

# FOREIGN FIRMS AND FIRST MOVERS: THE FLOW OF FDI TO THE APPAREL INDUSTRIES OF LESOTHO AND SWAZILAND

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Lesotho and Swaziland seem unlikely sources of merchandise for Gap retail outlets and Wal-Mart Superstores in the United States. These tiny enclave nations in South Africa, however, have ranked among Africa's top countries in attracting Foreign Direct Investment (FDI) from prominent apparel exporters abroad. In recent years, Lesotho's apparel manufacturers have outperformed those in Swaziland, even though these two countries have had similar experiences with economic development. Lesotho's apparel sector receives more FDI than any of its African competitors, making the country the most important exporter of clothing and related goods in the continent.<sup>1</sup> The divergent realities of each nation's textile manufacturers therefore raise the question of which factors explain the larger success of Lesotho's apparel manufacturers.

To answer this question, this paper will apply the microeconomic first mover advantage theory to each country's apparel sector. I argue that certain structural dynamics of Lesotho's economy—namely its business environment, industrial relations, and recent industrial background—have created conditions in which all of its foreign apparel manufacturers were able to reap the benefits normally accrued by the first firm to enter a new market. As the first firms from abroad to invest in the country, Lesotho's foreign apparel manufacturers enjoyed a prominent public presence, which they leveraged to monopolize the government's resources

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<sup>1</sup>Lesotho's apparel exports to the U.S. rose to \$456 million in 2004, out of a Gross Domestic Product (GDP) of about \$1.4 billion. The apparel industry's largest impact on GDP is through wages, because firms import raw materials, export finished products, and repatriate capital and profits easily (Lall 999).

and to dictate the country's terms of labor relations. Lesotho's nascent apparel firms thus ensured that they would be sheltered from inter-sector competition as they grew to dominate the country's manufacturing sector.

The first section of this paper will discuss the exogenous factors that have encouraged FDI in southern Africa overall. Central among these factors is the artificial competitive advantage lent to Africa's Least Developed Countries (LDCs) by international trade agreements, such as the Lomé Conventions and the World Trade Organization's Multi-Fiber Agreement (MFA). The second section of this paper will address the certain attributes of Lesotho and Swaziland that are important to investors considering potential investment locations. Such factors include macroeconomic performance, sector-specific policies, and broader sociopolitical environments. The factors in Lesotho's apparel industry that distinguish it from Swaziland's and create the former's first mover advantage will then be discussed in detail in section three. A comparative study of Swaziland will follow in part four.

I believe that the usually accepted parametric determinants of FDI flows, such as political stability and GDP growth, do not adequately explain the high level of foreign investment in the apparel industry in Lesotho. Both Lesotho and Swaziland have experienced significant political turmoil since independence, but neither country has witnessed long-term decreases in investment due to such turmoil. Swaziland's GDP has grown faster and more steadily than Lesotho's, but FDI in the apparel sector has been higher in Lesotho than in Swaziland. Essentially, FDI has increased in Lesotho because of the following factors: the accommodating business environment, the positive framework for addressing labor disputes, and the early success of apparel firms. These factors crucially reinforced the firms' natural tendency to agglomerate by creating a sector-wide first mover advantage.

## I. EXOGENOUS REASONS FOR INVESTMENT IN SOUTHERN AFRICA

During the 1980s and 1990s, southern African nations experienced a large influx of FDI despite their relatively low levels of economic and industrial development. Foreign investors and companies were initially attracted to South Africa by the generous investment incentives and the permissive political environment that the country provided in an effort to compensate for its status as an international outcast. As the divestment campaigns took their toll, however, South Africa-based clothing companies were forced to consider relocation in the face of declining U.S. and European demand for their products.

Nonetheless, foreign contractors did not want to *entirely* leave the southern African region. Nations in this region maintained special trade status with the U.S. and Europe, thus allowing exporters to maintain lower prices than their global competitors. Cheaper direct and indirect relocation costs improved the competitiveness of South Africa's neighboring countries. Their proximity to the firms' original production locations in South Africa allowed for the easier transfer of physical production capital. Thus, distance from South Africa played an important consideration in the firms' relocation decisions. Lesotho's capital, Maseru, and Swaziland's capital, Mbabane, are each only about 230 miles from Durban, South Africa's busiest harbor; the transportation infrastructure between each of these cities adequately supported the foreign investors' logistical needs (Lesotho National Development Corporation [LNDC]). Additionally, Lesotho and Swaziland were members of the Southern African Customs Union (SACU), the institutional vehicle for many of southern Africa's trade exemptions (Southern African).

