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THE PHASING-OUT OF THE MULTI-FIBRE AGREEMENT (MFA): ITS IMPLICATION ON THE ECONOMY OF LESOTHO

On December 31, 2004, the Multifiber Arrangement (MFA), which establishes quotas on different categories of apparel and textile imports to the US and the EU, was fully phased out...

Background

The MFA is a trade agreement adopted in 1973 by the United States, Canada, and Europe that set quotas for the amount of textiles and apparel that other countries could export to these countries. It came into force in 1974, and was seen as a protectionist measure intended to prevent the loss of textile and garment industry jobs in the US, Canada, and the EU to other countries, mainly developing countries, where such goods could be more cheaply produced. However, by the end of 2004, following a 10-year phase-out program governed by another agreement, the Agreement on Textile and Clothing (ATC), that came into force along with the World Trade Organization (WTO) agreement in 1995, the MFA system came to an end. This means, beginning 2005, all WTO members had unrestricted access to the European, US, and Canadian markets. The expiration has both positive and detrimental effects on all economies that rely heavily on textile and garment industries. In small developing economies, the costs of the abolition far outweigh the benefits. In addition, in Sub-Saharan Africa, Lesotho remains one of the key exporters of textile and clothing, and as such the phasing out of the MFA implies that Lesotho will be strongly hurt, due to fierce competition from the other cheap exporters. Hence, it is important to review the reasons for the expiration of the MFA, the implication on the Lesotho economy and provide appropriate strategies that could be pursued.

Reasons For Abolition Of The MFA

In January 1995 the WTO put into effect a new agreement that replaced the MFA called the ATC. This was basically a 10-year plan to phase-out the MFA system of quotas and integrate textiles and garments into the General Agreement on Tariffs and Trade (GATT) rules. The ATC, which was preceded by seven years of complex negotiations, was the transitional tool that facilitates quota removal. The following reasons were advanced for the abolition of the MFA: some developing countries felt that the quota system should be abolished because it prevented them from having greater access to the lucrative North American and European markets and thus hindered growth in their countries. Many countries in the south sought an end to the MFA as they saw it as operating primarily in the interests of the industrialised countries' domestic textile and garment sectors. However, severe competition in the market place, emanating from the abolition of the quota system will adversely affect smaller economies.

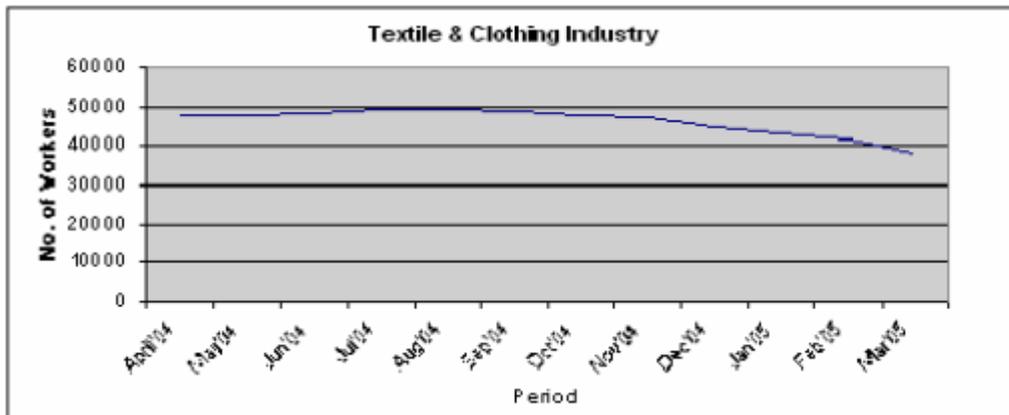
Lesotho's Textile and Clothing Industry

The Lesotho economy has since 2001 been driven by the manufacturing sub-sector. The textile and clothing industry remains the key driver of economic activity in the manufacturing sub-sector, under the auspices of African Growth and Opportunities Act (AGOA)¹. Since then, the economy has been registering positive growth rates largely due to the remarkably good performance of the textile and clothing industry. In addition, this sub-sector remains the largest formal employer in the economy, with an employment level of 38,195 at the end of March 2005. However, the level of employment has been

deteriorating since 2003, largely on the back of the strengthening of the rand and hence loti against the US dollar. The appreciation of the rand vis-à-vis the US dollar had a negative effect on the profitability of clothing and textile industry, and hence the lay-off in number of employees. This was further exacerbated by the expiration of the MFA, on 31 December 2004. The expiration meant that, the country would face fierce competition from other low cost producers such as China, India and Pakistan, which have been predicted potential beneficiaries under the new arrangement. Thus, the expiration has a negative impact on the employment level in the textile and clothing industry in Lesotho. Furthermore, the abolition implies a decline in overall exports, and hence foreign exchange earnings.

The Impact On The Employment Level To Date

Figure 1



Source: Lesotho National Development Corporation (LNDC)

As earlier mentioned, the restructuring of the textile and clothing industry that has been ushered in by the removal of quotas has meant job losses for many in Lesotho. As depicted by the graph above, the number of workers in the textile and clothing industry was generally steady from April 2004 to November 2004. However, following the phasing out of the MFA in December 2004, the number of workers employed in the textile and clothing industry dropped steadily due to closure of four textile firms in the first quarter of 2005. More than 4,570 workers were reported to have lost their jobs at the end of March 2005. Although it is too early to make any conclusive remarks, the continued loss of jobs will be most hard felt by workers in Lesotho, as there are weak or non-existent social safety nets and few opportunities for employment in other sectors.

