Economic Review - July 2004

RECENT TRADE POLICY AGREEMENTS: WHAT ARE THE IMPLICATIONS FOR THE ECONOMY OF LESOTHO?

Recent negotiations on global trade policy have placed emphasis on substantial reductions in, with the view of phasing out, all trade distorting subsidies on agricultural exports, and the elimination of textile import quotas that are applied mainly in industrialised countries...

Background

The international trade theory posits that trade is an engine of economic growth. As this mechanistic metaphor implies, trade and economic growth were thought to be closely linked by gears as it were. One of the major components of this gear box is trade policy. The extent to which trade positively influences growth depends on the efficiency of trade policy. Over the years, protectionist policies have been embraced by nations globally. Several benefits showered from these policies, such as protection of the infant industries and generation of government revenue and have since been strong towers of arguments supporting protectionism.

However, protagonists of the trade-growth nexus argue for liberalised trade because free trade promotes economic growth. The basis of this proposition is the principle of comparative advantage which postulates that each country could prosper first by taking advantage of its assets in order to concentrate on what it could produce best, and then by trading these products for those that other countries can produce best. All countries, including the poorest, have assets- be they human, industrial, natural, or financial- which could be employed to produce goods and services for domestic, regional and international consumptions. Consequently, since liberal trade policies allow for unrestricted flow of goods and services, the rewards such as producing the best products, with the best design, and at the lowest price could be enjoyed by the entire globe. Therefore, to ensure that nations derive the desired benefits from international trade, trade policy should demolish factors that distort free trade and the World Trade Organisation (WTO) attempts to help nations in this respect.

What is the WTO? It is a forum for negotiating trade policy issues by national governments, and operates a system of trade rules that govern trade to ensure free trade, promote fair competition, and protect intellectual property rights. Its overriding purpose is to help trade flow as freely as possible -without any undesirable side-effects- throughout the world. It evolved from the General Agreement on Tariffs and Trade (GATT), through a number of rounds of negotiations. The agreements under the WTO currently cover trade in services, in commodities and in traded inventions, creations and designs. Although certain aspects of the GATT allowed for Agriculture and Textiles, several loopholes triggered continued negotiations resulting in new Agreements on both Agriculture and Textiles. It is worth the effort to examine the policy agreements on agriculture, and textile and clothing, which are the major exports from the developing members of the Southern African Development Community (SADC).

The Agreement on Agriculture (AoA)

The objective of this agreement is to reform trade in the agricultural sector and to make policies more market oriented. This would improve predictability and security for importing and exporting countries. The new rules and commitments have three-fold application to 1) enhance market access by substantial reductions of various trade restrictions confronting imports, 2) improve export competitiveness using methods that do not distort trade, and 3) reduce, with the view of phasing out, all forms of export subsidies, for example, farm subsidies.

Special and differential treatment for developing countries constitutes an integral part of the AoA, as note is taken of the various unique country specific circumstances. Hence, AoA allows governments to support their rural economies preferably through policies that cause less distortion to trade. The way the commitments contained in it are implemented is flexible. For instance, developing countries do not have to cut their subsidies or lower tariffs as much as developed countries, while least-developed ones do not have to do these at all. Under the AoA, developing countries (with the exception of the least-developed countries) committed to reducing their bound rates by an unweighted average of 24 percent over ten years, subject to a minimum reduction of 10 percent in each tariff line throughout the period 1995-2004.

No doubt farm subsidies had several disadvantages on developing countries. First, the European Union (EU) is the largest trading partner for a vast number of Sub-Saharan African countries, in commodities where the tariffs are high. These products account for a high share of the total trade, output, and employment for the African economies. Second, farm subsidies encourage massive surpluses which are dumped on poorer countries' markets and because these products are at low prices, they undermine local farmers. Third, these distortions hinder developing countries from benefiting from international trade. For example, South Africa (SA) produces sugar at lower cost than the EU, but due to subsidies, the EU farmers are able to push prices lower than those prevailing in South Africa and push South African products out of the market and thus resulting in unemployment and falling export earnings to the detriment of the South African economy and the rest of the SADC.

