Global Value Chains, Sustainable Development, and the Apparel Industry in Lesotho

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International Centre for Trade and Sustainable Development

Country Case Study

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LIST OF ABBREVIATIONS

AGOA	African Growth and Opportunity Act
ALAFA	Apparel Lesotho Alliance to Fight AIDS
CMT	cut-make-trim
DCC	Duty Credit Certificate
FDI	foreign direct investment
GDP	gross domestic product
GVC	global value chain
LNDC	Lesotho National Development Corporation
MFA	Multi-Fibre Arrangement
ROO	rules of origin
SACU	South African Customs Union
SADC	Southern African Development Community
SDG	Sustainable Development Goal
SSA	Sub-Saharan African
TCF	Third Country Fabric

EXECUTIVE SUMMARY

The apparel industry has been central to Lesotho's economy. It accounts for around one third of Lesotho's gross domestic product, 60 percent of total exports, and employs 80 percent of Lesotho's manufacturing workforce. The possibility of Lesotho embarking on an industrialisation path depends very much on its well-being. Hence, maintaining the momentum of this sector is of immense importance for Lesotho's economic sustainability.

The apparel industry in Lesotho took off post-2000 with foreign direct investment (FDI), primarily from Taiwanese investors, already linked into global value chains supplying the US market, and interested in using Lesotho as a production base to take advantage of duty free imports to the US market through the African Growth and Opportunity Act (AGOA). The clothing industry experienced a new resurgence with regionally based FDI from South African firms relocating production to Lesotho in the second half of the decade. It is the interplay between these two different sets of FDI driving two very different value chains – the one global, the other regional – with differential impacts on sustainability that makes the Lesotho case such an interesting one, revealing different paths to sustainable development.

The central dynamic driving US exports is preferential duty free access to the US market through AGOA. The central dynamic driving South African exports is South African Customs Union (SACU) duty free access and escaping the inflexibilities of the South African labour market.

These two value chains have different power dynamics, drivers, characteristics, potential impacts on promoting the Sustainable Development Goals (SDGs), and implications for sustainability.

The most substantial socioeconomic impact has been on employment. A considerable number of people, especially women, have found wage employment within Lesotho, which is a significantly positive SDG impact. Given high unemployment levels in Lesotho and the fact that almost half of the population lives below the poverty line, the rise and sustainability of the industry is of crucial importance for employment generation, female incomes, poverty reduction, and industrial development.

Taiwanese firms have created some local skills as employees are given on the job training in handling sewing machines. However this training is generally limited to basic production and most workers are taught to perform one task or operate one machine. South African firms also train workers but in more complex tasks. They also employ more locals in supervisory positions and some management positions.

Two challenges affecting all apparel producers in Lesotho stand out: (i) inadequate hard and soft infrastructure, and (ii) tackling local upgrading and intensive skill development.

The paper recommends the following policy recommendations to overcome these challenges and promote a sustainable industry.

Ensure that preferential trade access (AGOA, SACU) continues. Government should directly engage the US government and support the African Clothing and Textile Industries Federation in lobbying key members of the US Congress to reduce policy uncertainty over AGOA.

Provide support to expand relationships with buyers in the US, EU, and SA. The diversification of end markets and creating new value chain linkages is crucial. Firms require financial support to attend trade fairs, send country delegations abroad, and bring buyers to the country. This is especially important for developing the EU as an alternative end market.

Provide incentives to set up supply chain development programmes. There is a real opportunity to encourage South African retailers to upgrade, develop systemic competitiveness, and bolster their supply chain linkages in Lesotho if financial incentives for local supply chain development programmes existed.

Provide financial support to contract external consultants developing firm capabilities. Independent service providers play a crucial role in assisting firms become more competitive through implementing world class manufacturing programmes. Matching grant schemes which firms could access would facilitate utilising such consultants from South Africa.

Provide support to create clusters. Government should follow the example of the South African clothing industry where industrial policy created matching grant incentive schemes using private sector facilitators to create operational clusters in Maputsoe to facilitate joint action, comparative benchmarking, and learning networks between these firms.

Raise the general level of skills through customised training programmes. This is a crucial policy intervention to upgrade the industry and put it on a trajectory less dependent on simple assembly. Government should upgrade the training institutions and programmes in existence. In addition, grant funding or tax incentives should be provided for in-house training. The focus should be to provide differential, customised, and specific training initiatives aimed at management, supervisory, and machinist levels.

Support local firm development and supplier linkages in the local economy. This is particularly important in respect of firms operating in providing services to the apparel industry, as the development of the service sector can play an important general role in developing and diversifying industry in Lesotho.

Facilitate regional integration and value chains. Intra-regional formal and informal trade barriers remain high in Sub Saharan Africa. Improvements in intra-regional transport, logistics, and customs facilities are central to reduce costs and lead times of regional trade. The Lesotho government should actively promote an intra-regional trade programme facilitating partnerships between existing cotton ginners, textile mills, clothing factories, and regional buyers to increase regional sourcing and production networks.

Improve physical, regulatory, and bureaucratic infrastructure. These limit access to and raise the cost of backbone services, in particular in the areas of transport, logistics, and customs facilities as well as energy, water, and waste treatment.

1. INTRODUCTION

The apparel and textiles value chain has historically played a central role in the process of industrialisation and is generally regarded as being a potential first step for developing countries embarking on an export based industrialisation path.[1] Barriers to entry are low with low fixed costs and relatively simple technology, production is labour intensive, and tradability of goods is high. The sector is a major absorber of large numbers of unskilled, and mostly female, workers providing upgrading opportunities, and hence impacting on sustainability of development processes (Gereffi and Memedovic 2003; Morris et al. 2015).

Many low income and less developed countries have aimed at becoming clothing manufacturing exporters following the historical trajectory where exports became dominated by developing countries – from around 25 percent of global clothing exports, to 37 percent in the late 1980s, and by 2013 over 80 percent of clothing exports coming from developing countries. This trend is not globally spread as the Asian developing countries massively dominate global apparel exports. However, since the beginning of the millennium, a number of Sub Saharan African countries have placed apparel manufacture, employment, and exports as a firm priority on their agenda. By 2103 these countries had developed their clothing exporting industry to occupy the dominant place in the share of manufactured exports – Madagascar (76.3 percent), Mauritius (54.4 percent), Lesotho (48.8 percent), Ethiopia (21.2 percent), Kenya (20.2 percent), and Swaziland (11.5 percent) (Morris et al. 2015).

