990, largely building on this diagnostic assessment, the World Bank prepared the Industrial and Agroindustries Development Project. Principal components included: 1) support for policy changes to improve the investment environment for foreign direct investment (FDI) in manufacturing; 2) a five-year twinning arrangement with the Irish Industrial Development Authority (technical assistance, training, and exposure and promotional visits) to build capacity and implement an Investment Promotion

Women at work in the cutting operation.

Center in the Lesotho National Development Corporation; and 3) financing for serviced industrial infrastructure to encourage foreign and indigenous investment in Lesotho's industrial and agro-industries sectors.

Lessons Learned

1) To assist in designing an FDI-promotion intervention, learn the country's fundamental long-term competitive advantages.

The diagnostic documented fundamental aspects of Lesotho's potential as an attractive investment site, such as:

Low-cost productive labor force. Asian investors produce mainly for the competitive U.S. and European markets and therefore must have an overall internationally competitive cost environment. Lesotho's high nominal wages, compared with those of some African countries, were compensated for by the higher productivity of its labor force.

Special trade arrangements. In the 1990s, Lesotho enjoyed preferential access to South African, European, and U.S. markets, which included: 1) almost unqualified free-trade access through the Southern Africa Customs Union (SACU), 2) duty-free access to the European Common Market in accordance with the Lomé Convention, 3) preferential access of goods under the General System of Preferences into 18 industrial countries, and 4) quota-free status under the Multi-Fibre Agreement. Since 2000, Lesotho had benefited from preferential trade arrangements under the U.S. African Growth and Opportunity Act and the European Union initiative Everything But Arms. Efficient external trade mechanisms exist for exporters within the SACU, including an automatic duty-exemption system based on bonded warehouse arrangements and a favorable exchange rate with the rand throughout the period (except for 2002–04).

Above-average road infrastructure. Lesotho's location within South Africa ensures, for example, easy and proximate access to the efficient East London port, which reduces the overall costs of production, shipping, and transportation.

Utility infrastructure. Lesotho had begun—and committed to expand with project financing—a program of well-serviced industrial estates in key locations within the country to meet the demand from foreign investors.

Supportive living environment. Lesotho offered a supportive public understanding and an agreeable and secure living and leisure (casino) environment for foreign investors and their expatriate workers and families.

Supportive policy environment. The country had a nucleus of Chinese investors that came in the second half of the 1980s and established apparel operations, although the operations initially grew slowly due to an unsupportive environment. But when Lesotho's policy environment changed and the Lesotho Investment Promotion Center (LIPC) began to offer proactive service and support to investors and their concerns, Asian investors actively promoted FDI from their home countries.

2) To create a sustainable enabling environment for FDI, tailor the project and policy interventions so as to lower costs and risks.

A country's policy, regulatory, and institutional environment plays an important role in lowering the costs and risks of investment and in marketing and promoting the country as an attractive potential investment site. In 1990, Lesotho introduced a policy package to improve the environment for foreign investment as part of the preconditionality associated with the Industrial and Agroindustries Development Project that was launched in 1991. The LIPC began operating in January 1992. The key elements of the policy and institutional development package implemented under the project included the following:

Reduced taxation. The government replaced the unpopular tax holiday with a 15 percent flat tax rate for manufacturing firms as part of the regular tax code. In 2006, the government went further, introducing a zero-tax incentive on export earnings from exports to countries outside the SACU.

Reduced regulation. Prior to the project, investors had complained bitterly about the virtual impossibility of getting work permits for key management staff and sometimes even for themselves. Under the project, the government committed to reducing regulatory burdens by introducing automation into the issuance of industrial licenses and work permits for investors and key management staff.

Limitations on minimum-wage increases. The year before the project was appraised, the government of Lesotho had increased the minimum wage by 50 percent, in line with an implicit policy to match South African wage levels. Under the project, the government pledged that the minimum-wage policy would take into account Lesotho's competitive position and that real wage increases would be based on productivity improvements. That Lesotho's wage rates remained competitive over the project period, combined with high levels of productivity, was a major promotional asset.

