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## SMALL STATES IN TRANSITION – FROM VULNERABILITY TO COMPETITIVENESS

# LESOTHO

## MANAGING THE TRADE SUPPORT NETWORK

Port of Spain, Trinidad & Tobago – January 2004

## 1. **INTRODUCTION**

The purpose of this paper is to outline, generally, the economic performance of Lesotho in terms of its productive capacity, and the challenges facing the country in this regard. The ultimate objective of the analysis is to assist the forum in suggesting a realistic Lesotho export strategy, which can form a basis for sustained improvement in the export performance of the country.

## 2. **THE COUNTRY'S SITUATION**

### 2.1 ***Physical attributes***

Lesotho is a small country (approximately 30000 km<sup>2</sup> in land area) completely encircled by the Republic of South Africa (RSA). It is characterised by a rugged mountainous terrain, which covers the better part of the country leaving around 11% of total land area as arable. The country possesses few endowments, which include, inter alia, mineral deposits, water and diamonds.

Lesotho has 2.2 million inhabitants. The capital city is Maseru. More than 80% of Lesotho's population resides in rural areas, and depends for livelihood in subsistence farming and limited pastoral production.

### 2.2 ***Structure of the economy***

One distinctive feature of the Lesotho's economy is that the Gross National Product (GNP) is substantially larger than the Gross Domestic Product (GDP). This gap is caused by the large value of factor income from abroad, which mainly comprises migrant workers remittances from RSA mines.

The Gross Domestic Product (GDP) has grown at an average rate of 4% in the past 10 years. The main contributor to this growth has been the industrial sector, which has consistently accounted for an average 40% of sectoral output in the past 10 years. The primary sector contribution to GDP has declined significantly in recent years, relinquishing its position as the mainstream of the economic growth in Lesotho. The share of agricultural output has dropped from 30% in the early eighties, to 19% in 2002. Severe drought has been the main contributor to this unfavourable situation. The service sector has however increased its contribution to GDP. This situation is attributable mainly to increased Government spending on social services that include education and healthcare.

Notwithstanding these developments, the economy is still reliant on limited agricultural and pastoral production for subsistence purposes. This is specifically because around 80% of the population resides in rural areas and their livelihoods depend on this sector. In addition the economy also depends on: revenues from the common customs pool under the Southern African Customs Union(SACU); royalties arising from water sales to RSA; the declining remittances from Lesotho mineworkers in RSA; as well as light manufacturing in clothing and textile products, shoe and leather products, as well as consumer electronics and electrical products.

Light manufacturing has accounted for an average 17% of GDP in the past 10 years. The industry currently accounts for 99% of Lesotho's exports, which is predominantly clothing and textile products destined solely to the United States (US) market, under the African Growth and Opportunities Act (AGOA) and other General Systems of Preferences (GSP).

The striking feature of the light-manufacturing sector is that, the Lesotho economy depends for growth, employment and export revenues on this sub-sector. This sector is owned and managed almost 100% by foreign investors of East Asian origin. The driving forces behind the growth of this industry are temporary trade

privileges offered by developed markets like the US. This type of investments are however traditionally renowned for being 'foot loose' and could relocate when trade privileges are phased out one day in future.

### **2.3 Trade and Investment regime**

Lesotho is a member of SACU, a growth and development-trading block of the Southern African region. Under the existing SACU agreement (currently under revision), RSA exercises a lot of power in shaping the trade regime of the trading block. In shaping trade relations with 3<sup>rd</sup> parties RSA applies a range of trade policy instruments, which include; customs tariffs, excise duties, customs valuations, rules of origin and trade remedies. Monetary and exchange rates policies are also led by RSA. 4 members of the 5 countries trading block, however exercise a Common Monetary Area (CMA) agreement on which member's currencies are pegged to and freely convertible into RSA rand at par.

The investment regime is the responsibility of the individual member country. Lesotho is in the process of reviewing its investment policy.