The apparel industry has been central to Lesotho's economy. It accounts for around one third of Lesotho's gross domestic product (GDP), 60 percent of total exports, and is the largest formal employer, employing nearly half of the formally employed workforce and 80 percent of Lesotho's manufacturing workforce (ComMark 2009; Lesotho Government 2012). The apparel industry in Lesotho took off post-2000 with foreign direct investment (FDI), primarily from Taiwanese investors who were already linked into global value chains (GVCs) supplying the US market. They were interested in using Lesotho as a production base to take advantage of duty free imports to the US market through the African Growth and Opportunity Act (AGOA). They played a central role in the growth of export-oriented apparel sectors in Lesotho as these entrants used their global positioning to secure access and connectivity to GVCs feeding into US retail chains. The clothing industry experienced a new resurgence with regionally based FDI from South African firms relocating production to Lesotho in the second half of the decade. It is the interplay between these two different sets of FDI driving two very different value chains – the one global, the other regional – with differential impacts on sustainability that makes the Lesotho case such an interesting one, throwing up different paths to sustainable development.

1 This paper is based on three sets of information – a corpus of published research undertaken by Morris, Staritz, and Barnes over the past decade, as well as recent research by Barnes et al. 2015 and Kao 2015. It follows the ICTSD 6 step methodology for analysing global value chains and sustainable development (ICTSD 2015).

2. MAPPING THE LESOTHO APPAREL VALUE CHAINS

Global exports of apparel from Lesotho grew rapidly from US$153 million in 2000 to US$494 million in 2004, dropped to US$424 million the following year and then declined to US$396 million in 2014 (Table 1). The principal markets for apparel exports from Lesotho were to the US (until 2007 over 95 percent), supplemented from 2008 with increasing exports to South Africa. Apparel exports to the US from Lesotho jumped dramatically from US$146 million in 2000 to US$482 million in 2004. This upward trajectory stalled, dropping just as dramatically to US$408 million in 2005, a direct consequence of the expiration of the Multi-Fibre Arrangement (MFA) and around eight Taiwanese owned firms closing shop in December 2004. Apparel exports to the US continued to decline steadily on a yearly basis to US$290 million by 2014. Throughout this period Lesotho was the major exporter of apparel to the US within Sub Saharan Africa. Its share of SSA apparel exports to the US ranged between a quarter and over a third between 2002 and 2014 (Table 1).

Table 1. Lesotho Apparel Exports to the US Market (US$ million)

	2000	2002	2004	2005	2006	2008	2010	2012	2014
Lesotho to World	153	348	494	424	420	383	351	392	396
Lesotho to US	146	342	482	408	407	359	281	301	290
Share to US	99%	98%	98%	96%	97%	94%	80%	77%	73%

Source: General Customs Value; Apparel represents HS 61+62. Comtrade

The central dynamics driving US exports were the MFA quota restrictions on large Asian producing countries (which ended in December 31 2004), and the AGOA implemented in 2000. AGOA secured preferential market access to the US market coupled with non-restrictive rules of origin (ROOs) as the Third Country Fabric (TCF) derogation, which allowed for single transformation for lesser-developed countries. These ROOs generally stipulate triple transformation (yarn, fabric, and apparel), but the TCF derogation is a special rule applying to less developed Sub-Saharan African (SSA) countries (per capita incomes of less than US$1,500 in 1998) allowing duty free access for apparel made from fabric originating anywhere in the world (Staritz and Morris 2015).

Taiwanese transnational investors with already established value chain linkages to US retail buyers moved rapidly into Lesotho post 2000 to take advantage of these two preferential trade access agreements. Consequently Taiwanese FDI in these early years accounted for most of the escalating exports, increase in firm numbers, and rise in workers employed in the apparel sector (Morris et al. 2011). In 2012 there were 21 Asian-owned plants (17 Taiwanese and four mainland Chinese) operating in and around Maseru (Morris and Staritz 2016).

The other market of significance was South Africa. Apparel exports to South Africa were either absent or miniscule throughout most of this period when the US market completely dominated the Lesotho global value chain. However, in 2008 South Africa emerged as a new end market, with exports across the border taking off dramatically. In 2008 they jumped to US$13 million, and then escalated on a yearly basis to reach US$93 million by 2014 — doubling from US$46 million in 2010 to US$93 million in 2014 (Table 2). This percentage increase is even starker if one takes into account the real monetary exchange taking place between exporter and importer. Exports from Lesotho to South Africa are denominated in Rands against which its currency is pegged. For purposes of tabular collation these are converted into US$. Given the depreciation of the Rand against the US dollar over this period

the real escalation of exports to the South African market is therefore underestimated by the use of $ values. Hence, if viewed in Rand terms, the real export increase to the South Africa market is a threefold increase from R335 million in 2010 to R1014 million in 2014.

Table 2. Lesotho Apparel Exports the South African Market (US$ million)

Lesotho to World	153	348	494	424	420	383	351	392	396
Lesotho to SA		0	0	2	2	13	46	74	93
Share to SA	-	-	-	0.5%	0.5%	3.0%	13.0%	19.0%	24.0%

Source: General Customs Value; Apparel represents HS 61+62, SARS, Comtrade.

The central dynamic driving the importance of the South African end market lies in the duty free access granted by membership of the South African Customs Union (SACU). South African apparel manufacturers servicing the South African retail sector used this to relocate their plants to Lesotho in order to take advantage of the lower cost operating environment (labour and overhead cost),[2] escape the rigid and inflexible labour market conditions governing South African labour relations, and still gain duty-free market access through SACU to supply South African retailers (Morris et al. 2011). In 2012 there were 15 South African owned firms operating in Maputsoe (Morris and Staritz 2016).

This fracturing of the Lesotho apparel value chain into different end markets is very apparent from the share of exports going to the US and SA. Between 2002 and 2008 the share of apparel exports going to the US market ranged between 99 percent and 94 percent. However, by 2010 the total dominance of the US end market had changed – the share dropped to 80 percent and by 2014 only 73 percent of apparel exports from Lesotho were US bound. The bulk of the remainder was increasingly exported into the South African market – rising from 13 percent in 2010 to 24 percent by 2014 (Table 2).