The Agreement on Textiles and Clothing (ATC)

Another strong export sector for developing countries in Africa is Textiles and Clothing. This sector has also benefited from the African Growth and Opportunity Act (AGOA) under which eligible countries gained duty free access into the US market. Lesotho has also benefited from this act since April 2001. This led to an increase in the share of the manufacturing sub-sector as a percentage of GDP, exports as well as total employment. Currently, the economy of Lesotho is extremely vulnerable to any shock against this sector. Using 2003 figures, the manufacturing sub-sector accounted for around 20 per cent of GDP, and this sector employed around 45,000 Basotho.

It has been realised that among the most distorting measures in world trade are import quotas applied on a country-by-country and product-by-product basis, while still other countries face no restrictions. As a result, the Agreement on Textile and Clothing (ATC) which would be effected on January 1, 2005, has been promulgated with a view of creating a levelled playing field for all. It underscores phasing out textile import quotas applied mainly in industrialised countries. It is designed primarily to boost economies of poor countries that use textiles as a basis for their industrial development through free trade. When conditions under this Agreement are implemented, China and India –that are currently under heavy restrictions from the EU, the US and Canada-are likely to become more competitive and are set to dominate world trade in Textiles and Clothing. According to a report by the WTO, China would scoop more than half of the global market under this new Agreement that would end the quota system that has governed international trade since the 1960's. What do these policies imply for Lesotho and the SADC region?

The implications for Lesotho and the SADC

Although the Agreement on Agriculture may not have a direct effect on Lesotho, it implies several opportunities and poses some challenges for the SADC region. The region should therefore recognise the importance of trade as an engine of growth, and the complex links between trade, economic growth and poverty reduction. The major benefit from the Agreement is that it would create a levelled playing field in international trade. It would further boost export growth and increase more export earnings. Moreover, it would create employment and help in poverty reduction. Thus, the countries should endeavour to remove domestic bottlenecks in order to capitalise on the opportunities. The first challenge is to streamline trade issues into national development strategies so as to improve the competitiveness of their economies. Second, trade liberalisation could be a potential source of fiscal instability because many countries depend heavily on trade related tax revenue. This implies that SADC member states should strengthen their domestic tax administration and collection. It could be acknowledged that the government of Lesotho has made strides in this area, yet still few improvements could be needed.

Since, the Agreement on Textile and Clothing allows for abolition of quotas even for countries such as China and India, there are fears looming that these countries could dominate the market even more, with millions of jobs around the world at stake. The delivery time- taken for products to reach consumers- is increasingly gaining importance. As a result, the most likely exporters to lose market share are those located far away, this could befall the SADC member countries and harm their economies in several ways. First, it would negatively affect the competitiveness of Lesotho's textile products against the rest of the world and erode the demand for these products. Second, it could slowdown production in this sub-sector which would hamper GDP growth. Third, thousands of people may end up jobless. Fourth, this could further exacerbate the problem of poverty. However, the extension of AGOA beyond 2008 is a blessing in disguise. Lesotho can offset the adverse effect of ATC by effectively making use of AGOA.

Conclusions and Recommendations

By no means is the above discussion exhaustive. It does however provide insight into the key issues that would influence the prospects for the growth and development of textile and clothing sub-sector, as well as agriculture in Lesotho and the rest of the SADC. This brief review brought up challenges that these trade policy developments pose for Lesotho, and makes some recommendations.