The Impact On The Export Sector To Date

The phasing out of the MFA also had detrimental effects on Lesotho's economic growth. The textile and clothing exports account for a significant share of overall exports. In addition, textile exports account for a significant source of Lesotho's foreign exchange earnings. Therefore, the expiration of the MFA will impact adversely Lesotho's foreign assets. Since the loti is pegged at par to the South African rand, foreign exchange earnings are important in underwriting Lesotho's fixed exchange rate regime. As shown by the figure below, textile and clothing exports fell during the first three months of the MFA expiration. The slump in exports further implies the widening of the Current Account Balance (CAB). The multiplier effect of declining exports has some adverse impact on national income and other economic indicators.

Figure 2



Source: Lesotho Revenue Authority (LRA)

Strategies That Could Be Pursued

In response to the phasing-out of the MFA a number of reports have called for increasing productivity through skills training and technology upgrades as ways in which garment and textile industries in countries at risk of losing orders can meet the challenge of the post-MFA era. Furthermore, diversification, developing local inputs, and investing in infrastructure improvements are also often recommended as ways to face up to the phase-out.

Bilateral trade agreements have also been predicted to be important factors that could shape the garment and textile-trading environment. In addition, a common SADC trade policy could also curb the adverse effects. Another option Lesotho could explore could be to consider **specialising in goods with higher value addition, requiring more of capital and technical know-how. As such, export revenue could be raised not by increasing quantity exported but instead by raising price through greater value addition.** Others have also called for the development of regional trading blocs in other parts of the world as a possible key strategy for remaining competitive. **Last**, with downward pressure on wages being one of the predicted impacts of the phase-out of quotas, efforts to push for living wages needs to be considered.

Conclusion

The phasing out of the MFA represents a unique set of threats for the Lesotho economy, more specifically to the textile and clothing industry. Its phasing out implies that Lesotho faces fierce competition from lower cost producers and thus is bound to brace itself to face the chill winds emanating from an increasingly liberal and competitive market. As such, the traditional exports may be under threat and Lesotho is bound to review its whole strategy to ensure its international competitiveness is not undermined. On the other hand, the benefits accruing under AGOA are expected to some extent mitigate the adverse effect resulting from the phasing out of the MFA.

This paper benefited from www.cleanclothes.org

LESOTHO: LATEST ECONOMIC AND FINANCIAL INDICATORS

Table 1. Monetary and Financial Indicators+

	Feb	Mar	April
1. Interest rates (Percent Per Annum)			
1.1 Prime Lending rate	12.17	12.17	11.83
1.2 Prime Lending rate in RSA	11.00	11.00	10.50
1.3 Savings Deposit Rate	1.22	1.22	1.00
1.4 Interest rate Margin(1.1 – 1.3)	10.95	10.95	10.83
1.5 Treasury Bill Yield (91-day)	7.94	7.72	7.70
2. Monetary Indicators (Million Maloti)			
2.1 Broad Money (M2)	2381.5	2451.8	2488.4
2.2 Net Claims on Government by the Banking System	-982.3	- 958.1	-1198.8
2.3 Net Foreign Assets – Banking System	4058.2	4266.3	4645.0
2.4 CBL Net Foreign Assets	2941.5	2960.1	3312.6
2.5 Domestic Credit	-365.2	-312.4	-559.1
2.6 Reserve Money	349.6	440.3	415.7
3. Spot Loti/US\$ Exchange Rate (monthly average)	6.017	6.037	6.152
4. Inflation (year-on-year percentage change)	4.0	3.7	3.5
	2004		2005
5. External Sector (Million Maloti)			
	Q3	Q4	Q1
5.1 Current Account Balance	- 210.0	- 116.5	22.3
5.2 Capital and Financial Account Balance	170.6	225.6	- 39.3
5.3 Reserves Assets	-15.5	-1.2	- 199.8

+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

	2001	2002	2003	2004*
1. Output Growth(Percent)				
1.1 Gross Domestic Product – GDP	3.2	3.5	3.3	3.4
1.2 Gross Domestic Product Excluding LHWP	3.5	3.3	3.2	3.2
1.3 Gross National Product – GNI	0.2	1.6	6.3	3.9
1.4 Per capita –GNI	-1.9	-0.4	4.1	2.4
2. Sectoral Growth Rates				
2.1 Agriculture	0.5	-4.2	-1.9	-0.4
2.2 Manufacturing	7.8	6.9	5.2	5.0
2.3 Construction	1.4	6.9	4.3	4.0
2.4 Services	2.2	2.2	4.4	3.9
3. External Sector – Percent of GNI Excluding LHWP				
3.1 Imports of Goods	68.2	82.8	74.5	79.2
3.2 Current Account	-17.4	-24.5	-21.1	-25.8
3.3 Official Reserves (Months of Imports)	11.7	6.4	5.5	5.5
4. Government Budget Balance (Percent of GDP)	-1.0	-2.7	-2.5	2.5

* Preliminary estimates

¹ This is an Act promulgated in the United States (US) that significantly liberalised trade between the (US) and 37 designated Sub-Saharan African (SSA countries) including Lesotho.