These two value chains servicing different end markets have different power dynamics, drivers, characteristics, impacts on Sustainable Development Goals (SDGs), and implications for sustainability. Hence, we now turn to differentiating them and analysing their consequences.

2 Rural South African wages for qualified machinists are still more than double the minimum wage for machinists in Lesotho without considering social benefit scheme contributions (Pike & Godfrey 2011).

3. UNDERSTANDING THE DIFFERENT GVC POWER DYNAMICS

US buyers require largely basic apparel products in high volumes and emphasise the ability to produce to buyer specifications. They nominate fabric and other input suppliers, mostly from Asia and are generally not interested in innovation or design from suppliers. The buyers provide specifications to the head office in Taiwan, which in turn determines the cost-effective production locations, decides where the products will be sourced, and the distribution of goods across the value chain. Their sourcing strategy depends on drawing on their own textile mills or established sourcing networks based in Asia.

Local linkages within Lesotho are hence limited since the Taiwanese head offices generally source inputs for all their plants on a global scale and local managers are generally not empowered to make sourcing decisions. Without local sales and merchandising competencies there are also no direct relationships between the Taiwanese plants in Lesotho and US buyers. The exception is Formosa, Nien Hsing's fabric mill, as well as a few independent service providers/ finishing units, including two embroidery firms and three screen printing firms (Staritz & Frederick 2012).

Global cost comparators and global regulatory regimes were primary investment drivers for Taiwanese investment. These were MFA quota hopping coupled with AGOA and the TCF derogation, as well as the availability of special FDI incentives – subsidised factory rentals, serviced industrial sites, a low corporate tax rate, free repatriation of profits, tax exemptions on imported machinery and equipment, full rebates on imported inputs for exporting (Bennett 2006), and until 2011 an export incentive scheme – the Duty Credit Certificate (DCC) scheme.

The governance structure and firm set-up of Taiwanese-owned firms in Lesotho is very specific. Most Taiwanese owned firms are local affiliates of transnational producers with head offices in Taiwan, who follow a global exporting and sourcing strategy. Their export strategy is targeted at the U.S. market driven by AGOA, and involves long run production for export of a narrow range of basic products. These are produced in highly inflexible large plants specialising in a narrow range of functional activities.

The critical decision-making power and higher-value functions, including input sourcing, product development and design, logistics, merchandising and marketing, and the direct relationship with buyers are located in Taiwan. The Taiwanese owned firms in Lesotho are organised functionally, with cutting, assembly, quality control, finishing, and packaging generally planned in weekly cycles, and with large lots of work-in-progress passed from one functional area to the next over the course of the production cycle. The firms are generally large employing on average 1,543 employees. Production plants in Lesotho are generally reduced to cut-make-trim (CMT) activities (Staritz and Morris 2012).

South African firms are wholly dependent on South African retailers who source more than 90 percent of their apparel. South African buyers demand not only competitive prices but also flexibility in lead times and volumes from their Lesotho plants. These plants are regionally embedded with head offices (and other production activities) remaining across the border in South Africa. The South African owned firms are generally smaller than the Taiwanese plants – on average South African firms employ 584 employees. They also largely perform CMT functions. South African firms produce shorter runs (sometimes as few as 1,000 pieces) and generally also more complex and/or quicker response or replenishment products with moderately higher fashion content (Morris et al. 2011; Morris and Staritz 2016).

Similar to the Taiwanese value chain, input sourcing is generally organised at the South African head offices. Textile inputs are largely sourced from Asian-based firms, with some inputs coming from South Africa or regional sourced from Mauritius.

In terms of governance there exists a fluidity of movement between the South African operations and their plants in Lesotho. Hence, the Lesotho based management has potentially more decision-making power, with the geographical proximity enabling greater interaction and a more fluid division of labour within management with regard to sourcing, design, and product development between head offices and manufacturing plants. Moreover, since the South African head offices do not own foreign subsidiaries and are not global operators, their Lesotho plants are not as easily substitutable as those of transnational producers. Consequently, these regional production networks have a geographical advantage over Asian based networks.

The dynamics and drivers of these two value chains are distinct and make overlapping activities difficult. The production set up and overhead structure for the South African market is not competitive for the US market. Likewise, the Taiwanese firms' long run, basic products set up is not competitive in the smaller run, higher fashion, and more quick response business for the South African retailers. Furthermore, the location of most decision-making functions, in particular sales and merchandising, in Taiwan, makes establishing relationships with South African retailers difficult.

4. UPGRADING IN THESE TWO APPAREL GVCs

The integration of these particular Lesotho apparel firms into US/Asian based and South African/regional value chains has important impacts on the production processes, technology used, and the products produced in Lesotho. It also has crucial implications for the upgrading and innovation possibilities in these firms. Upgrading possibilities and dynamics are determined not only by local capabilities, skills, and operating environments, but also by the role certain locations have in GVCs and thus by governance structures and the strategies of lead firms in these chains.

Apparel manufacturers in the US/Asian value chain Lesotho are locked into a particular set of low value-adding assembly processes, not only as a result of deficiencies in their operating environments, but also as a deliberate strategy of the parent companies of the foreign owned plants. The specific integration of Lesotho into apparel value chains through Asian triangular manufacturing networks limits the possibility for taking over higher value-added functions, as these functions are ensured by the headquarters on a global basis. Hence, the functions these transnational producers decide to locate in Lesotho not only relates to buyer requirements, available local skills, and capabilities. Rather, it is determined by their strategic choice of what and how to produce in their global sourcing network as the Taiwanese-owned firms are able to leverage the skills and expertise of their head offices and other production plants for value-adding activities. The primary exporting strategy for the Taiwanese-owned firms is to continue to utilise their head offices in Taiwan to market their Lesotho capacities. Hence, these local Lesotho based firms are simply low level manufacturing centres for their centralised product development, design, fabric management, and merchandising operations in Taiwan (Morris et al. 2011; Morris and Staritz 2016).