Macroeconomic considerations were also among the foreign investors' main concerns in funneling FDI into Lesotho and Swaziland. Due to the size of their economies, neither country could maintain a floating exchange rate without risking instabilities in their respective money markets. Thus, Lesotho and Swaziland pegged their currencies to the South African Rand in 1986. As the largest economy in the region, South Africa was less susceptible to unpredictable monetary disturbances than its neighbors.

This fixed currency system therefore helped assuage foreign investors' fears of possible currency collapses (*The Economist* 1987: 45).

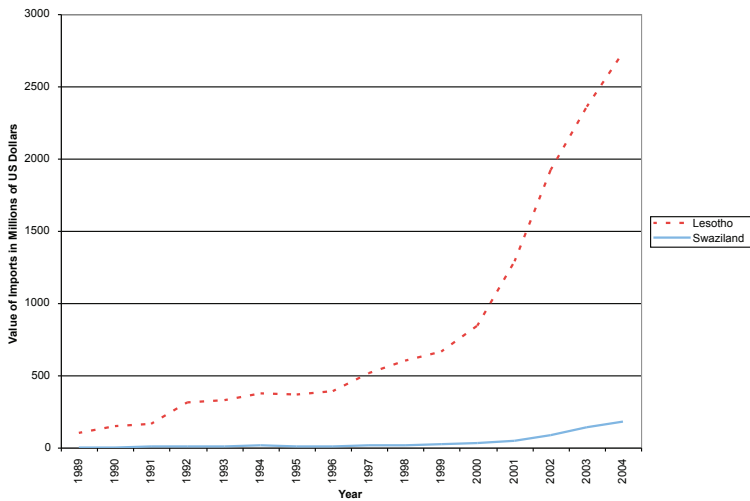
Further, owing to international trade treaties, South Africa's neighbors had preferential access to European and American markets. In 1974, the Multi-Fiber Arrangement (MFA) imposed limits on developing countries' apparel exports to the developed world—particularly restraining the competitiveness of East Asian countries. The MFA quotas, however, did not affect clothing exporters in most African countries, including Lesotho and Swaziland. Their apparel export sectors were so underdeveloped that they could increase export volume significantly without worrying about exceeding the MFA's import volume restrictions (Textile). Hence, the MFA quotas represented a direct motivator for firms to move into South Africa's neighboring countries (Investment Policy 55). The Lomé Convention in the early 1980s further enhanced the attractiveness of the region by providing privileged access to European markets beyond that already established by MFA. Signatories to the Lomé Convention were allowed duty-free imports of apparel into the European Union.

The African Growth and Opportunity Act (AGOA), the most recent trade agreement to benefit African countries, was the impetus for Lesotho's FDI explosion in 2000. This U.S. agreement was signed into law in May 2000 with the intent of increasing U.S. trade and investment with thirty-seven eligible countries in sub-Saharan Africa; several amendments have extended its provisions to 2015. Under the legislation, AGOA countries can export clothing without paying duties or abiding by quotas. This marks the most liberal access to the U.S. market ever granted to a country or region that does not have a free trade agreement with the U.S. Countries classified as LDCs under AGOA face the additional advantage of exemption from the rule of origin requirement for apparel. They are permitted to use non-local and non-U.S. fabric and yarn in apparel that is assembled in an African LDC before export to the U.S. This has been particularly auspicious for international apparel firms in Lesotho who import

the majority of their raw materials from East Asia.

Consequently, AGOA sparked a massive increase in trade and FDI in Lesotho, Swaziland, and many other African nations as East Asian investors rushed to capture the expanded U.S. market (Figure 1). Relatively few countries export apparel to the United States under AGOA, but those who qualify for the rule of origin exemption are likely to export substantially greater quantities than those who do not qualify. Total U.S. imports of Africa-produced apparel have increased from \$954 million in 2001 to \$1.75 billion in 2004, and Lesotho has emerged as the leading apparel exporter among AGOA countries. The level of FDI in Lesotho has increased in parallel, with twenty-five apparel firms entering the country between 2001 and 2003.