Table 3: Unit Labor Cost Comparisons in Select Countries, 1994

	China EPZ	Ghana	India	Kenya	Lesotho	Mauritius	Republic of South Africa	Zimbabwe
Monthly wage (U.S. dollars)	120	30–45	60	55	82–95[b]	120	244–267	70–75
Number of garments produced per machine operator during an 8-hour shift								
Men's casual shirts	18–22	12	16	12–15	18-19	—	15	12–14
Index of unit labor cost (for men's casual shirts)[a]	0.040	0.022	0.027	0.026	0.026	—	0.059	0.034

— Not available.

a. The nominal wage rate divided by the dollar value of output per worker per month, assuming a 26-day work-month.

b. Wage rate for 1995.

Table 3 compares Lesotho's low unit labor costs with those in neighboring African countries, including the Republic of South Africa, and China and India. Unit labor costs are determined through consideration of wages and worker productivity. The high productivity of Basotho

labor—reported by Asian investors to be 80 percent of that in China—yields unit labor costs comparable to some of the world's lowest-cost countries. Lesotho's quota-free access to U.S. markets and its access to the European market under the Lomé Agreement were also important considerations.

For example, the quota cost for one shirt from China's Export Processing Zone (EPZ) could raise the landed price in the United States by $2, adding 30 percent to its free onboard cost. The comparative cost analysis was done in the mid-1990s, when most of the decisions by foreign investors were made.

Investment in industrial infrastructure. This project and its predecessors financed a program of advanced factory-shell construction, as well as road, electrical, and water infrastructure on industrial estates. Factory shells were available for rent to investors, substantially reducing their upfront investment costs and risks. To ensure the cost-effectiveness of this component, a cost-recovery rental program allowed factory investments to see a 20 percent return. The project and its follow-up activities provided for foreign experts to advise the government on its policies and the operation of the public utilities firms to improve the availability and cost of utilities.

3) Establish an active investor promotion and service institution, focused on creating well-paying jobs rather than large fixed investments.

Under the project, the country's investment promotion efforts, which had previously been limited to natural resource–based projects, were redirected toward labor-intensive, export-oriented manufacturing activities, with an emphasis on proactive investor promotion, information, and service. Also, an LIPC was established under the state-owned Lesotho National Development Corporation. It functioned as an investor promotion and service organization that facilitated the delivery of necessary licenses and permits and that voiced investors' concerns to the government, while reducing investors' perceived risk and investment-related management costs.

The project supported the LIPC by financing a twinning relationship with the Irish Industrial Development Authority (IDA) and a resident investment-promotion expert, also from IDA, who assisted with building LIPC's capacity and operations for the five years of the project period. The operational procedures and structure of the LIPC have been maintained, and in the late 1990s, a Coopers and Lybrand investor survey named Lesotho's Investment Promotion Center the third-best investment promotion agency in Africa and among the 20 best in the world.

However, a recent deterioration in Lesotho National Development Corporation's finances has affected its capacity to manage its investment promotion and its factory shell construction programs. These developments—together with slow growth in the U.S. market and the international financial crisis—may affect future growth of textile and apparel operations in Lesotho.

One of Lesotho's well-paid, productive textile employees.

Conclusion

Over the past 20 years, despite recent lapses, Lesotho has consistently sustained the lessons of maintaining a competitive policy and infrastructure environment and a service-oriented and investor-friendly promotion and facilitation capacity. From the solid beginnings of the project, Lesotho's textile and clothing sector has shown great resilience, even when faced with tremendous upheavals—including the transformation of South Africa from apartheid to empowerment of its black population; the 1998 riots that devastated the country's capital and other cities; the spread of HIV, which reached over 40 percent of the population in Maseru in 2005; an appreciation of its currency from 2002–04 that resulted in a worsening of the terms of trade for the sector and a decline of 20 percent in employment in 2005; and the need for the sector in Lesotho to adapt to changes in U.S. and global trade policies as well as the major global recession of 2009.

Indeed, a large drop in sector employment occurred in 2009 due to recession and severe global competition. Although data from Lesotho Statistical Bureau indicate that employment sharply rebounded in the first quarter of 2010, concerns about future growth remain.

Nevertheless, the garment sector's expansion over the past two decades, has had far-reaching implications for the country's economy and industrial development. Lesotho's proactive, stable, and welcoming policy environment has also debunked criticisms about the "footloose" nature of garment investments based on trade concessions. Now, backward linkages—created under the pressure of the U.S. African Growth and Opportunities Act rules of origin—have catalyzed a $120 million textile mill that was established in Lesotho in the early 2000s to supply denim factories with fabric. Lesotho's success is evidence that Africa can compete!