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LESOTHO'S POTENTIAL FOR EXPORT DIVERSIFICATION

There is need to lessen the extent to which the economy is currently dependent upon preferential market access for the export of clothing ….

Background

Lesotho is disadvantaged by its geographical location. It is one of the land-locked poor countries. Lesotho's economy is dependant on a narrow flow of exports of clothing largely destined to one country-the United States of America (US). At the end of 2005 exports to the US accounted for nearly 60 per cent of the total exports. The issue of narrow product flow and market is paramount to Lesotho because of three reasons namely; the indication of preferential tariffs being eroded, the Multi Fibre Agreement (MFA) quota system has come to an end in 31 December 2004, allowing for ascension of more competitive countries, like China, into the World Trade Organization. The derogation from the Africa Growth and Opportunities Act (AGOA) rules of origin (ROO) which will come to an end at the end of 2007, presents a challenge on sourcing of inputs.

Lesotho's economy has been experiencing periods of high growth , but the benefits have not been translated into better lives for many Basotho, as indicated by a high level of unemployment.. Inflation remains subdued and this augurs well for the economy. In the period 1980s to late 1990s, economic growth benefited from capital injection attributed to the Lesotho Highlands Water Project (LHWP). Since 2001 the economy has relied on the exponential growth of exports in the clothing sector as a result of the introduction of AGOA. We subsequently explore why this dependency is a challenge.

Lesotho's Export Structure

Lesotho faces a problem of heavy reliance on clothing and garment exports destined to mainly one market, the US. Access to this market is dependent on rules as embodied in AGOA. Therefore the dependency of the economy on one market will last as long as such concessions are in place. This implies directly that if the tariffs are eroded, Lesotho will be unable to trade above the 17.9 percent tariff that it would have to face in the absence of preferences. It should, however, be cautioned that the volume of exports in clothing also include a pool that goes to the South African market. Using data from 2002, it is indicative that eleven of the top 20 trade lines at the (Harmonized System) HS 6 level are related to clothing of exports. It should be noted that the share of the US and South Africa does not account for all of Lesotho's external trade. It is also noted that footwear, water, bricks, TV components and milling products, which constitute nine lines are destined for the South African market only. This implies denim material and products constitute a major line with a market outside South Africa. Data for 2004 indicates that there was some penetration of the Canadian and Botswana Markets.

Export Diversification

At this level an attempt is made to underscore the importance of the South African and US markets. It is observed that three products seem to top the list namely; footwear, TV and Electronics and water. There is however need to understand these issues by reading the finer prints. Water is a potential industry if it can graduate from the current level of channel transfer to South Africa to include the water bottling industry; accompanied by massive marketing strategy. The TV and Electronics is an established industry but has a potential to grow only if new products are introduced. Footwear depicts a mixed picture. There is no established direction of growth. The cereal industry has a potential, as Lesotho imports almost all of its food consumption. The potential is also realised on furniture manufacturing, pharmaceutical products and diamond industry. In addition bricks and sand stone and ceramics are deemed capable of being exported. It is therefore noted that Lesotho has a potential to diversify to the latter category of products, if policy effort is directed at enhancing their productivity and competitiveness.

Learning from Global Stars

It is highly considered that the Lesotho export structure can learn from export products that are dominating international markets. This helps in-as-far as it gives guidelines on which products have demand and who dominates in that market. It is noted that for the period 1985 to 2000, three sectors appeared to be dominating the international product market; automobiles and parts, clothing and electronics. Lesotho is highly involved in clothing whose growth in the global market exceeded world average, indicating encouraging prospects. Lesotho also features in the electronics category, though on a small scale. And Lesotho does no feature in automobile and parts production. The top 40 star product lines include medicaments, furniture and diamonds. Therefore, this highlights the extent to which Lesotho can harvest, if properly repositioned.

It is realized that the need for such growth to take place, there is a mammoth task to look into promotion and marketing of such products. The Government of Lesotho will, among others need to awaken the apathy that is observed in the private sector, in particular emphasis should be on repositioning of the local business community to enhance its understanding of the economy and be able to act as a catalyst for growth.

Productivity and Labor Costs

The ability of a country to have presence in the international product market is influenced by the country's competitiveness. The two categories that are of importance to Lesotho are labor productivity and labor costs. The former is found to be generally low in Lesotho, especially if compared to other low cost producers like China, Sri Lanka and India. There is however a note that productivity has a potential of increasing if training activities for workers are intensified.

It is clear that labor costs in Lesotho are low compared to its peers in the same export categories. Labour in Lesotho is of a high educational level, and this makes it easer to retrain them into newer skills. It is therefore envisioned that the balance between productivity and labor costs determines production and export mix of a country. It should be noted that the weave of labour cost, productivity and infrastructure is integral to policy planning.