The very reason these Taiwanese firms set up operations in Lesotho and created a competitive advantage in maintaining these networks is the very same reason why these subsidiaries cannot (or find it very difficult to) upgrade. The dynamics of this US value chain and specifics of the South East Asian triangular manufacturing networks lock these Lesotho firms into certain low-value activities with no incentives from head offices to relocate more functions to Lesotho. Only a few Taiwanese owned firms have invested in more capital intensive finishing operations such as laundry, embroidery, screen printing, and dyeing, and only one has integrated backwards into fabric and yarn production investing in a denim mill and a ring spun mill. The functional upgrading challenge is not therefore simply one of creating broader capabilities (e.g., input sourcing, product development, or design) and developing the associated skills required to do so, but rather fundamentally challenging the very reason for the establishment of production facilities in Lesotho in the first place. The functional upgrading challenge is hence much more complicated than simply creating broader capabilities. It requires fundamentally challenging the raison d'être for the establishment of production facilities in Lesotho, which is marketing and extracting rents from dis-embedded production units based on preferential market access (Morris et al. 2011; Morris and Staritz 2016).

A key determinant of success for any apparel manufacturer is its ability to introduce new process technologies and work organisation strategies which raise operational performance and ensure the ongoing competitiveness of the firm. When Taiwanese investors came to Lesotho they brought crucial knowledge and capabilities with regard to production set up and processes. However, very few firms have undertaken major process innovations after their initial investment, and if introduced mostly only involve ongoing investment in

machinery. The quality checking process is mainly dependent on external auditing because the local representative of the US buyer checks the quality of the products on site before the shipment takes place. Taiwanese firms work largely off the basic assumption that worker costs and speed are the most critical components of competitive production and there is very limited awareness of alternative methods and philosophies of manufacturing. In short, they are fundamentally not dynamic with a high level of operational inflexibility. Taiwanese firms argue that the wages of their operations in Lesotho are higher than at those of their competitors overseas. They compare labour costs to their sister firms in countries such as Bangladesh, Cambodia, China, and Vietnam.

With regard to product upgrading these Taiwanese firms are similarly locked into value chain dynamics which limit them. Taiwanese-owned firms export large orders of basic or semi-basic apparel products (e.g., simple cotton trousers) to the US. This determines their product range which tends to be narrow and largely undifferentiated. Some firms have changed their products to meet buyers' demands for more fashionable products. However, these changes are minor and largely involve some additional styling detail, rather than a fundamental product change. Insofar as the Taiwanese firms are producing apparel products that require more detailed styling, difficult fabrics, intricate embroidering, and an increase in trims, this process has mainly been driven by buyers' demands rather than by the firms themselves. Taiwanese firms primarily assume that worker costs and speed are the most critical components of competitive production and there is very limited awareness of alternative methods and philosophies of manufacturing (Morris and Staritz 2016).

The South African owned firms in Lesotho also largely depend on certain key functions – product development, design, fabric sourcing, and merchandising – being based at their head offices. However, they have relocated some broader production-related functions to Lesotho, and there is some interest in relocating more functions to Lesotho. The reasons lie in high costs and labour market rigidities in South Africa, which are pushing them to move their labour intensive operations out of the South African operating environment. There is also the need to be physically close to the assembly operations to increase flexibility. This factor is pulling their pre- and post-production processes to Lesotho.

For example, Jonsson Manufacturing (the largest South African owned firm in Lesotho) has all its product design and development activity in the Durban head office, but management within the Lesotho firms have the flexibility/capacity to make operational decisions (Kao 2015). Moreover, the proximity of the head office enables senior management to quickly send out management expertise to respond to problems or opportunities in Lesotho. The embeddedness of South African owned plants within this regional manufacturing networks creates a certain tightness, proximity, and incentive to relocate more production functions, maintaining a flexible porous relationship between head office and their regionally located plants.

With regards to product and process upgrading in this South African value chain, there are similarities to the Taiwanese chain but also critically important differences. The top ten export products to South Africa are also basic products but more complex products are also included in the export mix – "men's jackets and blazers of other textiles materials," "men's suits of other textile materials," "women's cotton blouses," and "brassieres" (Morris and Staritz 2016). The absence of support industries in embroidery and printing in Lesotho inhibits the further upgrading of these South African owned firms as it limits their ability to keep up to date with fashion trends and meet complex embellishment requirements.

Most South African firms focus on products requiring shorter runs, a quicker response, and slightly higher fashion content, which require production flexibility and higher and more versatile skills. Shorter production runs necessitate reducing time lost in line changes, since extended change over times reduces labour productivity. Moreover, higher product variety requires shorter lead times, which in turn requires building in quality at source. The reason for this is that there is no time to check quality at the end of the line and substantially rework the product. The consequence of these end market requirements is that the value chain dynamics driving these South African-based firms are forcing them into some types of process upgrading to achieve greater flexibility and operational efficiency. This is reflected in significantly lower work-in-progress inventory rates for the South African firms (7.2 days) than for the Taiwanese plants (24.4 days) (Morris and Staritz 2016).

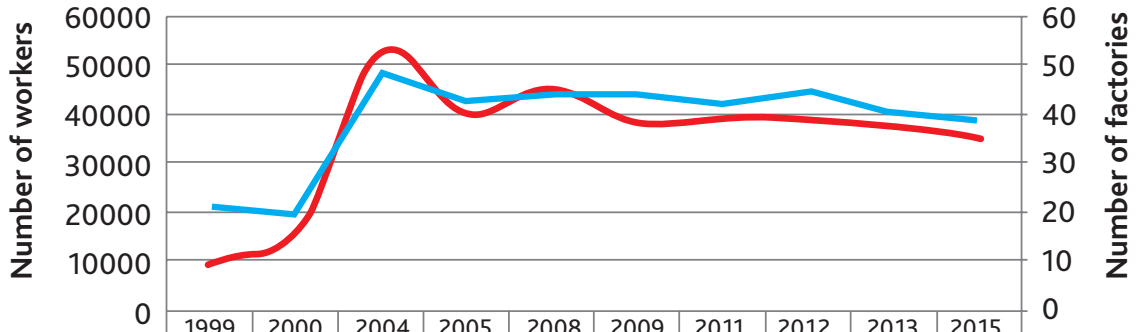
5. THE IMPACT OF THESE GVCs ON THE SUSTAINABLE DEVELOPMENT GOALS

5.1 Employment

The most substantial socio-economic impact of the growth of the apparel industry in Lesotho has been the employment effect. The growth of the apparel industry and the rise of these two apparel exporting value chains have dramatically changed the manufacturing landscape of Lesotho. A substantial number of people, and especially women, have found industrial wage employment within Lesotho. Given the fact that historically Lesotho has served as a labour reserve for male migrant workers on the South African gold mines, which over the last couple of decades has been a declining source of employment, this is a significantly positive impact in SDG terms. Given the high unemployment levels in Lesotho and that almost half of the population lives below the poverty line, the rise and sustainability of the apparel industry is of crucial importance for employment generation, female incomes, poverty reduction, and industrial development.