**Figure 1. U.S. Imports of Textile and Apparel Goods from Lesotho and Swaziland (U.S. Imports).**



Swaziland has seen even more dramatic growth across sectors, though the volume of its apparel exports is still just 7 percent of Lesotho's apparel exports (U.S. Imports). In fact, before AGOA, only two garment manufacturers were present in Swaziland, both supplying the SACU market; by 2003, fifteen new

companies had been established in Swaziland. Growth in Swaziland's textile and apparel sector occurred later than in Lesotho in part because the former country did not qualify for the rule of origin exemption until 2001 (Swaziland).

## II. A SECTOR-WIDE FIRST MOVER ADVANTAGE

The aforementioned factors created a variety of exogenous reasons for attracting trade to all LDCs in the South African region throughout the 1980s and 1990s. However, why did Lesotho see a particular bulk of investment in its apparel industry? This section will introduce a framework to evaluate Lesotho and Swaziland specifically as investment locations for the apparel industry, as well as to discuss the factors that created a sector-wide first mover advantage for the apparel sector in Lesotho.

National macroeconomic performance is the starting point for evaluating the potential profitability of an investment in a particular country. Favorable indicators such as healthy real GDP growth, currency stability, low rates of inflation, and a controlled budget are often fundamental in encouraging foreign investment. The second category of factors that influence an investor's location decision is industry-specific. It includes trade relationships, infrastructure, the labor market, and past investment in the particular sector. Finally, broader political and social environments pose additional considerations in location decision (Austin 5-7). While the type of government is important for some firms, it is often not as important as overall governmental stability. Some political risks that investors consider are the confiscation of private property, the imposition of price controls, and tax discrimination. The enforcement of law is even more crucial, and it is ideally evidenced by minimal corruption and an efficient bureaucracy. Investment incentives, however, can induce foreign investors to overlook some negative factors. These incentives can include tax holidays, corporate tax breaks, and subsidies for facilities and training.

The following table summarizes the degree to which socio-

political, macroeconomic, and industry-specific factors have attracted or repelled investment in Lesotho and Swaziland.

**Table I. Factors That Have Affected Investment in Lesotho (L) and Swaziland (S).**

Political and social	Form of governance	X	X —	Both have had periods of military rule, but L is now a democracy and S a monarchy
	Government stability	X —	X —	Both have had periods of extreme instability
	Legislative environment	✓	✓	Adequate legislative protection for foreign investors in both L and S
	Application of laws	✓	X	S's FDI exceeded capacity of the development corporation
	Investment incentives	✓+	✓	L's incentives were much more extensive than S's in the 1980s
Macro-economic	Real GDP growth	X	✓	S's growth has been consistently higher than L's since independence
	Currency stability	✓	✓	Both pegged to the rand
	Inflation	✓	✓	Both follow South African monetary policy
	Gov. debt (percent of GDP)	✓	X	L's ratio of total debt service to exports of goods and services is much higher than S's
Sector	Trade relationships	✓+	✓+	L and S enjoy privileged access to Western markets
	Infrastructure	X	X	Weak in both countries
	Human capital	✓	✓	Workers have high literacy rates and good English skills, but little vocational training
	Wage level	✓+	✓+	Reliable wage data for L and S is unavailable, but low wages are an attraction in both countries
	Unionization	✓	X	Both countries have struggled with labor disputes, but L's government is more proactive in their resolution
	Apparel history	✓+	X	The success of early investors in L drew others; apparel investors in S left after the end of Lomé

Key: ✓ = Good conditions have strongly attracted FDI  
 ✓ = Fine conditions have slightly attracted FDI  
 x = Poor conditions have slightly discouraged FDI  
 x — = Bad conditions have strongly discouraged FDI

All of the factors listed above are integral to a firm's FDI decision. The following sections will focus on discussing these factors in greater detail, especially those that distinguish Lesotho from Swaziland. The major differences between these two countries are their business environments, industrial relations, and the historical development of their apparel sectors. Again, these three factors are components of a "first mover advantage," which

has particularly facilitated the development of the apparel industry in Lesotho. The theory of the first mover advantage is most commonly used on a microeconomic level in order to refer to the first firm that enters a new market or utilizes a new technology, thereby reaping the benefit of public awareness and economies of scale. Thus, Lesotho's apparel sector experienced comparative advantage over that of Swaziland in the 1980s and 1990s.