## **3. THE CHALLENGES FACING LESOTHO'S ECONOMY**

The challenges facing Lesotho today include, inter alia, the following:

### **3.1 Extreme poverty and high rates of unemployment**

Eliminating extreme poverty is one of the greatest challenges facing Lesotho today. A research that has been carried out indicates that more than 50% of the population is leaving below poverty line, with rates and severity particularly high in rural and mountainous areas. In addition statistics indicate that 40% of the active labour force is presently unemployed.

### **3.2 Inequitable distribution of income**

Lesotho is also regarded as one of the most unequal society in the world, as measured by the Gini coefficient, which is around 0.6.

### **3.3 HIV Prevalence**

Lesotho is also plagued by high levels of HIV. It is estimated that around a 3<sup>rd</sup> of the population is infected with this deadly virus.

### **3.4 Infrastructural development**

The country's weak infrastructure acts as a constraint to diversified and accelerated industrialisation. The present industrialisation rate is already exerting tremendous pressure on the existing infrastructure.

### **3.5 Skills development**

Pervasive skills deficit in technical and managerial areas is also not doing this country any favours. There are indications that the present available skills are insufficient to match the demands of the light manufacturing industry, which produces for the lower end of the market through production of basic products.

### **3.6 Few natural resources**

Lesotho is very poor in natural resources. Arguably, a resource that can be processed easily for export market is water. There are also few minerals and diamonds. The country's terrain however makes it costly to extract these resources from the ground as apposed to other areas of the region with similar resources base.

### **3.7 *Agricultural land***

The size and richness of the arable land makes it difficult to engage in commercial farming and commercial pastoral production. Arable land accounts for around 11% of land total area. There is also empirical evidence that extreme drought and overgrazing is further causing land degradation. Climate conditions also make it difficult to produce a variety of high value crops.

### **3.8 *Entrepreneurship***

There is an apparent lack of entrepreneurship culture at the present moment. This could be one area that needs to be developed in order to support sustainable economic growth and development.

### **3.9 *Institutional strengthening***

Institutional strengthening to support trade and investment could also prove to be essential. While Lesotho has made strides in this regard there is room for further improvement. For example the private sector currently remains fragmented and ineffective as far as advocating for pro-business policies. There are also insufficient central sources of comprehensive business information to facilitate trade and investment decisions.

## **4. MEASURES IN PLACE TO ADDRESS CHALLENGES**

Cognisant of the country's economic constraints and limitations, the Government of Lesotho (GoL) is at present engaged in formulating strategies in collaboration with a number of international agencies. The objective of these interventions is to promote sustainable growth and development, as well as alleviating widespread poverty.

Notable amongst these interventions include the following:

### **4.1 *Integrated Framework for Trade Capacity (IF)***

The IF is a high level WTO initiative aimed at facilitating coordination of trade related technical assistance, as well as promoting an integrated approach to assist the Least Developed Countries (LDC's) in enhancing their trade opportunities. The IF has been structured in a manner, which ensures better integration of trade with national development strategies.

The IF process has, inter alia, given birth to the Lesotho Trade and Poverty Programme (LTPP), which is a process based-action plan to assist Lesotho in achieving a trade-oriented growth path. The overarching objective of this action plan is to enhance capacity in appropriate Lesotho institutions to formulate, negotiate and implement inclusive and pro-poor trade policies, which benefit Lesotho. This process is ongoing.

### **4.2 *Poverty reduction strategy***

Eliminating extreme poverty is one of the greatest challenges facing Lesotho presently. Mindful of this challenge, Lesotho has developed a comprehensive poverty reduction strategy framework. The core strategy of this framework has been identified as export-led economic growth. Coupled with this, there is also heavy emphasis on the enhancement of social services, particularly in health care and education, in order to break the vicious circle of poverty.

The poverty reduction strategy is still an on-going, interactive and inclusive process, currently being subjected to fine-tuning.