Lesotho's Peculiarity

The issue of whether Lesotho is in a peculiar situation becomes necessary when we seek to understand whether Lesotho is the only country facing challenges surrounding the Textile and Apparel imports from Africa into US. Preliminary commerce data from the US Department of Commerce shows that textile and apparel imports from Africa are on a declining trend. The rate of decline has grown from 8.35 percent during January to June 2005, to -11.74 percent in January to July, to -13.01 percent in January to August 2005. The overall rate for the year is an average of -16.40 percent.

The 2005 trend has demonstrated in greater detail that Africa is the only region in the world which has experienced a greater decline in apparel exports to the US. The scenario is depicted by the insert table below;

US Textile and Apparel Imports from Africa			
Country	Jan-Dec 2004	Jan-Dec 2005	% Change
Botswana	5.835	7.836	34.24

Cape Verde	1.146	0.914	-20.24
Ghana	9.331	6.515	-30.18
Kenya	73.396	73.225	-0.23
Lesotho	111.128	93.458	-15.90
Madagascar	69.414	62.281	-10.28
Mauritius	37.406	28.932	-22.65
South Africa	57.362	28.445	-50.41
Swaziland	61.469	54.638	-11.11
Tanzania	1.541	1.616	4.87
Sub-Sahara	462.100	386.333	-16.40

It is therefore worrying that Africa's export in this category is declining while exports from else where are increasing.

Possibilities for Product Diversification

The understanding should be that the current production should still go on, though the challenges have to be noted as real and having a potential to derail economic growth. There is a need to seek new markets and expand them (this can be European Union, Australia and Canada among others). It is important to entrench broader penetration into the US market through buyer and distribution networks; thus broadening the narrow product base by looking at a bigger pool of products in the US and SACU where preferential tariffs exist.

There is also hope that this can be achieved as Government policy in Lesotho is geared towards private sector development, with the assistance of the World Bank. The sectors that are likely to be explored are those supported by trade data; horticulture, garments industry, and tourism.

The paper benefited from Lesotho: Potential Export Diversification Study

Table 1: Monetary and Financial Indicators +

	Oct.	Nov.	Dec.
1. Interest rates (Percent Per Annum)			
1.1 Prime Lending rate	11.50	11.50	11.50
1.2 Prime Lending rate in RSA	10.50	10.50	10.50
1.3 Savings Deposit Rate	1.24	1.24	1.24
1.4 Interest rate Margin(1.1 – 1.3)	10.26	10.26	10.26
1.5 Treasury Bill Yield (91-day)	6.74	6.60	6.95
2. Monetary Indicators (Million Maloti)			
2.1 Broad Money (M2)	2519.7	2593.5	2590.0
2.2 Net Claims on Government by the Banking System	-1209.13	-1103.20	-910.08

2.3 Net Foreign Assets – Banking System	4683.29	4580.33	4211.18
2.4 CBL Net Foreign Assets	3436.3	3200.22	3076.22
2.5 Domestic Credit	-481.56	-365.57	7.16
2.6 Reserve Money	425.36	392.09	545.31
3. Spot Loti/US$ Exchange Rate (monthly average)	6.5895	6.6561	6.3691
4. Inflation (year-on-year percentage change)	3.4	3.4	
5. External Sector (Million Maloti)	**2005**		
	QI	**QII**	**QIII**
5.1 Current Account Balance (Excl. LHWP)	52.86	-122.41	34.71
5.2 Capital and Financial Account Balance (Excl. LHWP)	-69.05	187.88	-102.54
5.3 Reserves Assets	-119.83	-94.55	26.53

+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

	2002	2003	2004	2005*
1. Output Growth(Percent)				
1.1 Gross Domestic Product – GDP	3.5	3.1	3.1	1.2
1.2 Gross Domestic Product Excluding LHWP	2.9	2.9	3.7	1.1
1.3 Gross National Product – GNI	1.6	6.0	6.1	0.3
1.4 Per capita –GNI	-0.2	3.7	3.9	-0.9
2. Sectoral Growth Rates				
2.1 Agriculture	-4.2	-1.8	1.2	1.8
2.2 Manufacturing	6.9	5.2	5.9	-8.3
2.3 Construction	6.9	4.3	0.4	2.0
2.4 Services	2.2	3.9	4.4	4.2
3. External Sector – Percent of GNI Excluding LHWP				
3.1 Imports of Goods	93.9	80.1	81.3	76.0
3.2 Current Account	-11.6	-5.8	1.0	0.5

3.3 Capital and Financial Account	6.4	3.8	1.4	0.4
3.4 Official Reserves (Months of Imports)	6.2	5.8	5.2	5.8
4. Government Budget Balance (Percent of GDP)	-2.8	-0.3	8.4	1.5

* Preliminary estimates