The apparel industry has become the largest formal employer, employing nearly half of the formally employed workforce and 80 percent of Lesotho's manufacturing workforce (ComMark 2009; Better Work Lesotho 2011). Women comprise over 80 percent of employment in the Lesotho apparel industry as full time permanent workers — the majority being young and poorly educated — but men occupy the majority of lower management. The number of apparel firms and employed workers has increased markedly. In 1999 there were 21 firms in the Lesotho apparel sector employing 9,847 workers. By 2004 the number of firms involved in the industry had more than doubled to 49 firms, while the number of workers employed had increased fivefold to 53,087 (Figure 1).

Figure 1: Number of Firms and Workers in Lesotho Apparel and Textiles



	1999	2000	2004	2005	2008	2009	2011	2012	2013	2015
	Pre AGOA		End of MFA		Economic Crisis		Latest*			
# of employees	9847	16417	53087	40364	45310	38437	39197	39210	37560	35306
# of factories	21	19	49	42	44	44	42	44	40	39

Source: LTEA (2012), Morris et al. (2012), LNDC database.

This table presents the only available data but there are strong indications it understates the actual number of firms and employees post 2008. This is because smaller firms not supplying the US but catering to the South African regional market tend to fall outside the purview of the Lesotho National Development Corporation (LNDC) and the Lesotho Textile Exporters Association (LTEA).

This did not last since we have already noted that the phase out of the MFA at the end of 2004 with the consequent ability of China and other low-cost Asian apparel producer countries to export to developed country markets without being hampered by quota provision, as well as the global economic crisis in 2008/09, had severe impacts on the Asian owned value chains' ability to maintain high levels of exports to the US. This impacted significantly also on the number of firms and workers in the industry. In 2005 eight Taiwanese factories closed in December 2004 (Bennet 2006; Morris et al. 2011) and around 13,000 workers (around one quarter of total employment) were laid off.

However, the rise of the South African based regional value chain post 2008 has been able to partially compensate for the decline of the Asian owned/US servicing value chain. The entry of at least 15 new South African owned firms accounting for about 30 percent of the workers employed in the sector has arrested the decline and stabilised the overall apparel industry firm and employment profile (Morris and Staritz 2016). Although the employment data is not wholly reliable, official figures report this as 39 firms employing 35,306 workers in 2015.[3]

5.2 Wages and Working Conditions

Lesotho's normal working week consists of 45 hours a week, with a one-hour lunch break, and overtime is restricted to 11 hours a week, paid at a premium. Sector minimum wages are set annually by the Ministry of Labour and Employment, based on wage increase proposals from a multi stakeholder Wages Advisory Board (consisting of unions, employer and Labour Ministry representatives). The sector wages set for 2015 for trained machine operators and for textile general workers with more than 12 months with the same employer were set at M1260 and M1187 per month respectively (Lesotho Government Gazette 2015). In US dollar terms this was around $101 and $95. However, given the radical depreciation of the South African Rand in the latter part of 2015 the equivalent would now be below US$80 for a qualified machinist. The Taiwanese firms tend to pay wages in line with the statutory set wages. However, Jonsson Manufacturing (the largest South African owned firm employing 3000 workers) pays on average 8.33 percent higher than the minimum wage (Kao 2015).

There are five unions operative in the industry, but union membership at the company level is not strong. At firm level unions may negotiate higher wages for employees but in many factories union membership is below the threshold for recognition and workers therefore have no organised body to negotiate higher wages on their behalf (ILO 2012). It is claimed that only 14,000 workers out of 40,000 belong to the three major unions (IndustriAll 2014). Wages are generally similar between the genders although there are jobs that are traditionally filled by men, such as mechanic positions that are higher paid than that of a general textile worker. The low wages in the female-dominated positions within the sector have an important impact on the national gender wage gap although Lesotho ranks quite high on the Global Gender Gap Index (Silvander 2013; World Economic Forum 2014).

The impact of civil society groups in the US on global value chain suppliers has also manifested itself in respect of accepted general working conditions in the industry. The ILO Better Work Programme has received traction in the Lesotho apparel industry and this is manifested in the improvement of general working and social conditions of apparel workers. Almost 60 percent (23/39) of Lesotho's textile factories participate in the Better Work Programme. This programme has contributed to improvements in occupational safety and health conditions within the participating factories and has also supported

3 According to the LNDC, by 2013 the number of firms involved in supplying the US and South African markets was roughly similar.

worker empowerment through the promotion of factory compliance to national labour laws and regulations (Better-Work 2014).

A public-private partnership (industry, government, donors, pharmaceutical companies, private doctors, and trade unions) was set up in 2006 to provide free workplace health services for factory workers in response to the HIV epidemic (ALAFA 2014). The programme provided a large number of services ranging from peer education, condom distribution, educational materials, testing and treatment (for HIV, TB, sexually transmitted diseases), and the prevention of mother to child transmission (ALAFA 2014; Silvander 2013). In 2014 the workplace health services were handed over to the firms with their commitment to maintain the programmes and provide free health services to their employees or provide the services at a reduced cost.