### III. LESOTHO

The apparel sector was the first manufacturing industry in Lesotho to attract a significant amount of foreign investment, beginning with the first two apparel investors from Taiwan, who arrived in the late 1980s (About Lesotho). The apparel industry now claims 90 percent of all FDI flows into the country (Lall 1000). Such investment occurs despite a relatively unstable politico-economic environment. Lesotho has experienced uneven GDP growth in the past two decades due to deep-set political uncertainty. In the 1980s, real GDP growth averaged 4.2 percent per year, fueled by development in manufacturing and services. However, the economy contracted sharply in 1998 due to post-election unrest. Such political discontent stems from the country's process of gaining independence from Britain in 1968. This exacerbated all existing political cleavages in Lesotho's society and parliamentary government. Rifts intensified among different subsets of society. Rural and urban Basotho (the principal ethnic group of Lesotho), major and minor tribal chieftains, and Catholics and Protestants all experienced heightened tensions (Gill 128-139).

However, aggregate FDI in Lesotho during the 1980s peaked at \$21 million in 1988 after the International Monetary Fund stabilization package was introduced. FDI peaked again in 1994 with increased investment in garment manufacturing, coinciding with the termination of diplomatic relations between South Africa and Taiwan. On a per capita basis, Lesotho achieved average annual FDI inflows of \$15 million during the years 1996-2000,

compared to \$6 million for the average LDC. Although it did not attract as much FDI as some of its neighbors (including Swaziland, which saw continued investment in agro-processing), the concentration of foreign capital in the fast-growing apparel sector still made a strong impact on the Lesotho economy (Investment Policy 1-2).

To explain the growth of FDI in the apparel industry, we first turn to a discussion of the country's business sector. Surveys of industrialists conducted in 1986 by *Business Focus*, a journal on development issues, and in 2001 by the United Kingdom Department for International Development, both show that favorable factors in business environment were particularly important reasons for attracting investment (Baffoe 79; Salm 2-8). The business environment can be broken down into three components: legislation, application of laws, and investment incentives.

The legislative environment in Lesotho has been and remains to be conducive to investment and production, though firms were impacted by the periodic instability created by Lesotho's political upheaval. Foreign investors are treated equally with national investors in most facets of business. Land-lease titles are a clear exception: foreign investors may not lease directly from private corporations and must instead lease from the LNDC, which creates a problematic strain on resources (Investment Policy 24). The Industrial Licensing Act requires both foreign and domestic investors to obtain annual licenses for manufacturing and trading, and it grants an "exclusive protection" right to some manufacturers that effectively guarantees protection from domestic competition. This legislation does not affect the export-oriented apparel industry, and industries that depend on scale are likely to be monopolistic regardless because of the tiny domestic market (Baffoe 72-73). Lesotho does not impose local content regulations on its exports, which benefits the Taiwanese investors who prefer to import raw materials from Asia (Baffoe 81). The legislative environment imposes some administrative burdens on foreign investors, but it is equal to or better than other governments in the region.

Lesotho's record on government-business interaction is positive as well. Business generally enjoys normal commercial freedoms with limited interference from the government. The bureaucracy's interactions with business are relatively efficient, though the number of mandatory permits creates some obstacles. Lesotho's Ministry of Trade and Industry streamlined procedures in the 1980s, increasing its ability to process applicants under the Industrial Licensing Act and the Pioneer Industry Enterprises Act. Sixty-seven industrial licenses were issued between 1980 and 1985, compared with just thirty-five in the previous five years (Baffoe 76). The judiciary is independent of the government and has historically remained effective even during military rule. The government is willing to add foreign judges to the bench in certain cases, so that foreign firms may have an extra layer of protection from discrimination. Corruption is not a significant issue in Lesotho, due in part to the lack of money available for redistribution through corruption. Corruption is most prevalent among members of the civil service, who are paid a high minimum wage ostensibly intended to prevent workers from establishing other loyalties. An unusually high level of bribery and embezzlement characterized the government-led Highlands Water Project. However, the government is fiercely prosecuting those involved in order to enhance the country's anti-corruption credentials (Investment Policy 41). The LNDC serves as an advocate between firms and the government that eases the administrative hassle of operating in a foreign country. Overall, then, the general business environment is conducive to investment, and industrialists list it as a leading incentive to invest in Lesotho (Salm 2).