#### **4.3 Investment policy review**

The GoL has recently embarked in an Investment Policy review in collaboration with the United Nations Conference on Trade and Development (UNCTAD). The final product of this review has been envisaged as a stable, predictable, and transparent investment environment, which is conducive to increased investment.

The final report stating recommendations and follow-up programme has since been issued. This process is still in progress and sources of funds are being identified to support the follow up programmes.

#### **4.4 National Vision 2020**

The GoL is at present in the process of developing a long-term vision and strategy framework aimed at addressing growth and development needs in a coordinated comprehensive and systematic manner. This broad framework has been named Vision 2020.

Like the other processes, this is an interactive and inclusive process, currently being subjected to honing.

#### **4.5 Public Private Partnership policy framework (PPP)**

The GoL has decided to utilise the PPP as a policy framework whereby the private sector can finance public infrastructure and services. This initiative is a response to the increasing socio economic demands of the country in the light of the diminishing GoL revenues.

The legal and regulatory framework aimed at enduring transparency in the implementation this new policy framework is on the cards.

## **5. OBSERVATIONS**

As it enters the new millennium, Lesotho is faced with vast challenges given the changing patterns of the World economic landscape within the framework of globalisation. Whilst the instituted interventions as discussed above could have a profound impact on sustainable economic growth and development, Lesotho appears to remain very vulnerable to integration in the global economy.

Issues of critical concern in the new dispensation include the following:

### **5.1 The country's geographical characteristics**

Lesotho is characterised by a mountainous terrain with very few endowments. Arable land accounts for around 11% of the total land area. The country has been plagued with drought in recent history, coupled with overgrazing; land degradation has become a prominent feature, thus causing a reduction in arable land. Climatic conditions have also made it difficult to produce a wide range of agricultural produce, especially high value cash crops.

As such farming has been limited to subsistence, even then production has fallen short of consumption demand. The resultant situation is that Lesotho is a net importer of food.

The country's terrain has also made it impossible to extract the limited minerals and diamonds cost effectively, vis-à-vis other locations with abundance of similar resources. Water has so far proved to be a resource, which is in abundance and easy to process in Lesotho. However insufficient structures have been provided for irrigation purposes in a drought-ridden country.

### **5.2 *Weak infrastructure***

The weak infrastructure especially in the form of utilities have limited the productive capacity of the country and has as such stalled the industrialisation programme. Industrialisation has as such been limited to light manufacturing.

### **5.3 *Inadequate Industrial skills***

Local technical and managerial skills are lacking in order to support local industrialisation programme.

### **5.4 *Institutional arrangements***

The private sector institutions appear to be weakly developed and fragmented in respect of business policy advocacy. Vocational training outfits also do not appear to meet the skills requirements of the established industries.

### **5.5 *Over reliance in one sector and one market as an export driver***

The Lesotho's economy depends for growth, employment and export earnings in one sector which engages in light manufacturing on a cut-make –and trim basis (CMT). Because of its nature, this sector contributes very little to meaningful skills transfer, linkages with local business, as well as towards the GoL tax base.

The light-manufacturing sector has accounted for an average 17% of GDP in the past 10 years. The sector currently accounts for 99% of Lesotho's exports. This sector is owned and managed almost 100% by foreign investors originating from the Far East. Specifically Taiwan.

The growth of this sector in Lesotho is attributable to a large extent, on temporary trade privileges under the WTO development provisions. The current lucrative privileges are specifically directed at the US market. The striking feature of this sector lies on the fact that it is traditionally 'foot-loose', with potential to relocate one day when the present privileges are withdrawn.

## **6. CONCLUSIONS**

The foregoing scenario depicts a difficult situation for a small country like Lesotho. But all is not gloom, as nothing is impossible under the sun. Mauritius has made it with meagre resources. Why not Lesotho!!! Surely with the right interventions, we can also make it.