The Better Work Programme has also played a role in bolstering the country's maternity laws by putting a strong emphasis on maternity protection rights. Although not mandatory and at the discretion of each apparel company as to its implementation, in 2013 paid maternity leave was increased from two weeks to six weeks. Women also were entitled to a one hour per day paid breastfeeding break during the first six months after they return from maternity leave (Better Work Lesotho 2014). There are differences in the application of maternity leave between the two value chains. The largest Taiwanese plant, Formosa Textiles, allows six weeks maternity but only three weeks are on full pay. Jonsson Manufacturing offers its workers 12 weeks of paid maternity leave (six weeks before and six weeks after the birth). This is double the length of paid maternity leave that is recommended by the labour code for textile sector workers but is in line with the stipulated period for workers in other sectors (Kao 2015).

5.3 Skills Upgrading

The upgrading limitations (functional, process, and product) discussed earlier are manifested in the attitude towards local skill utilisation and development, and hence sustainability. When Taiwanese firms came to Lesotho there were no local technological and management skills available. Instead of investing in local skills, since this was not in accordance with their global cost containment strategy, they imported technological and management skills on a contract basis from Bangladesh, China, Mauritius, the Philippines, South Africa, and Sri Lanka. Consequently, nearly all technical, management, and even supervisory positions are currently filled with expatriates. Top management is mostly Taiwanese, middle management mostly (mainland) Chinese, and shop floor supervisors are (mainland) Chinese, Sri Lankan, and some locals. Amongst management the common language is Chinese. This reliance on expatriate workers is demonstrated in the foreign employment figures. Foreign workers accounted for 2.6 percent of total employment in the apparel export sector. Asian owned firms are above the average with a share of 3 percent (LNDC 2012).

The high use of expatriates, with often little management experience and related language and cultural barriers, limits skill transfer and learning by local workers. Most of the training for workers is provided on the job within the first three months of the probation period. There is little local transfer of technology and technical know how. The language and cultural barrier between the Mandarin speaking technicians and the Sotho speaking local employees compounds the problem. The short term cost advantage the Taiwanese-owned firms generate from operating this human resources model is to the detriment of creating demand for the development of higher-level skills within the local apparel industry.

Taiwanese firms have created some local skills as employees are given some on the

job training in handling sewing machines. But this training is generally limited to basic production and most workers are taught to perform one task or operate one machine. More complex skills such as cross training on multiple tasks, machine maintenance, layout, and pattern making are generally not taught. As the Lesotho National Development Corporation (LNDC) Investment Promotion Manager put it:

> In general, within the Taiwanese factories there are no skills transfer…as a result employees only do one task,…a worker only knows how to put in buttons or pockets. There is not enough transfer of skills in the way they produce. (Kao 2015)

The instability of preferential market access to the US is a further reason for Asian transnational producers being reluctant to invest in their Lesotho plants as the large majority of these firms will leave if AGOA or the TCF derogation should not be extended. This is relatively easy as long as capital investments are largely limited to CMT production and they have limited local and regional relationships.

South African firms also employ expatriates for management (South Africans), and supervisory and technical positions (South African and Asian workers). But there are more locals in supervisory positions and also some management positions. In some firms all supervisors are locals and only certain key management positions are filled by South Africans. The higher use of locals in technical and managerial positions is also related to the difficulties these firms face in getting enough South Africans to move to Lesotho. In contrast to the Asian owned firms, the South African owned firms' share of foreign employees at 1.2 percent is well below the industry average of 2.6 percent (LNDC 2012).

The difference in approach to skills upgrading between these two value chains derived from their different value chain dynamics is evident in Jonsson Manufacturing approach to local promotion and skills development. The company has a policy to empower and use local resources whilst also ensuring that workers are mentored. The firm promotes the rise of local women within its management structures and has also supported their workers getting access to education that will enable them to progress to managerial positions. About seven years ago middle and top management at the firms were expatriates who were contractually expected to mentor and empower local Basotho. A management training organisation from South Africa was contracted by Jonsson's head office to provide training for six months to local employees that had the potential to become supervisors. The training programme was also followed through to middle management.

This emphasis is evident in the distribution of management between men/women and local/foreign. Women dominate supervisory and middle management (including factory management) positions. Locals also dominate over foreigners in these positions. Of the 70 supervisors, all of whom are local, 60 are women and 10 are men. In terms of factory managers, six are woman and four are men, eight are local and only two are foreign. This pattern is only broken in respect of the four top management positions (MD, Operational, Compliance, HR) — three are men and one is a women, three are foreign and one is local. In terms of production activities, all the production staff receive on-the-job training by a full time internal trainer in each plant. Through this on-the-job training programme, Jonsson also supports the training of lower level workers to diversify their skills within the production line (Kao 2015).

Lesotho has two Skills Development Centres – in Maseru and Maputsoe — offering training in human resources management and industrial relations, communication, supervisory skills, basic and advanced machinist training, mechanic training, productivity interventions, and quality assurance management. Currently the Skills Centres are providing three months skills training – each month focusing a particular skill. In terms of general public training, the success rate is very low as most

of the trainees do not complete the training programme. They seem to regard registration as a means of getting into the factory gate rather than actually acquiring the necessary skills to upgrade their capabilities. As one trainer interviewed put it:

> On the first day we have 60 trainees, on 15th of the month, less than half of the trainees remain, and towards the end of the first month only a few trainees remain. Most of the trainees are coming from the rural areas and after 15 days, they will have gained some skill, and therefore have an opportunity to be employed without the employer training them (Kao 2015).

Jonsson Manufacturing has used private/public institutional training partnerships, including the local Skills Centre in Maputsoe, in a more creative manner to develop the skills of its employees. At least 10 percent of the operator workforce in each plant has been trained through the Better Work and the Apparel Lesotho Alliance to Fight AIDS (ALAFA) programmes. Through partnering with the Skills Development Centre in Maputsoe, supervisors and line management have undergone management skills training ranging from three days to one week. With assistance from the Directorate of Dispute Prevention and Resolution, supervisors and line managers have also received training in labour relations (Kao 2015).

6. CHALLENGES AND OPPORTUNITIES FOR SUSTAINABLE DEVELOPMENT

There are a number of general challenges affecting all apparel producers in Lesotho. Principal amongst these are those that relate to hard and soft infrastructure. These are crucial infrastructure challenges related to physical infrastructure decrepitude; institutional infrastructure operating deficiencies, transport logistics, border and customs delays, inadequate water supply, lack of waste water treatment facilities, energy supply problems, and the shortage of factory shells and industrial infrastructure (Staritz 2011; Barnes et al. 2015; Morris and Staritz 2016).