Offering investment incentives is also one of the ways that Lesotho has made itself more attractive to foreign investment (Table 2). The Pioneer Industries Encouragement Act of 1969 aimed to attract foreign and domestic investment in underdeveloped sectors through tax concessions, financial incentives, tariff concessions, and access to markets.

**Table 2. Investment Incentives Offered in Lesotho in 1989 (Baffoe 73-81).**

<b>Taxes</b>	<ul style="list-style-type: none"> <li>• Investors may transfer profits and interest from the CMA subject to 10 and 15 percent withholding taxes respectively.</li> <li>• Tax holiday of up to ten years (with possible extension to 15 years).</li> <li>• General tax allowances on machinery and equipment, factory buildings, employee training, employee wages, and employees' dwellings.</li> <li>• Losses can be carried forward for tax purposes.</li> </ul>
<b>Infrastructure</b>	<ul style="list-style-type: none"> <li>• Purpose-built factories for rental or sale at three industrial estates.</li> <li>• Estate layout and maintenance.</li> </ul>
<b>Administration</b>	<ul style="list-style-type: none"> <li>• Declared government policy to protect all FDI from nationalization, strictly adhered to in the past.</li> <li>• Administrative assistance in securing permits, licenses, plans, labor recruitment and labor disputes.</li> </ul>

Additional motivations for investment in Lesotho are related to its industrial relations. Investors cite well-educated, trainable labor as an inducement to invest in Lesotho. The literacy rate in Lesotho has historically been one of the highest in the region at 71.6 percent of the adult population in 1990 and 79.2 percent in 2003 (Human Development). Although the work of apparel laborers does not require sector-specific skills, it is still nonetheless easier to train a literate and formally educated work force.

Some development agents, however, cite the educational system as still considerably inadequate for stimulating more advanced industrial development. Even though the country boasts high primary and secondary school enrollment rates, the Basotho traditionally have not been trained in sector-specific or managerial skills. The system produces few qualified technicians, accountants, or other such professionals, and graduates are unprepared

to move into higher-level roles within foreign firms or to establish competing or complementary enterprises themselves. An emphasis on vocation and technical training was finally introduced in the 1980s. The traditional non-technical education prevents the backward integration that would maximize the economic impact of foreign investment and raise marginal costs for foreign investors (Investment Policy 61-65).

Despite this negative interpretation, the fact remains that limited educational attainment permits the low wages that are an immensely important draw for foreign investors in labor-intensive industries such as apparel. All of the factories in Lesotho's apparel sector are what are called Cut, Make and Trim (CMT) operations, which means that they are only involved in the physical manufacturing, as opposed to the design, of garments (Salm 21). CMT operations are reliant on cheap, low-tech labor. Lesotho's average wage is lower than South Africa's, which provides an extra incentive for foreign investors in South Africa to relocate, especially following the imposition of sanctions against South African goods (Salm 15).

Even though Lesotho's average wage level is close to Swaziland's, the former's history of peaceful industrial relations contrasts sharply with the latter's past of worker militancy. Because the apparel sector was the first major manufacturing industry in Lesotho, firms did not have to adapt to a previously established industrial precedent. Consequently, there were very few labor tensions at the time of investment. The peaceful labor force and the small scale of labor organization in Lesotho thus attracted foreign firms (Salm 37). Furthermore, Lesotho has a modern labor code, introduced in 1992, that provides for light regulation of employment contracts and conditions. The government has actively intervened in labor disputes and moderated conflicts through a neutral dispute resolution mechanism (Investment Policy 34-35). Industrialists describe good relations with workers as a benefit of investment in Lesotho, and they report no recurring problems with unions (Investment Policy 68). The only exceptions have been three high-profile strikes and labor conflicts

in the mid-1990s. However, these strikes represented more of a regional, rather than national, trend as they affected Swaziland as well. Overall, the government's proactive response has sustained Lesotho's competitive advantage in compliant, low-wage labor.

The final reason that Lesotho's apparel industry has attracted significant FDI is its recent historical background. Lesotho had seen relatively little development in the manufacturing sector before foreign investors opened production facilities in the late 1980s. Thus, Taiwanese apparel companies could more easily overpower domestically owned companies in Lesotho's apparel export manufacturing market. The southern Africans could not acquire production resources at the prices necessary to compete with the Taiwanese firms' low operating costs (Lall 1004). The positive experiences of these pioneer Taiwanese investors in Lesotho acted as a significant draw for fellow Taiwanese investors later in the 1990s. Investors communicated both officially and through word of mouth about Lesotho's profitable business environment, thereby stimulating investment build-up even before AGOA (Salm 11-12). This allowed the apparel sector to build up external economies of scale with a large number of firms sharing the same infrastructure and specific labor demand, comparable to the internal economies of scale that a first mover firm enjoys.