It is recommended that Lesotho's policy stance, in order to address the challenges and utilise all the opportunities, should attach more value on the following:

- Diversifying the export product base; the current export base covers mainly Textile and Clothing and this is risky;
- Developing a competitive agricultural sub-sector to ensure that the produce/output could reach levels where surpluses could be exported, in order to take advantage of the special and differential treatment and the overseas markets. Of course, this would underscore the need to implement agricultural reforms that could facilitate commercial farming and establish sustainable irrigation schemes that could improve agricultural production in competitive and sustainable ways;
- Strengthening the linkages between the various sectors of the economy, for example, agriculture sub-sector could later facilitate the needed yarn in the textile industry;
- Ensuring that the industrial culture is entrenched in Lesotho, through the involvement of local entrepreneurs in the manufacturing sub-sector; for instance, joint ventures between local and foreign investors would tend to transfer the technological know-how;
- Increasing the capital stock, improve the human resources capacity, and uphold the enabling environment for investment, this would go a long way in attracting investors
- Ensuring diversification and competitiveness. Currently, Lesotho's textile products are competing on price only, and there is need to broaden this to high quality and timely delivery of these goods to the customers; and
- Reducing the dependency on tariff revenue and curb fiscal instability. This calls for a need to broaden the tax base or continue to improve the efficiency in tax collection.

N.B: This report is benefited by the Business Day, Tuesday, August 3, 2004 and www.wto.org

Table 1. Monetary and Financial Indicators+

	May	June	July
1. Interest rates (Percent Per Annum)			
1.1 Prime Lending rate	12.5	12.5	12.5
1.2 Prime Lending rate in RSA	11.5	11.5	11.5
1.3 Savings Deposit Rate	2.31	2.31	2.31
1.4 Interest rate Margin (1.1 – 1.3)	10.19	10.19	10.19
1.5 Treasury Bill Yield (91-day)	9.36	9.31	9.27
2. Monetary Indicators (Million Maloti)			
2.1 Broad Money (M2)	2294.0	2353.47	2424.2
2.2 Net Claims on Government by the Banking System	-693.6	-539.52	-552.4
2.3 Net Foreign Assets – Banking System	3962.7	3858.72	4031.3
2.4 CBL Net Foreign Assets	3070.6	2831.31	2911.5
2.5 Domestic Credit	-89.6	73.98	74.0
2.6 Reserve Money	326.2	289.522	356.4
3. Spot Loti/US$ Exchange Rate (monthly average)	6.7844	6.4476	6.2050
4. External Sector (Million Maloti)	**2003**	**2004**	
	Q4	**Q1**	**Q2**
4.1 Current Account Balance	-299.8	-193.2	-161.64
4.2 Capital and Financial Account Balance	320.0	-23.5	181.73
4.3 Reserves Assets	-156.6	257.5	-251.39

+These indicators refer to the end of period. Prime and deposit (savings) rates are averages of all commercial banks' rates operating in Lesotho. The Statutory Liquidity Ratio in Lesotho is 25 percent of commercial banks' short-term liabilities.

Table 2. Selected Economic Indicators

	2000	2001	2002	2003

1. Output Growth(Percent)				
1.1 Gross Domestic Product – GDP	1.3	3.2	3.5	3.3
1.2 Gross Domestic Product Excluding LHWP	0.0	3.5	3.3	3.2
1.3 Gross National Product – GNP	-3.2	0.2	1.6	6.3
1.4 Per capita –GNP	-5.2	-1.9	-0.4	4.1
2. Sectoral Growth Rates				
2.1 Agriculture	2.8	0.5	-4.2	-1.9
2.2 Manufacturing	4.4	7.8	6.9	5.2
2.3 Construction	9.7	1.4	6.9	4.3
2.4 Services	-0.9	2.2	2.2	4.4
3. External Sector – Percent of GNP Excluding LHWP				
3.1 Imports of Goods	-64.384	-68.180	-82.797	-74.519
3.2 Current Account	-21.262	-17.436	-24.466	-21.112
3.3 Official Reserves (Months of Imports)	8.9	11.7	6.4	5.5
4. Government Budget Balance (Percent of GNP)	-4.9	-1.0	-2.7	-2.5