Taiwanese firms have distinct perceptions of what constitute the most central challenges to their export activities. They see policy and cost based challenges, such as the insecurity with AGOA, the Rand/dollar exchange rate, infrastructure including transport, logistics, and customs related costs as their main challenges. These firms are not escaping from the hub of their production activities in South East Asia where higher value adding activities in the pre and post-production stages are located. There is no push, only a pull to use Lesotho for as long as the AGOA preferential market access prevails and as long as they can keep their operating costs to a minimum.

Another important challenge is distance from raw material suppliers and buyers, and associated with this are lead times, in particular related to the unavailability of local or regional yarns and fabrics. Taiwanese firms import the majority of raw material from Asia which does not only lengthen their lead times considerably, but the cost of importing raw material over these long distances and through South African customs is high (Morris and Staritz 2016).

Given that their primary reason for locating in Lesotho is AGOA duty free access, these firms are extremely nervous of losing this advantage. There is no strategic reason beyond the ongoing accumulation of AGOA trade rents for being located in Lesotho, and this stunts the need for investments in upgrading and skill development. The lesson from Madagascar provides a useful comparative lens on this issue. When the US administration withdrew AGOA from Madagascar in 2009, the Asian firms that were wrapped up in supplying the US market took flight, and consequently this Asian/US apparel value chain has largely disappeared from the Madagascan industry (Morris & Staritz 2014).

The South African owned firms are frustrated by a different set of operating issues to the Taiwanese owned firms whose local existence is almost solely focused on cost containment as their major challenge. South African firms are inherently more interested in upgrading and transferring more production functions from their South African plants. Hence, they take skill and capability development more seriously. Thus, low productivity, limited local capabilities and technical skills, and inadequate training institutions constrain their ability to leverage off their regional advantages.

Local upgrading and intensive skill development is a crucial challenge and opportunity for the Lesotho apparel industry to concentrate on. However, the apparel firms in Lesotho can only tackle this issue to a limited extent. The Lesotho government, through a focused industrial policy, has the primary responsibility in this regard. A public private partnership approach is required to develop a strategic set of industrial policy interventions aimed at upgrading the public institutional fabric of training and infrastructure. The primary focus has to be furthering local involvement at the entrepreneur and management level, building skill sets at the operational level, and fostering local value addition and linkages.

This South African value chain does not, however, exist in a vacuum. It also faces

competition from other producers in the Southern African region who also derive duty free access to the South African market. The challenge comes from intense competition from Swaziland, and the growing capabilities of even lower cost Madagascan-based producers. Swaziland within SACU, as well as Madagascar and Mauritius, are able to garner duty free access (albeit with stricter conditions) under Southern African Development Community (SADC) rules of origin. These alternative regional producers exhibit an ability to meet and exceed the competitive advantages of the South African firms based in Lesotho on a variety of crucial dimensions — delivering speed-to-market, reliability, flexibility, quality and complexity of products, and still maintaining a cost advantage (Barnes et al. 2015). Lesotho is considered significantly less cost competitive than Madagascar. Lesotho and Madagascar costs may be similar when running large production orders, but in the smaller South African market, where such large volumes are seldom reached, Madagascar's cost advantage is amplified through its ability to manufacture smaller production volumes (Barnes et al. 2015).

Lesotho's regional proximity still remains a major plus but South African owned firms in Swaziland supplying the South African market are regarded as being more competitive, with less of the infrastructure challenges, than Lesotho based firms, hence significantly undercutting this advantage. Finally, apparel firms in Mauritius are developing expertise in dimensions that Lesotho based firms have none at all — design and pre-production operations. It is not surprising that the more fashion focused South African retailers are increasingly moving their regional business to Mauritius (and Madagascar), in order to better service the fashion market and secure quick response sourcing capabilities (Barnes et al. 2015).

7. POLICY RECOMMENDATIONS FOR A SUSTAINABLE INDUSTRY

The existence of two distinct value chain variants driving different production plants in Lesotho has major policy implications for the apparel industry. There are some general recommendations that will assist all value chains and firms in the Lesotho apparel industry, whilst others are specific to each of the two value chain variants.

The Asian owned firms in the US export market value chain have played a crucial role in establishing the industry, and providing employment, but there are limitations in terms of long term sustainability. The only competitive advantage this section of the Lesotho clothing industry has is its duty free access to the US market. It has no other competitive basis to sustain it and is struggling to maintain its current size. If Lesotho loses its AGOA status or if the AGOA/TCF derogation is not renewed in the future then this section of the industry will simply die. As long as these firms can export through AGOA they will contribute to GDP, tax revenues, and provide significant employment, which cannot be gainsaid, as the impact is substantial. However, the skill content of the jobs will remain at a low and semi-skilled machinist level, localisation of management will be very limited, and competitiveness will not be based on upgrading. The focus of these firms will be based on being a CMT sector for head offices based in Taiwan, their major concern will remain reducing factor costs, and their innovative dynamic will be static.

This has the following policy implications specific to this value chain:

- The major policy task required is to ensure that AGOA/TCF derogation is maintained into the medium term. This requires the Lesotho government directly engaging with the US government, as well as supporting these firms in their own lobbying of the US Congress through their membership of the African Clothing and Textile Industries Federation (ACTIF).
- In terms of market access, the Lesotho government should provide support to secure and expand relationships with US buyers. The Better Work Programme can be of help in this respect. New US buyer relationships can be developed through the government providing intelligence on alternative US buyers, subsidising attendance at US trade fairs, and bringing buyers to visit firms in Lesotho.

The South African owned section of the clothing industry exporting to the regional market (i.e., to South Africa) holds greater promise for industrial expansion, employment generation, skill acquisition, and hence long-term sustainability. The regional end market is very proximate, favouring firms that are flexible and able to take advantage of shorter lead times. Upgrading opportunities are favourable as South African firms are keen to develop and employ local lower/higher management staff, and head offices are in principle open to shifting functions from South Africa to Lesotho. However, they are constrained by the lack of available local human resource capacity at all levels. This would require these firms to focus on developing local technical, design, and most importantly management skills. The major threat that this value chain faces is complacency and ignoring the increasing competition from other more flexible, nimble, and innovative firms in the region – Madagascar, Mauritius, and Swaziland. The policy response has thus to be based on upgrading the operational competitiveness of these Lesotho clothing suppliers through a focus on strengthening value chain linkages, raising firm level competitiveness, and building skill capacities.