The success of apparel firms established during the 1980s signaled a good business environment, which attracted firms in 2000 that sought access to AGOA trading privileges. Firms that moved into the country later have not been as successful as the original investors, however. Many of the Asian factories that lead sector growth in the early 2000s have been operating in Lesotho since the late 1980s, thus illustrating the traditional form of the first mover advantage (Lall 1006).

This section has identified three factors that have made Lesotho an attractive investment location when Taiwanese apparel firms left South Africa: an enabling business environment, positive industrial relations, and the history of its earliest investors in the industry. The confluence of these factors counterweighed the political and financial risk of investment in the country.

#### IV. SWAZILAND

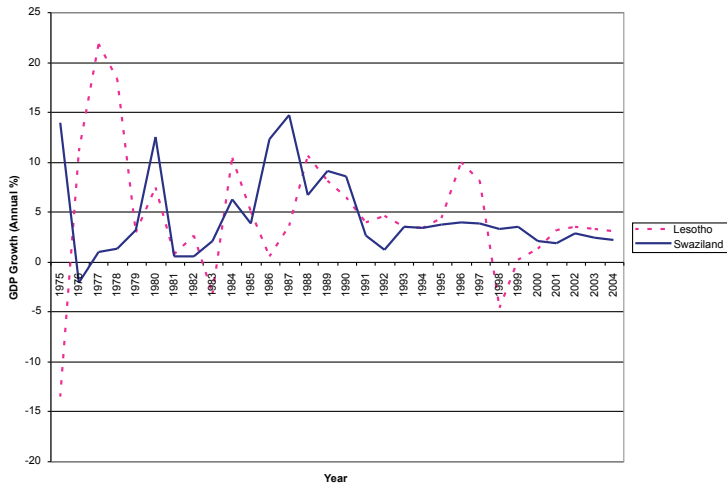
Swaziland is remarkably similar to Lesotho in history, geography, and culture, but dissimilar in foreign investment, thus causing the two national economies to diverge. After independence, Swaziland encouraged South African investment in sectors that exploited its natural endowments—endowments with which Lesotho could not compete. Agglomeration occurred in the wood pulp and juice canning industries instead of in the textile and apparel industry. This section will begin with an overview of Swaziland's political and economic history and continue with an examination of the factors that differentiated investment in Lesotho and Swaziland.

As noted, Swaziland enjoys a greater abundance of natural resources than Lesotho, as well as greater industrial diversification. Over 80 percent of the population is still engaged in subsistence agriculture, but better soil conditions create higher productivity than in Lesotho. South African investors attracted to the country under King Sobhuza II, whose reign lasted from 1921 to 1982, established manufacturing production facilities in wood pulp production, drink processing, fruit canning, and sugar processing. South Africa is still the dominant force in the economy, accounting for most expatriate employees and investors. Over 85 percent of Swaziland's imports come from or through South Africa, and 50 percent of Swaziland's exports go to South Africa (Hilligas 4).

Swazi politics fostered growth and FDI in the 1970s, but subsequent decades were marked by turbulence that forestalled new FDI inflows. After a coup in 1973 by King Sobhuza II, a remarkable period of stability began, which fostered the confidence of foreign investors who worked closely with European settlers and the Swazi aristocracy to develop production capacity in Swaziland. After King Sobhuza's death in 1982, a power struggle resumed, causing political uncertainty until the early 1990s. Even though a draft constitution was drawn and publicized in May 2003, it has not yet been finalized, in part due to sharp criticism

from civil society groups in Swaziland and international human rights groups. King Mswati is criticized in the international community as well for his extravagant lifestyle, which includes a fleet of luxury cars and extensive mansions for his wives (Kanduzi et al. 68-70).

Figure 2. GDP Growth in Swaziland and Lesotho, 1975-2004 (The World Bank Group).



The first significant difference between Lesotho and Swaziland is their business environments. In terms of the legislative environment, Swazi structural legislation lacks the ability to support a solid investment climate. An outdated Companies Act governs general corporate conduct, and protection for patents, trademarks, and copyrights is much worse than in Lesotho. Swazi regulations require exporting firms to abide by a 25 percent local content rule if the importing country does not set its own standard; since most Western markets impose more stringent regulations, this requirement is usually superseded (De Vletter 159). The application of laws is relatively regular, but the form of government increases the perception of political risk. Judicial procedure can be confusing for foreign firms because of the dual

legal system that combines Roman-Dutch law and common law. As in Lesotho, corruption is relatively mild, and the government is working to make it even more so. Prime Minister Absolom Dlamini's government has set up an Anti-Corruption Unit and several members of Parliament have been caught and charged with corruption and fraud. However, King Mswati's absolute rule and ambiguous delineation of decision-making power within the government has made it difficult to navigate and has posed a potential risk for foreign investors (The Economist 2003: 6).

The Swaziland Investment Promotion Authority (SIPA), the Swazi version of the LNDC, was established in 1987 in order to replace the defunct National Industrial Development Corporation of Swaziland. It is a "one-stop-shop investment promotion authority" with the mandate to renovate old factories, construct new factory shells, and advertise Swaziland's investment incentives (Table 3). These incentives intend to offset the risks of investment in Swaziland and to establish two major performance requirements: that firms hire qualified Swazi workers wherever possible and that exports labeled "Made in Swaziland" contain at least 25 percent local materials. However, the World Bank warned in 1985 that the existing incentives tended to promote capital-intensive technology. The high demand for assistance from incoming investors (many of them relatively capital-intensive agricultural industries) overwhelmed SIPA's capabilities as early as the 1980s, making the country much less attractive for later investors in the apparel sector (De Vletter 234-235). The investment incentives offered by SIPA were fewer than those offered by the LNDC, and not enough to counterbalance the otherwise unattractive business environment in Swaziland.

Swazis enjoy the same level of education that enabled the development of the apparel industry in Lesotho. Literacy and education are high, with 90 percent of urban Swazis boasting writing skills and a passable command of English. However, in general, Swazis are insufficiently trained and experienced in the field of garment manufacturing and exporting, so firms employ a majority of expatriate managers (Hilligas 11). Both Lesotho and

Swaziland must address this issue in order to attract and retain more-advanced FDI.

**Table 3. Investment Incentives Offered in Swaziland in 1989, and 2005 Where Noted (De Vletter 154).**

<b>Taxes</b>	<ul style="list-style-type: none"> <li>• Tax holiday of 5 years, afterwards 37.5 percent or lower at SIPA's discretion.</li> <li>• 10-year exemption from withholding tax in dividends (2005).</li> <li>• New firms eligible for depreciation, initial, and training allowances prior to taxation (150 percent training allowance in 2005)</li> <li>• Losses can be carried forward for tax purposes.</li> <li>• SIPA has discretion to offer additional incentives</li> </ul>
<b>Infrastructure</b>	<ul style="list-style-type: none"> <li>• Industrial land real estates developed for incoming industries</li> <li>• Factory shells constructed for industry.</li> </ul>
<b>Administration</b>	<ul style="list-style-type: none"> <li>• SIPA disseminated information regarding regulation, etc.</li> </ul>

Swaziland's history of industrial relations also deters labor-intensive investments in the country. Nationwide strikes in 1963 set the stage for an antagonistic business-labor relationship that continued through the 1980s and 1990s. Agro-industry manufacturing industries developed before the apparel sector and set a precedent of militant unions, government oppression, and strained industrial relations. The state reacts aggressively against worker grievances because organized labor has historically incorporated political opposition into its platform. In fact, the Swaziland Federation of Trade Unions has tended to lead the progressive movement (The Economist 2003: 71).

In 1989, labor force hostility increased when improving growth rates and a budget surplus were not reflected in average earnings, and strikes proliferated and threatened to deter new relocations to Swaziland. Rising political expectations and high

inflation fueled by drought in the early 1990s created growing restiveness in the Swazi working class. General strikes occurred in the mid-1990s in parallel with strikes in Lesotho. The strikes in Lesotho were endogenous to the apparel industry, and the government was readily available to negotiate between business and labor. In Swaziland, on the other hand, general strikes were staged in response to both business and political conditions, continuing the country's long-established pattern of labor militancy (The Economist 2003: 76).