This has the following policy implications for this South African oriented value chain:

- The Lesotho government should strengthen current value chain linkages by providing incentives for lead firms and retailers in

South Africa to bolster their supply chain linkages in Lesotho.

- Government policy should focus on providing support to these South African owned retailers to set up supply chain development programmes with their own Lesotho based clothing suppliers so as to create systemic competiveness within the chain.

- Industrial policy should include specific financial incentive support for firms to contract external consultants to develop local firm capacity through incorporating world-class management programmes in their production processes.

- Government should follow the example of the South African clothing industry where industrial policy created matching grant incentive schemes using private sector facilitators to create operational clusters in Maputsoe to facilitate joint action, comparative benchmarking, and learning networks between these firms.

- Skill capacity of locals can be expanded and upgraded by government setting up or financing customised training programmes that these firms can access on the basis of tax or matching grant schemes. The focus should be to provide differential, customised, and specific training initiatives aimed at management, supervisory, and machinist levels.

- Training initiatives should be flexibly organised so that they can be tailored to a specific firm's requirements operating either in-house or sending employees to training institutions. There should also be general certified training programmes offered within training institutions at the machine operator level to ensure completion of training activities. A major government sponsored training initiative at this level would allow for the transference of higher skill functions into these Lesotho based plants.

There are also general policies relevant for all types of firms and value chains in the apparel industry that the Lesotho government can institute. These general policy initiatives should address the following:

- *Raising the general level of skill development in the industry*: Incentives or direct support for in-firm training that addresses crucial efficiency and skill deficits should be created. Tax-free incentives that are currently available to foreign firms need to include investments in training and increased use of locals in higher skill positions. Further, a government-supported "skills upgrading fund" organised at the industry level could support productivity improvements and upgrading by offering low-cost funds for investments in skills that enable more efficient and flexible production processes and the development of broader capabilities.

- *Creating new end market opportunities*: The diversification of end markets and creating new value chain linkages is crucial. Accessing the EU apparel market is the next challenge for all firms in the Lesotho industry. A major effort on the part of the Lesotho government should be expended to assist local firms to make their presence known in the EU through measures such as subsidising attendance at European trade fairs, and generally promoting Lesotho in the EU market as a viable sourcing production centre.

- *Supporting local firm development and supplier linkages in the local economy*: Supporting linkages through attracting foreign firms and supporting local entrepreneurs to supply the local apparel industry is a prerequisite to build a sustainable local industry. This is particularly important in respect of firms providing services to the apparel industry, as the development of the service sector can play an important general role in developing and diversifying industry in Lesotho.

- *Facilitating regional integration and value chains*: Regional integration has already played a central role in reducing lead times and costs, capturing more value added in the region, and diversifying end markets. The most important challenge to increased intra-regional trade and investment are intra-regional formal and informal trade barriers which remain high in SSA. Improvements in intra-regional transport, logistics, and customs facilities are central to reducing costs and lead times of regional trade. Coordination and strategic partnerships between different countries in the region, as well as, between cotton, textile, and clothing sector associations, is central to establishing competitive regional production and sourcing networks. The Lesotho government should actively promote an intra-regional trade programme facilitating partnerships between existing cotton ginners, textile mills, clothing factories, and regional buyers to increase regional sourcing and production networks.

- *Improving physical, regulatory, and bureaucratic infrastructure*: These limit access to and raise the cost of backbone services, in particular in the areas of transport, logistics, and customs facilities as well as energy, water, and waste treatment, and have to be addressed. Problems in respect of wastewater treatment are major infrastructural constraints for textile mill investments.

8. CONCLUSION

There is nothing to suggest that Lesotho based apparel firms are by definition unable to compete successfully and build sustainable industry. The ultimate source of the competitive constraints these firms face does not lie in insurmountable structural problems. Rather they are to be found in the deficiencies of industrial policy and state implementation capacity. The Lesotho state has limited capacity and a relatively low level of industrial policy capability. But essentially apparel firms in both value chains are confronted with a *passive* Lesotho government that fails to develop a detailed industrial policy, pays no attention to active engagement with the South African and foreign lead firms driving the regional value chain, fails to support training and productivity improvement interventions in Lesotho factories, and results in substantial costs for private firms when they attempt to deepen their own capabilities (Barnes et al. 2015).

Upgrading of the local industry is especially important if the South African based chain is going to take the necessary steps to avoid being locked into a low value added market segment. The LNDC, a parastatal institution, is regarded as very supportive in respect of the provision of competitively priced factory infrastructure, but there seems to be a total absence of government support for process, product, or functional upgrading interventions. This creates a particularly serious challenge in respect of management capability development, which remains highly constrained, leading to an ongoing dependence on expensive expatriate skills.

South African retailers and design houses highlight major discrepancies in their experiences of government support in Lesotho and Mauritius. The ramping up their sourcing from Mauritius is partly attributable to the intensive intervention of government — for example, Enterprise Mauritius (the state-owned investment and trade organisation) supports trade missions to the island, as well as subsidising follow-up activities, such as paying for retail buyers to visit potential Mauritian suppliers – which is in stark contrast to a lack of any engagement with them from the Lesotho government.

There is a limit to how much local upgrading and skill development the private sector can undertake. The state has a major responsibility in this regard. The Lesotho government – together with the industry – will have to develop a strategic set of industrial policy interventions to upgrade the public institutional fabric of training and infrastructure with a particular focus of furthering local involvement at the entrepreneur and management level, and fostering local value addition and linkages. Unconditional FDI attraction policies are not enough to support local embeddedness, upgrading, and sustainability. Unless some way is found to overcome these various limitations, the benefits of the apparel industry in Lesotho will be limited to its direct employment creation, rather than its ability to generate skills and knowledge spillovers, greater levels of upgrading, and local linkages. Without some form of concerted government effort in this direction, assisted by international institutions, the South African-driven value chain may hit a ceiling similar to the Taiwanese/US one.

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