Although Swaziland seems to be an investment location comparable to Lesotho, closer analysis shows that its weak business environment and tense industrial relations have deterred investment in the apparel industry. These factors account for the difference in performance between Lesotho and Swaziland before and after AGOA.

## V. LESSONS AND CHALLENGES

Lesotho's successful development of an FDI-driven apparel sector points to two important conclusions. First, underdevelopment is not always a disincentive for investment, even though it is often considered a self-perpetuating economic state. The absence of pre-existing industries in Lesotho could have signaled a bad investment location, but it also indicated the availability of government resources and the unorganized labor pool. Both factors were of sufficient value for foreign apparel firms to choose Lesotho as an appropriate investment location. Small LDCs should therefore emphasize the advantages of their underdevelopment to attract foreign investment.

Second, the attraction of underdevelopment creates a trend toward economic convergence among LDCs. Investors seeking LDC conditions (low wages, preferential trade agreements, and low corporate taxation) will choose one of the least developed countries in the group over a country with a long industrial history, all else being equal. The chosen country will enjoy an immediate influx of FDI that will level off as the new industry expands

to capacity. This trend will likely contribute to the convergence of low-income countries in following years, following Lesotho's model.

In concluding, however, it is also worth noting that although the apparel sector currently remains among the most dynamic in developing countries due to AGOA, the end of the MFA might pose serious challenges to that dominance. The Agreement terminated on January 1, 2005 after a 10-year phase-out governed by the WTO Agreement on Textiles and Clothing (Hilligas 2). African exporters and foreign subsidiaries in the region have lost the protection they had enjoyed against more competitive Asian producers, which was one of the major reasons that Africa-based firms exploited AGOA trade privileges so successfully. The phasing out of the MFA has introduced a fierce new competitor to the apparel market—China—and the apparel sectors in Lesotho and Swaziland are both struggling to remain competitive. “Dark clouds are beginning to gather following the end of the Multi-Fiber Agreement,” warned Lesotho's Finance Minister Timothy Thahane in February 2005 (Lesotho's Economy).

African countries are already finding themselves unable to compete with Chinese goods, despite the privileges they enjoy as AGOA countries. Wages in Lesotho are about the same as in Vietnam and somewhat lower than in Bangladesh, India, or China. However, export-oriented foreign firms are increasingly demanding technical, supervisory, and management skills that Basotho workers do not possess. Related to this factor is worker productivity, which is uncompetitive in Lesotho and Swaziland. Eleven foreign affiliates in Lesotho estimated that Basotho workers in foreign apparel firms are, on average, half as productive as those in East Asia (Investment Policy 62-63). The government of Lesotho must act immediately to address low skills and inadequate education before the country experiences rapid capital flight.

Investors are pulling out of Lesotho and other African nations, so the opportunity for other AGOA countries to imitate its successful policies is limited. African countries' share of the

apparel market will likely shrink by 70 percent by the end of the year, and the worst hit countries will be those whose exports have relied on privileged and artificial access to U.S. and EU markets, Lesotho being the prime example. In fact, around 6,000 Basotho workers lost their jobs within two months of the end of the MFA (Industries).

A few factors might mitigate the end of MFA, such as safeguards imposed by the United States against China, a possible extension of AGOA privileges, and the development of a SACU-U.S. free trade area. China's accession agreement to the WTO included safeguard provisions that developed countries may utilize in response to import surges of Chinese apparel. These safeguards can be in place until December 31, 2008, during which African nations could compete on the terms that they previously enjoyed. Lesotho's and Swaziland's apparel exports still enjoy duty-free access to U.S. markets, and their exemptions from AGOA's local content requirement may be extended beyond September 2007. Finally, AGOA legislation establishes provisions for the negotiation of a free trade agreement between the U.S. and the South African Customs Union, which would offer Lesotho and Swaziland the opportunity to negotiate improvements in textile and apparel benefits (Hilligas 16-18).

Lesotho's attractiveness as an investment location for foreign apparel firms stemmed from its strong business environment, good industrial relations, and early agglomeration, which combined to impart a first mover advantage to the sector. This is a wasting asset that mitigates its own benefits as they are realized but, in the process, applies pressure on the government and the economy to adapt to the industry. Lesotho can salvage its apparel sector through further development of incentive programs and proactive government participation, qualities that initially attracted foreign investment and hold the potential to maintain it in the crucial years to come.

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